THE TAX SYSTEM OF PAKISTAN AND THE AGENDA OF TAX REFORMS

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ABSTRACT

The study focuses on key features of taxation of Pakistan. The report analyzes various tax bases in order to identify existing tax gaps, highlighting discrepancies between potential and actual revenues, and providing insights into the underlying factors contributing to these shortfalls. Based on this in-depth analysis, a broad agenda of tax reforms has been presented at both the federal and provincial levels, which is projected to result in an overall increase of 3% of GDP, alongside additional reforms anticipated for the fiscal year 2024-25, aimed at increasing the efficiency and effectiveness of the tax system while addressing existing revenue shortfalls.

SUMMARY

The report titled 'The Tax System of Pakistan and The Agenda of Tax Reforms' has been prepared with the objective of undertaking an in-depth analysis of the tax system of Pakistan, both at the Federal and Provincial levels, leading thereby to a comprehensive agenda of tax reforms.

Chapter 1 describes the tax system of Pakistan in terms of the tax laws, tax rates and trends in revenues.

Chapter 2 reviews the literature on tax reforms in Pakistan. The first section of the chapter highlights the reform proposals by the PIDE-PRIME Tax Reforms Commission of 2024. This is followed by listing recommendations for changes in the tax system proposed by Hafiz A. Pasha in his book on the Charter of the Economy (Pasha, 2021) and Saeed Ahmed's articulation of the required changes in the tax system (Ahmed, 2023). The last section focuses on the path of reforms adopted earlier in India.

Chapter 3 examines why the tax-to-GDP ratio of Pakistan has fallen from a peak of 11.3% of the GDP in 2017-18 to 10.5% of the GDP in 2023-24. Changes in the individual tax-to-GDP ratios are decomposed into 'rate' and 'base' effects. The conclusion is that the fall in the tax-to-GDP ratio is due entirely to the 'base effect' on the tax revenues. This is also confirmed by the low overall buoyancy coefficient of total tax revenues to the GDP of significantly below unity at 0.88.

Chapter 4 identifies the determinants of tax-to-GDP ratio in a sample of 27 developing countries with populations of at least 20 million. The results of multiple regression analysis are that the tax-to-GDP ratio tends to be higher in countries with larger per capita income, more income inequality, smaller share of agriculture in the economy, and higher imports to GDP ratio. The derived equation is used to predict the Federal tax-to-GDP ratio in 2023 in Pakistan. The predicted magnitude is higher by 1.4% of the GDP of the Federal actual tax-to-GDP ratio.

Chapter 5 uses the 'representative tax system' approach on the same sample of 27 countries as in Chapter 4. Pakistan has a ranking of 20th in the income tax-to-GDP ratio among the 27 countries. The ranking is somewhat better in the indirect taxes-to-GDP ratio at 16th. Overall, in relation to the average in the 27 countries, the approach reveals that the tax-to-GDP ratio of Pakistan needs to be higher by 3.1% of the GDP. This confirms the relatively poor performance of governments in Pakistan in generating tax revenues. Two thirds of the shortfall is in direct taxes.

Chapter 6 uses the 'monetary' approach for quantification of tax evasion, first used by Tanzi (1993). There has, in fact, been a steady increase in the currency to circulation as a percentage of money supply in Pakistan. Multiple correlation of this variable with the tax-to-GDP ratio, interest rate and number of bank branches, reveals that tax evasion was as high as 6% of the GDP in 2015-16 and has since declined to 4.2% of the GDP. This is still high and indicates that the withholding and advance tax regime has not played an adequate role in limiting tax evasion. The sectoral analysis reveals that the likelihood of tax evasion is the highest in the wholesale and retail trade sector of Pakistan.

Chapter 7 adopts the opposite approach of estimation of the 'tax gap' via the 'bottom up' approach. The findings confirm that there is substantial potential for generating more revenues at the Federal level, as indicated by the 'top-down' approaches adopted in Chapters 5 and 6. For example the potential revenues from the personal income tax could be as much as 134% of the actual revenues.

The tax gap is close to 27% of actual revenues in the case of the corporate income tax and 40% in the sales tax on goods.

Chapter 8 estimates the 'tax gap' in Provincial taxes with the same 'bottom-up' approach. The tax gap is very large in the agricultural income tax at Rs 880 billion, with the tax base of 2023-24. Similarly, the tax gap in the sales tax on services is large at Rs 650 billion. Therefore, there is enormous potential for raising provincial tax revenues through reforms and stronger fiscal effort.

Chapter 9 looks at the taxation of property and how this could contribute substantially to inclusive growth, through generation of revenues in a very progressive manner and with earmarking of revenues partly for poverty alleviation. The Chapter highlights that the Constitution of Pakistan and Federal and Provincial tax laws enable various types of taxes on property in Pakistan, ranging from the urban immoveable property tax, capital value tax, rental income and capital gains tax, and stamp duty.

The 'tax gap' in the urban immoveable property tax is estimated at Rs 220 billion, while that in the capital value tax has been quantified at Rs 300 billion. Overall, over Rs 1,070 billion could be generated from property-related taxes, whereas the actual revenue in 2023-24 were only Rs 344 billion.

Chapter 10 proceeds to determine the incidence of taxes in Pakistan. Review of the earlier research on Pakistan indicates only mild progressivity of the tax system. Separate analysis of incidence is undertaken of each federal tax. The income tax is significantly progressive with 66% of the tax burden being borne by the top quintile. As opposed to this the sales tax on goods is markedly regressive, while the customs duty has a neutral incidence and the excise duty is slightly progressive. The overall incidence of federal taxes is only mildly progressive, similar to earlier findings. The progressivity will need to be bolstered by relatively more development of direct taxes. Chapter 10 also reveals that there is considerable variation in the sectoral and sub-sectoral incidence of taxes.

Chapter 11 examines the large number of taxation measures in the current Federal budget for 2024-25 and the estimates of the additional revenues from implementation of these measures. There are problems both with the targets for individual taxes and the estimated overall additional revenues. Consequently, a revised set of estimates is made of revenues in 2024-25. These are Rs 750 billion less than the official targets.

Already, in the first five months of 2024-25, there has been a shortfall in FBR revenues of almost Rs 400 billion. However, the growth rate, in the presence of the wide-ranging taxation measures, is projected at 29%. This will contribute to raising the tax-to-GDP ratio from 10.5% in 2023-24 to 11.6% in 2024-25. This will still represent a significant improvement.

Chapter 12 starts with the perspective that there is substantial tax gap as highlighted by estimates that the actual to potential tax revenues are less than 1% in the agricultural income tax, 10% in the urban immoveable property tax, 43% respectively in personal income tax and the sales tax on services. Overall, the 'tax gap' is estimated at 3.7% of the GDP. Also, there is need to make the overall tax system more progressive by focusing particularly on income and property taxes.

Consequently, a comprehensive set of reforms have been presented in both Federal and Provincial taxes. The size of the tax bases is as of 2023-24. Proposals have also been made for changes in tax laws and also in tax administration.

The total of additional revenues that can be generated by implementation of the proposed reforms is Rs 2505 billion. The methodology of estimation of additional revenues from proposals is presented in the Technical Annexure. The direct tax revenues are likely to increase by Rs 1900 billion, implying a share of almost 84% in the total increase. There is need also to recognize that the share of provincial taxes in the targeted increase is larger at almost 58%. This will be due primarily to the development of the agricultural income tax.

Overall, the recommended agenda of reforms has the potential of raising national tax revenues by 2.0% of the GDP. Combined with the increase in the tax-to-GDP ratio of 1.2% of the GDP due to taxation measures in the Federal budget of 2024-25, the outlook could be for an increase in the tax-to-GDP ratio from 10.5% of the GDP in 2023-24 to 13.8% of the GDP. This will close a large part the total 'tax gap' in Pakistan.

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

THE TAXATION SYSTEM IN PAKISTAN

Pakistan's tax system is characterized by multiple structural problems. First, it has a low tax-to-GDP ratio causing an overall large budget deficit during the last many years. Second, there has been an overall dependence on indirect taxation that has caused the incidence of taxes to be less progressive. Moreover, the industrial sector bears a disproportionate burden of taxes that has caused a rise in the cost of doing business and affected production.

The objective of this chapter is to introduce the basic tax structure and tax collecting agencies of Pakistan and to look at the trend in federal and provincial tax revenues. A key feature of the tax system in terms of the tax rates is also highlighted.

1.1. The Existing Taxes and Collecting Agencies

The 1973 Constitution of Pakistan gives the allocation of fiscal powers between the Federal government and the Provincial governments. The Federal Board of Revenue (FBR) is the principal collecting agency of the Federal government and is responsible for collecting various taxes as shown in Table 1.

Table 1: Federal and Provincial Taxes and Collecting Agencies

Federal Board of Revenue	Provincial Board of Revenue	Provincial Excise and Taxation	Provincial Revenue Authority/ Board
▸ Income tax ▸ Customs duty ▸ Excise duty ▸ Sales tax ▸ Capital Value Tax	▸ Agricultural Income Tax ▸ Land revenue ▸ Stamp duty	▸ Urban Immoveable Property Tax ▸ Tax on professions, trades and calling ▸ Provincial Excise ▸ Motor Vehicle Tax ▸ Capital value tax on Immoveable Property	▸ Sales Tax on Services

Source: Authors' computations.

The Provincial governments also collect a wide range of taxes. These taxes are both direct and indirect. The existing direct taxes include agriculture income tax and the urban immovable property tax, while the indirect taxes are the sales tax on services, land revenue and the motor vehicle tax. The sales tax on services was transferred to the Provincial governments following the 18th Amendment to the Constitution in 2010. It has emerged as a largest source of revenue at the sub-national level.

1.2. The Tax Laws

1.2.1. Federal Taxes

Income Tax Ordinance 2001

The personal income tax in Pakistan has an exemption limit of Rs 600,000 and has six slabs. The structural problem of Pakistan's income tax is the heavy reliance on the withholding taxes, of which many are regressive in nature. According to the FBR annual report of 2022-23 the withholding taxes contributed over 56% of the total direct tax collection. It has been estimated that they contributed 60% in 2023-24.

Withholding taxes are collected at source, such as when payments are made to suppliers, salaries are paid to employees, or when certain transactions occur. These withholding taxes are then adjusted against the final income tax liability of the taxpayer. The heavy reliance on withholding taxes in Pakistan's income tax system is due to the country's relatively narrow tax base, with a large informal economy and high level of tax evasion.

However, the over-dependence on withholding taxes can create distortions in the tax system and place an additional burden on businesses and individuals. At present, it is customary to impose separate taxes on distinct income blocs. This has substantially diminished the tax system's progressiveness. Typically, only earned income is included in the tax return. Separate presumptive taxation applies to unearned income accrued as interest, dividends, property income, and capital gains.

Customs Duty Act 1969

The Customs Act 1969 regulates the import and export of goods into and out of Pakistan. It covers topics like customs duties, valuation of goods, exemptions, penalties, and enforcement. Customs duty had been the largest source of federal revenue collection up till the early 90s. The contribution of customs duty has been reduced to only 1.1% of the GDP in 2022-23 from 1.9% in 2000-01. Since the adoption of trade liberalization, the customs duty has had the maximum rate of 20%. However, there are some large regulatory duties on items which are classified as luxury goods.

Sales Tax Act 1990

The main law governing the sales tax system in Pakistan is the Sales Tax Act of 1990. This act outlines the framework for the imposition and collection of sales tax in the country. Sales tax is levied at domestic and import stages, excluding those items exempted in the 6th Schedule of the Sales Tax Act, 1990. Within the sales tax, the tax on imports is the major contributing component of the federal tax receipts. According to the Revenue Division Yearbook of 2023-24, the contribution of sales tax on imports was around 60% to the total sales tax receipts in 2023-24.

The Federal Excise Act, 2005

The excise duty in Pakistan is primarily governed by the Federal Excise Act of 2005 and its subsequent amendments. The Federal Excise Duty (FED) is levied on the production of certain goods and the provision of specific services. It is imposed in addition to the standard sales tax. The goods and services subject to FED include cigarettes, tobacco products, beverages (alcoholic and non-alcoholic), cement, vehicles, telecommunications services, and certain financial services. Cigarettes, cement, big cars and air travel have a combined share of around 77% in FED revenues.

1.2.2. Provincial Taxes

According to the allocation of fiscal powers in the Constitution, the Provincial governments have been given taxes on the basis of exclusion of residual powers not assigned to the Federation. The two taxes partitioned out are the sales tax on services from the sales tax on goods and agriculture income tax out of the overall income tax.

Sales Tax on Services Act, 2011

The sales tax on services is yielding significant revenue in all four provinces. It contributed almost 65% of the total provincial tax revenue in 2023-24. The variation of the tax rate on services is from 15% to 16% among the provinces. However, certain services that include banking and telecommunication are subject to slightly higher tax rates.

Urban Immoveable Property Tax Act, 1958

The provincial urban immoveable property tax is a tax levied by the Provincial governments of Pakistan on the ownership and occupation of immoveable properties located in urban areas. Each province has its own legislative framework and regulations governing this tax. The tax is applicable to all types of immoveable properties located within the defined urban areas of the province, including residential, commercial, and industrial properties. The tax rates range between 10% to 20% of the rental value depending on the type of the property and whether it is owner-occupied or rented.

Agriculture Income Tax Act, 1997

The 1973 Constitution of Pakistan gives Provincial Assemblies the exclusive power to make laws pertaining to taxes on agricultural income. All four Provincial governments have instituted some form of tax on agriculture land or incomes. In its implementation this tax is largely a land tax (based on acreage) rather than a tax on agricultural income. As per Punjab Agricultural Income Tax act 1997, the income is exempt for tax if cultivated area is less than 12.5 acres.

Motor Vehicle Taxation Act, 1958

The Motor Vehicle Taxation Act 1958 is a provincial level legislation. Pakistan has regulated the taxation and registration of motor vehicles. It requires the registration of all motor vehicles operating within a Province and permits the Provincial government to levy various taxes on motor vehicles, such as annual token tax, and registration fees.

The Stamp Duty Act 1899

The Stamp Duty Act 1899 is the primary legislation that governs stamp duty and stamp paper requirements in Pakistan. This duty is essential for establishing legality of transactions.

1.3. Level of Tax Rates

Income Tax

The tax rates shown below are for the fiscal year, 2024-25. The personal income tax rates are as follows for salaried individuals:

PERSONAL INCOME TAX – SALARIED INCOME		
Slab	**Taxable Income**	**Rate of Tax**
1.	Where the taxable income does not	Rs 0

	exceed Rs 600,000	
2.	Where the taxable income exceeds Rs 600,000 but does not exceed Rs 1,200,000	5% of the amount exceeding Rs 600,000
3.	Where the taxable income exceeds Rs 1,200,000 but does not exceed Rs 2,200,000	Rs 30,000 + 15% of the amount exceeding Rs 2,200,000
4.	Where the taxable income exceeds Rs 2,200,000 but does not exceed Rs 3,200,000	Rs 180,000 + 25% of the amount exceeding Rs 2,200,000
5.	Where the taxable income exceeds Rs 3,200,000 but does not exceed Rs 4,100,000	Rs 430,000 + 30% of the amount exceeding Rs 3,200,000
6.	Where the taxable income exceeds Rs 4,100,000	Rs 700,000 + 35% of the amount exceeding Rs 4,100,000

Source: Authors' computations based on information gathered from Pakistan Bureau of Statistics.

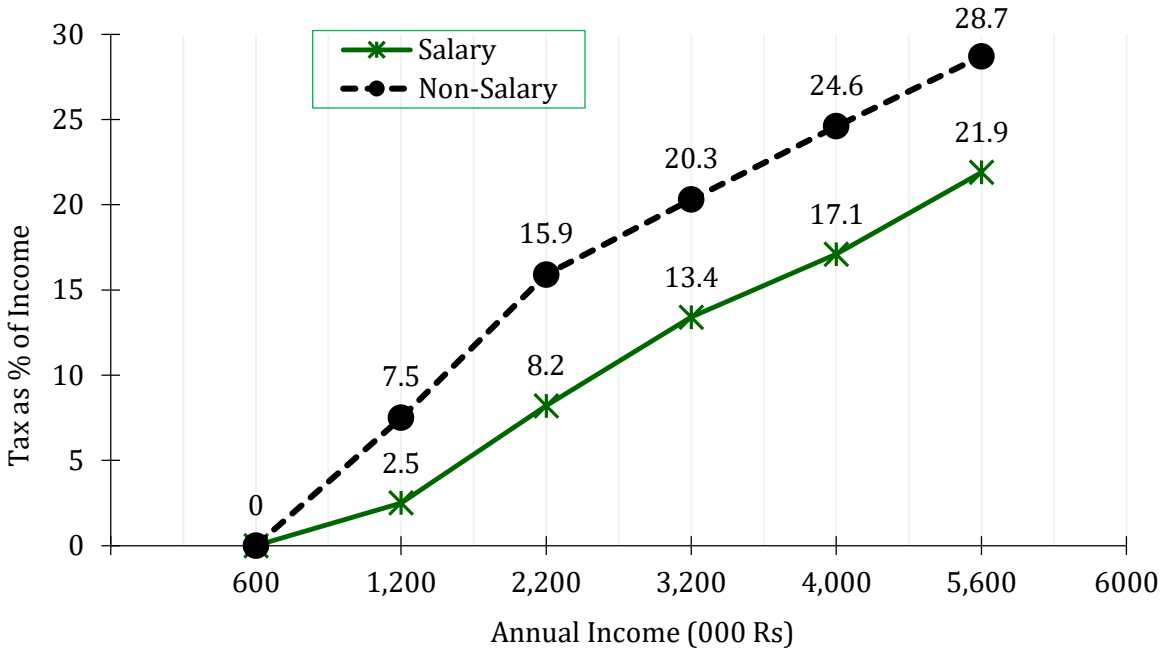
The tax rates for non-salaried income are given below:

PERSONAL INCOME TAX – NON-SALARIED INCOME		
Slab	**Taxable Income**	**Rate of Tax**
1.	Where the taxable income does not exceed Rs 600,000	Rs 0
2.	Where the taxable income exceeds Rs 600,000 but does not exceed Rs 1,200,000	15% of the amount exceeding Rs 600,000
3.	Where the taxable income exceeds Rs 1,200,000 but does not exceed Rs 1,600,000	Rs 90,000 + 20% of the amount exceeding Rs 1,200,000
4.	Where the taxable income exceeds Rs 1,600,000 but does not exceed Rs 3,200,000	Rs 170,000 + 30% of the amount exceeding Rs 1,600,000
5.	Where the taxable income exceeds Rs 3,200,000 but does not exceed Rs 5,600,000	Rs 650,000 + 40% of the amount exceeding Rs 3,200,000
6.	Where the taxable income exceeds Rs 5,600,000	Rs 1,610,000 + 45% of the amount exceeding Rs 5,600,000

Source: Authors' computations based on information gathered from Pakistan Bureau of Statistics.

The rise in the incidence of the income tax with increase in income is shown in Chart 1.1. It rises sharply with income and the tax is markedly progressive.

Figure 1: Incidence of Personal Income Tax by Level of Income (%)



Source: Authors' computations based on information gathered from Pakistan Bureau of Statistics.

There are a series of withholding/ advance income and fixed tax rates which are highlighted in Table 2.

Table 2: Withholding, Advance and Fixed Taxes in the Income Tax Regime

Type	Section of the ITO	Tax Rate
Imports	148	1% to 6%
Dividends	150	0% to 35%
Interest on Bank Deposits	151	15%
Rendering or Providing of Particular Services	152	4-9%
Payment for Contracts	153	8%
Exports – Goods	154	1%
IT Services	154A	0.25%
Motor Vehicles (by cc)	234	Rs 30,000 or % of value
Goods Transport	234	Rs 2.50 per kg of laden weight
Electricity Bill – Commercial and Industrial Consumers	235	up to Rs 500 – zero > Rs 500 to Rs 20,000 10% > Rs 20,000 1950 + 5% of amount above Rs 20,000

Source: Authors' computations based on information gathered from Pakistan Bureau of Statistics.

Therefore, FBR has put in place a very comprehensive scheme of withholding and fixed taxes. They yielded over 60% of the total income tax revenues in 2023-24. Advance tax and payment with returns contributed 37% and collection out of demand the remaining 3%.

Sales Tax

The standard sales tax rate on goods is 18%. However, there are a number of schedules in the Sales Tax Act which give lists of imports or domestically produced goods which are either exempt or enjoy reduced rates as shown in Table 3.

The Provincial Sales tax rate on services varies among the provinces. It ranged from a low of 13% in Sindh to a high of 16% in Punjab. Now Sindh in the budget of 2024-25 has raised the rate to 16%.

Table 3: The Contents of Different Schedules

Schedule	Description	Items
Third	Taxed at Retail Price	Non-essential food items, motorcycles, auto rickshaws, household appliances, cement, etc.
Fifth	Exemptions	Supplies to Diplomats, Inputs into EPZ, Supplies to Gwadar Free Zone, Petroleum Crude Oil
Sixth	Exemptions, Imports and Supplies	Food items, books, medicines, medical equipment, materials for Gwadar Port, Pesticides, LNG for fertilizer manufacture, CKD Kits for electric vehicles, Fertilizers (excluding DAP) POL Products
Eight	Tax Rates Lower than 18%	Imported Natural Gas (5%) Small Locally Manufactured Cars (12.5%) Computers (10%) Inputs for Pharmaceuticals (1%) Stationery (10%) Tractors (10%) Small Mobile Phones (10%)
11th & 12th	Specific Rates	Brick Kilns, Steel, etc.

Source: Sales Tax Act, 1990.

Customs Duty

There are five rates of statutory import tariffs, as follows:

0%, 3%, 11%, 16%, 20%

In addition, there are large regulatory duties imposed mostly on luxury imports.

The WTO publication, *World Tariff Profiles*, gives the average duty rates for different imports by Pakistan in 2022. These are presented in Table 4.

Table 4: Average Import Tariff on Different Imports

	Share in Imports (%)	Average Import Tariff
Edible Oil	7.8	6.7
Cotton	2.5	0.0
Minerals and Metals	20.1	9.3
Petroleum	16.8	10.9
Chemicals	17.0	5.2
Textiles	4.0	11.4
Machinery	7.9	5.5
Transport Equipment	5.7	22.7
Overall Average		**8.7**

Source: WTO, World Tariff Profiles, 2022.

Table 4 clearly shows that Pakistan has made a transition to a low import tariff regime. The average trade-weighted tariff is down to only 8.7%.

Excise Duty

The excise duty is levied only on few selected items at tax rates given below:

Aerated Waters *(% of Retail Price)*	20
Locally Produced Cigarettes:	
If retail price does not exceed Rs 12,500 per 1,000 Cigarettes	Rs 5,050 per 1,000 cigarettes
If price exceeds Rs 12,500	Rs 16,500 per 1,000 cigarettes

Therefore, an extremely high excise duty has been imposed on cigarettes to discourage their harmful consumption.

The Sales Tax on Services

The sales tax on services is a new tax that has been levied under a special Act in 2011. The Province of Sindh earlier had a lower rate of 13%, compared to 16% in Punjab. 45% of the national revenue from this tax is collected in Sindh and 45% also in Punjab. The remaining 10% is the combined revenue from Khyber-Pakhtunkhwa and Balochistan.

There is a comprehensive list of services which are subjected to this tax. The major services taxed are shown in Figure 2.

Figure 2: Major Services liable to the Sales Tax on Services

No.	Services	No.	Services
98.01	Hotels, Restaurants, Marriage Halls	98.11	Services by Laundries
98.02	Advertisements	98.12	Telecom Services
98.03	Chartered Flight Services	98.13	Services rendered by Financial Institutions
98.06	Sale of Property Services	98.14 & 98.15	Services rendered by Professionals and Consultants
98.07	Services Rendered by Property Developers	98.18	Services rendered by Security Agencies and other Special Agencies
98.08	Courier Services	98.23	Franchise Services
98.10	Services by Beauty Parlors	98.24	Construction Services

Source: Sindh Sales Tax on Services Act, 2011.

Figure 2 indicates the potentially comprehensive coverage of the sales tax on services. The following economic sectors fall within its ambit:

- Accommodation and Food Services
- Information and Communication
- Finance and Insurance Activities
- Other Private Services

However, the incidence of the tax on the combined value-added in these four sectors is only 4.4%. Therefore, there is enormous scope for development of this tax, as it is also more progressive compared to other indirect taxes. Currently, the largest revenues are from airports, ports and terminal operators, franchises, telecommunications, banks and insurance.

Petroleum Levy

The petroleum levy is a charge which substitutes for the sales tax on POL products. The objective of the Federal government was to reduce the size of the divisible pool of taxes with the Provincial governments as per the NFC Award. Consequently, it has been declared as a non-tax source of revenue. However, in *de facto* terms it is a tax and should be seen in combination with the sales tax. The IMF also views this as a tax.

As of October 2024, the maximum leviable petroleum levy is Rs 70 per liter. It is at Rs 60 per liter in the case of Motor Spirit and HSD oil and Rs 50 per liter on light diesel, high octane blending components and 95 RON petrol.

1.4. Trend in Tax Revenues

The tax to GDP ratio is low in Pakistan. Presently it stands at close to 10.5% of GDP as shown in Table 1.5. This is inclusive of the petroleum levy. The federal tax-to-GDP ratio, including the levy, stands at 9.7%. Despite a wide range of the taxes the provincial tax revenues are 0.8% of the GDP.

The trend in the tax-to-GDP ratio suggests that the tax-to-GDP ratio had been close to 8.8% of the GDP during the tenure of PPP (2008-09 to 2012-13). However, it rose significantly in 2017-18 and reached 11.3%. Since then, there has been a simultaneous decline in the federal and provincial taxes-to- GDP ratios, reducing the overall tax-to-GDP ratio. There has been some recovery in 2023-24.

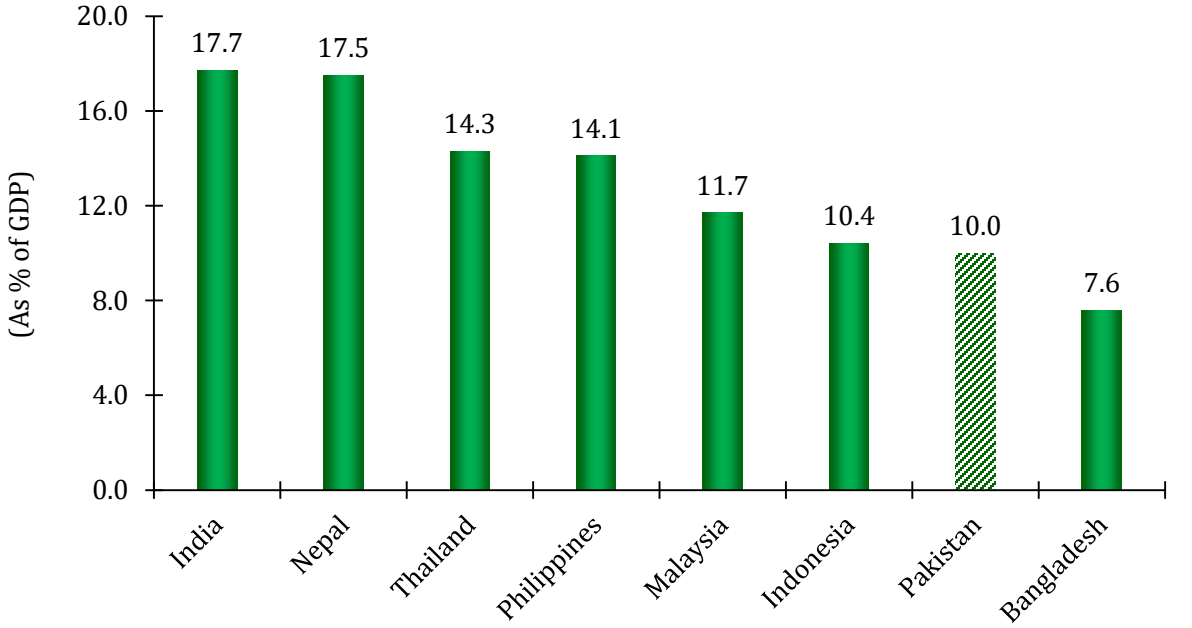
Table 5: Trend in Tax Revenues, 2002-03 to 2023-24

	(Rs. Billion)				***(as% of GDP)***			
	Federal Tax Revenues (FBR)	**Provincial Tax Revenues**	**Petroleum levy**	**TOTAL**	**Federal Tax Revenues (FBR)**	**Provincial Tax Revenues**	**Petroleum levy**	**TOTAL**
2002-03	463	22	47	532	7.0	0.3	0.7	8.0
2007-08	1010	41		1051	8.0	0.3	0.1	8.4
2012-13	2048	151	110	2309	8.2	0.6	0.0	8.8
2017-18	4065	401	179	4645	10.4	1.0	0.2	11.3
2022-23	7169	650	580	8399	8.5	0.8	0.7	10.0
2023-24	9311	774	1019	11104	8.8	0.7	1.0	10.5

Source: MOF, Fiscal Operations.

As compared to some selected countries from South and East Asia, Pakistan has one of the lowest tax revenues as % of the GDP, as shown in Figure 3. It is relatively low compared to India and Nepal in South Asia. However, it is higher than Bangladesh.

Figure 3: Government Tax Revenue as % of GDP in Selected Countries, 2021

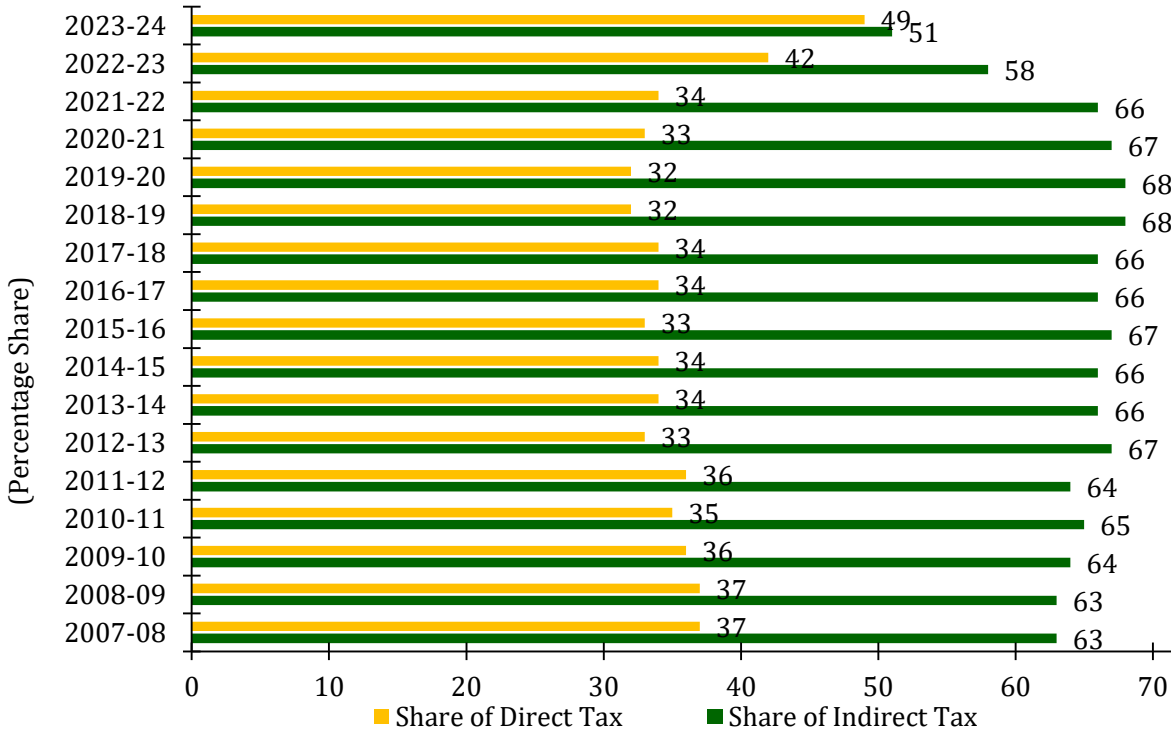


Source: WDI, World Bank.

1.4.1. Composition of Tax Revenues

The composition of tax revenues indicates a relatively regressive nature of the tax structure in Pakistan. From a 38.4% share of direct taxes in total tax revenue of FBR in 2007-08 to an increase to 49% in 2023-24, yet the rest, 51%, is still collected from indirect taxes as shown in Figure 4.

Figure 4: Percentage Share of Direct and Indirect Taxes in FBR Revenues



Source: Fiscal Operations, Ministry of Finance, Pakistan.

Of the indirect taxes, almost 53% is collected from the sales tax on the goods whereas 19% was collected from the customs duty in 2022-23. There has been a considerable growth in the petroleum levy of 23.5% annually. In fact, there has been an increase from Rs 128 billion to Rs 1019 billion from 2021-22 to 2023-24.

Table 6: Trend in Individual FBR Tax Revenues, 2002-03 to 2023-24

(Rs. in Billion)

	Income Tax	Sales Tax	Custom Duty	Excise Duty	Total
2002-03	153 (33.0) *	195	69	46	463
2007-08	378 (37.4)	385	150	87	1010
2012-13	736 (37.9)	840	240	124	1940
2017-18	1536 (39.9)	1491	608	214	3849
2022-23	3272 (45.6)	2592	935	370	7169
2023-24	4530 (48.6)	3098	1104	577	9309

**Figures in the parenthesis show the share of income tax in FBR revenues.*
Source: MOF: Fiscal Operations.

1.4.2. Trend in Provincial Tax Revenues

The sales tax on services is generating significant revenues for all four provinces as shown in Table 7. It has almost 64% share in the total tax collected by them. Punjab has 66% revenue collected by the sales tax, whereas it is 60% and 65% in Sindh and Khyber-Pakhtunkhwa respectively. The highest share is in Baluchistan with 74% contributed by the sales tax in the total tax revenue.

Table 7: Trend in Provincial Tax Revenues, 2002-03 to 2023-24

(Rs. in Billion)

	Sales Tax on Services	Stamp Duty	Motor Vehicles	Others	Total
2002-03	-	7	4	11	22
2007-08	-	11	8	22	41
2012-13	-	18	14	119	151

		(9.8%) *	(11.2%)	(33.7%)	(26.1%)
2017-18	224	63 (25.0%)	24 (10.8%)	90 (-5.5%)	401 (19.5%)
2022-23	417 (12.4%)	65 (0.6%)	32 (5.8%)	136 (8.2%)	650 (9.7%)
2023-24	504 (20.8%)	62 (-4.7%)	34 (6.2%)	174 (27.9%)	774 (19.1%)

**Annual compound growth rate.*
Source: MOF, Fiscal Operations.

REVIEW OF LITERATURE ON TAX REFORMS

This Chapter focuses especially on tax reforms that have been identified for implementation in Pakistan in recent years. It also highlights the type of reforms proposed earlier in India.

2.1. The PIDE- PRIME Tax Reforms Commission (2024)

The objectives and parameters of a new tax policy are as follows:

1. A citizen friendly, transparent, stable and predictable tax regime to stimulate growth and investment.
2. Simplification and harmonization to facilitate tax payers and ease of paying taxes.
3. Automation and digitization to eliminate direct interface between the taxpayer and the tax authority.

The major proposals for reforms by tax are presented below:

Personal Income Tax

- Same rate of tax on all sources of income irrespective of source.
- Exemption limit to be raised to 800,000 Rs. Six slabs with rates of 0%, 5%, 12.5%, 20%, 27.5% and 35%. Maximum rate to be attained at taxable income exceeding Rs 30,000,000.
- Withdrawal of deemed rental income, Capital Value Tax on foreign assets, Super tax, etc.

Corporate Income Tax

- Corporate tax rate to be brought down to 25%. To be reduced further to make Pakistan regionally competitive.
- Withdrawal of Super Tax, Turnover Tax, Inter-Corporate Dividend Income, Presumptive/Final Tax Regime.

General Sales Tax

- Harmonized and equalized VAT mode, across goods and services, and across provinces, wholesale and retail.
- VAT rate to be brought down to 10% in five years.
- Import of plant and machinery, industrial raw materials and intermediate goods to be zero-rated.

Customs Duty

- Elimination of exemptions and concessions.
- Withdrawal of regulatory duties and additional customs duties.

Excise Duty

- Higher excise duties on tobacco and other products declared harmful for health or environment.

Withholding Taxes in Income Tax

- Should be classified as advance income tax.
- All kinds of withholding taxes, except on payroll, interest and dividends, should be discontinued in the long run.

Tax Exemptions

- No new exemptions/concessions in GST, except activities supporting education and health, which should be zero-rated.
- Restore investment tax credits and accelerated depreciation allowance.

The Tax Reforms Commission estimates that the process of tax rationalization will yield Rs 4 trillion additional revenue in the first three years. The increase will be 26% of the base collection of 2021-22 by the third year. This is based on the presumption that the reduction in tax rates will lead to a substantial expansion in the tax bases.

Tax Administration Reforms

- 'Non-filers' should be treated as tax defaulters and prosecuted.
- VAT mode to be completed initially with commercial importers and wholesalers and Tier 1 retailers and thereafter with Tier-2 and Tier-3 retailers.
- Priority to digitization and automation.
- Make Customs Valuation rulings more transparent using AI algorithms.
- Enhance the capacity and autonomy of PRAL.
- Formation of a Pakistan Fiscal Policy Institute.

2.2. The Recommended Tax Reforms (2021) By Hafiz A. Pasha

Pasha (2021) in his book, *Charter of the Economy*, has identified the following tax reforms for Pakistan:

Direct Taxes

- Transition from blocwise to comprehensive income taxation
- Rationalization of the withholding tax regime
- Changing the tax credit scheme
- Broadening the base of the capital gains tax by withdrawal of exemption linked to holding period
- Progressive corporate income tax, rather than super tax
- Incentives for filing returns and penalties on non-filers
- Taxation of large pensions
- Tax exemption only to NGOs in education, health and social safety nets
- Retention of the initial depreciation allowance and tax credit on BMR
- Reduction of number of slabs in the personal income tax and increase in exemption limit
- Higher income taxation of commercial banks
- Taxing the informal sector through electricity bills, with more slabs

Indirect Taxes

- Move towards a national integrated sales tax on goods and services with VAT features
- Imposition of a sales tax and import duty on selected imported services on the 'reverse charge' principle
- More luxury consumer goods subject to sales taxation on the retail price
- Levy of excise duty on activities which pollute the environment

2.3. Other Recommendations

Ahmed (2023) has proposed a home-grown five-point agenda of tax reform. First, there is need to clearly communicate the vision of tax policy and ensure strict adherence to it.

Second, the Provincial governments are endowed with substantial fiscal powers but their performance in revenue mobilization has been very disappointing. Top priority must be placed on increasing the revenue generation capacity of the Provincial governments.

Third, ad-hoc and stop-gap steps to be done away with. They lead to distortions in the tax system and lead to violation of either horizontal or vertical equity.

Fourth, there needs to be a strong and effective audit mechanism in place. Heightened risk of being caught and associated penalties can be a strong deterrent to tax evasion.

Fifth, a fundamental institutional reform of the FBR is required. It needs to be restructured into a professional, autonomous organization with an independent board of eminent personalities.

2.4. Tax Reforms in India

Acharya (2005) identifies the pending reforms in India as follows:

Import Duties

Bringing down the level of import duties to 'East Asian Levels'. Withdrawal of the complex plethora of exemptions. Reduction in the variation in import tariffs, especially on agricultural items.

Excise Duties

Resurrecting the role of (additional) special excises on luxury consumer goods and durables.

Integration of CENVAT and State VATs

This is to be achieved in a manner which most closely approximates the destination based, unified, retail level VAT for the country.

Direct Taxes

Withdrawal of wide-ranging exemptions, especially the location-specific tax breaks.

Tax Administration

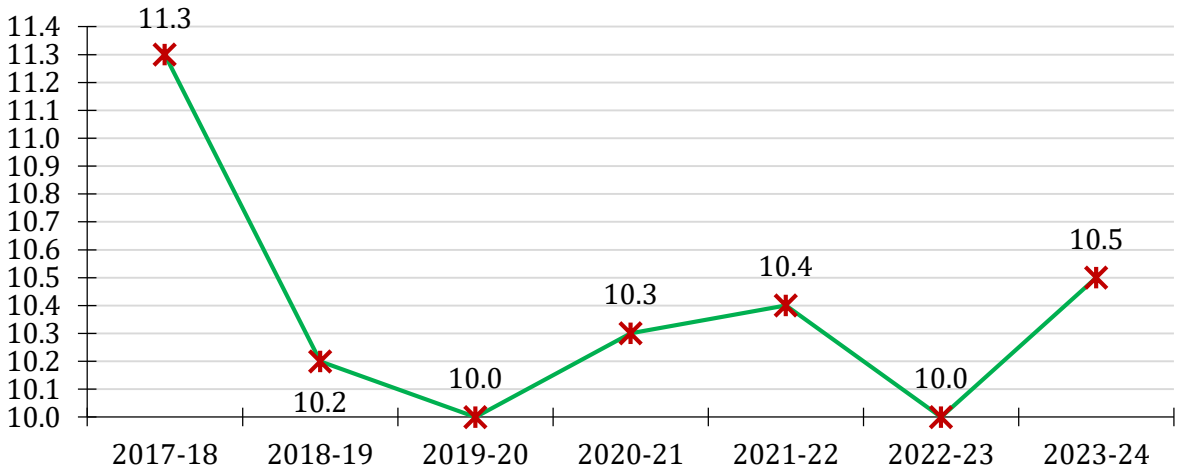
Concerted programme needed to deploy information technology, digitization and modern risk assessment methods to both direct and indirect taxes.

The above reforms proposals are also very relevant for the tax system of Pakistan, although they were identified in 2005, because the pace of reforms in Pakistan has been much slower than in India. India has achieved a much higher tax-to-GDP ratio above 17% of the GDP.

WHY THE TAX-TO-GDP RATIO HAS FALLEN

The fundamental problem with the tax system[1] of Pakistan is that not only is the tax-to-GDP ratio low but it has also been declining. It was 11.3% of the GDP in 2017-18 and has since fallen to 10.5% of the GDP in 2022-23, as shown in Figure 5. The big fall in the tax-to-GDP ratio was in 2018-19.

Figure 5: The Tax-to-GDP Ratio from 2017-18 to 2023-24



Source: Authors' computations based on information gathered from Pakistan Bureau of Statistics.

The objective of this chapter is to analyse the reasons for the drop in the tax-to-GDP ratio by 0.8% of the GDP from 2017-18 to 2023-24.

3.1. Methodology

The objective of the analysis is to decompose the fall in the tax-to-GDP ratio into two parts, as follows:

the 'base' effect

the 'rate' effect

with; T = Tax Revenue, B = Tax Base, Y = GDP

$$\frac{\boldsymbol{T}}{\boldsymbol{Y}} = \left(\frac{\boldsymbol{T}}{\boldsymbol{B}}\right)\left(\frac{\boldsymbol{B}}{\boldsymbol{Y}}\right)$$

The 'base' effect quantifies if and the extent of the fall in the tax-to-GDP ratio is due to a decline in the size of the tax base, ***B***, of the tax in relation to the GDP, ***Y***.

The 'rate' effect is the fall in the effective tax rate as measured by the ratio of the tax revenue, ***T***, to the tax base, ***B***.

Based on this, we have that the change in year ***t*** is relation to year ***o*** in a particular tax-to-GDP ratio is derived as follows:

[1] This includes all the federal and provincial taxes identified in Chapter 1, plus Petroleum levy.

$$\left(\frac{T}{Y}\right)_t - \left(\frac{T}{Y}\right)_o = \left(\frac{T}{B}\right)_t \left(\frac{B}{Y}\right)_t - \left(\frac{T}{B}\right)_o \left(\frac{B}{Y}\right)_o$$

This is transformed to

$$\left(\frac{T}{Y}\right)_t - \left(\frac{T}{Y}\right)_o = \left(\frac{T}{B}\right)_t \left[\left(\frac{B}{Y}\right)_t - \left(\frac{B}{Y}\right)_o\right] + \left(\frac{B}{Y}\right)_o \left[\left(\frac{T}{B}\right)_t - \left(\frac{T}{B}\right)_o\right] \ldots\ldots [1]$$

The first expression on the RHS of the above equation is the change in the Tax-to-GDP ratio due to the base effect and the second is the change due to the rate effect.

The above analysis is undertaken of the following taxes:

- Income Tax
- Sales Tax + Petroleum Levy
- Sales Tax on Services
- Import Duties
- Excise Duty

The relevant tax base for each of the above taxes is repeated here and shown in Table 3.1 below.

Table 8: Tax Base of Individual Taxes

Tax	Tax Base
1. Income Tax	Non-Agricultural GDP
2. Sales Tax on Goods + Petroleum Levy	Value Added in Large-Scale Manufacturing + Rupee Value of Imports + Import Duty Revenue
3. Sales Tax on Services	Value Added in Accommodation and Food Services, Information and Communication, Finance and Insurance and Other Private Services
4. Import Duties	c.i.f. Rupee Value of Imports
5. Excise Duty	Value Added in Selected Activities

3.2. Change in the Individual Tax-to-GDP Ratio

The change in the individual tax-to-GDP ratio from 2017-18 to 2023-24 is given in the Table 3.2 below.

Table 9: Change in Individual Tax-to-GDP Ratios

(Rs in Billion)

	2017-18	% of GDP	2023-24	% of GDP	Change in % of GDP
Income Tax	1,536	3.9	4,531	4.3	0.4
Sales Tax on Goods + Petroleum Levy	1,670	4.3	4,118	3.9	-0.4

Sales Tax on Services	224	0.6	505	0.5	-0.1
Import Duty	608	1.6	1,104	1.0	-0.6
Excise Duty	214	0.5	577	0.5	0.0
Other Provincial Taxes	177	0.4	269	0.3	-0.1
TOTAL	**4,429**	**11.3**	**11,104**	**10.5**	**-0.8**
GDP	39,190		105,741		

Source: Fiscal Operations, MOF.

Table 9 indicates that the big falls are in the sales tax and import duty. Fortunately, the income tax-to-GDP ratio has increased by 0.4% of the GDP.

3.3. Analysis of Individual Taxes

Income Tax

We first analyse why the income tax-to-GDP has increased by 0.4% of the GDP. The relevent tax base of the income tax is the non-agricultural GDP of Pakistan. The Federal income tax does not cover argicultural incomes, which are in the provincial domain.

The relevent ratios of the income tax are presented in Table 10.

Table 10: Income Tax (%)

	2017-18	2023-24	Change
Tax Base as % of GDP	78.35	76.67	-1.68
Tax Revenues as % of the Tax Base	5.01	5.60	0.59
Tax Revenues as % of GDP	3.92	4.30	0.38

Application of equation 1 leads to the following decomposition:

The 'Base' Effect	The 'Rate' Effect	Overall Change in Tax-to-GDP Ratio
-0.1	**0.5**	**0.4**

The results indicate the presence of a significant 'rate' effect. This reflects the widespread coverage of the withholding tax regime and some enhancement in tax rates.

However, the effective tax rate of the income tax is Pakistan is less than 6%. This highlights the high level of tax evasion in the country. The number of income taxpayers is 3.69 million, equivalent to less than 5% of the number of employed. In India, with a population about six times that of Pakistan, the number of income taxpayers is twenty five times the number in Pakistan. Clearly, one of the reforms is the introduction of incentives and/or penalties to facilitate the filing of returns.

Sales Tax Plus Petroleum Levy

Part of the sales tax has been substituted by the petroleum levy. Therfore, the two taxes are taken together for the analysis. The tax-to-base and tax base-to-GDP magnitudes are given in Table 11.

Table 11: Sales Tax plus Petroleum Levy (%)

	2017-18	2023-24	Change
Tax Base as % of GDP	29.11	25.86	-3.25
Tax Revenues as % of Tax Base	14.64	15.01	0.37
Tax Revenues as % of GDP	4.26	3.88	-0.38

There has been a significant decline in the tax revenues to GDP ratio of almost 0.4% of the GDP.

This is attributable to the following effects:

The 'Base' Effect	The 'Rate' Effect	Change in Tax-to-GDP Ratio
-0.4	**0.0**	**-0.4**

The 'base' effect is due particularly to the efforts by the SBP to restrict non-essential imports by management of the letters of credit in 2022-23 and 2023-24. This has implied a revenue loss of Rs 423 billion to FBR.

Sales Tax on Services

The sales tax on services is levied by the Provincial Governments as per the allocation of fiscal powers in the Constitution of Pakistan, as highlighted earlier in Chapter 1.

The two ratios of the tax are presented in Table 12.

Table 12: Sales Tax on Services ($ per litre)

	2017-18	2023-24	% Change
Tax Base as % of GDP	8.57	10.51	1.94
Tax Revenue as % of Tax Base	6.66	4.54	-2.12
Tax Revenue as % of GDP	0.57	0.48	-0.09

The tax base has been curtailed by the lack of imposition of the tax on various services especially the large number of private services.

The 'base' and 'rate' effects have been derived and are given below:

The 'Base' Effect	The 'Rate' Effect	Overall Change in Tax-to-GDP Ratio
0.1	**-0.2**	**-0.1**

Therefore, the small fall in the tax-to-GDP ratio is due to the decline in the effective rate. This is likely to be the consequence of evasion, especially by professionals who are operating more in the informal sector and providing services. The rate could also be significantly enhanced by broadening the tax base on services.

Import Duty

There was a time up to the early 90s when FBR was heavily dependent on import duties. The process of trade liberalization since then has reduced the contribution of import duties to total tax revenues.

The key ratios for import duty are presented in Table 13.

Table 13: Import Duty

	2017-18	2023-24	% Change
Tax Base as % of GDP	18.63	15.22	-3.41
Tax Revenues as % of Tax Base	8.32	6.85	-1.47
Tax Revenues as % of GDP	1.55	1.00	-0.55

Application of Equation 1 leads to the following decomposition:

The 'Base' Effect	The 'Rate' Effect	Overall Change in the Tax-to-GDP Ratio
-0.2	**-0.4**	**-0.6**

The reason for the decline in the tax-to-GDP ratio is primarily attributable to efforts in recent years to reduce imports of non-essential high duty imports like automobiles, electrical equipment, etc. This is clearly visible in Table 14.

Table 14: Contribution of Different Imports to Import Duty Revenues (%)

	2017-18	2022-23
Vehicles (Non-Railway)	16.0	9.5
POL Products	11.7	30.0
Iron and Steel	6.8	5.8
Machinery	6.4	3.9
Electrical Equipment	5.1	4.0
Edible Oil	4.6	5.1
Plastic Resins	2.0	3.9
Others	49.4	37.8
TOTAL	**100.0**	**100.0**

Table 14 reveals clearly the decline in shares of automobiles and electrical equipment. The share of relatively low duty POL products has increased from 11.7% to 30%.

Excise Duty

Currently, almost 60% of the revenue is from cigarettes and cement. The revenues from different industries are given in Table 15.

Table 15: Composition of Excise Duty Revenues (Rs in Billion)

	2017-18	2022-23	Growth Rate (%)
Cigarettes	67	142	111.9
Cement	54	66	22.2
Services of Trave by Air	44	40	-9.1
Others	41	122	197.5
TOTAL	**206**	**370**	**79.6**

There has been a small fall of less than 0.1% of the GDP in the tax-to-GDP ratio. As such, the separate 'tax' and 'base' effects are very small.

The excise duty rate has been enhanced substantially on cigarettes. However, the limited growth rate over the five-year period indicates the likelihood of substantial tax evasion. The track and trace system will have to be applied rigorously on this industry.

3.4. Overall Findings

A summary is presented below in Table 16 for each tax of the changes in the tax-to-GDP ratio and the decomposition of the changes into the 'base' and 'rate' effects.

Table 16: Change in Individual Tax-to-GDP Ratio and the 'Base' and 'Rate' Effects from 2017-18 to 2023-24 (%)

	Tax-to-GDP Ratio			'Base' Effect	'Rate' Effect	Change
	2017-18	2023-24	Change			
FEDERAL						
Income Tax	3.9	4.3	0.4	-0.1	0.5	0.4
Sales Tax + Petroleum Levy	4.3	3.9	-0.4	-0.4	0.0	-0.4
Import Duty	1.6	1.0	-0.6	-0.2	-0.4	-0.6
Excise Duty	0.5	0.5	0.0	0.0	0.0	0.0
PROVINCIAL						
Sales Tax on Services	0.6	0.5	-0.1	0.1	-0.2	-0.1
Other Taxes	0.4	0.3	-0.1	n.a	n.a	n.a
OVERALL	**11.3**	**10.5**	**-0.8**	**-0.6**	**-0.2**	**-0.8***

**Different from 0.8 due to rounding off.*

The important findings are as follows:

(i) The issue is whether the pricing policy on petroleum products is appropriate or not. A comparison is made of the price of the two major petroleum products, motor spirit and HSD oil, in a sample of Asian countries. It appears that motor spirit is significantly underpriced in Pakistan. As such, there is a case for enhancement in the sales tax rate on this product even in the presence of the petroleum levy. A bigger reduction may be justified in HSD oil. This is likely to make the tax less regressive.

(ii) The fall in tax-to-GDP ratio of import duty is due to the containment of high duty luxury imports.

(iii) There has been a small fall of less than 0.1% of the GDP in the tax-to-GDP of the excise duty. The excise duty rate has been enhanced substantially on cigarettes. However, the limited growth rate over the five-year period indicates the likelihood of substantial tax evasion. The track and trace system will have to be applied rigorously on this industry.

3.5. Elasticity and Buoyancy of Taxes

Another way to examine the trend in the overall tax-to-GDP ratio is to look at the elasticity and buoyancy of individual taxes and the overall tax system.

The measure of elasticity of an individual tax is the relationship between the growth of the tax base of the tax and the growth of the national economy over a specified period. It is designated as ε.

Buoyancy measure of a tax relates to the relationship between the actual growth of revenues from the tax and the GDP growth. It is designated as β.

The following outcomes are possible.

$\varepsilon < 1 \; ; \; \beta < 1$	Declining ratio of the tax base and tax revenues to the GDP
$\varepsilon < 1 \; ; \; \beta > 1$	Declining ratio of the tax base to the GDP, but rising ratio of tax revenues because of a rise in the effective tax rate
$\varepsilon > 1 \; ; \; \beta > 1$	Rising ratio of the tax base and tax revenues to the GDP
$\varepsilon > 1 \; ; \; \beta < 1$	Rising ratio of the tax base to the GDP but falling ratio of actual tax revenues because of decline in tax rates

There are two sets of earlier estimates of the elasticity and buoyancy of individual taxes and total tax revenues by Mukarram (2001) and Bilqees (2004). These estimates are presented in Table 17.

Table 17: Elasticity and Buoyancy of Individual Taxes and Total Tax Revenues (%)

	Fouzia Mukarram	Faiz Bilqees

	1980-81 to 2000-01		1974-75 to 2003-04	
	Elasticity	Buoyancy	Elasticity	Buoyancy
Income Tax	1.13	1.61	1.21	1.23
Sales Tax + Petroleum Levy	0.99	1.51	1.50	1.41
Customs Duty	0.32	0.55	0.43	-1.19
Excise Duty	0.47	0.76	0.44	0.48
Total Taxes	0.64	1.00	0.88	0.92

Both estimates highlight the above unity elasticity and buoyancy of the income tax. The high elasticity is attributable to the fact that the tax base excludes agricultural income, which trends to grow less rapidly than the other sectors in the national income. The high buoyancy is also attributable to the expansion of the withholding tax regime in the decade of the 90s and rising marginal tax rate with growing nominal personal incomes.

The lowest buoyancy is observed in customs duty. This reflects the continuing process of decline in the level of import tariffs, as part of the process of trade liberalization and focus more on export promotion.

The high elasticity and buoyancy of the sales tax is attributable to development of the value-added tax and the relatively fast growth of the large-scale manufacturing sector.

The Table 3.11 presents the most recent estimates of the elasticity and buoyancy of taxes for the period, 2017-18 to 2023-24. As highlighted earlier, this is a period when the overall tax-to-GDP ratio has declined.

Table 18: Estimates of the Recent Elasticity and Buoyancy of Taxes, 2017-18 to 2023-24 (%)

	Elasticity	Buoyancy
Income Tax	0.98	1.09
Sales Tax + Petroleum Levy	0.90	0.91
Customs Duty	0.81	0.60
Excise Duty	1.07	1.00
Sales Tax on Services	1.21	0.82
TOTAL TAXES	**0.97**	**0.88**

The worrying finding is that unlike the earlier years the buoyancy coefficient is lower than the elasticity. This reflects the greater negative impact of falling rates, as in excise duty and petroleum

levy, and greater under coverage of services by the sales tax on services. Customs duty buoyancy has been substantially reduced in recent years by physical controls over non-essential imports, like automobiles, consumer durables, mobile phones and luxury foods, which carry relatively high rates of import duty.

Clearly, the agenda of tax reforms must focus on raising the overall buoyancy of the tax system to significantly above unity.

DETERMINANTS OF THE TAX-TO-GDP RATIO

The objective of this Chapter is to explore the determinants of the tax-to-GDP ratio at the country level by analysis of the cross sectional and time series data of a sample of countries.

The first section describes the criteria used for selection of the countries and the resulting choice of 27 countries. Data on these countries has been selected on these countries from 2000 to 2023. The World Indicators database of the World Bank has been accessed.

The second section presents scatter diagrams of the tax-to-GDP ratio with respect to the likely determinants. The third section then presents the results of the econometric analysis of determinants of the tax-to-GDP ratio. These results are then used in the fourth section to predict the tax-to-GDP ratio of Pakistan and a comparison made with the actual ratio. This will reveal the relative performance of Pakistan in the level of fiscal effort given its economic characteristics.

4.1. Choice of Countries

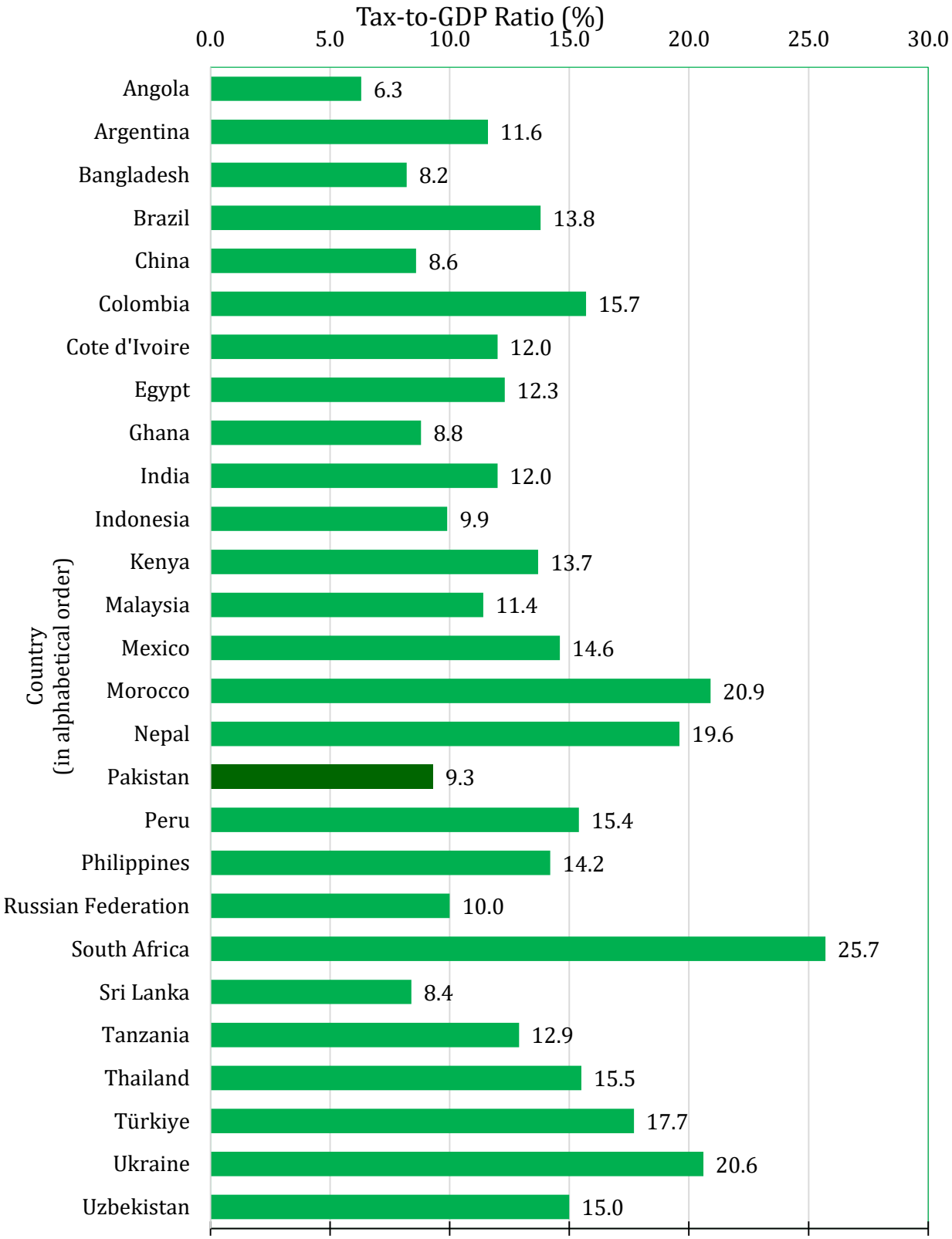
The criteria used for selection of a country are as follows:

- lower or upper middle-income country
- population of at least 20 million.

This has resulted in the selection of 27 countries. They are identified in Figure 6, along with their tax-to-GDP ratios in the latest year, 2023. There is substantial variation in the tax-to-GDP ratio among the sample countries. The maximum value in 2023 is observed in South Africa at 25.7% and the minimum value in Angola at 6.3%. Pakistan is closer to the lower end with a ratio of 9.3%.[2]

Figure 6: Selected Countries and their tax-to-GDP Ratios in 2023

[2] Lower than the observed overall ratio because of the non-inclusion of petroleum levy and provincial taxes.



Source: WDI, World Bank.

The trend in the tax-to-GDP ratio of 27 chosen countries is shown from 2000 to 2023 in Table 4.1. Over the period of over two decades there has been an increase in the ratio in 16 countries and a fall in 11 countries. The large increase is observed in the case of Nepal, an LDC. The tax-to-GDP ratio has gone up in Nepal from 8.7% in 2000 to 19.6% by 2023. This is an extraordinary fiscal effort in a country with a low per capita income. Other countries which have shown a relatively big increase are Ukraine, South Africa, Mexico and South Africa.

The biggest fall is observed in Angola. This is also a country with a low per capita income. There has been a large fall in the tax-to-GDP ratio from 28.7% to only 6.4%. Other countries which have shown big declines in the ratio are Ghana, Sri Lanka, Kenya and the Russian Federation.

The list below identifies four types of countries based on Table 4.1

Increase in 2000 to 2010; Increase from 2010 to 2023	Increase in 2000 to 2010; Decrease from 2010 to 2023	Decrease in 2000 to 2010; Increase from 2010 to 2023	Decrease in 2000 to 2010; Decrease from 2010 to 2023
Bangladesh	Argentina	Philippines	Angola
Colombia	Brazil		China
Cote d'Ivoire	**Pakistan**		Egypt
India	Peru		Ghana
Nepal	Morocco		Indonesia
South Africa			Russian Federation
Tanzania			Sri Lanaka
Thailand			Türkiye
Ukraine			Kenya
Uzbekistan			Malaysia
Medico			
[11]	**[5]**	**[1]**	**[10]**

11 countries have managed to increase the tax-to-GDP ratio throughout the period. 10 countries have shown the opposite trend. Pakistan is one of the few countries with a variable trend of increase from 2000 to 2010 and fall thereafter.

Table 19: Trend in Tax-to-GDP Ratio of the Selected Countries (% of GDP)

Country *(in alphabetical order)*	2000	2010	Change from 2000 to 2010	2023	Change from 2010 to 2023	Change from 2000 to 2023

Angola	28.7	16.6	-12.1	6.3	-10.3	-22.4
Argentina	9.6	12.9	3.3	11.6	-1.3	2.0
Bangladesh	7.2	7.8	0.6	8.2	0.4	1.0
Brazil	14.0	14.2	0.2	13.8	-0.4	-0.2
China	11.5	10.2	-1.3	8.6	-1.6	-2.9
Colombia	11.2	12.1	0.9	15.7	3.6	4.5
Cote d'Ivoire	9.3	10.2	0.9	12.0	1.8	2.7
Egypt	15.3	14.1	-1.2	12.3	-1.8	-3.0
Ghana	19.0	13.4	-5.6	8.8	-4.6	-10.2
India	8.8	11.0	-2.2	12.0	1.0	3.2
Indonesia	12.8	10.5	-2.3	9.9	-0.6	-2.9
Kenya	18.1	16.1	-2.0	13.7	-2.4	-4.4
Malaysia	13.7	13.3	-0.4	11.4	-1.9	-2.3
Mexico	9.1	9.7	0.6	14.6	4.9	5.5
Morocco	19.0	21.1	2.1	20.9	-0.2	1.9
Nepal	8.7	13.4	4.7	19.6	6.2	10.9
Pakistan	**7.5**	**9.4**	**1.9**	**9.3**	**-0.1**	**1.8**
Peru	12.6	15.5	2.9	15.4	-0.1	2.8
Philippines	12.4	11.6	-0.8	14.2	2.6	1.8
Russian Federation	13.7	13.0	-0.7	10.0	-3.0	-3.7
South Africa	21.0	22.5	1.5	25.7	3.2	4.7
Sri Lanka	14.5	10.9	-3.6	8.4	-2.5	-6.1
Tanzania	9.0	9.9	0.9	12.9	3.0	3.9
Thailand	13.0	14.9	1.9	15.5	0.6	2.5
Türkiye	19.3	18.9	-0.4	17.7	-1.2	-1.6
Ukraine	13.6	15.0	1.4	20.6	5.6	7.0
Uzbekistan	12.0	13.2	1.2	15.1	1.9	3.1
Number of Countries *Increase in Ratio*			**16**		**12**	**16**
Reduction in Ratio			**11**		**15**	**11**

Source: WDI, World Bank.

4.2. Choice of Determinants

Diverse determinants of the tax-to-GDP ratio have been identified, as follows:

- GDP per capita *(PPP, current international $)*
- Imports of Goods and Services as % of GDP
- Agriculture Value Added *(% of GDP)*
- Industry Value Added *(as % of GDP)*
- Services Value Added *(as % of GDP)*
- Gini Index of Inequality
- Self-Employed as % of Total Employment
- Score in the World Bank Governance Index

The above determinants include level of per capita income and the extent of income inequality. Variation in structure of the economy is captured by the sectoral shares and level of international trade, as measured by the level of imports as % of the GDP. An attempt is also made to explore the extent to which the informal economy reduces taxable capacity. This is measured by the share of the self-employed in total employment. Also, the quality of governance is included in this analysis as it also implies better or worse tax administration.

4.3. Visual Analysis of Role of Determinants

The relationship between per capita income and the tax-to-GDP ratio is shown by the scatter diagram in Figure 7. The relationship is not clear. The highest tax-to-GDP ratios are observed in middle income countries. One of the highest income countries, the Russian Federation, with per capita income above $35000 has a low tax-to-GDP ratio of 10%. The first indications are that there is no significant positive relationship between per capita income and the tax-to-GDP ratio in 2023.

Turning to Chart 4.3 we see the tax-to-GDP ratio with respect to the level of income inequality, as measured by the Gini coefficient. There is a clustering in the scatter diagram in the range of the Gini coefficient from 0.3 to 0.5, with some indications that the tax-to-GDP ratio tends to be higher, as expected, with greater income equality. However, there are notable outliers. For example, Nepal has a very low Gini coefficient of 12.4%, but it has a high tax-to-GDP ratio of 19.6%. At the other extreme, Angola has a high Gini coefficient of 48.6% but a very low tax-to-GDP ratio of only 6.3%.

Figure 7: Per Capita Income in US $ (PPP) and The Tax-to-GDP Ratio, 2023

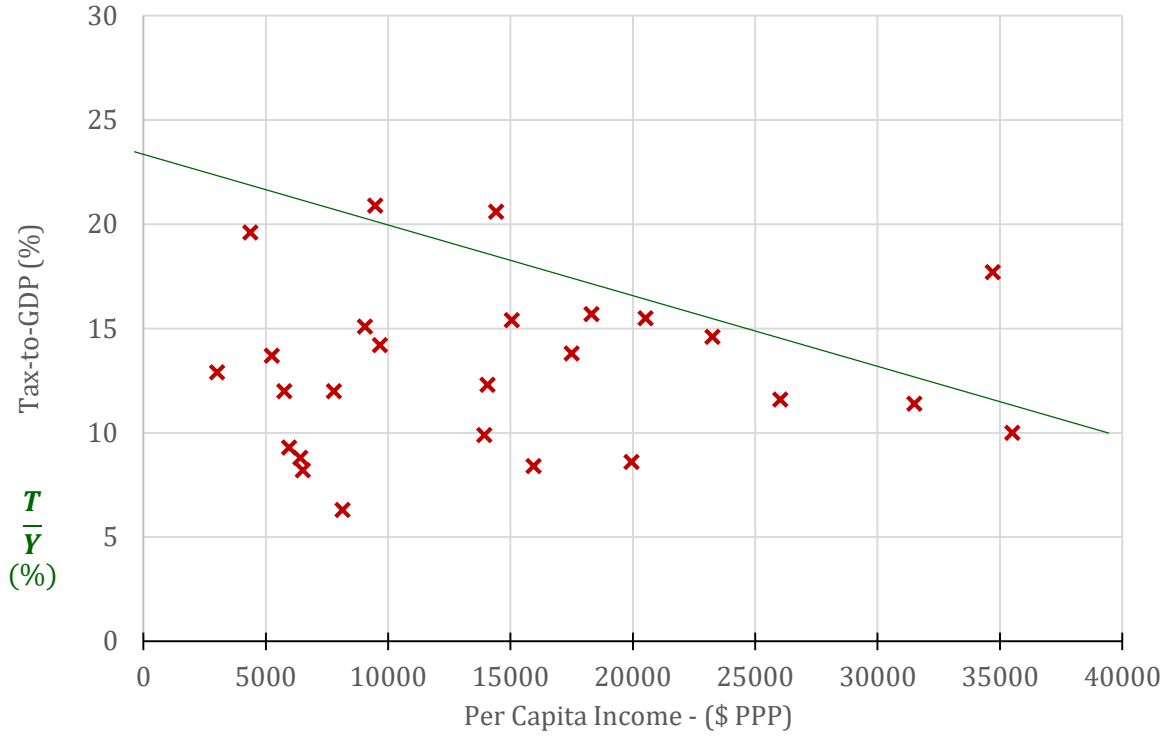


Figure 8: The Level of Inequality and the Tax-to-GDP Ratio, 2023

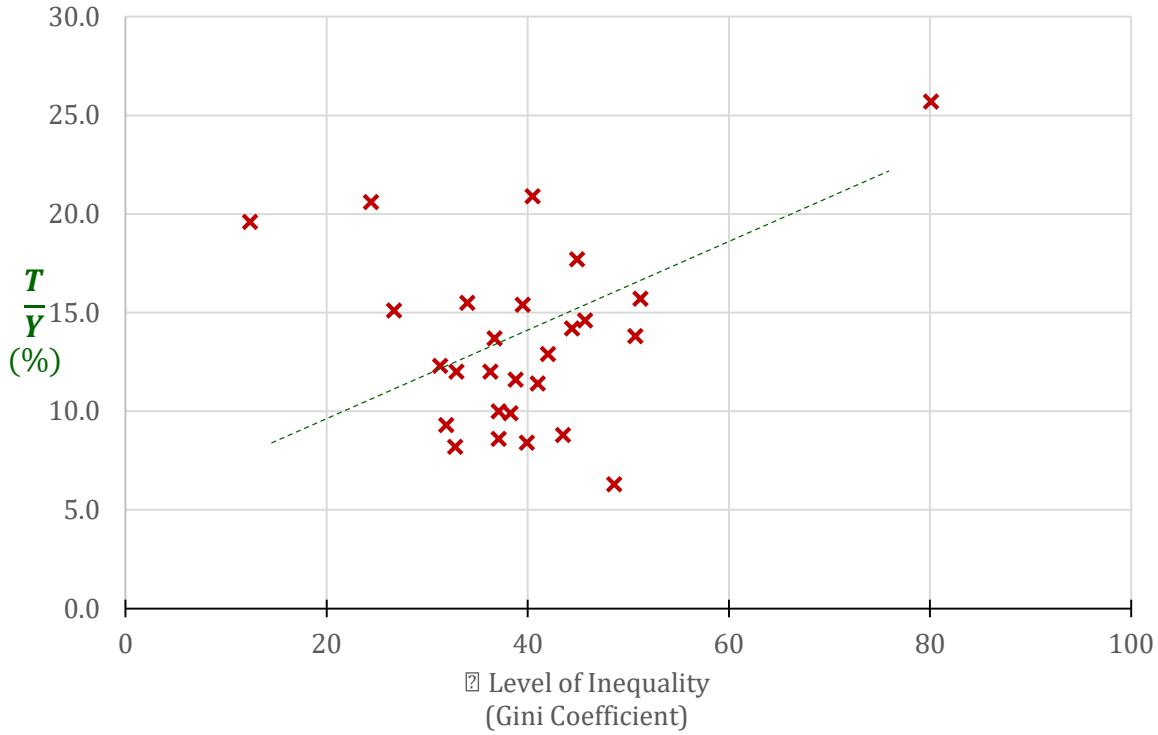


Figure 9 presents the scatter diagram of tax-to-GDP ratio and the share of imports in the GDP. There is a visible positive relationship. As the share of imports in the GDP increases, the tax-to-GDP ratio

tends to rise significantly. Imports generally are a preferred tax base for higher rates and frequently for providing more protection to domestic industry and agriculture.

Figure 9: Imports as % of GDP and Tax-to-GDP Ratio, 2023

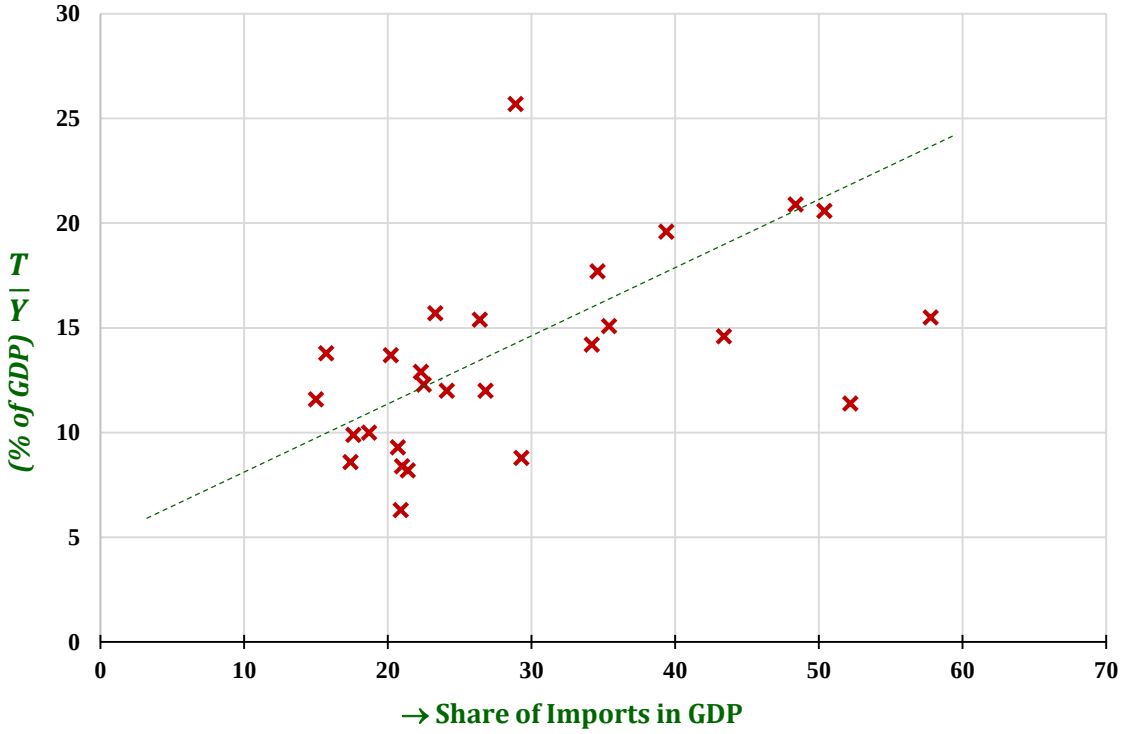
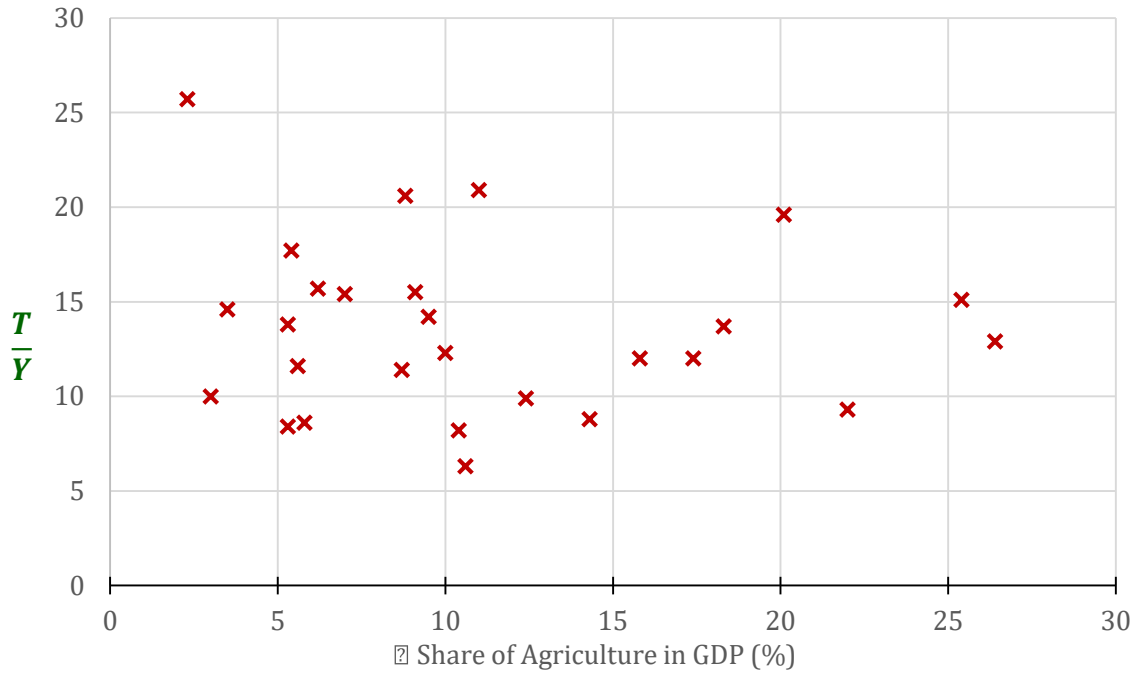


Figure 10 shows visually if the share of agriculture in the GDP impacts on the tax-to-GDP ratio in the 27 countries. Here there is evidence of a negative relationship. The highest tax-to-GDP ratio of 25.7% is observed in South Africa. It has a very small share of agriculture of 2.3%.

Figure 10: Share of Agriculture in the GDP and the Tax-to-GDP Ratio, 2023



4.4. The Results

The best results of a number of multiple regressions are given below:

$$\frac{T}{Y} = \underset{(7.00)}{7.028} * - \underset{(-1.93)}{4.9 \times 10^{-5}} Y + \underset{(7.29)}{0.119} * G - \underset{(-4.02)}{0.094} * Ag + \underset{(11.56)}{0.107} \left(\frac{M}{Y}\right)$$

$\bar{R}^2$ = 0.266, **F** = 58.18 | *Significant at the 5% level

where;

$\frac{T}{Y}$ =	Tax-to-GDP Ratio ***(%) (T/Y)***
Y =	GDP per capita, PPP International **$ (Y)**
G =	Gini Index of Inequality ***(0% < G < 100%)***
A_g =	Share of the Agriculture Sector in the GDP ***(0% < Ag < 100%)***
$\frac{M}{Y}$ =	Imports of Goods and Services as % of GDP ***(0% < $\frac{M}{Y}$)***

Therefore, the significant results are as follows:

$$\frac{\partial\left(\frac{T}{Y}\right)}{\partial G} > 0, \qquad \frac{\partial\left(\frac{T}{Y}\right)}{\partial A_g} < 0, \qquad \frac{\partial\left(\frac{T}{Y}\right)}{\partial\left(\frac{M}{Y}\right)} > 0$$

The relationship between Y and T/Y is not significant and negative. This is contrary to expectations. However, the Chart 4.2 had already indicated the likelihood of this happening.

The other results are as expected. The positive relationship of the tax-to-GDP ratio with the Gini Index of inequality reflects that especially in direct taxes, with exemption limit and rising marginal tax rates,

the revenue yield will be higher with a more unequal income distribution as a higher proportion of pre-tax income will face higher marginal income tax rates.

The negative relationship of the tax-to-GDP ratio with the share of agriculture in the GDP is also as expected. The agricultural sector is characterised by low documentation of transactions, thereby reducing the revenue potential of the income tax in this sector. Also, a large share of output of this sector is of basic food items, which are seldom subject to the sales tax or other taxes.

The positive relationship between the tax-to-GDP ratio and the level of imports highlights the presence of import tariffs and sales tax on imports as a measure of protection to domestic industry and for increasing revenues. The coefficient in the above estimated regression equation is also relatively large. A 10% increase in the ratio of imports to the GDP adds over 1 percentage point to the tax-to-GDP ratio.

4.5. Pakistan's Performance

The above regression equation is used to predict the tax-to-GDP ratio of Pakistan in different years, given its characteristics in those years. The results are presented in Table 20. The difference between the predicted and actual magnitude is also shown in Table 20 and in Figure 11.

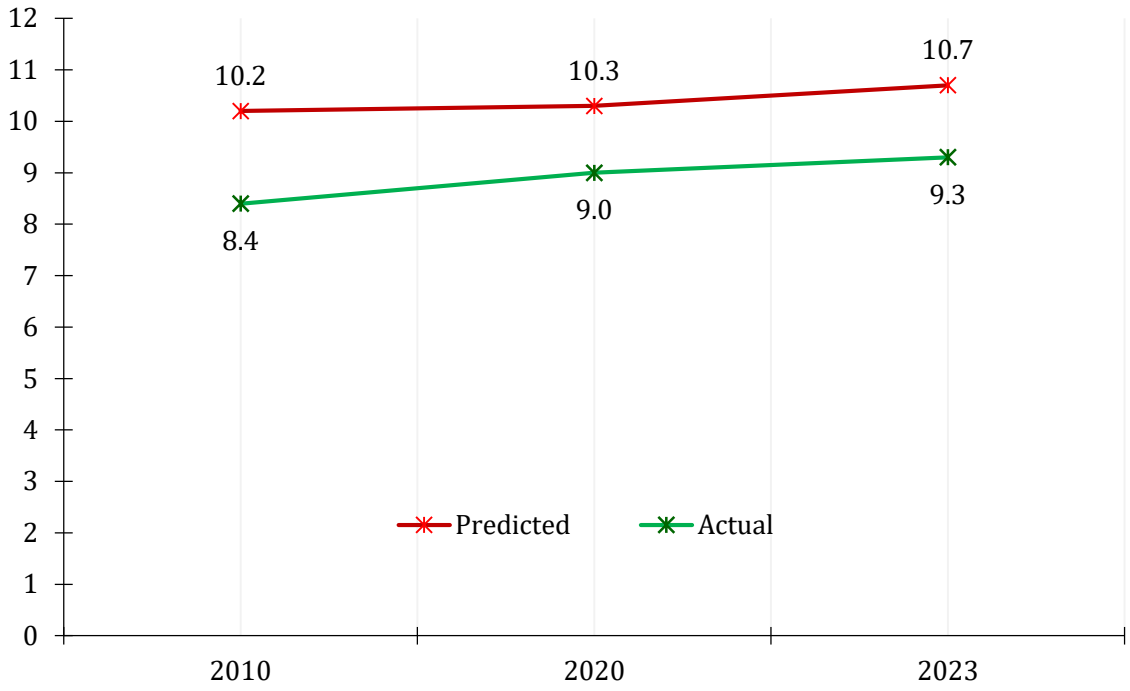
Table 20: Predicted and Actual Tax-to-GDP Ratio

	2010	2020	2023
Tax-to-GDP Ratio			
▸ Predicted	10.2	10.3	10.7
▸ Actual	8.4	9.3	9.3
▸ Difference*	-1.8	-1.0	-1.4

**Actual – Predicted.*

Therefore, the level of federal and provincial tax revenues combined, excluding the petroleum levy, should have been higher by 1.4% of the GDP in 2023. This is the minimum target of increase in the tax-to-GDP ratio in the design of the agenda of reforms.

Figure 11: Actual Vs Predicted Tax-to-GDP Ratio



Some important results emerge from the analysis. First, as shown in Chart 4.6, the nature of evolution of the structure of the economy would have led to only a modest increase in the tax-to-GDP ratio of Pakistan by 0.4% of the GDP between 2010 and 2023.

Second, the gap between the predicted and actual tax-to-GDP ratio was the largest in 2010 at 1.8% of the GDP. This gap was narrowed to 1% of the GDP by 2020. However, the tax system appears to have performed poorly in 2023 and consequently, the gap between the predicted and actual tax-to-GDP ratio widened to 1.3% of the GDP.

Overall, Pakistan has emerged as a relatively poor performer with a lower tax-to-GDP ratio than the level achievable given its economic characteristics. This demonstrates the need and scope for achieving a higher tax-to-GDP ratio through reforms.

THE 'REPRESENTATIVE TAX SYSTEM' APPROACH AND POTENTIAL REVENUES

The 'representative tax system' approach has sometimes been used by quantify the level of potential tax revenues in a country and consequently the 'tax gap'. This approach was first developed by Roy Bahl (1972) for measuring the tax effort in developing countries. It has subsequently been used by Lucke (1984), J. Martinez-Vasquez (1996) and most recently by Matsumoto (2022).

The first section of the chapter describes the methodology used in the representative tax system approach. The second section identifies the countries with which Pakistan's fiscal effort is compared. The third, fourth and fifth sections include respectively the application of the approach to the income tax, indirect taxes on domestically produced goods and services and to import duties on imports generally for 2020-21. The sixth section summarises the findings and quantifies the 'tax gap' in terms of the overall additional revenues that can be generated.

5.1. Methodology

The representative tax system involves the identification for countries included in the study the tax base of a tax and the incidence, t_{ij}, as the ratio of the tax revenues to the tax base as follows:

For the ***ith*** country,

T_{ij} = tax revenue in the ***ith*** country from the ***jth*** tax.

B_{ij} = tax base in the ***ith*** country of the ***jth*** tax.

We have

t_{ij} = effective tax rate in the ***ith*** country of the ***jth*** tax.

where;

$$t_{ij} = \frac{T_{ij}}{B_{ij}} \, x \, 100 \qquad \ldots \quad \ldots \quad \ldots \quad [1]$$

The total number of countries chosen is *n*. Therefore, the average tax rate, t_j, of the ***jth*** tax across the countries is

$$t_j = \sum_{i=1}^{n} t_{ij} \qquad \ldots \quad \ldots \quad \ldots \quad [2]$$

This analysis is undertaken for each tax, with the number of m, corresponding to the total number of taxes.

The potential total tax revenue, T_P, can then be derived for Pakistan as

$$T_P = \sum_{j=1}^{m} t_j \; B_{jP} \qquad \ldots \quad \ldots \quad \ldots \quad [3]$$

where; ***Bjp*** is the tax base of the ***jth*** tax in Pakistan.

There is, of course, the likelihood that the magnitude of the potential tax revenue could be higher or lower than the actual tax revenues, depending on the level of fiscal effort in the country.

5.2. Choice of Countries

The same countries have been selected as in Chapter 4. They are listed in Table 21 with the latest population estimate.

Table 21: List of Chosen Countries

Name *(in alphabetical order)*	**Population *(million)***
Angola	36
Argentina	46
Bangladesh	171
Brazil	215
China	1,412
Columbia	52
Côte d'Ivoire	28
Egypt	110
Ghana	33
India	1,417
Indonesia	275
Kenya	54
Malaysia	34
Mexico	128
Morocco	37
Nepal	30
Pakistan	**236**
Peru	34
Philippines	116
Russian Federation	144
South Africa	60
Sri Lanka	22
Tanzania	65
Thailand	72

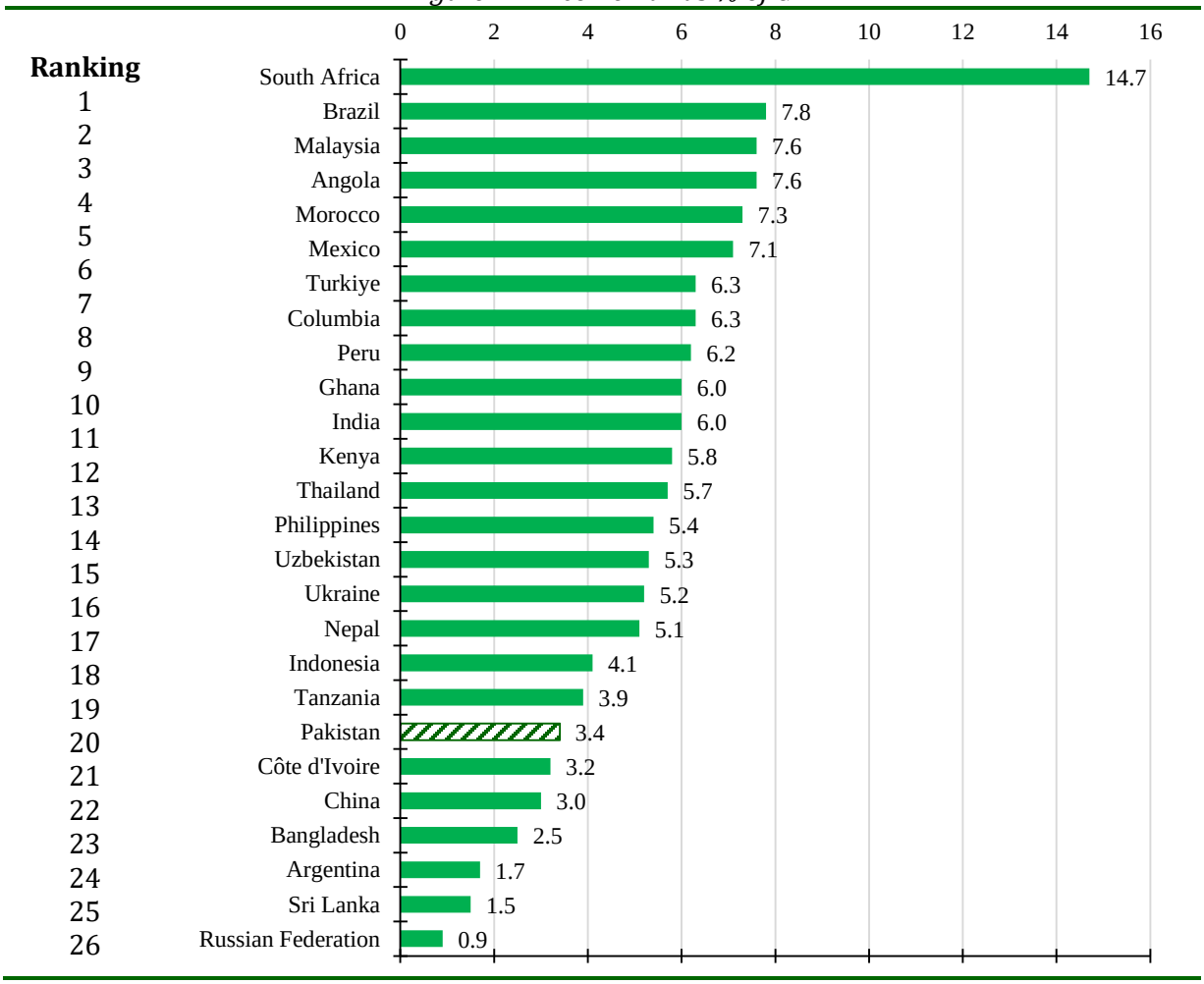
▸ Türkiye	85
▸ Ukraine	38
▸ Uzbekistan	35
TOTAL POPULATION	**4,985**

5.3. Income Tax

The latest estimates have been obtained from the data source, *World Development Indicators* of the World Bank, of the tax revenue from income, profits and capital gains as a percentage of the GDP.

The resulting magnitudes are presented for each of the countries in Figure 12 in descending order of magnitude.

Figure 12: Income Tax as % of GDP



Source: WDI, World Bank.

The summary statistics for the 27 Countries and separately for the 5 South Asian countries are derived below in Table 22.

Table 22: Summary Statistics on the

	27 Countries	5 South Asian Countries
Range:		
▸ Maximum	14.7	6.0
▸ Minimum	0.9	1.5
Average	5.6	3.7

PAKISTAN: 3.4
Ranking in 27 Countries: 20th
Ranking in 5 South Asian Countries: 3rd

There is considerable variation in the income tax to GDP ratio. It ranges from as high as 14.7% in South Africa to a low of only 0.9% in the Russian Federation. Pakistan is ranked relatively low at the 20th position, with the income tax ratio of 3.4%. This is below the average for the 26 countries by 2.2 percentage points of the GDP. Clearly, the fiscal effort of Pakistan in the realm of direct taxes is disappointing and needs to be raised substantially.

Within the South Asian group, Pakistan is ranked third. India has a substantially higher ratio of 6% of the GDP. The average is 3.7% of the GDP, which is somewhat higher than the ratio for Pakistan.

5.4. Indirect Taxes on Goods and Services

The next measure of relative fiscal effort relates to the level of indirect tax revenues, from taxes like the sales tax, as a percentage of the value added in the domestic production of goods and services.

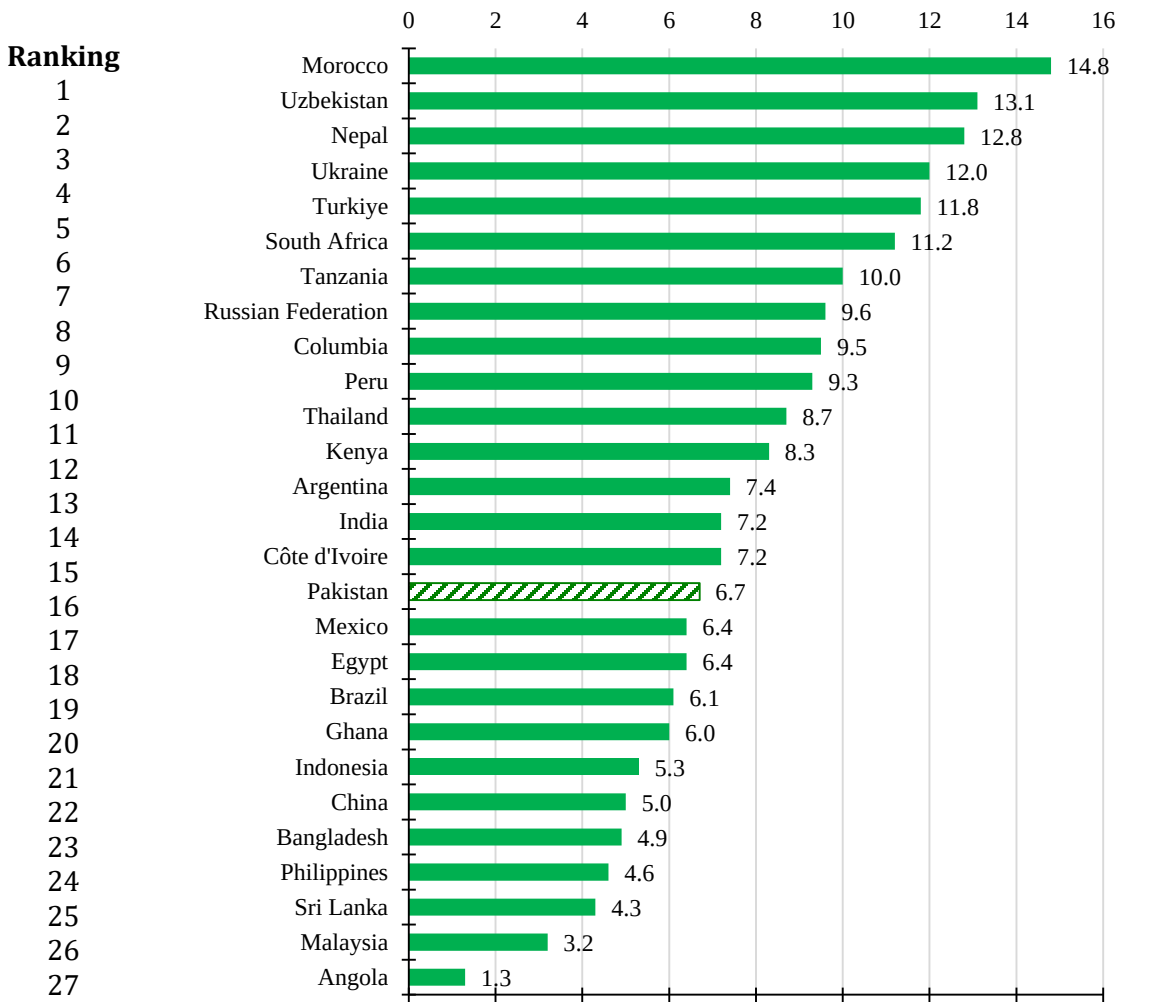
The country-wise magnitudes in descending order are presented in Figure 13. The summary statistics are presented in Table 23.

Table 23: Summary Statistics on the Indirect Tax Revenues as % of Value-Added in Goods and Services

	27 Countries	5 South Asian Countries
Range:		
▸ Maximum	14.8	12.8
▸ Minimum	1.3	4.3
Average	7.9	7.2

PAKISTAN: 6.7
Ranking in 27 Countries: 16th
Ranking in 5 South Asian Countries: 3rd

Figure 13: Countrywise Taxes on Goods and Services



Source: WDI, World Bank.

Pakistan's performance in indirect taxes on value-added in goods and services is also below average. However, the gap is smaller with respect to the other 26 countries of 1.2 percentage points of the GDP.

Within South Asia, Pakistan has the same third ranking, behind Nepal and India. However, the difference from the regional average remains small at 0.5% of the GDP.

5.5. Average Unweighted Import Tariff

This information has been obtained from the publication, *World Tariff Profiles* of the WTO. The ranking of the 26 countries is visually highlighted in the Figure 14.

The summary statistics are presented in Table 24.

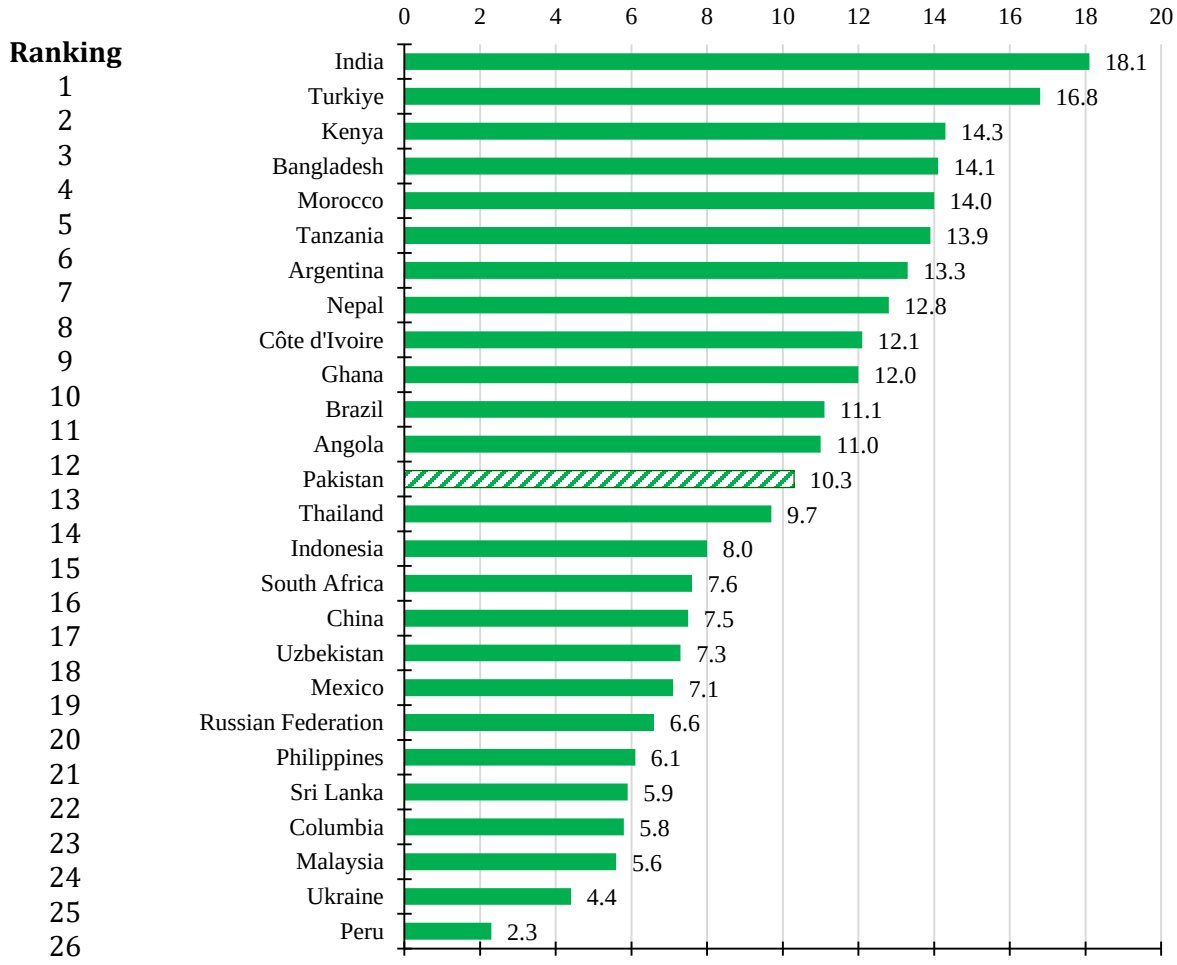
Table 24: Summary Statistics on the Unweighted Average of Import Tariffs

	26 Countries	5 South Asian Countries
Range:		
▸ Maximum	18.1	18.1

▸ Minimum	2.3	5.9
Average	9.0	12.2

PAKISTAN: 10.3
Ranking in 26 Countries: 13th
Ranking in 5 South Asian Countries: 4th

Figure 14: Unweighted Average of MFN Import Tariffs



Source: WTO, World Tariff Profiles.

The level of import tariffs is not necessarily an indicator of fiscal effort. It is more likely to reflect the view of policy makers in a country as to the extent of effective protection that should be provided to domestic production activities against imported goods or services.

The level of import tariff in Pakistan is 10.3%, as compared to the average for the 26 countries of 9%. This is the only area of taxation where the incidence is higher than the average. However, Pakistan's average tariff is lower than the South Asian average.

5.6. Potential Additional Revenues

The tax related data for most countries is for 2020-21. Therefore, the analysis is conducted with respect to the size of the tax base of Pakistan is for 2020-21 also. The resulting estimates of additional revenue are presented in Table 25.

Table 25: Potential Additional Tax Revenues in Pakistan, 2020-21 (Rs in Billion)

	Tax Base (Billion Rs)	27 Countries	
		Difference	Additional Revenues
Tax on Income, Profits and Capital Gains	55,836	2.2	1,229
Indirect Taxes on Value-Added in Goods and Services	39,600	1.2	475
TOTAL			**1,704**
% of GDP			***3.1***

The potential augmentation of revenues if Pakistan's tax ratio rises to the average of the 27 countries is large at over 3% of the GDP. This will require both a rationalization of tax rates and improved efforts at tax collection by reduction in the quantum of tax evasion.

MONETARY APPROACH TO QUANTIFICATION OF TAX EVASION

A very innovative approach to quantification of the extent of tax evasion was first developed by Tanzi (1993). This involves estimation of the 'excessive' currency in circulation (induced by the presence of underground activities) and then by making some assumptions for deriving estimate of the size of the underground economy.

The first section of this chapter describes the methodology of analysis which applies the Tanzi approach. This is followed in the second section by econometric analysis of the determinants of the ratio of currency in circulation to the money supply in the Pakistani setting. Section 3 presents the estimates of the quantum of tax evasion and the size of the black economy in Pakistan. Section 4 then derives the policy implications of the findings.

6.1. The Methodology

The methodology essentially follows the methodology developed by Vito Tanzi and more recently in Pakistan by Kemal (2007).

The currency in circulation, deposits and money supply are designated as follows:

CC = Currency in Circulation

D = Deposits

MS = Money Supply

We have

$$MS = CC + D \qquad \ldots \ldots \ldots [1]$$

and $$\frac{CC}{MS} = \frac{CC}{CC + D}$$

The ratio of currency in circulation to money supply is taken to be dependent on the following:

- per capita income ***(y)***
- rate of inflation ***(p)***
- development of the banking system ***(B)***

  (measured by the number of branches to population)
- Tax-to-GDP ratio $\left(\frac{T}{y}\right)$

The equation to be estimated is as follows:

$$\frac{CC}{MS} = \beta_2 - \beta_1 y + \beta_2 p - \beta_3 B + \beta_4 \left(\frac{T}{y}\right) \qquad \ldots \ldots \ldots [2]$$

Therefore, the hypotheses are that

$$\frac{\partial\left(\frac{CC}{MS}\right)}{\partial y} < 0, \frac{\partial\left(\frac{CC}{MS}\right)}{\partial p} > 0, \frac{\partial\left(\frac{CC}{MS}\right)}{\partial B} < 0, \frac{\partial\left(\frac{CC}{MS}\right)}{\partial (T/y)} > 0$$

In effect, as per capita income rises and with a more educated population the access to banking increases. A higher rate of inflation increases the transaction demand for cash and the need for larger

cash balances. Development of banking services facilitates more depositors, especially in the relatively remote areas.

Higher incidence of taxes, as measured by the tax-to-GDP ratio, increases the gains from tax evasion and non-declaration of transactions. These transactions take place in cash to avoid any documentation and detection of evasion. Consequently, the currency in circulation to money supply tends to be higher.

The methodology involves determination of the currency in circulation ratio when the tax-to-GDP ratio is zero.

This is designated as

$$\left(\frac{CC}{MS}\right)_O = \left(\frac{CC}{MS}\right) - \beta_4 \left(\frac{T}{y}\right) \quad \ldots \ldots \ldots [3]$$

The level of currency in circulation, (CC_O), in the absence of taxation can be estimated from the following equation:

$$\frac{CC_O}{D + CC_O} = \left(\frac{CC}{MS}\right)_O \quad \ldots \ldots \ldots [4]$$

The quantum of tax evasion is given by

$$TE = CC - CC_O \quad \ldots \ldots \ldots [5]$$

where CC is the actual level of currency in circulation

Then the size of the underground economy is given by UGE

$$\frac{TR}{GDP - UGE} = \frac{TE}{UGE} \quad \ldots \ldots \ldots [6]$$

where TR is the actual tax revenues and GDP, the size of the economy.

Then the share, SUGE, of the underground economy can be determined as

$$SUGE = \frac{UGE}{GDP} \quad \ldots \ldots \ldots [7]$$

6.2. The Econometric Estimates

The time series of the ratio of currency in circulation to money supply is given in Figurer 15. It has a U-shaped trend. It attained a peak of 29.38% in 2019-20, because of the emergency cash needs for medical assistance during period of the COVID-19 pandemic. It also increased in 2022-23 because of the high rate of inflation of almost 30%. However, there is a significant decline in 2023-24.

Figure 15: The Currency in Circulation Ratio to Money Supply

1999-2000 to 2023-24

Source: SBP | MOF.

The results of estimation of the equation [2] are presented in Table 26.

Table 26: Results of Estimation of the Regression Equation

	Coefficient	t-value
Constant	-3.889	-1.99**
Tax-to-GDP Ratio	1.198	3.02*
Rate of Inflation	0.106	2.17*
Banking Services	-0.572	-1.49
Lagged Dependent Variable	0.890	11.68*

R^2 = 0.91, F = 61.61, D-W = 2.02

**Significant at the 5% level | **Significant at the 10% level*

The results confirm the significant role of the rate of inflation and the tax-to-GDP ratio in determining the magnitude of the currency in circulation to money supply ratio. The banking services variable has the right negative sign but it is not significant.

6.3. Estimates of the Quantum of Tax Evasion

The estimated magnitude of tax evasion from 2001-02 to 2022-23 is given in Table 27.

Table 27: Estimated Quantum of Tax Evasion and Size of the Underground Economy of Pakistan

	Quantum of Tax Evasion *(Rs in Billion)*	Annual Growth Rate *(%)*	Tax Evasion as % of the GDP	Underground Economy as % of the GDP
2010-11	786	15.5	4.0	31.6
2015-16	1965	18.3	6.0	34.9
2018-19	2579	9.0	5.9	36.6
2022-23	4847	15.7	5.8	38.2
2023-24	4497	-7.2	4.2	30.8

Source: Authors' computations.

There has been an increase in the magnitude of tax evasion as a percentage of the GDP up to 2022-23. It was 4.0% of the GDP in 2010-11 and has risen to 5.8% of the GDP in 2022-23. In fact, the peak of 6% of the GDP was attained in 2015-16. The good news is that there is evidence of a decline in the quantum of tax evasion in 2023-24. It has declined in absolute terms by 7.2%. The latest estimate of the underground economy is 30.8% of the GDP. There is need to give due credit to FBR for doing a better job of tackling tax evasion in 2023-24, both by changes in tax laws and a more effective process of auditing returns.

6.4. Policy Implications

The not so big surprises in the findings are the high incidence of tax evasion in Pakistan with fortunately some evidence of a recent decline. This is despite the presence of an elaborate and comprehensive advance and withholding tax regime in Pakistan, which contributed to over 58% of income tax revenues in 2023-24.

The size of the informal economy is first estimated as a proxy for the underground economy. The informal economy consists of production units of the self-employed, households and establishments with employment of less than 10.

The Labor Force Surveys of the PBS give estimates in terms of employment of the size and sectoral composition of the informal economy of Pakistan. Estimates from the latest Survey of 2020-21 are presented in Table 28.

Table 28: Extent of Informal Employment and Sectoral Distribution 2020-21

	Total Employed	Total Informal Sector	% Employment in the Informal Sector**	Sectoral Share of Informal Employment (%)
TOTAL	**42.03**	**30.46**	**72.47**	

Manufacturing	10.02	6.15	61.38	20.19
Construction	6.39	5.97	93.40	19.60
Wholesale & Retail Trade	9.68	9.29	96.00	30.50
Transport & Communication	4.17	3.56	85.37	11.69
Community, Social & Personal Services	10.76	5.33	49.53	17.50
Others*	1.01	0.15	14.85	0.49

**Mining & Quarrying, Electric and Gas, Finance and Insurance | **Outside Agriculture*
Source: Labor Force Survey, PBS.

The distribution by sector of the informal employment is also given in Table 29. The five sectors with a big share of informal employment are small-scale manufacturing, construction, wholesale and retail trade, transport and communications and community, social and personal services.

The withholding tax regime of Pakistan covers each of these sectors as indicated in Table 6.4, along with the revenue yield as a percentage of the sectoral value added.

Table 29: Advance/Withholding Taxes by Sector and Revenues

	Covered by Sections of the ITO	Advance/ Withholding Tax Revenue (Rs in Billion)	Revenue as % of Sectoral Value Added
Wholesale & Retail Trade and Manufacturing	148, 153, 235, 236	54	2.0
Transport and Communications	231, 234, 236	118	2.1
Construction	153	148	6.8
Community, Social and Personal Services	152, 153	122	1.2
TOTAL			**2.1**

Source: FBR | PES

Despite the elaborate regime of withholding and advance taxes, the collection is only 2% of the value added of sectors, with a high share of informal activities.

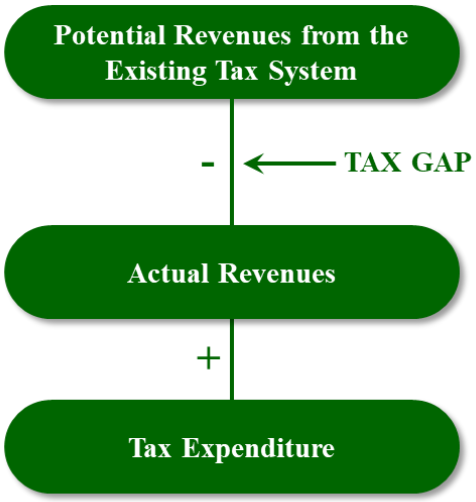
The conclusion is that there is need to identify the evasion even in these withholding/ advance taxes and develop better collection mechanisms. Also, the withholding/ advance tax rates are low in some sections of the ITO.

THE BOTTOM-UP APPROACH TO ESTIMATION OF THE 'TAX GAP' IN FEDERAL TAXES

The earlier chapter on the Representative Tax System had adopted a top-down approach to estimation of the tax gap. This chapter focuses on a bottom-up approach. The basic question is will the two approaches lead to estimates of the tax gap which are not too far from each other?

The Tax Gap is shown in Chart 7.1 below. It is the gap between potential revenues and actual revenues plus the tax expenditure on exemptions and lower tax rates.

Figure 16: Identification of the 'Tax Gap' in a Tax



TAX GAP = Potential Revenues from the Existing Tax System – Actual Revenues – Tax Expenditure

The first part of the chapter focuses on quantification of the tax gap in the personal income tax. This is followed in the next section by estimation of the tax gap in the corporate income tax. The third section derives estimates of the tax gap in federal indirect taxes, especially in the sales tax.

7.1. 'Tax Gap' in the Personal Income Tax

The FBR report on 'the tax gap' of 2022 uses the latest Household Integrated Economic Survey of 2018-19 to estimate the tax gap in the personal income tax. This is the latest HIES. There are 116,499 earners covered in the national HIES Sample.

The methodology used is to find in the case of each earner/worker the gross annual income, excluding any agricultural income. The tax liability is then derived by application of the statutory personal income tax rates. Summation across all the workers enables determination of the average tax liability. This is then blown up to get a national estimate of the potential revenue.

The problem with the HIES is the large understatement of income and expenditure by the respondents. This is tested by deriving the per capita annual expenditure in different quintiles and applying this to the population in each quintile and then summing up across the quintiles. The resulting estimate of national household consumption expenditure in 2018-19 is Rs 15,513 billion.

According to the National Income Accounts, the actual magnitude is Rs 36,301 billion. Therefore, there is need for substantial enhancement of reported incomes.

The assumption is also made that in the face of higher marginal tax rates earners in higher income quintiles are more likely to underreport more their incomes.

The methodology used to derive the estimate of the personal income tax from each income quintile is given below.

We designate the following for the *ith* quintile:

Population in the quintile =	42.79 million in 2018-19
Household Size =	h_i
Number of households =	$\frac{42.79}{h_i}\ million$
Average Earners in each household =	$\boldsymbol{e_i}$
Total earners =	$\frac{42.79}{h_i} \cdot e_i$
Share of Household Income = *(with some adjustment for more underreporting by higher quintiles)*	S_i
National Household Income* =	37,054 billion Rs
Average Income per earner = (Rs)	$\frac{37054\ x\ 10^3\ \times\ S_i\ \times\ h_i}{42.79\ e_i}$
The tax liability =	T_i
The overall tax payment =	$\frac{T_i\ e_i}{1000}\ billion\ Rs$
*excluding retained profits by production units	

This is summed across the income quintiles.

Table 30 shows the results of the application of the above methodology. Only the top two quintiles have a tax liability. The three lower quintiles are exempt because of incomes below the exemption limit of Rs 400,000 per annum.

Table 30: Estimation of Potential Revenue from a Comprehensive Personal Income Tax, 2018-19

	Top Quintile	Second Quintile
Population *(million)*	42.79	42.79
Average Household Size *(No)*	4.72	5.78
Number of Households *(million)*	9.066	7.403

Earners per Household *(No)*	1.50	1.78
Total Number of Earners *(million)*	13.599	13.177
Share of National Household Income with adjustment for Underreporting	51.26	19.50
Total Household Income *(Billion Rs)*	18,994	7,234
Annual Average Income per Earner *(Rs)*	1,396,720	548,987
Income Tax Liability per Earner	129,008	11,898
Total Potential Income Tax Revenue *(Rs in Billion)*	1,754	157
TOTAL *(Rs in Billion)*		**1,911**
Less Revenue from Taxation of Agricultural Income at Same Rates		341
NET POTENTIAL *(Rs in Billion)*		**1,570**

However, the above methodology does not exclude agricultural income and, as such, includes wrongly the tax liability of large agricultural income earners. Therefore, the methodology described below has been used to estimate the personal income tax of agricultural income earners, which cannot be included in the potential tax revenue.

There are ***i = 1, …7***, slabs of farm size with individual farmer income above Rs 400,000. The resulting tax liability is given in Table 31, with net income after sharing with tenants per acre of Rs 70,000 in 2018-19.

Table 31: Potential Revenue from Agricultural Income Tax, 2018-19

	Number of Farms *(000)*	**Average Area of Each Farm**	**Income Per Farm**	**Potential Tax per Farm**	**Total Tax Revenue *(Rs in Billion)***
5 to 7.5	1132	5.7	470,141	1403	1.6
7.5 to 12.5	917	9.5	784,914	17991	16.5
12.5 to 25.0	561	16.7	1,373,610	76,861	43.2
25.0 to 50.0	210	31.9	2,623,963	284,293	59.7
50.0 to 100.0	66	62.0	5,101,863	900,012	59.4
100.0 to 150.0	12.6	111.1	9,144,423	2,065,327	26.0

150 and above	13.4	435.6	35,840,586	10,074,175	135.0
				TOTAL	**341.4**

Source: Agriculture Census.

The resulting estimate of the tax contribution if agricultural incomes were subject to the Federal personal income tax in 2018-19 is Rs 341 billion.

Overall, the estimated 'tax gap' is presented in Table 32.

Table 32: Estimation of the Tax Gap in the Personal Income Tax, 2018-19 (Rs in Billion)

	FBR Tax Gap Report	This Report
Potential Revenue from the Personal Income Tax	1453	1570
Actual Revenue from the Personal Income Tax	670	670
Tax Gap	783	900
Tax Gap as % of Actual Revenue	**116.9**	**134.3**

Therefore, the bottom line is that there is a considerable amount of tax evasion in the payment of the personal income tax in Pakistan. This is one of the areas where efforts will need to be launched to identify segments of the economy where there is greater need for documentation of transactions to curb rampant tax evasion.

7.2. 'Tax Gap' in the Corporate Income Tax

The FBR tax Gap Report includes only those sectors in the economy where business is carried out by corporations, either public or private. These are the following:

- Large-Scale Manufacturing
- Electricity, Gas and Water Supply
- Information and Communications
- Finance and Insurance

We have also focused on these sectors.

The rate of profitability and the corporate income tax paid has been derived from the database of the SBP on public limited companies. The estimates have been derived for 2022, and presented below in Table 33.

Table 33: Composition of Value-Added in Sub-Sectors and CIT paid, 2022 (Rs in Billion)

	Profit before Tax	Depreciation	Employee's Remuneration	Value Added	Corporate Income Tax Paid
Manufacturing					
Textiles	181.7	42.5	153.4	377.6	33.0
Sugar	15.0	8.7	17.7	41.4	4.2
Food	56.4	11.6	44.1	112.1	16.9

Chemicals	202.2	30.6	90.0	322.8	81.4
Mineral Products	14.3	3.0	10.5	27.8	3.1
Cement	116.4	33.1	44.4	193.9	42.3
Motor Vehicles	54.2	12.1	32.3	98.6	24.9
Coke & Petroleum	351.7	36.6	60.9	449.2	146.5
Paper & Products	18.1	7.0	15.5	40.6	6.9
Elect Machinery	7.0	2.0	8.8	17.8	2.8
Other Manufacturing	80.6	14.5	46.9	142.0	27.0
TOTAL	**1097.6**	**201.4**	**524.8**	**1823.8**	**389.0**
Energy	317.5	71.8	103.7	553.0	131.0
Information & Communication	-14.2	50.6	85.0	121.4	-3.0
Banks	675.9	144.5	464.2	1295.7	356.1

Source: SBP.

The next step is to derive the overall contribution to the corporate income tax by sector. It is assumed that private limited companies have a somewhat lower level of profitability than the generally larger public limited companies. As such, the overall level of profitability in relation to value-added is taken as 10% lower for the sector as a whole in relation to the level of profitability of public limited companies.

The potential tax revenue is derived in Table 34, as per the methodology given below.

We designate the following for a sector:

PVA =	Value Added by Public Limited Companies (PLC)
RVA =	Value Added in the rest of the Sector
π =	Rate of Profits as % of Value Added in PLC

Then the Potential Tax Revenue is given by T where

$$T = t\,[PVA \cdot \pi + 0.9\pi \cdot RVA]$$

The value of t is 29% generally, with the exception of the financial sector where it is 39%.

Table 34: Potential Tax Revenue from the Corporate Income Tax, 2022

	Value Added by Public Limited Companies (PLC)	**Sectoral Value Added in 2021-22**	**Profitability of PLC* (%)**	**Overall Sector Profit**	**Potential CIT Revenue**

Manufacturing	1824	7041	60.1	3918	1136
Electricity and Gas	553	1086	57.4	702	204
Information and Communication	121	1231	-11.3	n	-
Finance and Insurance	1296	1515	52.2	778	303
TOTAL	**3794**	**10873**		**5398**	**1643**

**as % of value added.*

Therefore, the estimated potential corporate income tax revenue was Rs 1643 billion in 2021-22.

The estimated tax expenditure in this tax has been derived by the FBR at Rs 139.5 billion in 2021-22.

The major tax expenditures in the corporate income tax in 2021-22 were as follows:

		(Rs in Billion)
1.	Part-VII of Chapter II of Section 49 of the ITO	26.5
2.	Deductible Allowance for WWF / WFP	11.8
3.	Tax Credit for Newly Established Industrial Undertaking	6.0
4.	Tax Credit for Investment in Plant and Machinery by New Undertaking	18.2
5.	Income from REIT Scheme	20.7
6.	Profits from Electric Power Generation Project	56.0
	TOTAL	**139.5**

Source: FBR, Tax Expenditure Report.

The resulting estimates of the tax gap in the corporate income tax are presented in Table 35.

Table 35: Tax Gap in the Corporate Income Tax (Rs in Billion)

	FBR Estimates	This Report Estimates
Gross Tax Collectible	1380	1390
Tax Expenditure	-	140
Actual Collection	985	985
TAX GAP	**395**	**265**

Therefore, the two estimates are close to each other.

7.3. 'Tax Gap' in the Sales Tax on Goods

The FBR 'Tax Gap' Report has quantified the tax gap in the Federal sales tax on goods by first identifying the sectors of the economy which come within the ambit of the tax, as follows:

- Mining and Quarrying
- Manufacturing Sector
- Electricity, Gas and Water Supply

The analysis is undertaken for 2019-20. The sales tax gap is derived as follows based on the consumption approach:

Sales Tax Gap =	Σ (Final Consumption) x 17% - Sales Tax Expenditure – Gross Tax Collection

We have adopted a different approach to estimating the sales tax gap. Manufactured Imports have been categorised in two groups. The first group consists of consumer goods, which yield final sales tax revenue on the c.i.f. value plus the revenue from import duties on these items.

The second part of the tax base is the entire large-scale manufacturing sector. The tax is quantified on the value of output of this sector. Information has been made available on the sectoral value of outputs by the PBS. Mining and Quarrying outputs are assumed to be largely inputs into the manufacturing and the gas sub-sector within the electricity and gas sector.

The final sale of electricity and gas is included in the sales tax base. The input into industry is excluded from the tax base.

The overall sales tax base for a particular year is derived as follows:

Sales Tax on Goods Tax Base =	(c.i.f. value **+** import duty paid) on manufacturing goods imports **+** Value of Large-Scale Manufacturing Output *minus* the value of manufactured exports **+** non-industrial sales value of electricity and gas

The estimates are presented in Table 36.

Table 36: Size of the Sales Tax on Goods Tax Base (Rs in Billion)

	2020-21	2021-22	2022-23
Value of Manufactured Consumer Goods[1] imported *(c.i.f. value + import duty)*	1,951	3,888	2,952
Value of Large-Scale Manufacturing [+] Output	18,919	27,076	32,701
Value of Manufactured Exports [-]	-3,341	-4,695	-5,606
Electricity and Gas Sales to Non-Industrial Consumers [+]	3,279	2,894	5,205
Total Potential Tax Base	20,808	29,083	35,252
Tax Rate (%)	17	17	17.25**

Potential Tax Revenue	**2,527**	**4,944**	**6,081**
Tax Expenditure***	840	1,478	2,960
Net collectible Tax Revenue	2,697	3,466	3,621
Actual Revenue	1,990	2,531	2,592
TAX GAP	**707**	**935**	**1,021**
% of Actual Revenue	35.5	36.9	39.7

** The goods included are Vehicles (CBU), 80% of POL products, mobile phones, 50% of Electrical Equipment, Aircraft and Ships, Clothing, Medicines, Fertilizer and Insecticides. ** The Sales Tax rate was enhanced from 17% to 18% in March 2023. *** The tax expenditure is estimated to have substantially increased because of the big increase in petroleum levy as a partial substitute for the sales tax.*

A comparison is made of the estimate of the tax gap in the sales tax on goods in Table 37.

Table 37: Estimates of the Tax Gap in Sales Tax on Goods (Rs in Billion)

	FBR 'Tax Gap' Report 2019-20	This Report		
		2020-21	2021-22	2022-23
Tax Collection	2209	2697	3466	3621
Actual Tax Collection	1690	1990	2531	2592
TAX GAP	**519**	**707**	**935**	**1021**
Tax Gap as % of Tax Collection	**30.7**	**35.5**	**36.9**	**39.7**

Therefore, our estimates of the tax gap as a percentage of the actual tax revenues are significantly higher than that of FBR. The tax gap in the sales tax on goods was 1.2% of the GDP in 2022-23.

The overall estimate of the Tax Gap in Federal taxes is given in Table 38.

Table 38: Overall Estimate of the Tax Gap (Rs in Billion)

Income Tax	In Report		% of GDP
	Year	Tax Gap	
Personal Income Tax	2018-19	900	2.05
Corporate Income Tax	2021-22	265	0.40
Sales Tax on Goods	2021-22	935	1.41
TOTAL			**3.86**

Therefore, the estimate of the overall tax gap in the FBR revenues is close to 4% of the GDP. This is somewhat larger than the estimate of 3% of the GDP from the top-down methodology of the Representative Tax System.

THE 'TAX GAP' IN PROVINCIAL TAXES

The latest estimates of Provincial tax revenues as a percentage of Provincial Gross Regional Products are given in Section 1 of the Chapter. This is followed in Section 2 by a description of the composition of these revenues.

Sections 3 to 5 quantify respectively the 'tax gap' in the three major taxes, namely, sales tax on services and agricultural income tax. The 'tax gap' in urban immoveable property tax is estimated in the next chapter. The overall 'tax gap' is highlighted in Section 6.

8.1. Level of Provincial Tax Revenues

The level of total tax revenues of each province as a percentage of the provincial Gross Regional Product at current prices is presented in Table 39.

Table 39: Level of Provincial Tax Revenues, 2023-24 (Rs in Billion)

	Punjab	Sindh	Khyber-Pakhtunkhwa	Balochistan	Pakistan
Provincial Tax Revenues	326	364	54	30	774
Provincial Tax Revenues as % of Provincial GRP	0.56	1.22	0.37	0.70	0.73

Source: MOF Fiscal Operations | Pasha (2022a and b).

The overall Provincial tax to GDP ratio of the four Provinces combined is very low at 0.7% of the GDP. Sindh has the highest tax to GRP ratio of 1.2%, while the lowest ratio is that of Khyber-Pakhtunkhwa at less than 0.4%.

The composition of the Provincial tax revenue by tax is presented in Table 40, for 2017-18 and 2022-23 respectively.

Table 40: Revenue from individual Taxes of the four Provinces combined (Rs in Billion)

	2017-18	2022-23	2023-24	Annual Growth Rate (%)
Sales Tax on Services	224	417	504	13.5
Stamp Duties	63	65	63	0.0
Motor Vehicle Tax	24	32	34	5.8
Land Revenue	18	21	24	4.8
Agricultural Income Tax	2	3	3	6.7
Others	64	104	146	13.7

TOTAL	**403**	**652**	**774**	**10.9**

Source: MOF Fiscal Operations; Provincial Budget Documents.

The largest tax at the Provincial level is the sales tax on services. It was introduced in 2011 and has since grown to now account for 64% of Provincial tax revenues. Beyond this, there is a varied collection of taxes yielding relatively small magnitudes of revenue. Also, the growth rates of revenues from different sources is low.

We turn now to the estimation of the tax gap in the yield from different Provincial taxes, starting with the Agricultural income tax.

8.2. 'Tax Gap' in the Agricultural Income Tax

There has been much greater focus recently on development of the agricultural income tax. The tax had been legislated by the provincial governments almost three decades ago but it lay moribund. Only Rs 3 billion were generated in 2023-24 from this tax by the four provinces.

The new three-year Extended Fund Facility of Pakistan with the IMF has clearly identified the agricultural income tax as the tax to be developed. The structural benchmark included on the tax is as follows:

'Each province amends their Agricultural Income Tax legislation and regime to fully align with the federal personal income tax regime for small farmers and the federal corporate income tax regime for commercial agriculture so that taxation can commence from January 1, 2025'

Therefore, based on the implementation of the above reform, the revenue potential of the agricultural income tax is quantified below on the basis that the tax structure will correspond to that used currently for non-salaried personal income, with the maximum rate at 45%.

The methodology used is based on the following variables:

$\mathbf{N_i}$ **=**	Number of farms in the ***ith*** size category, ***i = 1 to 10***

The size distribution is given in Table 8.3, and is derived from the last Agricultural Census.

$\mathbf{F_i}$ **=**	Average Farm Area per farm in the ***ith*** size category
V =	Average Value-Added per Acre

It is assumed that there is no significant variation by farm size in value added per acre.

$\mathbf{S_i}$ **=**	Share of the Owner in the value-added $S_i < 1$

This allows for sharing with tenants and payment of wages for any labor inputs.

Therefore, the net income, I_i, in the ***ith*** size category is;

$$I_i = F_i \cdot V \cdot S_i$$

The tax amount to be derived on I_i, based on tax rates for non-salaried individuals

$$t_i = t\,(I_i)$$

For the ***ith*** size category of farms, the total tax liability is;

$$T_i = N_i\, t_i$$

and the overall tax potential is TP where;

$$TP = \sum_{i=1}^{10} T_i$$

The estimates based on application of the above methodology are presented in Table 8.3.

The following results emerge:

(i) Farmers owning up to 5 Acres will effectively be exempt because of net annual income below Rs 600,000.

(ii) The tax liability rises rapidly with farm size, as larger farmers face higher marginal tax rates.

(iii) ***The estimated revenue potential of the agricultural income tax on crop income is estimated at Rs 880 billion on the estimated income from crops.***

(iv) The revenue potential is equal to 8% of the projected value added in the crop sector of the economy in 2023-24.

Clearly, the agricultural income tax has significant revenue potential. It will more than double the provincial tax-to-GDP ratio and increase the national tax-to-GDP ratio by 0.7% of the GDP.

Table 41: Size Distribution of Farms, Net Income of Owner and Income Tax per Owner

	Number of Farms (000)	Farm Area Per Farm (Acre)	Cultivated Area Per Farm (Acre)	Value Added of Farm (000)	% VA as Income of Owner (%)	Income of Owner (Rs 000)	Tax Liability per Farm on Owner (000)	Total Potential Tax Revenue (Rs in Billion)
Under 1.0	1,255	0.4	0.4	107	85.5	91	0	0.0
1.0 – 2.5	2,342	1.6	1.5	402	70.0	305	0	0.0
2.5 – 5.0	1,754	3.4	3.2	858	69.8	598	0	0.0
5.0 – 7.5	1,132	5.7	5.3	1,420	61.9	879	42	47.5
7.5 – 12.5	917	9.5	8.7	2,332	60.4	1,409	132	121.0
12.5 – 25.0	561	16.7	14.7	3,940	57.8	2,277	373	209.3
25.0 – 50.0	211	31.9	25.5	6,834	60.4	4,128	1,021	215.4
50.0 – 100.0	67	62.0	44.8	12,006	60.0	7,204	2,332	156.2
100.0 – 150.0	13	111.1	74.7	20,019	52.5	10,510	3,820	49.6
150.0 & above	13	453.3	114.1	30,659	51.6	15,820	6,209	80.7
TOTAL	**8,265**							**879.7**

8.3. 'Tax Gap' in the Sales Tax on Services

Examination of the existing tax system and the law on the sales tax on services reveals that the tax base of this tax consists primarily of the following four service sub-sectors in the National Income Accounts.

- Accommodation and Food Services
- Information and Communication
- Banking and Insurance
- Other Private Services

These sectors are mostly location specific and there is little scope of export among Provinces of the tax burden of this tax. The respective sizes of the above sectors in each Province have been derived from Pasha (2022a and b).

The estimates of the tax gap is derived as follows:

Value Added in the four sub-sectors in the Province **i (i – 1, ..,4)**	**= V_i**
Share of the Value Added in the Formal Sector	**= F_i**
Sales Tax on Services Tax Rate in Province **i**	**= t_i**
Actual Revenue	**= T_i**
Then the Tax Gap, **TG_i,** is given by **$TG_i = V_i . F_i . t_i - T_i$ (i = 1, .., 4)**	

The above magnitudes are given in Table 8.4.

Table 42: Tax Gap in the Sales Tax on Services (Rs in Billion)

Sector	Value Added	Share of Formal Sector (%)	Value Added in Formal Sector	Tax Potential*
Accommodation and Food Services	1,534	14.7	225	36
Information and Communication	1,497	75.0	1,123	180
Banking and Insurance	3,711	83.3	3,091	495
Other Private Services	8,737	31.8	2,778	444
TOTAL				**1,155**
Actual Revenue				***504***
Tax Potential as % of Actual Revenue				***229.2***

*16% tax rate

The tax gap is relatively large at Rs 651 billion, equivalent to over 129% of the actual revenues. Sindh has exploited most the tax base. In fact, it has the lowest tax rate at 13% and could raise it to either 15% or 16%, like the other Provinces. This was done in the 2024-25 Budget.

8.4. Overall 'Tax Gap'

The tax gap is provincial taxes of the agricultural income tax and the sales tax on services was Rs 1530 billion on the tax base of 2023-24. Therefore, there is lot of scope for development of the provincial tax system. The potential level of tax revenue is Rs 2304 billion, equivalent to 2.2% of the GDP, whereas the actual level was 0.8% of the GDP in 2023-24.

TAXATION OF PROPERTY AND INCLUSIVE GROWTH

The objective of this chapter is to demonstrate in Section 1 how the various forms of taxation of property will contribute to a more progressive tax system in Pakistan. Section 2 identifies the different taxes on property that exist currently and are levied currently by either the Federal or the Provincial Governments.

Section 3 quantifies the collection currently from the different taxes on property and reveals the very paltry magnitude of the total revenues generated. Section 4 develops and quantifies the revenue potential of the various taxes. It appears that subject to appropriate changes in laws, procedures and reforms the total yield of taxes on property could be above 1% of the GDP.

Section 5 highlights why development of these taxes is essential if the distortion in the composition of private investment is to be ended and a shift take place to towards more export-led growth away from non-tradeable services.

9.1. Progressivity of Taxes on Property

The basic finding is that the inequality among income quintiles is greater in income from property than total income. The former is derived as the imputed rental value of owner-occupied property by a household and/or rental income from a property owned.

The share in property income by quintile is given in Table 43. The source of data is the last Household Integrated Economic Survey (HIES) of 2018-19 by the Pakistan Bureau of Statistics. The distribution has been given for the entire sample of households and separately for urban households. The latter distribution is relevant with regard to the urban immoveable property tax.

Table 43: Share by Quintile of Property Income of All Households and Urban Households in Pakistan, 2018-19

	Bottom 20%	2nd	3rd	4th	Top 20%	Total
	PAKISTAN					
Share of Property Income	5.1	7.8	11.0	18.8	57.3	100.0
Share of Total Income	8.6	12.4	15.3	20.5	43.2	100.0
	URBAN PAKISTAN					
Share of Property Income	5.1	8.1	11.8	16.5	58.5	100.0
Share of Total Income	8.4	11.5	14.8	19.7	45.6	100.0

Source: GOP (2020).

The skewness in the distribution of property income is clearly more pronounced. For the country as a whole, the top quintile has 57.3% of the property income as compared to 43.2% of the total income. Similarly, the top quintile of urban households pre-empts 58.5% of the property income.

The two measures of inequality, namely, the Gini-coefficient and Pashum Ratio, are presented respectively for total income and property income respectively in Table 44.

Table 44: Gini Coefficient and Pashum Ratio of Inequality in the Distribution of Property Income, 2018-19

	Pashum Ratio	Gini Coefficient
PAKISTAN		
Total Income	0.532	0.310
Property Income	0.924	0.462
URBAN PAKISTAN		
Total Income	0.575	0.330
Property Income	0.997	0.461

Source: Derived from Table 43.

The Pashum Ratio is a more sensitive measure of inequality. It reveals that inequality in property income is higher by over 70% in relation to the inequality in total income.

The other case for levy of property-related taxes is that they are generally the most important type of revenue that local/city governments can collect. This is facilitated by the physical identification of properties within particular jurisdictions.

The other side of progressivity of these taxes is that at the local level they generate the funds needed to provide critical local services like water supply, sewerage, urban public transport, slum improvement and garbage collection.

Therefore, taxes on property have the merit both from the viewpoint of progressivity of incidence on upper income households and use of the revenues generated more for the provision of basic services to low-income households.

9.2. Existing Taxes on Property

There are six taxes currently on property in Pakistan, as shown in Figure 17.

Figure 17: Provincial and Federal Taxes on Property

PROVINCIAL		FEDERAL	
1.	Urban Immoveable Property Tax	1.	Income Tax on Rental Income
2.	Stamp Duty	2.	Capital Gains Tax on Property
3.	Capital Value Tax on Property	3.	Advance Tax on Sales/Purchases of Property

A description of each of these taxes is given below.

Urban Immoveable Property Tax: This tax is leviable in each Province. In Punjab, it is chargeable under the Punjab Urban Immoveable Property Tax Act of 1958, with Amendments. The tax base is annual rental income, actual or imputed, with exemption linked to the size of the plot. The tax rate is 20% on rented properties and 10% on owner-occupied properties. Both residential and commercial properties are covered by the Act.

Stamp Duty: This tax is leviable, for example, under the Sindh Stamp Act of 1899. It is at a fixed rate of 2% on the value of property transacted.

Capital Value Tax on Property: This tax was introduced through the 18th Amendment to the Pakistan Constitution. Fiscal powers to collect this tax have been given to the Provincial Governments. It is leviable on the capital value of both residential and commercial properties at rates ranging from 1% to 3%.

Income Tax on Rents: This levy is covered by the Federal Income Tax Ordinance 2001. Rental income from both residential and commercial properties from part of the tax base. The exemption limit is Rs 300,000 per annum. Thereafter, the tax slabs rise progressively with the tax rate of 5% to 25%.

Capital Gains Tax on Property: This tax is also leviable under the Federal Income Tax Ordinance of 2000, and also covers both residential and commercial properties. The tax base is the nominal increase in the value of property at the time of sale. There was an exemption earlier whereby if the transaction was within six years of the construction or earlier sale of the property. This facility has now been withdrawn in the Federal Budget of 2024-25. The tax is now leviable irrespective of the holding period at 15%.

Advance Tax on Sales/Purchase of Property: This is provided for under the withholding tax provisions of the Federal Income Tax Ordinance of 2001. The rate varies from 3% to 4% depending on the value of the property.

9.3. Level of Revenues

Latest estimates of revenue from the above taxes on property are for 2022-23. These are presented in Table 45.

Table 45: Revenues from Taxes on Property, 2020-21 and 2022-23 (Rs in Billion)

	2020-21	2022-23	% of Total Tax Revenue***
PROVINCIAL		**68**	**10.5**
Uban Immoveable Property Tax		22	
Stamp duty*		46	0.462
CVT on Property		0**	
FEDERAL		**202**	**2.8**
Income Tax on Rental Income		36	
Capital Gains Tax on Property		9	
Advance Tax on			
Sale of Property		72	
Purchases of Property		85	
TOTAL		**270**	**3.4**

*50% of revenue | **Negligible | ***At different levels and consolidated

Overall, taxes on property generated revenues of Rs 270 billion in 2022-23, by both the Provincial and Federal Governments combined. The overall national tax collection during the year was Rs 7,169 billion. As such, the contribution by taxes on property is only 3.4%.

The very small generation of property-related revenues is further highlighted by the fact that these are equivalent to only 0.3% of the GDP. A comparison is made with the performance of selected developing countries in the level of revenue from property related taxes in Table 45.

Table 46: Level of Revenues from Taxes on Property in Selected Developing Countries (% of GDP)

Countries	Total Taxes on Property		Recurrent Taxes on Property* (% of GDP)
	% of GDP	% of Taxes	
Brazil	2.10	15.9	0.50
Indonesia	0.35	2.7	0.35
India	0.60	3.8	0.30
Morocco	1.76	5.7	0.35
Pakistan	**0.30**	**3.0**	**0.06**
Türkiye	1.20	4.2	0.90
Uzbekistan	1.27	4.0	0.70

Source: IMF Data Base on IFS.

Table 9.4 reveals considerable variation in the tax-to-GDP ratio of taxes on property. It ranges from a maximum of 2.1% of the GDP in Brazil to the lowest at 0.3% of the GDP in Pakistan.

The Table 45 also reveals that the share of recurrent taxes, like the annual urban immoveable property tax and the rental income tax, is relatively small in the majority of countries in the Table. Apparently, more reliance is placed on property transactions.

9.4. Elite Capture

The property-owning elite of Pakistan has played a fundamentally negative role in the development of property-related taxes in Pakistan.

This has included the included the identification and implementation of the following measures by both the Federal and Provincial Assemblies and Governments:

(i) Stopping the up-dating of Gross Annual Rental Values (GARVs) of properties for determination of the tax liabilities under the Urban Immoveable Property Tax Act. Consequently, in many of the metropolitan cities of Pakistan, like Karachi, the GARVs are over two to three decades out-of-date.

(ii) There has been no comprehensive survey of properties, both residential and commercial, in recent years by the relevant tax departments.

(iii) The Capital Value Tax on Property, which is a proxy of the Wealth Tax, has been allocated to the Provinces, like the Agricultural Income Tax, with the expectation that Provincial Governments will not have the political will or capacity to collect these taxes.

(iv) The tax rates on the rental income tax at the Federal level have been kept low in relation to the rates on other income. The maximum tax rate is 25%, whereas the maximum tax rate on other incomes is 45%.

(v) A special exemption was given on the capital gains tax on property if the holding period was less than six years. Fortunately, this exemption has now been withdrawn. However, instead of a progressive tax structure, capital gains on properties are subject to a flat rate of only 15%.

(vi) Commercial properties have generally been outside the ambit of property taxation.

(vii) No mechanisms have been formally established for cross-checking the reported property values and corruption is rampant in the acceptance of declared values.

(viii) Large and high value properties are frequently located in residential areas developed by the Defence Housing Authorities in the eight large cities of Pakistan. The urban immoveable property tax is collected in these areas by the Cantonment Boards. These revenues are not shared with the Municipal Government which is responsible for construction and maintenance of connecting roads and bulk water supply.

9.5. Economic Impact of Low Taxation of Property

The economic impact of extreme under taxation of property is becoming increasingly visible. The first major area of concern is the big change in sectoral composition of investment by the private sector.

Table 47 indicates that there has been an alarming shift in private investment from industry to other sectors, especially real estate and other services. Believe it or not, the absolute level of real private investment in industry in 2023-24 was even lower than the level as far back as 1999-2000.

Consequently, the share of industry in private investment has plunged from almost 27% to only 14%. After 2017-18, there has been a decline of over 52% in the level of private investment in industry.

The diversion is towards investment in real estate and other services. Cumulatively, the level of investment in real estate has increased since 1999-2000 by 150%, while it has actually declined in absolute terms in industry.

Table 47: Level of Private Investment by Sector (Rs in Billion at 2015-16 prices)

	Agriculture	Share (%)	Industry	Share (%)	Real Estate	Share (%)	Other Services	Share (%)	Total Private Sector
1999-2000	612	34.8	474	26.9	280	15.9	394	22.4	1760
2007-08	754	23.7	805	25.3	383	12.0	1238	38.9	3180
2012-13	861	31.0	538	19.4	466	16.8	905	32.6	2770
2017-18	988	35.4	969	25.0	563	14.5	1359	35.0	3879
2022-23	1052	32.1	598	18.0	673	20.5	956	29.2	3279
2023-24	1104	34.5	462	14.4	699	21.9	932	29.1	3196

Source: PBS, National Income Accounts.

The explanation for this massive diversion of investment away from industry is due largely to the much higher tax burden on industry. Inclusive of all taxes, the previous chapter has revealed that the tax incidence on industry is five times the national average. It is substantially below the national average in the case of real estate.

The bottom line is that if this huge distortion persists in the tax system of Pakistan, then a goodbye may well be given to export-led growth, with investment shifting to non-tradeable sectors. This is perhaps one of the strongest imperatives for reform of the tax system of Pakistan.

There is yet another reason why the boom in real estate has to be quelled. The import of inputs is large, with no compensating exports from the output. The total import bill linked to residential and commercial construction was over $8 billion in 2023-24.

9.6. Estimate of Potential Revenue

This is the last section of the Chapter and pertains to the estimate of potential revenues from the collection of taxes on property.

The first estimate is for the urban immoveable property tax. This is an important as the revenue from this tax are shared with municipal government and help in tackling urban poverty.

The Chart 9.2 presents in a visual form the methodology used.

The steps are as follows:

(i) Estimate of rental income, owner-occupied and rented, in residential real estate of Rs 3705 billion in 2023-24 according to the National Income Accounts.

(ii) Derivation of the urban share from the latest HIES at 46.3% of the national rental income.

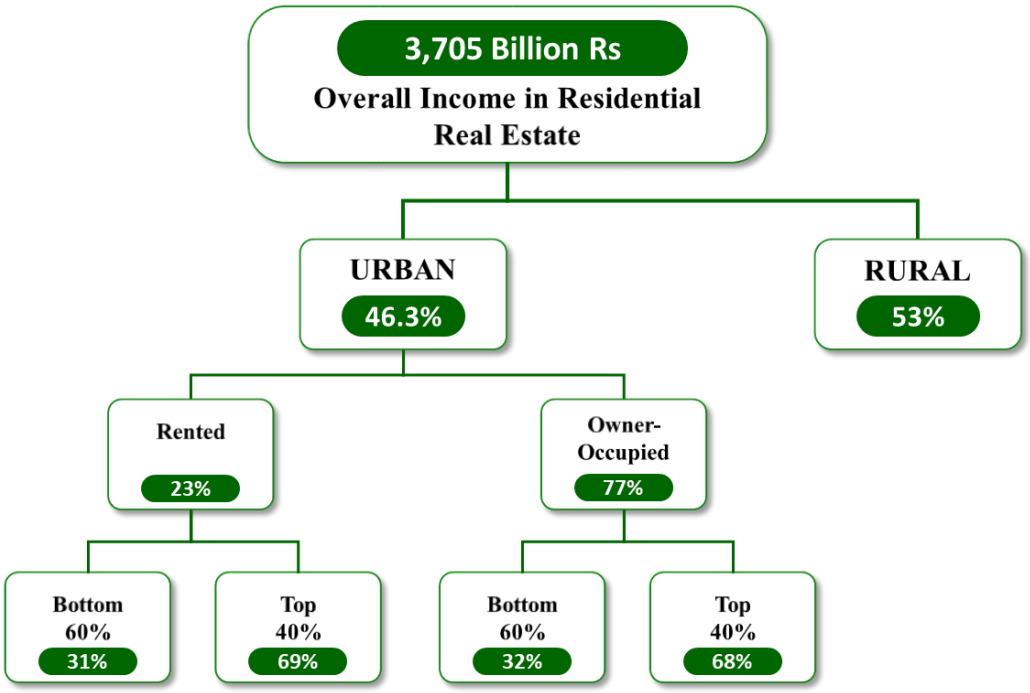
(iii) Estimate that 77% of urban rental income accrues from owner-occupied housing units and 23% from rented units.

(iv) Within rental income, the share of the top 40% is 69%. The corresponding share of the top 40% in owner-occupied housing is 68%. It is assumed that the remaining 60% are exempt.

(v) The resulting estimates are as follows:

Type	Taxable Rental Income (Rs in Billion)	Tax Rate (%)	Revenue Yield (Billion Rs)
Rented Properties	272	20	54
Owner-Occupied Properties	911	10	91
TOTAL	**1183**		**145**

Figure 18: Estimation of the Tax Revenue from the Urban Immoveable Property Tax, 2023-24



Source: PBS, NIA and HIEs.

We turn next to the potential revenue from commercial properties. The Population and Housing Census of 2023 has given the number of commercial properties and residential properties in urban areas of Pakistan. Based on the assumption that on the average a commercial property has two times the rental value of a residential property, the tax base of commercial properties is estimated at 34% of the residential tax base. This implies that with the tax rate of 20%, the revenue yield should be Rs 80 billion.

***Overall, the potential revenue yield from the urban immoveable property tax is Rs 225 billion*, with the tax bases of 2023-24.**

The second estimate is for the rental income tax, as follows:

(i) The total value of actual rental income is estimated at 20% of the overall residential real estate income, according to the latest HIES. Both urban and rural rented properties are part of this tax base. As such, the estimated rental income from properties is Rs 740 billion.

(ii) It is assumed conservatively that the tax base, beyond the exemption limit, is approximately two-thirds of the total actual rental income. This yields a tax base of close to Rs 500 billion.

(iii) The marginal tax rate ranges from 5% to 25%. As such, with an average tax rate of 15%, the potential revenue in 2023-24 would have been Rs 75 billion.

The third estimate is for the Capital Value Tax on Property. The tax base currently exists only on properties transacted during a particular year. The estimation methodology applied is as follows:

(i) It is assumed that 2% of the properties are traded annually.

(ii) The ratio of capital value to rent of a property on average is 25.1

(iii) 2/3rds of the value of traded properties is liable for CVT.

(iv) The estimated value of taxable traded properties is approximately Rs 12400 billion. With an average tax rate close to 2.5%, the potential revenue yield is close to Rs 300 billion.

The next estimate is of the potential revenue from the Capital Gains Tax on property, as follows:

(i) It is assumed that on average a property is traded after 15 years.

(ii) With an average inflation rate 8% of the capital gains component in the trading value is 68%.

(iii) The revenue yield with 15% tax rate is close to Rs 90 billion.

The final estimate is of the stamp duty on property transactions. If the under-reporting of value is 50% on average, then the potential yield from the stamp duty is Rs 70 billion.

Overall, a comparison is made below in Table 9.6 on the actual versus potential revenues from the various taxes on property.

Table 48: Actual versus Potential Tax Revenues from the various Taxes on Property, 2023-24 (Rs in Billion)

	Actual Revenue*	Revenue Potential
PROVINCIAL	**81**	**355**
Urban Immoveable Property Tax	26	225
Stamp Duties	55	80
Capital Value Tax on Property	n	50
FEDERAL	**263**	**465**
Income Tax on Rental Income	47	75
Capital Gains Tax on Property	12	90
Advance Tax on Sale/ Purchase of Property	204	300
TOTAL	**344**	**820**
% of GDP	**0.32**	**0.80**

**Based on projections from the levels in 2022-23 of 19% in the case of provincial taxes and 30% in federal taxes.*

The potential additional revenues in 2023-24 was Rs 476 billion. This would have raised the total tax revenue from taxes on property to 0.72% of the GDP, with a significant jump of 0.4% of the GDP.

The precise set of reforms to realize this potential is described in Chapter 12.

THE INCIDENCE OF TAXES

Determination of the incidence of taxes is vital from the viewpoint of identifying the direction of future tax reforms in the country. There is a perception today in Pakistan that the overall burden of taxes is regressive, because of the heavy reliance on indirect taxes.

Therefore, the objective of the chapter is to quantify the incidence of taxes in terms of the burden placed on different income quintiles of population in the country. Section 1 reviews the findings of earlier research on incidence of taxes in Pakistan.

Section 2 then quantifies the distribution of the income tax among the quintiles. This is based on the disaggregation of the revenues by source given in the FBR Year Books. The latest publication is for 2022-23. Therefore, the analysis of incidence is undertaken for 2022-23.

Section 4 investigates the incidence of indirect taxes on the basis of commodity-wise distribution of revenues. The incidence is estimated separately for the sales tax on domestic output and on imports. This is followed by quantification of the incidence of the customs duty and excise duty.

The analysis of incidence has been limited to federal taxes. Data on the composition of provincial tax revenues is not available. However, the estimates of incidence are for over 92% of the tax revenues in the country.

Section 5 then consolidates the individual tax incidence estimates. Different measures are used to determine the regressivity or progressivity of the overall federal tax system and of individual taxes. Section 6 then presents the policy implications of the findings.

10.1. Review of Literature

The section reviews some earlier estimates of incidence of tax and the effective tax rates in Pakistan.

The tax structure of Pakistan has been analyzed by Kemal (1981), Alauddin & Raza (1981), Malik & Alli (1985), and Pasha (1995) to be regressive. This implies that the welfare of the poor is lower as the incidence of tax falls more on them.

Malik & Saqib (1989) estimate the incidence of federal taxes, for the fiscal year 1978-79, on households belonging to different income brackets by covering all the major direct and indirect taxes. Effective tax rates on the commodities are slightly higher for the lower income group at 11.2% compared to the higher income group with effective tax rate of 9.9%. The effective tax rate of direct taxes for the highest income group is 3.1% compared to a zero for the lowest income group, making the overall effective rates slightly progressive.

A comprehensive incidence and distributional analysis of GST in Pakistan is provided by Refaqat (2003). She also conducts an analysis of households ordered by income and uses the Household Integrated Economic Survey (HIES) to estimate effective tax rates fora detailed list of consumption items by expenditure deciles. She defines household annual consumption as a proxy measure for lifetime income. GST is somewhat progressive from a life-time income analysis with an effective tax rate of approximately 3.5% to 4.2%. Nevertheless, the annual incidence is regressive, when households are sorted by income.

There is literature available that presents the overall tax structure to be rather progressive in Pakistan. Martinez-Vazquez (2006) uses the tabulation of income and consumption with the data from HIES. They estimate the federal taxes to be progressive as 40% of the burden is borne by the highest income quintile, although their share in income is higher.

Wahid & Wallace (2008) have conducted an analysis of the incidence of taxes using HIES data for 2004-05 to investigate the incidence of direct and indirect taxes. The per capita effective tax rate of the direct tax is 2.3% for the bottom decile as compared to 6.7% for the highest decile. Moreover, it is 5.9% and 6.8% for the lowest and highest decile respectively for indirect taxes. Their findings suggests that consumption taxes are distributed in a relatively more proportional manner, with households across the income distribution having a similar tax burden. However, direct taxes are more progressive making the overall tax structure to be slightly more progressive.

Refaqat (2008) measures the social incidence if indirect taxes in Pakistan as a result of tax reform processes during1999-2001 focusing on the area of indirect taxes. In this regard the results show that a movement from dependence on trade tax revenue to GST revenues has made the tax system more progressive.

Jamal & Javed (2013) evaluated GST incidence and progressivity by applying the consumption data to access consumption tax structure by Kakwani summary index of tax progressivity. The results at national regional and provincial level for three commodities groups including food non-durable and durable expenditure. Their results show that overall incidence of GST to be progressive with the incidence of overall GST to fall on lowest decile to be 4.41% compared to 5.49% for the upper decile for the year 2010-11. The GST on the durable goods turned out to be more progressive with an effective tax rate of 2.69% on the lowest decile compared to 4.01% on the upper decile whereas the food group remains regressive with 1.66% to fall on the lowest and 1.02% to fall on the upper decile. The relative intensity in terms of magnitude the Kakwani index also confirm the similar pattern of the GST.

Ara & Ahmad (2022) have analyzed the tax incidence indicating the combined incidence of the three major components of indirect taxes on essential items is 4.3 %, while the combined incidence on non-essential items is 2.8%. The pattern of incidence of each tax is regressive across all household deciles for essential food items, which account for a significant portion of the expenditures of impoverished households. However, the bottom 40% of households exhibit a proportional pattern, while the top 60% exhibit a progressive pattern.

In comparison to Pakistan analysis, in the Indian tax system as highlighted by Toye (1976) the incidence of indirect taxes, particularly consumption taxes, appears to be regressive nature. On the other hand, there is literature that supports the view the taxation in India to be more progressive as suggested by Ahuja (1962). Aggarwal (1995) in his study estimates the effective tax rates for major indirect taxes in India for the fiscal year 1989-90. The combined effective tax rate for most essential commodities ranged from approximately 3% to 4%. In contrast, luxury items, such as mineral water and tobacco products, often faced much higher effective rates exceeding 30% implying some progressivity in indirect taxation.

10.2. Incidence of the Income Tax

The income tax is generally considered as the most progressive component of any tax system. The methodology applied here is based on the assumption that there is minimal shifting of direct taxes. In effect, the nominal and effective incidence are assumed to be the same.

The analysis of incidence of tax payments of income tax is based on the categorization of the tax by the FBR. Seven major sources of income tax have been identified, as shown in Table 49. These include advance payments of the corporate income tax, the tax on salaries, fixed tax on interest income from bank deposits and securities, fixed tax on dividends, withholding advance taxes on sale of goods, contracts, electricity, telephone bills and imports. These levies contribute 84% of the revenue from the income tax.

Table 49: Overall Incidence and of Different Components of The Income Tax (2022-23)

Item	% of Revenue	Basic for Allocation of Incidence	Share of Incidence (Quintile)						Type *
			Bottom	4th	3rd	2nd	Top	Total	
1. Advance Corporate Income Tax	35.8	Ownership of Equity	0	0	0	10	90	**100**	**P**
2. Contracts Withholding Tax	13.0								
2.1. Sales of Goods 2.2. Contracts		Sale of Goods Housing Rents	7.0	10.3	14.0	20.0	48.7	**100**	**P**
3. Salaries	8.4	Wages above Exemption Limit	0	0	0	20	80	**100**	**P**
4. Bank Interest and Securities	9.6	Access to Banking + Receipts	6.1	10.2	14.3	21.3	48.1	**100**	**P**
5. Dividends	2.7	Ownership of Equity	0	0	0	10	90	**100**	**P**
6. Electricity and Telephone Bills	5.6	Expenditure	6.7	10.3	14.8	20.2	48.0	**100**	**P**
7. Imports WT	8.9	Expenditure on Imports	10.2	13.3	16.5	20.0	40.0	**100**	**R**
8. Others	16.0	Income	8.6	12.4	15.3	20.5	43.2	**100**	**N**
TOTAL	**100.0**	**Overall Incidence**	**4.2**	**6.1**	**7.9**	**16.2**	**65.6**	**100**	**P****

**P = Progressive, N = Neutral, R = Regressive. **The Gini Coefficient of Share in Revenues versus Share in Income is 0.247.*

Different bases are used to allocate the tax payments among the income quantiles. For example, it is assumed that the burden of the corporate income tax falls on the owners of the equity of corporate

entities. As such, bulk of the incidence is likely to fall on the top income quantile. This is also the case with the tax on dividends.

Table 10.1 reveals that most of the components of the income tax are progressive in nature. The solitary exception is the withholding tax on imports. Also, the withholding tax on electricity and telephone bills have a less progressive incidence.

Overall, the estimates in Table 10.1 reveal the strong progressivity of the income tax in Pakistan. The top quantile bears over 65% of the burden of the tax. The incidence on the lowest income quantile is 4%. Ideally, of course, both the fifth and fourth income quintiles should be completely exempted from the income tax.

10.3. Incidence of Indirect Taxes

The incidence of indirect taxes has been derived on the assumption that there is full forward shifting of such taxes. As such, the distribution of the burden among quintiles depends on the consumption patterns. In the case of taxes on intermediate inputs or capital goods, the burden is placed on the goods produced with these inputs.

Sales Tax (Domestic)

Table 10.2 derives the incidence of the sales tax on domestic goods. The disaggregation includes eight major goods from which over 67% of the revenue is generated. These are electricity, POL products, sugar, natural gas, cotton yarn, cement, beverages and cigarettes. Appropriate tax bases of consumption expenditure have been chosen for distribution of the tax burden among income quintiles.

Four of the items yielding relatively large sales tax revenues appear to have progressive tax incidence. These are electricity, natural gas, cement, and beverages. The other four items with a regressive incidence are POL products, sugar, cotton yarn and cigarettes.

Overall, the incidence of the sales tax (domestic) is regressive in nature. Different measures of incidence are derived of each tax in Section 10.4.

Table 50: Overall Incidence and of Different Items in the Sales Tax (Domestic) (2022-23)

Item	% of Revenue	Basic for Allocation of Incidence (*per capita expenditure*)	Share of Incidence (Quintile)						Type *
			Bottom	4th	3rd	2nd	Top	Total	
1. Electricity	22.9	Electricity Bill	6.5	10.3	15.2	21.6	46.5	**100.0**	**P**
2. POL Products	15.6	Transport Cost Direct and Indirect	8.8	12.7	16.2	21.6	40.7	**100.0**	**R**
3. S*ugar	7.8	Sugar	17.3	19.1	20.4	21.0	22.2	**100.0**	**R**

4. Natural Gas	4.9	Gas Bill	4.1	9.1	15.0	25.0	46.8	**100.0**	**P**
5. Cotton Yarn	4.9	Clothing	10.7	14.4	17.3	21.5	36.1	**100.0**	**R**
6. Cement	4.2	Imputed Rent of Owner-Occupied Housing	5.6	8.5	12.3	18.8	54.8	**100.0**	**P**
7. Beverages	3.5	Beverages	6.0	9.8	14.4	21.8	48.0	**100.0**	**P**
8. Cigarettes	3.5	Cigarettes	12.0	15.6	18.4	22.2	31.8	**100.0**	**R**
9. Others	32.7	Other Expenditure	7.6	12.6	14.3	20.0	45.5	**100.0**	**P**
TOTAL	**32.7**		**8.0**	**12.3**	**15.6**	**21.2**	**42.8**	**100.0**	**R***

**P = Progressive, R = Regressive. **The Gini Coefficient of Share in Revenues versus Share in Income is -0.023.*

Sales Tax (Imported)

Turning to the incidence of the sales tax (imported), Eleven imports have been identified in Table 51, which collectively contribute more than 66% of the revenues. the remaining 34% are distributed among a large number of imported items, with a small revenue contribution by each item.

Table 51: Overall Incidence and of Different Items in the Sales Tax (Imported) (2022-23)

Item	% of Revenue	Basic for Allocation of Incidence (*per capita expenditure*)	Share of Incidence (%)						Type *
			Bottom	4th	3rd	2nd	Top	Total	
1. POL Products	18.8	Transport Cost, Direct & Indirect	8.8	12.7	16.2	21.6	40.7	**100.0**	**R**
2. Edible Oil	10.4	Vegetable Ghee	19.4	21.8	21.9	20.6	16.3	**100.0**	**R**
3. Iron & Steel	7.7	Imputed Value of 0-0 Property	5.6	8.5	12.3	18.7	54.9	**100.0**	**P**
4. Plastics, Resins	6.5	Beverages	6.0	9.8	14.4	21.8	48.0	**100.0**	**P**
5. Cotton + Man-Made Filaments & Fabrics	6.4	Clothing	10.8	14.4	17.3	21.5	36.0	**100.0**	**R**

6. Organic Chemicals	4.7	Medicines	10.0	13.2	16.8	22.1	37.9	**100.0**	**R**
7. Electrical Goods	4.0	Electricity	6.5	10.3	15.1	21.6	46.5	**100.0**	**P**
8. Oil Seeds	3.0	Livestock Products	8.8	13.6	17.0	23.5	36.2	**100.0**	**R**
9. Tea Coffee	1.9	Tea and Coffee	14.7	17.8	19.6	21.4	26.5	**100.0**	**R**
10. Paper & Paper Board	1.4	Stationery, Books	8.2	12.6	16.7	22.0	40.4	**100.0**	**R**
11. Tanning or Dying Extracts	1.4	Footwear	11.3	15.2	17.7	22.0	33.8	**100.0**	**R**
12. Others	33.8	Other Expenditure	9.4	12.5	15.6	20.5	42.0	**100.0**	**R**
TOTAL	**100.0**		**9.5**	**12.6**	**16.0**	**21.1**	**40.8**	**100.0**	**R****

**P = Progressive, R = Regressive. **The Gini Coefficient is -0.026.*

The striking finding is that eight out of the eleven items appear to have a regressive incidence. Among the major revenue spinners, this includes POL products, edible oil and inputs into the textile sector. The three items with a progressive burden are iron and steel, plastics and resins and electrical goods.

Given the high number of items imported with a regressive sales tax incidence, it is not surprising that the overall incidence of the sales tax on imports is significantly regressive.

Customs Duty

There is a heavy concentration of revenues from the customs duty on two types of goods, namely, POL products and vehicles. Combined they contribute over 40% to the total customs duty revenues. The other three items which have a significant share in revenues are iron and steel, edible oil and electrical goods. The incidence of estimates by income quintile are presented in Table 52.

Table 52: Overall Incidence and of Different Items in the Customs Duty (2022-23)

Item	% of Revenue	Basic for Allocation of Incidence (*per capita expenditure*)	Share of Incidence (%)						Type*
			Bottom	4th	3rd	2nd	Top	Total	
1. POL Products	31.0	Transport Cost, Direct & Indirect	8.8	12.7	16.2	21.6	40.7	**100.0**	**R**
2. Vehicles	9.4	Assumed	0	0	5	20	75	**100.0**	**P**

3. Iron & Steel	5.6	Imputed Value of 0-0 Property	5.6	8.5	12.3	18.7	54.9	**100.0**	**P**
4. Edible Oil	5.2	Vegetable Ghee	19.4	21.8	21.9	20.6	16.3	**100.0**	**R**
5. Electrical Goods	4.1	Electricity Bill	6.5	10.3	15.1	21.6	46.5	**100.0**	**R**
6. Others	44.7	Other Expenditure	7.6	12.6	14.3	20.0	45.5	**100.0**	**P**
TOTAL	**100.0**		**7.6**	**11.6**	**14.4**	**20.6**	**45.8**	**100.0**	**p**

**P = Progressive, R = Regressive. **The Gini Coefficient is 0.033.*

Excise Duty

Excise duty is the smallest indirect tax at the federal level. 6 items contribute 84% to the revenue, as shown in Table 53. These are cigarettes, cement, beverages, inland and external travel by air and autos. The incidence of five these items is progressive. The notable exception is cigarettes, with the justification on health grounds.

Overall, given the dominance of revenues from items with progressive incidence, the overall incidence of the tax is progressive.

Table 53: Overall Incidence and of Different Items in the Excise Duty (2022-23)

Item	% of Revenue	Basic for Allocation of Incidence (*per capita expenditure*)	Share of Incidence (%)						Type*
			Bottom	4th	3rd	2nd	Top	Total	
1. Cigarettes	39.6	Cigarettes	12.0	15.6	18.4	22.2	31.8	**100.0**	**R**
2. Cement	18.5	Imputed Rent of 0-0 Housing	5.6	8.5	12.3	18.8	54.8	**100.0**	**P**
3. Beverages	8.7	Beverages	6.0	9.8	14.4	21.8	48.0	**100.0**	**P**
4. Inland Travel by Air	6.5	Assumed	0	0	10	30	60	**100.0**	**P**
5. External Travel by Air	4.8	Assumed	0	0	0	10	90	**100.0**	**P**
6. Autos	5.9	Assumed	0	0	0	10	90	**100.0**	**P**
7. Others	16.0	Other Expenditure	7.6	12.6	14.3	20.0	45.5	**100.0**	**P**

TOTAL	**100.0**		**7.6**	**10.7**	**13.5**	**20.5**	**47.7**	**100.0**	**P**

**P = Progressive, R = Regressive, **The Gini Coefficient is 0.054.*

10.4. Overall Incidence of Taxes

The first aggregation is of the indirect taxes in Table 54. The perhaps not so surprising finding is the somewhat regressive nature of these taxes, individually and combined.

However, the regressivity is mild in nature. This is indicated by the small differences between the shares in household income and in the incidence of the taxes of each income quintile.

Table 54: Tax Burden of Indirect Taxes

	Quintile | *(Rs in Billion)*					
	Bottom	**4th**	**3rd**	**2nd**	**Top**	**Total**
Sales Tax	***237***	***323***	***414***	***547***	***1048***	***2569***
Domestic	86	122	159	211	397	**975**
Imported	151	201	255	336	651	**1594**
Customs Duty	***71***	***108***	***134***	***192***	***427***	***932***
Excise Duty	***27***	***38***	***48***	***73***	***170***	***356***
Petroleum Levy	***50***	***74***	***93***	***126***	***237***	***580***
Total Burden of Indirect Taxes*	**385**	**543**	**689**	**938**	**1882**	**4437**
% Share	**8.7**	**12.2**	**15.5**	**21.2**	**42.4**	**100**
% Share in HHY	***8.6***	***12.4***	***15.3***	***20.5***	***43.2***	***100.0***
*The Gini Coefficient is **-0.005**.						

Turning finally to the overall incidence of federal taxes, the estimates are presented in Table 55. Given the marked progressivity of the income tax, it is not surprising that the overall incidence of federal taxes in 2022-23 was progressive.

Table 55: Overall Incidence of Federal Taxes

	Quintile | *(Rs in Billion)*					
	Bottom	**4th**	**3rd**	**2nd**	**Top**	**Total**
Direct / Income Tax	136	199	259	530	2146	3270
Indirect Taxes	385	543	689	938	1882	4437
TOTAL	**521**	**742**	**948**	**1468**	**4028**	**7707**
Share (%)*	***6.8***	***9.6***	***12.3***	***19.0***	***52.3***	***100.0***
% Share in HHY	***8.6***	***12.4***	***15.3***	***20.5***	***43.2***	***100.0***

***The Gini Coefficient is 0.101, implying progressivity.**

Two measures of the nature of incidence have been used to derive the extent of progressivity or regressivity of taxes. These are the Gini Coefficient and the Pashum Ratio. The estimates are presented in Table 56. A positive magnitude indicates progressivity and a negative magnitude reveals regressivity of the tax. The absolute magnitude indicates the extent of regressivity or progressivity.

Table 56: Measures of Extent of Progressivity or Regressivity of Direct, Indirect and Total Taxes

	Gini Coefficient	Pashum Ratio	Type
Direct / Income Tax	0.246	3.333	Significantly Progressive
Indirect Taxes	-0.018	-0.004	Mildly Regressive
OVERALL FEDERAL TAXES	**0.109**	**0.016**	**Mildly Progressive**

The measures of extent of progressivity of direct, indirect and all taxes reveal that the overall tax system at the Federal level in 2022-23 was mildly progressive. The significant progressivity of the income tax is largely neutralized by the regressivity of the indirect taxes.

The bottom line for the agenda of tax reforms is to reduce the regressivity of indirect taxes and bolster the progressivity of direct taxes. The disaggregated analysis of each tax in the above sections gives in specific terms the appropriate directions of change.

10.5. Degree of Progressivity of the Tax System

The low degree of progressivity of the tax system of Pakistan, with respect to the incidence on different income quintiles, has been revealed as relatively low, with a Gini coefficient of only 0.109.

How does this degree of progressivity compare with the tax progressivity in other countries, especially those in South and East Asia? This analysis is undertaken below.

Estimates of the Gini coefficient of the tax incidence by income quintiles are generally not available for many countries for recent years. Therefore, proxies have been used to get the assessment of the likely progressivity of the tax system in a country.

The indicators chosen are as follows:

- Share in Total Revenues of Direct Taxes
- Share in Total Revenues of Indirect Taxes
- Maximum Income Tax Rate
- Corporate Income Tax Rate
- Sales Tax Rate

Based on these indicators, an Index of Tax Progressivity has been constructed. The methodology used is described in Technical Annexure-1.

The magnitudes of the indicators are presented in Table 57. The resulting estimates of the Index of Tax Progressivity are highlighted in Table 58 for the selected countries.

Table 57: Index of Tax Progressivity of Selected Countries

Ranking	Country	Index of Tax Progressivity (0 < I < 1)
1	Malaysia	0.556
2	India	0.538
3	Indonesia	0.487
4	China	0.480
5	Philippines	0.457
6	Thailand	0.453
7	**PAKISTAN**	**0.445**
8	Bangladesh	0.357
9	Mongolia	0.307
10	Sri Lanka	0.272

Table 58 reveals that East Asian countries generally have a more progressive system. Within South Asia, only India appears to be ranked high in tax progressivity.

The country with the highest index value is Malaysia. The share of income tax revenues in total revenues is the highest at 47.3% and it has the lowest sales tax rate at 10%.

The lowest index value is of Sri Lanka. The share of income tax in total revenues is very low at 26.5% and the highest marginal income tax rate is only 18%.

Pakistan has the seventh ranking in the Index of Tax Progressivity among the ten selected countries. This is partly due to a relatively low share of income tax in total revenues and a relatively high sales tax rate of 18%, which tends to increase the regressivity of the tax system.

Table 58: Indicators of the Progressivity of the Tax System in Selected Countries

Country	Max Personal Income Tax Rate (%)	Corporate Tax Rate (%)	Sales Tax Rate (%)	Share in Total Revenues (%)				Index of Progressivity
				Income Tax	Sales Tax	Customs Duty	Sales Tax + Customs Duty	

Bangladesh	25	27.5	15	25.8	43.2	9.4	52.6	0.357
China	45	25	13	36.3	52.2	3.1	55.3	0.480
India	42.75	35	18	45.6	40.8	5.0	45.8	0.538
Indonesia	35	22	11	37.9	34.7	2.5	37.2	0.487
Malaysia	30	24	10	47.3	19.5	1.5	21.0	0.556
Mongolia	20	25	10	20.6	38.6	12.8	51.4	0.307
Pakistan	**35**	**29**	**18**	**34.0**	**31.2**	**9.7**	**40.9**	**0.445**
Philippines	35	25	12	34.9	25.9	26.8	52.7	0.457
Sri Lanka	18	30	18	26.5	43.4	19.5	62.9	0.272
Thailand	35	20	7	35.5	43.9	4.0	47.9	0.453
Maximum	60	46.6	23.9	63.1			83.8	
Minimum	12	13.3	4.7	13.7			14.0	
Max – Min	48	33.3	19.2	49.4			68.8	

Data Source: WDI and Trading Economics.

Table 59: Index Value of the Progressivity of the Tax System in Selected Countries, Index Values

Country	Max Personal Income Tax Rate (Index)	Corporate Tax Rate (Index)	Sales Tax Rate (Index)	Share in Total Revenues (%)		Index of Progressivity
				Income Tax (Index)	Sales Tax + Customs Duty (Index)	
Bangladesh	0.271	0.426	0.463	0.244	0.447	0.357
China	0.687	0.351	0.568	0.457	0.408	0.480
India	0.641	0.651	0.307	0.646	0.544	0.538
Indonesia	0.479	0.261	0.672	0.490	0.668	0.487
Malaysia	0.375	0.321	0.723	0.680	0.900	0.556
Mongolia	0.167	0.351	0.723	0.140	0.464	0.307
Pakistan	**0.479**	**0.471**	**0.307**	**0.410**	**0.614**	**0.445**
Philippines	0.479	0.351	0.619	0.429	0.445	0.457
Sri Lanka	0.125	0.502	0.307	0.259	0.299	0.272
Thailand	0.479	0.201	0.881	0.441	0.514	0.453

Data Source: WDI and Trading Economics.

10.6. Sectoral Incidence of Taxes

An attempt has also been made to estimate the sectoral incidence of taxes, both direct and indirect, as of 2022-23. This will enable the identification of sectors which are relatively overtaxed and this

has reduced investment in and growth of these sectors. Also, the sectoral tax bases which have not been adequately exploited will become visible.

Table 60 identifies the major tax bases which are currently yielding revenues in different sectors. This is based on the methodology that if inputs are taxed then this is equivalent to taxation of outputs in sectors where these inputs produce the outputs. For example, taxes on sales of petroleum products fall mostly on the transportation sector of the economy and industry.

Table 60: Major Tax Bases in the Sectors

Sector	Direct Taxes	Indirect Taxes
INDUSTRY		
Mining & Quarrying	Corporate Profits	
Large-Scale Manufacturing	Corporate Profits Dividends, Salaries	Output of Major Industries
Electricity and Gas	AT* on Electricity Bills	Electricity and Gas Sales
Construction	AT on Contracts	Cement, Iron and Steel
SERVICES		
Wholesale & Retail Trade	AT on Sales AT on Imports	
Transportation & Storage		Petroleum Products Vehicles
Information and Communication		Telephones
Finance & Insurance	Corporate Profits AT on Interest Income from Deposits	
Real Estate	Rental Income AT on Purchase/Sale of Properties	
Public Administration and Social Security	Salaries	
Private Services	AT on Personal Income from Services Provided	

**AT = Advance Tax in the Income Tax Regime.*

The advance / withholding tax regime generates revenues in sectors like electricity and gas, construction, wholesale and retail trade, finance and insurance and real estate. The larger indirect tax bases are in the large-scale manufacturing sector and in the construction and transport sectors.

Based on the application of the above methodology the nominal sectoral incidence of different taxes has been derived in Table 61. The incidence of taxes on agriculture is very low, especially in the absence of significant collection from the agricultural income tax. Overall, it is estimated that in 2022-23, 50% of the tax revenues are generated from the industrial sector. This is the relatively overtaxed sector as its share in the GDP is less than 18%.

Table 61: Sectoral Distribution of Federal Tax Revenues, 2022-23

	Income Tax	Customs Duty	Excise Duty	Sales Tax (Imported)	Sales Tax (Domestic)	Petroleum Levy	Total
Revenues *(Rs in Billion)*	3272	932	370	1616	975	580	7745
SECTOR							
AGRICULTURE	**0.0**	**3.1**	**0.0**	**3.0**	**2.0**	**0.0**	**108**
INDUSTRY	**32.8**	**55.3**	**82.8**	**64.5**	**84.1**	**25.3**	**3893**
Mining & Quarrying	4.8	-	-	-	-	-	157
Manufacturing	18.5	46.7	64.3	50.8	60.4	25.3	2824
Electricity & Gas	3.6	4.1	-	4.0	16.2	-	379
Construction	5.9	4.5	18.5	9.7	7.5	-	533
SERVICES	**67.2**	**41.6**	**17.2**	**32.5**	**13.9**	**74.7**	**3744**
Wholesale & Retail Trade	16.8	9.1	-	15.7	2.2	-	910
Transport	1.6	30.5	17.2	14.0	11.7	74.7	1174
Information & Communication	2.9	2.0	-	2.8	-	-	159
Finance & Insurance	28.0	-	-	-	-	-	916
Real Estate	6.5	-	-	-	-	-	213
Public Administration	6.6	-	-	-	-	-	216
Comm, Social & Private Services	4.8	-	-	-	-	-	157
							3745
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	

Table 62 presents the sectoral incidence of the income tax. The effective rate is the highest on industry at 5.79% of the value added in the sector. The corresponding magnitude for the services sector is 4.82%.

There is substantial variation in the incidence of the income tax at the sub-sectoral level. The highest incidence of over 27% is on the finance and insurance sector, followed by the mining and quarrying sector with an exceptionally large corporate income tax payment by OGDC.

Table 62: Sectoral Incidence of the Income Tax

Sectors	Share of Income Tax Revenues	Share of the GDP	Relative Incidence	Effective Tax Rate (%)

			(Share of Revenues/ Share of GDP)	
AGRICULTURE	**0.0**	**24.6**	**0.0**	**0.00**
INDUSTRY	**32.8**	**21.8**	**1.50**	**5.79**
Mining and Quarrying	4.8	2.2	2.18	8.41
Manufacturing	18.5	14.3	1.29	4.98
Electricity and Gas	3.6	2.5	1.44	5.56
Construction	5.9	2.8	2.11	8.14
SERVICES	**67.2**	**53.6**	**1.25**	**4.82**
Wholesale & Retail Trade	16.8	21.4	0.78	3.01
Transport & Storage	1.6	5.4	0.30	1.16
Information & Communication	2.9	1.6	1.81	6.99
Finance and Insurance	28.0	4.0	7.00	27.02
Real Estate	6.5	4.2	1.55	5.98
Public Administration and Social Security	6.6	4.4	1.50	5.79
Comm, Social and Private Services	4.8	12.6	0.38	1.47
TOTAL	**100.0**	**100.0**	**1.00**	**3.86**

Sub-sectors with a large share of informal activities are characterised by low incidence of the income tax. It is relatively low in wholesale and retail trade, transportation and private services.

Turning to the sub-sectoral incidence of indirect taxes. As shown in Table 63, it is substantially higher on the industrial sector at 15.3% and much lower on the services sector at only 3.38%. However, inclusion of the sales tax on services could increase the incidence somewhat.

The highest incidence at the sub-sectoral level is on the transportation sector due to the indirect taxes on petroleum products and vehicles. There is also relatively high incidence of indirect taxes on manufacturing, electricity and gas and the construction sub-sectors.

Overall, based on the above findings, the Agenda of Tax Reforms must focus on broadening the tax base to the hitherto undertaxed sub-sectors and provide some relief, wherever possible, to the overtaxed sub-sectors.

Table 63: Sectoral Incidence of Indirect Taxes

	Revenue from Indirect Taxes	Share of Indirect Tax Revenues	Share of GDP (%)	Relative Incidence of Indirect Taxes	Effectivve Tax Rate (%)

	(Rs in Billion)	(%)		(Share of Revenues / Share of GDP)	
AGRICULTURE	**108**	**2.4**	**24.6**	**0.10**	**0.53**
INDUSTRY	**2830**	**63.6**	**21.8**	**2.90**	**15.34**
Mining & Quarrying	0	0.0	2.2	0.0	0.0
Manufacturing	2230	49.9	14.3	3.49	18.46
Electricity and Gas	261	5.8	2.5	2.32	12.28
Construction	339	7.6	2.8	2.71	14.33
SERVICES	**1555**	**34.3**	**53.6**	**0.64**	**3.38**
Wholesale & Retail Trade	360	8.0	21.4	0.37	1.96
Transport & Storage	1132	25.3	5.4	4.68	24.76
Information & Communication	64	1.4	1.6	0.86	4.54
Finance & Insurance	0	0.0	4.0	0.00	0.00
Real Estate	0	0.00	4.2	0.00	0.00
Public Administration and Social Security	0	0.0	4.4	0.00	0.00
Comm, Social & Private Services	0	0.0	12.6	0.00	0.00
TOTAL	**4473**	**100.0**	**100.0**	**1.00**	**5.29**

TAXATION MEASURES IN THE 2024-25 FEDERAL BUDGET

The federal budget of 2024-25 is an extraordinarily ambitious budget in terms of the targeted growth rate in FBR revenues. They are expected to increase from Rs 9,310 billion in 2023-24 to Rs 12,970 billion, yielding thereby a growth rate of over 39%.

The objective of this chapter is to identify the multitude of taxation proposals in the budget and the determine the feasibility of the revenue target being achieved. This is of special importance because the new IMF program has identified the level of FBR revenues as one of the key targets for 2024-25.

The chapter is organized as follows: Section 1 highlights the wrong targets set for individual FBR taxes in 2024-25. An alternative set of targets are presented. Section 2 describes the major taxation proposals, as identified in the IMF Staff Report of September 2024, and in the Finance Bill presented to the Parliament. Quantification has been made by the IMF of the likely revenues from the various taxation proposals. This is done separately for each tax and assessment made of the feasibility of the achievement of the additional revenue estimates from the taxation proposals by the IMF.

Section 3 presents the quarterly growth rates of total FBR revenues as targets according to the IMF. The actual revenues are presented for the first quarter of 2024-25 and the shortfall derived. An estimate is made of the overall annual shortfall in 2024-25 with the existing tax system.

11.1. Modifications of Revenue Targets

A serious error was made by the federal ministry of finance in estimation of likely revenues in 2023-24 from individual FBR taxes in early June at the time of presentation of the annual federal budget for 2024-25. The divergence between the revised estimates and the actual magnitudes is shown in Table 64.

There were large divergences of the actual magnitudes from the revised estimates. In the case of income tax there was an understatement of 21.7%, while in the case of the other three taxes there was a combined overstatement of 15.7%. The targets for 2024-25 were based on these wrong estimates for 2023-24.

Table 64: Revised Revenue Targets for FBR Taxes, 2024-25 (Rs in Billion)

	2023-24		2024-25		2024-25	
	Revised Estimates	Actual	Original Target	Growth Rate (%)	Modified Target	Growth Rate (%)
Income Tax	3,721	4,530	5,512	48.1	6,504	43.6
Sales Tax	3,607	3,099	4,919	36.4	4,227	36.4
Customs Duty	1,324	1,104	1,591	20.2	1,327	20.2
Excise Duty	600	577	948	58.0	912	58.0

TOTAL	**9,252**	**9,310**	**12,970**	**39.3**	**12,970**	**39.3**

The modified targets for 2024-25 are also presented in Table 64. The overall FBR revenue target in 2024-25 of Rs 12,970 billion remains unchanged. The target for income tax has been enhanced, while that for the other three taxes has been reduced in line with the lower actual revenues in 2023-24, while the targeted growth rates have remained largely unchanged.

The IMF will also need to incorporate these modified individual FBR tax revenue targets for 2024-25.

11.2. Major Taxation Proposals and Revenues

IMF has classified the taxation proposals into different categories, presumably with the agreement of FBR. We present below the groups of taxation proposals by tax in Table 65.

Table 65: Major Taxation Proposals in 2024-25 and Expected Revenues

	Expected Revenues (Billion Rs)
1. INCOME TAX	**994**
Personal and Corporate Income Tax	**357**
▸ Bringing exporters into the regular income tax regime ▸ Reducing salary income tax slabs to five ▸ Raising maximum tax rate for non-salary income to 45%	
Enhancing Withholding Taxes and Direct Taxation	**240**
▸ Raising withholding tax for non-filers ▸ Increasing taxes on property transactions with progressive rates ▸ Eliminating reduced rates for capital gains ▸ Increasing motor vehicle advance tax ▸ Increase in tax on dividends	
Improving Compliance Measure and Revenue Administration Measures	**347**
Bringing Retailers into the Tax Net through the Tajir Dost Scheme	**50**
2. SALES TAX	
Transforming the Sales Tax	**286**
▸ Moving some zero-rated products to standard rate ▸ Some education, health and agricultural inputs to be taxed at 5% or 10% ▸ End of the Preferential Export Scheme	
3. CUSTOMS DUTY	**65**

▸ Rationalizing tariffs and eliminating concessions on import duty	
4. EXCISE DUTY	**413**
▸ Levy of FED on property sales and sugar ▸ Harmonizing FED on locally manufactured and imported cigarettes ▸ Increasing FED on Cement and airline tickets	
TOTAL REVENUE FROM PAKISTAN PROPOSALS IN 2024-25	**1,758**

The estimate of revenue generation from taxation proposals is very large at Rs 1,758 billion, equivalent to 1.4% of the projected GDP in 2024-25. Over 56% of the additional revenues are anticipated from the taxation proposals in income tax.

Some taxation proposals in indirect taxes are very regressive in nature. These relate to taxation of education, health, medicines, sugar, etc.

Analysis has been undertaken of the estimated revenues from the various taxation proposals. There is an upward bias in the magnitudes especially in the following cases:

- Bringing exporters into the regular income tax regime
- Raising salary income and non-salary income tax rates
- Improving compliance and revenue administration measures
- Revenues from the Tajir Dost Scheme
- Taxation of agricultural inputs like fertilizer and pesticides, due to delays in implementation
- FED harmonization on cigarettes leading to more tax evasion

Overall, an optimistic estimate of the additional revenue from the taxation proposals in the 2024-25 federal budget is Rs 1,000 billion, implying thereby a shortfall of over Rs 750 billion, equivalent to 0.6% of the GDP.

11.3. Outlook for FBR Revenues in 2024-25

The IMF Program has also set quarterly targets for FBR revenues in 2024-25 in the list of Indicative Targets. These are shown in Table 66.

Table 66: Quarterly Projection of FBR Revenues in 2024-25 (Rs in Billion)

	2023-24 (Actual)	2024-25 (Target)	Growth Rate (%)
QUARTER			
July – September	2,042	2,652	29.9
October – December	2,428	3,357	38.2
January – March	2,242	3,159	41.0
April – June	2,600	3,745	44.0
TOTAL	**9,311**	**12,913**	**38.7**

It is significant that IMF expects an acceleration in the quarter-wise revenue growth rates. The target growth rate in the first quarter is close to 30% which rises to 44% by the fourth quarter. Such an acceleration in growth rate of revenues during a financial year has generally not been seen before.

The outcome for the first quarter of FBR revenues has been reported by the Ministry of Finance. The revenues of individual taxes are given in Table 67.

Table 67: Growth in FBR Revenues in the First Quarter of 2024-25 (Billion Rs)

	July – September		Growth Rate (%)	Annual Target Growth Rate (%)
	2023-24	2024-25		
Income Tax	935	1230	31.6	43.6
Sales Tax	727	905	24.5	36.4
Customs Duty	252	276	9.9	20.2
Excise Duty	128	151	18.0	58.0
Petroleum Levy	222	262	18.0	26.5
TOTAL			**25.5**	**34.3**

There has been a significant shortfall of the growth rate of 4.4 percentage points in the first quarter, implying that FBR revenues were Rs 89 billion below the target.

The biggest shortfall in the observed growth rates is in excise duty and customs duty of 40 percentage points and over 10 percentage points respectively. This is not surprising in the case of customs duty as the rupee value of imports increased by only 5.7% in the first quarter of 2024-25. Also, the biggest source of excise duty is the cigarettes industry. Production in this industry declined by almost 21% in the first two months of 2024-25.

The likelihood is that FBR will make stronger efforts to reduce the shortfall in revenues with respect to the target agreed with the IMF for the first quarter of 2024-25. The enhanced agricultural income tax is also to be implemented by the four Provincial governments from January 1, 2025. There is the likelihood that a mini-budget will also be introduced early in 2025 by the Federal government.

The projected revenues in 2024-25 are given in Table 68.

Table 68: Projected Level of Tax Revenues in 2024-25 (Rs in Billion)

	2023-24	2024-25	Growth Rate (%)
FEDERAL TAXES			
Income Tax	4530	6110	35.0
Sales Tax	3098	3950	27.5
Customs Duty	1104	1240	12.5

Excise Duty	577	720	25.0
Petroleum Levy	1019	1220	20.0
TOTAL FEDERAL REVENUES	**10328**	**13240**	**28.2**
TOTAL PROVINCIAL REVENUES	**774**	**970**	**25.0**
TOTAL REVENUES	**11102**	**14210**	**28.0**
Tax Revenues as % of GDP	***10.5***	***11.7***	

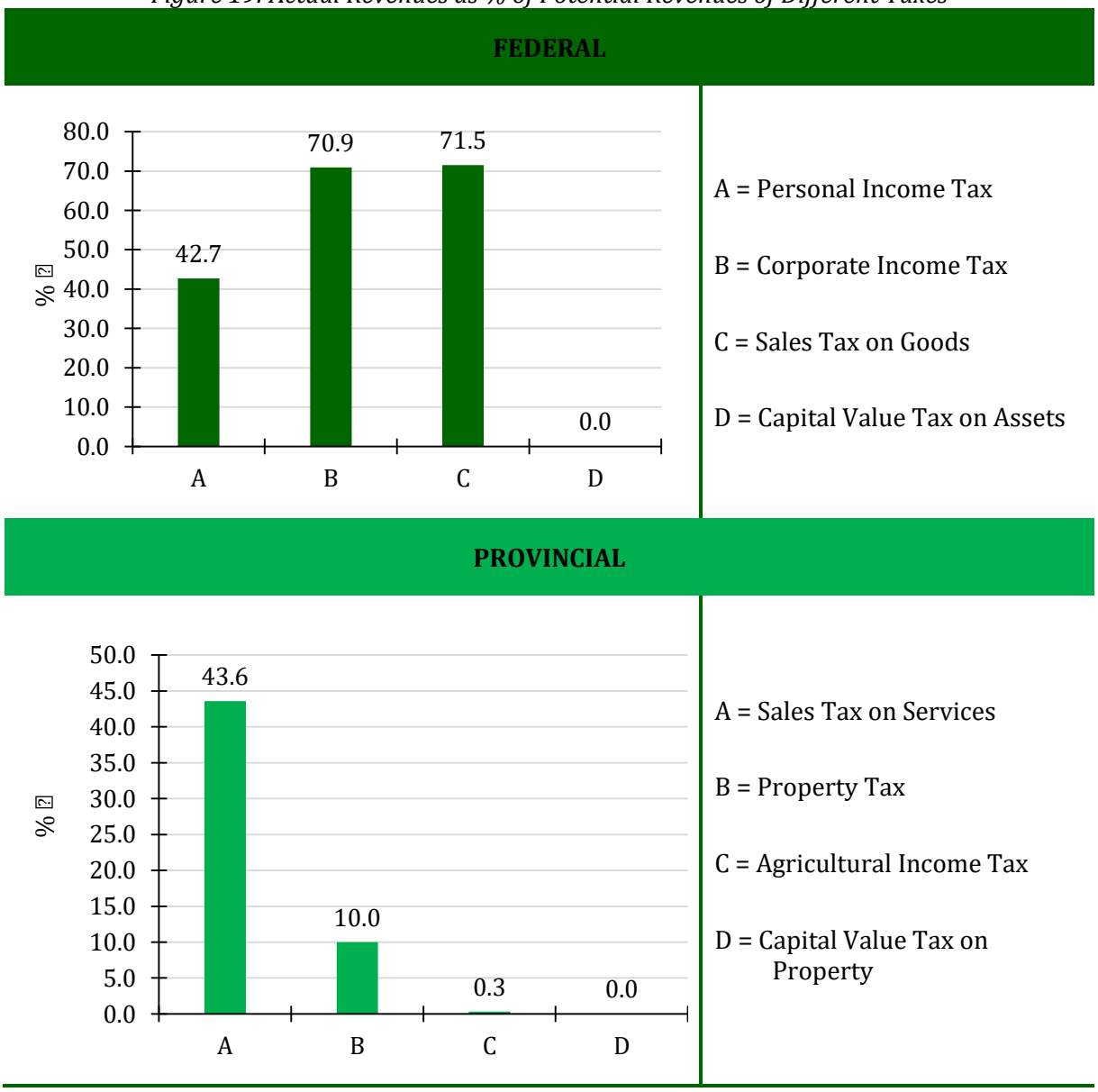
FBR revenues are expected to show fairly rapid growth of 29% in 2024-25. There will, however, still be a shortfall of upto Rs 950 billion. Provincial revenues are projected to increase by close to 25%. The actual growth in the first quarter of 2024-25 has been 21.7%.

The bottom-line is that the total tax revenues, combined of the FBR, Provincial governments and the petroleum levy, may be successful in raising the national tax-to-GDP ratio from 10.5% of the GDP by 1.2% of the GDP, leading thereby to a likely tax-to-GDP ratio in 2024-25 of 11.6% of the GDP. This will be the first year in which the tax-to-GDP ratio will exceed the earlier peak level attained in 2017-18 of 11.3% of the GDP.

THE AGENDA OF TAX REFORMS

The previous chapters have laid the grounds for presentation of a comprehensive agenda of reforms in both federal and provincial taxes. The primary conclusions are the scope for significant augmentation of the tax-to-GDP ratio and the need to make the tax system markedly more progressive. Chart 12.1 presents the actual tax revenues as a percentage of potential revenues, estimated in the earlier chapters. The overall tax gap is close to 3.7% of the GDP as of 2023-24.

Figure 19: Actual Revenues as % of Potential Revenues of Different Taxes



Section 1 presents the objectives of the reforms. Section 12.1 present the reform agenda in federal taxes and Section 12.2 on provincial taxes. Finally, in Section 12.3 an estimate is given of the revenues that will be generated from the reforms.

The Technical Annexure-1 gives the methodology used for computing the potential impact on revenues from each reform.

12.1. Objectives of the Reforms

The reforms proposed are aimed at achieving the following objectives:

- Move to a higher revenue-yielding and more buoyant tax system.
- Make the tax burden more equitable across income groups.
- Achieve a more balanced sectoral tax incidence.
- Promote investment, savings, exports, employment and more balanced regional development.
- Minimize multiplicity of taxation and focus on gradual rationalization of rates with broad-basing of revenue sources.
- Build in mechanisms, laws and institutional process to check tax evasion and corruption.
- Promote integration and cooperation between the Federal and Provincial tax systems.
- Lead to a simpler, transparent and a more friendly tax system, presently unwieldy and complex.
- Create a more modern, autonomous and functional tax administration.
- Formulate tax policy that is more evidence-based and consistent.

12.2. Reforms in Federal Taxes

Personal Income Tax

1. Merger of Unearned Income with Earned Income. Higher exemption limit and maximum rate at higher total income. Unearned income will include interest income from bank deposits, rental income from property and capital gains realized on property.

The proposed tax structure is as follows:

Taxable Income	Rate of Tax
Up to Rs 1,000,000	0%
1,000,001 to 2,000,000	5% above Rs 1,000,000
2,000,001 to 3,000,000	Rs 50,000 + 15% of the amount above Rs 2,000,000
3,000,001 to 4,000,000	Rs 200,000 + 25% of the amount above Rs 3,000,000
4,000,001 to 5,000,000	Rs, 450,000 + 30% of the amount above Rs 4,000,000
Above 5,000,000	Rs 750,000 + 35% of the amount above Rs 5,000,000

2. The same tax structure is proposed for all forms of income, that, is salaried, non-salary personal income and income of AOPs.

3. The reintroduction of the Investment Allowance to promote savings, up to 15% of taxable income. Investment exclusively in the following: medium-term or long-term National Saving Schemes.

- Behbood Certificates
- Defence Saving Certificates
- Regular Income Certificates
- Special Savings Certificates

4. Rationalization of the withholding tax regime. Reduction in small withholding/advance taxes, including, for example, the following:

Section	Description
156 B	Withdrawal from Pension Fund
233A	Stock Exchange
235B	Tax on Steel Melters, Rollers
236I	Advance Tax on Educational Institutions
236Y	Advance Tax on Persons Remitting Amounts Abroad

5. Enhancement of the Withholding Tax on Electricity bills of commercial consumers, following the failure of the Tajir Dost scheme, as shown below.

Withholding Tax on Electricity Bills of Commercial Consumers

PRESENT*		PROPOSED	
Size of Bill	**Tax Rate (%)**	**Size of Bill**	**Tax Rate (%)**
Up to Rs 500	0%	Up to Rs 2,000	0%
Rs 501 – Rs 20,000	10%	Rs 2,001 to Rs 5,000	10%
Rs 20,001 and above	Rs 1,950 + 12% of amount exceeding Rs 20,000	Rs 5,001 to Rs 20,000	15%
		Rs 20,001 and above	20%

* Under Section 235 of the ITO

6. Enhancement of the withholding tax on commercial importers, under Section 148 of the ITO, as follows:

Current Rate	Proposed Rate
3.5	5.0
5.0	7.5

7. Large annual pensions above Rs 2,500,000 to be subject to income tax at the flat rate of 10%.

8. The tax credit to NGOs should be made available only to those NGOs operating in the fields of social protection, education and health.

Corporate Income Tax

1. Introduction of progressive corporate income tax linked to the pre-tax return on equity and withdrawal of the super tax, as follows:

	Tax
▸ If Pre-Tax Return on Equity is less than 12%	29% of Profits
▸ If Pre-Tax Return on Equity is from 12% to 16%	29% on profits upto 12% of equity + 35% on profits above 12% of equity
▸ If Pre-Tax Return on Equity is from 16% to 20%	32.5% on profits upto 16% of equity and 40% on profits above 16% of equity
▸ If Pre-Tax Return on Equity 20% or above	34.0% on profits upto 20% of equity and 45% on profits above 20% of equity

2. Levy of a Federal Capital Value Tax on assets minus liabilities of a public or private company at the following rates:

(Assets – Liabilities)	Tax Rate
Up to Rs 100 million	Exempt
Rs 100 million to Rs 500 million	0.25%
Rs 500 million To Rs 2,500 million	Rs 1.250 million + 0.50% of amount Rs 500 million
Rs 2,500 million to Rs 10,000 million	Rs 11.250 million + 0.75% of amount above Rs 2,500 million
Rs 10,000 million and above	Rs 67.5 million + of amount above Rs 10,000 million

3. The credit extended by commercial banks to the socially preferred sectors including agriculture, SMEs, microfinance, small housing, and infrastructure is only 12% of total advances.

   The proposed taxation scheme is as follows:

   a) If the share is below 20%, then an additional tax of 5% will be levied on pre-tax profits.

   b) The provision for the deductibility for bad loans in these sectors will be increased to 3% of total advances.

4. *Fiscal Incentives for Investment:*

   ▸ Continuation of tax credit of 10% of the amount invested in acquisition of plant and machinery for purposes of balancing, modernization and replacement (BMR)

- Tax Holiday for new investment in industry anywhere in Pakistan of five years.

5. *Capital Gains Tax on Property*

Following the recent change in the Income Tax Ordinance the following types of properties are subject to the capital gains tax:

(i) Properties traded from 2024-25 onwards will be subject to the capital gains tax, irrespective of the length of the holding period.

(ii) Properties traded earlier than 2024-25 and then sold before the expiry of holding period of six years.

The appropriate tax base is the real capital gains and not the nominal capital gains. Based on the historical long-term trend in property values the recommended annual inflation factor is 6%. Any real capital gains can then be taxed at a flat rate of 20%.

6. *Changes in Audit Policy*

The following proposals are being tabled for the improvement in the audit system:

(i) Within the next three years, increase the percentage of returns audited to 10 percent.

(ii) Develop a risk-based audit policy. The parameters of tax evasion should be identified on the basis of research on demands raised following audit to different types of taxpayers.

(iii) A new taxpayer may be exempted from audit for the first three years, in order to promote compliance. This should apply only in the case of individual taxpayers and not companies or AOPs.

The time has also come for moving to composite audit of income and sales tax returns, under the IRS.

Federal Sales Tax

1. *Sales Tax on Import of Services*

There is a potential tax base in the import of services. Under items 24 and 27 of the Federal Legislative List the management of all imports is a federal responsibility.

The sales tax on imported services should be levied on the '*reverse charge principle*', whereby the tax payment is made by the domestic recipient of the service and charged accordingly from the foreign provider of the service.

There are a number of imported services which could be charged the sales tax on services, including the following:

- Life Insurance Services
- Reinsurance
- Financial Services
- Computer and Information Services
- Business Services

There is need to develop appropriate rules and procedures for tapping the full potential of the sales tax on import of services. Also, a 3% import duty may be levied initially on the above services.

2. *Broadening the Tax Base*

The Third Schedule of the Sales Tax Act of 1990 includes goods which are subject to sales tax payment by manufacturers on notified retail prices. This has been provided for under clause (a) of sub-section (2) of Section 3 of the Act. Currently, 17 items have been brought under the purview of this clause.

The provision has enabled the coverage of value added at the wholesale and retail stage. As such, it represents an important broad-basing of the sales tax system of Pakistan.

The proposal is to extent the taxation on the retail price to other consumer goods and consumer durables. Candidates for inclusion are the following: vegetable ghee, paints, motor cars, TV sets, air conditioners, etc.

Customs Duty

1. Escalation of Customs Duties

Given the dire need for tax revenues to make up for the large emerging shortfall in FBR revenues there is a case for escalation of customs duties in the forthcoming budget of 2025-26. As such, the proposed tariff slabs are as follows:

Present Customs Duty (%)	Proposed Customs Duty (%)
0	0
3	3
11	11
16	20
20	25

The zero, 3% and 11% tariff slabs are on basic food and other items and should remain unchanged, with a few exceptions highlighted below. The likely increase, with the above changes in the tariff slabs, is 6% in customs duty revenues on an annual basis.

2. Protection to Agriculture

There has apparently been an agreement with the IMF that Pakistan will not offer procurement or support prices on crops like wheat, cotton and sugarcane. This reinforces the need for more effective protection to farmers from imports. As such, it is recommended that the import tariffs be enhanced on wheat and cotton as shown below.

Import Tariff (%)		
	Present	Proposed
Wheat	3	11
Cotton	0	11

A change is not required on sugarcane, as the import duty on sugar is already high at 20% and in addition there is a regulatory duty. The duty drawback scheme should be allowed on cotton for textile exports.

Excise Duty

1. Excise Duty on Polluting Industries

There is need for levying and charging a relative high excise duty on industries which pollute the environment like leather tanning, chemicals or acid making, brick production, etc. This is because smog has become a very serious problem, especially in Punjab.

12.3. Reforms in Provincial Taxes

Agricultural Income Tax

One of the Structural Conditionalities that has been agreed to for implementation in the current IMF Program is as follows:

> *'Each province amends the Agricultural Income Tax Legislation and regime to fully align it with the personal income tax regime for small farmers and the federal corporate income tax regime for commercial agriculture, so that taxation can commence from January 1, 2025.*

This will represent a major structural reform and broad-basing of the tax system of Pakistan.

The full revenue potential of the Agricultural Income Tax has been estimated in Chapter 8 at Rs 880 billion.

However, there is likely to be very strong resistance initially to the drafting and passage of the amended AIR law by the large land owners, who represent the feudal elite, and have strong representation in the Provincial Assemblies. Further, even if enacted, there will be very big constraints both in assessment of tax liability and collection thereof from especially the large farmers.

There is need, of course, to see in the short run by January 1, 2025, if the AIT is appropriately amended and passed. However, the failure of the *Tajir Dost* Scheme indicates that full taxation or organized and politically powerful taxpayers is very difficult in Pakistan.

Sales Tax on Services

There is need to focus over the next few years on the process of the integration of the Provincial sales tax on services with the Federal sales tax on goods. This reform was completed by India seven years ago.

The reform envisages the following:

(i) Replacement of other domestic indirect taxes by the sales tax.

(ii) Harmonization of rates on goods and services to facilitate move to a proper VAT. Consequently, increase in the sales tax rate on services to 18%. This is likely to be progressive as the demand for services rises disproportionately with income of households.

(iii) Administration and harmonization of the sales tax with the same tax return, common IT system and common rules, with the powers to audit being shared by the federal and the provincial governments.

Urban Immoveable Property Tax

This tax must have the highest priority in the mobilization of resources by the Provincial governments as the revenues generated are shared with the urban local governments. They are used for providing basic services like water supply, sewerage, roads and slum upgrading.

The first task is for the Provincial Excise and Taxation departments to upgrade the Gross Annual Rental Values (GARVs) of residential and commercial properties in their jurisdiction. Alternatively, the GARVs can be derived from the up-to-date *Valuation of Immoveable Properties* by the FBR down to the individual locality level in the cities and towns of Pakistan.

The tax policy ought to be exemption of small properties up to 8 Marlas in size. Thereafter, the recommended formula for deriving the GARV is as follows:

GARV = 0.04 MV

where; MV of the property is its market value based on the FBR Survey.

The recommended tax rates are 15% for a rented property and 10% for an owner-occupied property.

Some examples of the GARV valuation and property tax liability are given in Table 69 below.

Table 69: Examples of Valuation of GARV

City	Locality	Market Value per Marla (000)	Size (Marlas)	Market Value (000)	Status Rented (R)/ Owner Occupied (0-0)	Property Tax (000)
1. Lahore	Allama Iqbal Town	1,407	20	28,140	0 – 0	112.6
2. Karachi	Abdullah Haroon Road	1,908	16	30,250	0 – 0	121.0
3. Abbottabad	Mansehra Road	2,855	12	34,260	0 – 0	205.6

Capital Value Tax on Property

As highlighted earlier, this fiscal power has been given to the Provincial governments following the 18th Amendment to the Constitution. However, the Provincial governments have not yet effectively levied this tax. The Punjab Government had in the Finance Act of 2006 levied this tax.

However, it was to be levied at 2% of the recorded value when a property was transferred. This is not the right concept underlying the incorporation of the tax in the Constitution. It is to be a proxy to the wealth tax which had been repealed in 2003 and, therefore, leviable every year as an asset.

The proposed structure of the tax at the Provincial level is given below:

Proposed Rates of the Annual Capital Value Tax on Property	
Property Value	**Tax Rate**

Up to Rs 5 million	0%
Rs 5 million to Rs 10 million	0.25%
Rs 10 million to Rs 25 million	0.50%
Rs 25 million to Rs 100 million	0.75%
Above Rs 100 million	1%

12.4. Overall Revenue Impact

The quantification of the revenue impact of implementation of the agenda of tax reforms is given in Table 70.

Table 70: Revenues Mobilized by Implementation of the Tax Reforms

	Estimates of Impact of Revenues* (Rs in Billion)
FEDERAL TAXES	**950**
INCOME TAX	**585**
Personal Income Tax	**235**
1. Merger of Unearned Income with Earned Income 2. Same Tax Structure for all forms of Personal Income	170
3. Reintroduction of Investment Allowance at 10% of Taxable Income	-110
4. Rationalization of the Withholding Tax Regime	-25
5. Enhancement of Withholding Tax on Commercial Consumer Electricity Bills	100
6. Enhancement of Withholding Tax on Commercial Importers	70
7. Taxation of Large Pensions	20
8. Restriction of Tax Credit to NGOs	10
Corporate Income Tax	***350***
1. Introduction of Progressive Income Tax and Higher Tax on Banks, with no Super Tax	130
2. Levy of Capital Value Tax	220
3. Minimum Credit by Banks to Socially Preferred Sectors	-50
4. Fiscal Incentives for Investment	-50
5. Capital Gains Tax on Property	-50
6. Changes in Audit Policy	150
Sales Tax	***230***
1. Sales Tax on Import of Services	150
2. Broadening of the Sales Tax Base	80
*on the tax base of 2023-24	

Table 71: Revenues Mobilized by Implementation of the Tax Reforms

	Estimates of Impact of Revenues* (Rs in Billion)
Customs Duties	***100***
1. Escalation of Customs Duties	60
2. More Tariff Protection of Agriculture	40
Excise Duty	***35***
1. Excise Duty on Polluting Industries	35
PROVINCIAL TAXES	**1445**
1. Agricultural Income Tax	880
2. Sales Tax on Services	150
3. Urban Immoveable Property Tax	220
4. Capital Value Tax on Property	195
TOTAL ADDITIONAL REVENUES	**2395**
% of GDP	2.2

*on the tax base of 2023-24

Therefore, the comprehensive agenda of tax reforms both at the federal and provincial level could generate Rs 2395 billion of additional revenues on the 2023-24 tax base, equivalent to 2.1% of the GDP.

There are special features of the increase in revenues, as follows:

(i) There is a bigger increase in provincial revenues. This reflects the present underdevelopment of provincial taxes, especially, the urban immoveable property tax and the agricultural income tax.

(ii) The provincial tax-to-GDP ratio could go up from 0.8% of the GDP to 2.2% of the GDP. The federal tax-to-GDP ratio could rise from 9.7% of the GDP to 10.6% of the GDP. Combined, the national tax-to-GDP ratio could rise from 10.5% of the GDP to 12.8% of the GDP.

(iii) Income tax on all incomes, including agricultural income could increase by Rs 14.85 billion, equivalent to 65.5% of the total increase from the reforms. This will make the tax system m of Pakistan markedly more progressive.

In conclusion, it needs to be said that the Agenda of Tax Reforms is comprehensive and progressive in character. Already, the reforms in the Budget of 2024-25 should raise the tax-to-GDP ratio from 10.5% in 2023-24 to 11.7% of the GDP.

Added on to this there will be another 2.3% of the GDP following implementation of the Agenda of Reforms. Pakistan's tax-to-GDP ratio could rise to 14% of the GDP. This will represent an overall increase of 3.5% of the GDP.

Consequently, the present 'tax gap' quantified in the earlier chapters will be largely closed by implementation of the proposed agenda of reforms.

TECHNICAL ANNEXURE

The methodology and the data used for quantification of the revenue impact of each tax reform at the federal and provincial levels is given below.

It many cases, data on the full relevant distribution of a variable is not available. Therefore, in such cases the quantification is with averages. This will tend to understate the impact of the reforms.

Federal Taxes

Personal Income Tax

1 & 2. Merger of Unearned Income with Earned Income and Same Tax Structure for all Personal Income

A comparison is made of the revenues from the existing personal income tax system and the proposed system of taxation of total income below.

Comparison of Tax Revenues in the Existing System of Personal Income Tax and the Proposed New System

Earned Income	Unearned Income	EXISTING SYSTEM			NEW SYSTEM		% Difference between [B] and [A]
		Tax on Earned Income	Tax on Unearned Income* [A]	Total	Total Income	Total Income [B]	
4,000,000	1,000,000	670,000	150,000	820,000	5,000,000	750,000	-8.5
4,000,000	2,000,000	670,000	300,000	970,000	6,000,000	1,100,000	13.4
5,000,000	1,250,000	1,015,000	187,000	1,202,500	6,250,000	1,187,500	-1.2
5,000,000	2,500,000	1,015,000	375,000	1,390,000	7,500,000	1,625,000	16.9
7,000,000	1,750,000	1,715,000	262,500	1,977,500	8,750,000	2,062,500	4.3
7,000,000	3,500,000	1,715,000	525,000	2,240,000	10,500,000	2,675,000	19.4
10,000,000	2,500,000	2,800,000	375,000	3,175,000	12,500,000	3,375,000	6.3
10,000,000	5,000,000	2,800,000	750,000	3,550,000	15,000,000	4,250,000	19.8

*Assumed at 15%

The table clearly indicates that as the share of unearned income in total income increases, the new system progressively yields more revenues. A conservative assumption is that the increase in revenues is nearly 15%.

The total personal income tax paid both on earned and unearned income is as follows in 2023-24.

	Revenue, 2023-24 (Rs in Billion)
Tax paid by Salaried Tax Payers	367.9
Tax paid by Non-Salaried Income	161.5
Tax on Bank Deposits	489.1
Tax on Rental Income from Property	42.0
Tax on Capital Gains on Property	96.0
TOTAL	**1156.5**

Therefore, the likely enhancement with the 2023-24 tax base is approximately Rs 170 billion.

3. Reintroduction of Investment Allowance

The proposed investment allowance is 10% of the taxable income.

The number of personal income tax payers in 2023-24 is reported by FBR at 4.8 million. Therefore, the average income tax paid per tax payer is Rs 110,000 Rs approximately. This implies that the taxable income was Rs 1,732,000 with a marginal tax rate of 15%. 10% investment allowance and marginal tax rate of 15% implies that the average revenue loss per tax payer will be approximately Rs 26,000.

The assumption is made that 90% of the tax payers will avail this facility. Therefore, the revenue loss is close to Rs 110 billion. However, this will lead to investment in Government Savings Schemes of almost Rs 830 billion. this should reduce interest rates on government bonds.

4. Rationalization of the Withholding Tax Regime

Most of the withholding provisions to be withdrawn have small revenue implications. Therefore, the combined revenue foregone should not be more than Rs 25 billion.

5. Enhancement of Withholding Tax on Commercial Consumer's Electricity Bills

The available information from the NEPRA State of the Industry report is that the average monthly consumption b a commercial consumer of electricity is 187.5 units. This implies a monthly bill of close to Rs 7100. Therefore, the withholding tax will be Rs 355 per month and Rs 4260 per annum per outlet on average. The revenue could approach Rs 100 billion.

6. Enhancement of the Withholding Tax on Commercial Importers

This is estimated to yield an additional Rs 70 billion.

7. Taxation of Large Pensions

Information on the size distribution of pensions is not available. The presumption is that the revenue yield will be small at Rs 20 billion, mostly from the corporate sector.

8. Restriction of Tax Credit to NGOs

Likely additional revenues of Rs 10 billion.

Corporate Income Tax

1. Progressive Corporate Income Tax

There is the proposal to introduce a progressive corporate income tax.

The estimated additional revenue from the corporate sector, with the data from the SBP, was Rs 110 billion approximately in 2023. It is projected at Rs 130 billion in 2024.

The other advantage of progressive corporate income tax is that it will reduce the tax burden on companies engaged in export like in the textiles industry where profitability is relatively low.

2. Levy of Capital Value Tax

The proposal is to levy a Capital Value Tax on the private and public limited companies assets minus liabilities at the following rates:

Net Assets – Liabilities	Tax Rate
Less than Rs 100 million	0%
Rs 100 million – Rs 500 million	0.25%
Rs 500 million – 2500 million	Rs 1.25 million plus 0.5% on amount above Rs 500 million
Rs 2500 million to Rs 12,500 million	Rs 11.25 million plus 0.75% on amount above Rs 2500 million
> Rs 12,500 million	Rs 86.25 million plus 1% on amount above Rs 12,500 million

The SBP Data base plus the statistics with SECP yield an estimated revenue of Rs 220 billion from the above Capital Value Tax.

3. Tax on Failure of Commercial Banks to give a Minimum Share of Credit to Socially Preferred Sectors

The credit extended by commercial banks to the social pretend sectors including agriculture, SMEs, microfinance, small housing, and infrastructure is only 12% of total advances.

The proposed taxation scheme is as follows:

If the share is below 20%, then an additional tax of 5% will be raised be levied on pre-tax profits.

The provision for the deductibility for bad loans in these sectors will be increased to 3% of total advances.

It is assumed that banks will attain the minimum target of 20%. There may be some fall in profitability leading to less revenues of Rs 50 billion, but it will greatly facilitate inclusive growth.

4. Capital Gains Tax on Property

The shift from taxation of nominal to real capital gains may lead to a revenue reduction of Rs 50 billion.

5. Changes in Audit Policy

This should be implemented with a target of raising additional revenues of Rs 150 billion.

Sales Tax

1. Import Duty + Sales Tax on Import of Services

An initial import duty plus a 15% sales tax will be applied on 'reverse charge' principle on the following services:

	Import ($ million), 2023-24
Insurance Services	420
Financial Services	513
Telecom, Computer and Information Services	396
Other Business Serv ices	1650
TOTAL	

The total revenue yield on the 2023-24 tax base would have been Rs 150 billion.

2. Broadening of the Sales Tax Base

The proposal is to levy the sales tax on manufacturers in particular industries not on the ex-factory price but on the retail price. The industries that could be included in this category are manufacturing products more for the higher income groups as follows:

▸ Readymade Garments	▸ Carpets	▸ Communication Apparatus
▸ Footwear	▸ Detergents	▸ Electrical Appliances
▸ Household Textiles	▸ Automobiles	▸

The potential additional sales tax revenue is Rs 80 billion.

Customs Duty

1. Escalation in Import Tariffs

IMPORT TARIFF (%)	
Present	**Proposed**
16	20
20	25

The proposed escalation in the import tariff structure is in the top two slabs as follows:

According to the WTO publication, World Tariff Profiles, of 2023 the share of imports by Pakistan with import tariffs above 15% is 9.1%, with total imports of $54.8 billion. This is equivalent to imports of $5 billion.

Consequently, the additional revenues are estimated at Rs 60 billion.

2. Protection to Agriculture

The proposed enhancement in import tariffs is as follows:

	Import Tariff (%)		Imports in 2023-24 ($ million)
	Present	Proposed	
Wheat	3	11	1100
Cotton	0	11	450

Based on the level of imports the extra revenue is likely to be close to Rs 40 billion.

Excise Duty

1. Excise Duty on Polluting Industries

The expected coverage is 5% of the manufacturing sector and electricity and gas sector. The tax base is Rs 159 billion in terms of the value of output. The 25% excise duty will fetch Rs 35 billion from a reduced output.

Provincial Taxes

Agricultural Income Tax

Chapter 8 has demonstrated on the basis of detailed calculations that the full potential of the agricultural income tax on the tax base of 2023-24 is Rs 890 billion.

Sales Tax on Services

The integration of the Provincial sales tax on services with the Federal sales tax on goods is proposed over the next three years. As such, no revenue impact is assumed in the short-run perspective.

Urban Immoveable Property Tax

The full additional revenue potential of this tax has been quantified earlier at Rs 220.

Capital Value Tax on Property

The proposed structure of the Capital Value Tax on property is as follows. It is to be levied like a wealth tax on all properties, above the exemption limit, and not just on traded or gifted properties. Both urban and rural properties will be in the tax base.

The proposed structure is as follows:

Value of Property (Rs)	Tax

Less than 10 million	Exempt
10 million – 25 million	0.25%
25 million – 100 million	0.50%
100 million – 500 million	0.75%
< 500 million	1.00%

The Population and Housing Census of 2023 gives estimation of the size distribution by number of rooms of residential property. the distribution is given below:

Number	% of Housing Units		Estimated Property Value (Rs in Billion)	Tax Rate	Rev
	% of rooms	% of value			
1	12.1	6.0			
2	24.6	24.1			
3	21.6	26.4	18,200	0.25	45
4+	29.7	43.5	30,000	0.50	150
Total Number *(Million)*	**100.0**	**100.0**			**195**

The tax base is likely to consist of properties with at least three rooms. The estimated revenue potential of the capital value tax on property is Rs 195 billion.

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