ANALYSIS OF TAX EXPENDITURES IN PAKISTAN

Muhammad Nadeem Sarwar and Shagufta Shabbar

(CGP # 05-170)

4TH RASTA CONFERENCE
Tuesday, September 03 & Wednesday, September 04, 2024
Roomy Signature Hotel, Islamabad

This document is unedited author's version submitted to RASTA.

5 August 2024

RESEARCH FOR SOCIAL TRANSFORMATION & ADVANCEMENT

Competitive Grants Programme for Policy-oriented Research

Pakistan Institute of Development Economics

ABSTRACT

Tax expenditure, a key instrument of fiscal policy, refers to revenue losses from tax preferences such as exemptions, credits, deductions, or preferential rates granted to specific sectors or groups. These measures are often intended to support social welfare or particular industries, however, these may distort market forces, leading to inefficient resource allocation and benefitting specific groups. The study estimates tax expenditures across sales tax in both goods and services, and customs duties which include other trade-related taxes such as regulatory duties as well. Utilizing Input-Output (I-O) table data and the RA-Gap model, the study finds that sales tax expenditures from imports total Rs. 872.96 billion, with an additional Rs. 2,663.71 billion from domestic goods. Customs-related tax expenditures amount to PKR 599.02 billion for 2023. Major beneficiaries include the export sector, especially textiles, food, and pharmaceuticals—along with households, embassies, and non-profits organization. Since sales tax on services is in provincial domain therefore, we studied the tax structure in Punjab and Sindh and found that though tax expenditures are not given in the sales tax on services but these tax structures have some other issues creating similar impacts. At federal level, most of the tax expenditures are introduced through Statutory Regulatory Orders (SROs) without clear objectives, leading to inefficiencies. The study recommends reducing tax expenditures and aligning the remaining ones with specific goals, enabling evaluation through cost-benefit analysis to determine their continuation or termination.

PREFACE

Taxes are one of the very important tools of fiscal policy which can be leveraged to give a boost to the economy, to any specific sector, to stabilize an overheating economy or to check the growth of any specific sector. Government sometimes gives preferential tax treatment to specific sectors, or specific groups through exemptions, tax credit, exclusion, deduction from gross income or by applying a preferential tax rate etc. to boost up these sectors or to oblige them. However, tax expenditures, an estimate of such preferential treatments, distort markets and empower the government or tax authority to oblige some people or sectors at the cost of loss of public revenue.

The present study estimates the tax expenditures in sales tax (at federal and provincial level) and custom duty, including other trade related taxes. Alongside, the present study also aims to document the tax concessions given and the sectors that enjoy its benefits along with giving recommendations on controlling tax expenditures. We intended to study tax expenditures in income tax as well, however, due to data limitations, we had to drop that.

Recent estimates show that tax expenditures are increasing continuously, reaching almost 3% of the GDP. On the other hand, increasing budget deficits despite low spending on social sectors makes a case for introducing fiscal discipline. Moreover, after the eighteenth amendment, sales tax on services and property tax fell under the domain of provincial tax authorities. Therefore, an estimate of the tax expenditures at federal and provincial level will help authorities in collecting more revenues and thus increase their spendings.

We are extremely thankful to RASTA CGP, RAC members, especially the chairman Dr Nadeem ul Haque, our mentors Dr Ather Masood and Dr Zahid Asghar for their support to this study. We are also thankful to the faculty members of the School of Economics and Social Sciences IBA Karachi, especially Dr Asma Hyder, for encouragement and guidance.

We hope that the recommendations of this study will be considered by the tax authorities to streamline the tax system in Pakistan.

TABLE OF CONTENTS

LIST OF FIGURES AND TABLES

ABBREVATIONS

CPEC	China Pakistan Economic Corridor
FBR	Federal Board of Revenue
GD	Good Declaration
IMF	International Monetary Fund
IO Table	Input-output Table
OECD	Organization for Economic Cooperation and Development
PRA	Punjab Revenue Authority
PV	Potential VAT
RA GAP	Revenue Administration Gap Analysis Program
SRB	Sindh Revenue Board
SROs	Statutory Regulatory Orders
TE	Tax Expenditures
VAT	Value Added Tax

INTRODUCTION

Fiscal policy is one of the tools available with the policymakers that can be used to give a boost to the economy, to any specific sector, to stabilize an overheating economy or to check the growth of any specific sector. Taxes are one of the very important tools of fiscal policy and often used for the purpose stated. Government sometimes gives preferential tax treatment to specific sectors, or specific groups through exemptions, tax credit, exclusion, deduction from gross income or by applying a preferential tax rate etc. to boost up these sectors or to oblige them. A loss in revenue because of any such measure is called tax expenditure and this is an alternative way of favoring some specific sectors or groups through subsidies or higher public spendings etc. Thus, tax expenditure is an alternative for the government to accomplish its policy goals centered on social welfare or returning a favor to some specific people through the tax structure.

According to economic theory, for optimal utilization of resources, it is necessary that all the economic agents or sectors of production should be treated equally so that market forces may work freely to lead to optimal resource allocation and maximize the welfare of the people in society. However, if some activities or groups receive special treatments which alter their cost of doing business, then the role of market forces in allocation of resources is limited which may lead to misallocation of resources and loss of welfare.

Tax expenditures are also a kind of distortion which adds complexity to the tax system, narrow the tax base, makes compliance more difficult, lead to decreasing the government revenues and fuel the inequalities. Moreover, since tax expenditures are not scrutinized in the same way as regular budget spendings therefore, taxpayers also have a strong perception that these special benefits are politically motivated to award certain special groups. This perception is also fueled by the fact that most of these expenditures are introduced through Statutory Regulatory Orders (SROs) which are mostly issued by government ministries, rather than tax authorities.

This perception also undermines transparency and hurts confidence in the tax system and government. A fall in revenue because of high tax expenditures may lead to increasing the tax rate which ultimately burdens already taxed people and encourages them either to move towards the 'preferred' sectors or to evade the taxes.

Pakistan has long been struggling with ballooning fiscal deficit and one of the causes of it is low revenue as reflected by low and declining tax to GDP ratio of the country. High tax expenditures, along with others, is one of the main reasons of low tax collection in Pakistan. Exemptions, preferential tax rates, and exclusions etc. are quite common in Pakistan's tax system and as a result, some industries continue to flourish without having significant productivity improvement over the time whereas some other industries and sectors remain at a disadvantage.

According to the estimates of the Federal Board of Revenue (FBR), tax expenditures during the fiscal year 2020-21 amounted to Rs. 1482.3 billion which is nearly one-third of the total tax revenues collected by the federal tax authority. 49.9% of these tax expenditures are from sales tax, 27% from income taxes and 23.1% are from customs duties. This huge amount of tax expenditures still does not take into account the preferential treatment of capital gain taxes from real estate. Most of these tax expenditures were allowed to attract investments. However, did they succeed in attracting some investments or not, is still not documented.

1.1 Objective of the Study

The present study aimed to estimate the tax expenditures at federal level considering four broad categories of taxes, income tax, sales tax, and custom duty and other trade related taxes. Alongside, the present study also aims to document the tax concessions given and the sectors that enjoy its benefits along with the purpose of the tax expenditures as stated by the government.

However, due to data limitations, we had to drop the calculation and analysis of income tax expenditures as the data of the tax returns of individuals, association of people and corporates has not been shared by federal bureau of revenue (FBR) despite our repeated requests and possible best efforts. Therefore, now the analysis is limited to sales tax expenditures, including additional sales tax expenditures, and custom duty tax expenditures which include additional custom duty and regulatory duty as well.

1.2 Significance of Study

Increasing budget deficits despite low spending on social sectors makes a case for introducing fiscal discipline. Pakistan has been struggling in increasing the tax to GDP ratio to the level of regional countries even. In this situation, an analysis of the tax expenditures might be useful to help the government increase the tax revenue without increasing the tax rate. Moreover, after the eighteenth amendment, sales tax on services and property tax fell under the domain of provincial tax authorities. Therefore, an estimate of the tax expenditures at provincial level will also help provinces to collect more revenues and thus increase their spendings. Furthermore, evidence on the effectiveness of tax expenditures will be useful for policymakers in deciding about the tax expenditures in future.

1.3 Key Findings

As per our estimates using I-O table data and RA-Gap model, the sales tax expenditures (including additional sales tax expenditures as well) calculated from the import data are Rs 872.96 billion. This includes Rs. 638.81 billion worth of sales tax expenditures and rest are the expenditures in additional sales tax at import stage. The sales tax expenditure on domestic goods is measured as Rs. 2,663.71 billion. We calculated the tax expenditures under Customs to be PKR 599.02 billion in 2023. Businesses, especially the export sector including textile, food, and pharmaceutical sectors are major beneficiaries of tax expenditures along with households, ambassies, and non-profit organizations. Most of the tax expenditures are introduced through SROs with no clear objectives and targets. Therefore, we recommend that the tax expenditures must be aligned with some objectives so that their effectiveness may be evaluated and based on the cost benefit analysis, their continuity or discontinuity may be decided.

LITERATURE REVIEW

The term "Tax expenditure" was first introduced by Surrey (1970) to support the government intervention in the economy through public spending rather than through preferential tax treatment. Bratić (2006) gives an overview of the diverse forms of tax expenditure such as reliefs, tax deductions, tax allowances, tax exceptions and special rates of taxation and the ways in which they are defined and calculated. There is no single and all-encompassing definition of tax expenditures. They cover the entire fiscal system and, hence, are channeled through different forms of taxes with the relative importance of each channel varying from country to country (Redonda, 2016). Determining whether a specific tax measure constitutes a tax expenditure requires first establishing the normal tax structure from which this measure deviates. There exists a debate regarding the methodology employed to evaluate the impact of tax expenditures, as they may induce different behavioral changes among taxpayers compared to direct spending (OECD, 2004). For our analysis and in line with the context of Pakistan we take tax expenditures defined as each item in the existing tax forms that represents a loss of revenue to the central government budget by reducing the tax base or reducing the tax due.

Tax expenditures have both positive and negative effects. Due to this it is necessary to have proper management and control of tax expenditure programmes. As well as reducing the central government budgets, they are often not part of the budgetary system, nor are their amounts controlled or audited, and they are not the subject of any contract. Overall, limited data and understanding of the nature and extent of the tax expenditure system have impeded detailed examination of these policies by academics, government agencies or various committees. There has been very limited economic evaluation to base the decisions regarding tax expenditures. Given this invisibility, the system would seem to have operated throughout the past on the basis of beneficiary induced demand. Collins & Walsh (2010) stress and provide a detail discussion that tax expenditures suffer from inherent disabilities and, if they are not appropriately controlled and measured, they lead to systemic degradation of the tax system. Galle (2012) states that the political system breeds inefficiency due to tax expenditures.

Gupta (1984) argued that tax expenditures can work provided given that more information about the tax system and tax laws to the public and creating conditions that enable fiscal policy, specially the taxation, to discourage unproductive sectors and encourage productive ones. Howard (1995) tried to test the effectiveness of tax expenditures against public spending however could not conclude something significant. Thus, more need for empirical analysis in this part was felt. Dharmapala (1999) also studied the significance of tax expenditures against subsidies and concluded that tax expenditures lower the subsidy level in various situations. However, the social welfare of the tax expenditures was higher than subsidies only under some restrictive conditions. The escalating quantity and magnitude of diverse tax expenditures pose significant challenges in their appropriate management, administration, and documentation. This challenge is particularly pronounced in countries lacking systematic recording of tax expenditures, where resulting revenue losses often go unreported, and the analysis of cost-benefit implications is hindered by the absence of accurate tax expenditure reports (Brixi & Swift, 2004).

Auerbach & Hassett (1992) suggest that the tax expenditure in the form of user cost of capital plays an important role in stimulating nonresidential fixed investment in the United States. Button (2021) and Arauzo-Carod et al. (2010), provide a useful overview of the literature, generally noting that tax incentives can have significant impact on the decisions to choose industrial locations and therefore appropriate tax expenditures can encourage investments in specific sectors. Shabbar et al. (2019) investigates that in the context of Pakistan the tax expenditures enhance the level of investment

Ahmed (2001) found that tax expenditure is considered to have a prominent deficiency in the shape of its ability to allow tax evasion and tax avoidance. Jen (2002) concluded that tax expenditures in Michigan increased over the time period and distorted the markets. Swift (2006) stressed on the importance of studying tax expenditures and developed an outline to study those. Metcalf (2008) suggested against the tax expenditures stating that these are worst as these distort the incentive system. Fuest & Riedel (2009) also concluded against the tax expenditures as it leads to increase tax evasion and tax avoidance. Ahmed & Ather (2014) studied tax expenditures in Pakistan and concluded that high tax expenditures not only cause fiscal deficit to increase but also fuel inflation in the economy.

Proponents argue that tax expenditures promote a broad array of economic, social and environmental policy goals including job creation, innovation, education, as well as reducing inequality. They also contend that these tax benefits internalize negative and positive external effects and are therefore a key instrument to correct market failures. Tax expenditures can benefit from lower administrative costs compared to spending programs where ministries would need to allocate resources to running programs in either cash or kind (Redonda, 2016). On the other hand, the critics question the effectiveness and efficiency of these instruments in reaching their stated objectives. They also argue that tax expenditures reduce public resources that are needed to reach other policy goals. Altshuler & Dietz (2008), Surrey (1970) and Thuronyi (1988) asserted that tax expenditures breed inequity and cause distortion in the marketplace. Fuest & Riedel (2009) and Kahn (1979) labelled them as hidden expenditures as they are not visible in the tax system and thus escape inspection unlike their counterpart.

Tax expenditures possess negative attributes, primarily due to their tendency to distort the neutrality of the tax system. An ideal tax system maintains neutrality by having a broad tax base devoid of tax expenditures and employing a standardized taxation framework. Consequently, adhering to tax system neutrality entails avoiding the utilization of tax expenditures (Craig et al., 2001). Additionally, it is advantageous for all stakeholders involved in the taxation system—both tax authorities and taxpayers—that taxes are collected as simply and inexpensively as possible, without excessive complexity for either party.

RESEARCH METHODOLOGY

There are three approaches to measure tax expenditures. The first approach is called the tax revenue foregone. According to this approach, tax expenditures are the difference between tax liability in absence of particular tax expenditure and tax liability in presence of that. This is the simplest way to calculate tax expenditures, however, it assumes no dynamic tax effect, no interdependence, and constant compliance and enforcement.

The second approach, called the tax revenue gain approach, provides an ex-ante estimate of the additional revenue that would take place from eliminating a given TE when behavioral responses are taken into account. This requires a good understanding of taxpayers' behavior, data on elasticities and general equilibrium-based models. However, the availability of such extensive data is a real challenge. The third approach is called the outlay equivalent method according to which the tax expenditure associated with a given provision is equal to the expenditure required if the subsidy was provided outside the tax system. However, this method does not take into account the other factors, such as taxable capacity, that determine the actual tax liability that an agent face (Brys et al., 2020).

Given the scope of our study and data limitations, we shall use tax revenue foregone approach. According to this approach, identification of benchmark rate is usually the starting point in the tax expenditure analysis. The benchmark tax is one which is applicable to all the taxpayers, and it includes the rate structure, accounting conventions, the deductibility of compulsory payments, provisions to facilitate administration and provisions related to international obligations (Kraan, 2004). The deviations from the benchmark tax are then calculated which makes up an estimate for the tax expenditure. We aim to use this methodology to achieve the first objective of the study.

For the second objective of the study, we aim to first document the purpose of the specific concession, exemption or any other kind of preferential treatment given to specific sector or group and provide the reference of relevant law or section.

DEFINITION OF TAX EXPENDITURE

Generally, tax expenditures mean the exemptions, concessions and other favorable treatments that are given to specific people, groups, sectors or industries which entitle them to pay tax at lower or zero rate as compared with the rest of the larger population, however, there is no globally agreed definition of the tax expenditures. As documented by Ahmed & Ather (2014), in Canada, tax expenditures are defined as the deviations from the benchmark tax system whereas in France, these are defined as legal or statutory measures whose implementation induces lower tax revenue for the state in comparison with the application of benchmark or norm. In United States of America (USA), tax expenditures are defined as revenue losses attributed to provisions of the federal tax laws which allow a special exclusion, exemption or deductions from gross income or which provide a special credit, a preferential rate of tax or a deferral of tax liability.

For this study, we follow the definition of the tax expenditures given by Ahmed & Ather (2014), which states that "tax expenditures are the tax revenue loss resulting from those preferential provisions of the law that provide certain taxpayers/class of taxpayers or certain sectors with concessions that are not available to other taxpayers or sectors and that results in the collection of less tax revenue than would be the case otherwise".

According to this definition, if a concession or exemption is available to all the people then the revenue loss due to it will not qualify as tax expenditure. However, if a concession, exemption, or preferential treatment is available to some specific people, sectors, businesses, sources of incomes, areas, certain goods or services etc. then the revenue foregone due to this provision will be recorded as tax expenditures.

There are three major sources of tax revenue in Pakistan: income tax, sales tax and custom duty. Income tax includes tax on income of the individuals, association of persons and corporations. Sales tax is indirect tax which is charged on different goods (by federal government) and services (by provincial governments) whereas custom duty is the tax charged on the imports.

CALCULATION OF THE TAX EXPENDITURES

After clarifying the definition of the tax expenditure to be used in this study, now we proceed with calculating the tax expenditures at federal level and provincial level. Customs duty and sales tax on goods are charged at federal level whereas sales tax on services is charged in provinces. Moreover, income tax, for both personal income as well as corporate income are also charged at federal level.

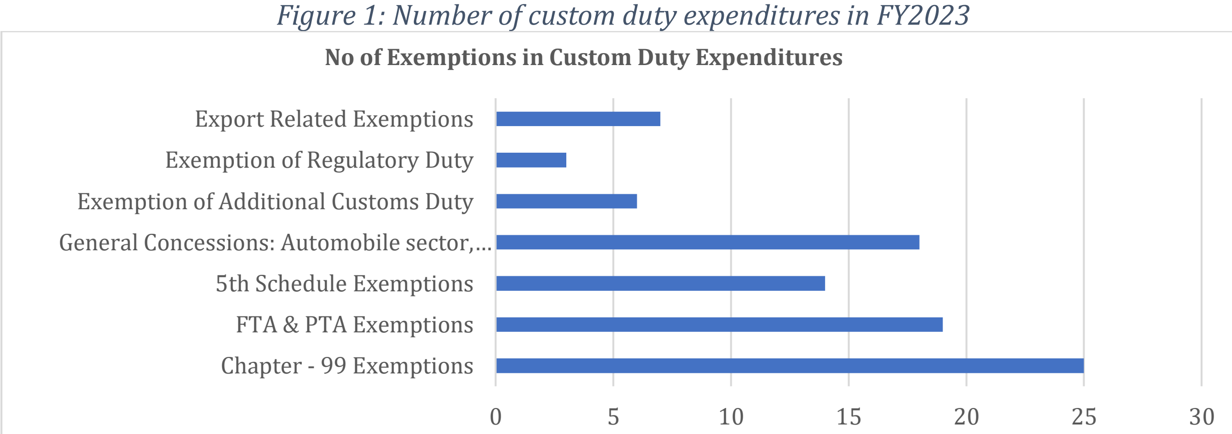
5.1 Tax Expenditures under Customs

Custom duties are one of the taxes that are levied on imports. Pakistan's current tariff structure is based on cascading principle – the raw materials are charged at lower rate whereas finished goods are charged at higher rate. Moreover, the rate difference also exists to protect local industry and if a raw material is locally available, then the tariff rate on its import is high. The exemptions, concession or special treatment in custom duty is granted through Statutory Regulatory Orders (SROs), special classification mentioned in the chapter 99 of Pakistan Customs Tariff and through specific tariff rates, mentioned in Pakistan Customs Tariff. Leveraging these provisions, tax expenditures in Customs were estimated at Rs. 521,704 million for the fiscal year 2021-22. These estimations were derived using Goods Declaration (GD) data.

Specifically, the rate difference arises because of trade agreement between two countries, like Pakistan and China have signed Free Trade Agreement, granting special concessions or exemptions to some organizations like Edhi or other organizations that are run through charity, duty exemptions on specific goods needed in emergency situations, like goods needed for relief and rehabilitation of flood effected people, and to diplomates or people associated with United Nations etc. Details of the tax expenditures under SROs, fifth schedule and Chapter 99 etc. are given in the appendix (Table 1A and 2A).

The figure 1 shows the number of custom tax expenditures that are present in FY 2023. Exemptions given by Chapter 99 are the highest, counting to twenty-five (25), followed by FTA and PTA exemptions. The total number of exemptions, or concessions given in the customs duty are ninety-two (92).

Figure 1: Number of custom duty expenditures in FY2023



Notes: Calculated by Authors based on Customs Tax Laws.

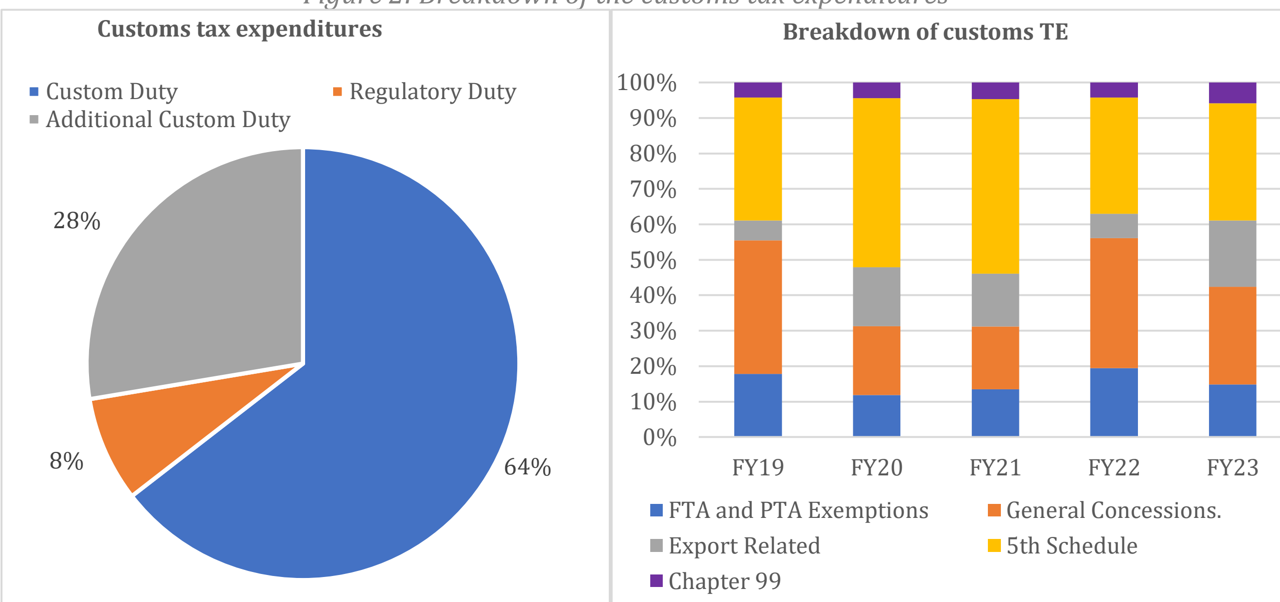
To calculate tax expenditures under customs, we utilized data from Pakistan Customs and used statutory rates as benchmarks and the difference between the tax at statutory rate and effective rate is noted as tax expenditure. The results of our calculations are given in the last column of the table below, whereas other columns report tax expenditures under customs as given in FBR tax expenditures reports.

Table 1: Tax expenditures under customs (Rs in billion)

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Tax Expenditures under Customs	253.11	287.8	342.89	521.7	599.02
Percentage of FBR Collection	6.60%	7.20%	7.20%	8.50%	8.50%
Percentage of the total Tax Expenditures	22%	21.90%	23.10%	23%	...

Sources: Authors' calculations (for FY 2023) and GOP (various issues).

Figure 2: Breakdown of the customs tax expenditures



Source: Authors' calculations.

From the calculations given in Table 1, we can see that tax expenditures given in custom duties are increasing over the years both in absolute as well as in relative terms. Further breakdown of these tax expenditures is given in the following figures.

Besides trade agreements with Sri Lanka, China, Indonesia, Malaysia, Mauritius and the agreement between SAARC countries under which the imports from these countries were exempted completely or partially from the import taxes, Pakistan also signed trade agreements with Turkiye and Uzbekistan. Under these agreements, the concession in import taxes were extended to the imports coming from these countries under SRO 502(I)/2023 (issued in April 2023) and 329(I)/2023 (issued in March 2023) respectively. However, due to challenging economic conditions, the imports were restricted through various administrative measures, therefore, the share of tax expenditure in this particular head decreased. With improving economic conditions, tax expenditures due to trade agreements are expected to increase in future.

Alongside, to improve the capacity of performing relief activities, the imports for flood relief work were also exempted through SRO 1638(I)/2022. Importers could avail themselves of this concession provided an authenticity from national or provincial disaster management authorities that these items are used for relief work. Similarly, exemption from custom duty on certain items, including mostly edible items, imported from Afghanistan through SRO 968(I)/2022. While there is no explicitly stated purpose of this, however, as these goods include coal, marble, sulphur, seeds and containers etc., therefore, the objective could be to get cheaper raw material from Afghanistan.

General concession to automobile sector, oil and gas exploration and production industries and China Pakistan Economic Corridor (CPEC) related sectors have been the part of tax expenditures since a number of years despite the fact that our automobile industry has failed to make any mark in the international market. The quality of locally available automobiles is low whereas the prices are high. Similarly, CPEC has also failed to realize the kind of prosperity propagated when it was initiated. There are many energy and infrastructure related projects that have helped Pakistan overcome the energy crisis and built a network of roads, however, on the industrialization aspect, the progress is not up to the expectation.

Considering the need for relief and rehabilitation work in the flood affected areas as well as the importance of the efforts to adopt and mitigate climate change impact, additional concessions have been extended to relief activities. With the completion of flood relief and rehabilitation work, it can be expected that the tax expenditures in this head will decrease. Other concessions, exemptions and preferential treatments have been a part of tax expenditures in customs duty in the past as well.

5.1.1 Mapping of SROs

Using various FBR Tax Expenditure reports and other sources, we checked the SROs issued in various years. As can be seen in table below most of the SROs have remained constant over the years indicating that certain segments continue to get benefits without careful consideration of the need for the exemptions. Moreover, none of the SRO has explicitly mentioned the purpose of the given tax expenditures.

Table 2: Mapping of SROs

	2019	**2020**	**2021**	**2022**	**2023**
558(I)/2004	ü	ü	ü	ü	ü
1296(I)/2005	ü	zero	ü	ü	ü
1274(I)/2006	ü	ü	ü	ü	ü
1640(I)/2019		ü	ü	ü	ü
1261(I)/2007	ü	ü	ü	ü	ü
741(I)/2013	ü	ü	ü	ü	ü
280(I)/2014	ü	ü	ü	ü	ü
894(I)/2006					zero
1151(I)/2007	ü	zero	zero	zero	zero
497(I)/2009					zero
329(I)/2023					zero
502(I)/2023					ü
268(I)/2015	ü	ü	ü	ü	ü
565(I)/2006	ü	ü	ü	ü	ü
499(I)/2013	ü	ü	ü	ü	ü
678(I)/2014	ü	ü	ü	ü	ü

107(I)/2019	ü	zero	zero	zero	zero
48(I)/2018	ü	zero	zero	zero	zero
642(I)/2016	ü	ü	zero	ü	ü
644(I)/2018	ü	ü	ü	ü	zero
40(I)/2017	ü	ü	zero	zero	zero
655(I)/2006	ü	ü	ü	ü	ü
656(I)/2006	ü	ü	ü	ü	ü
41(I)/2009	ü			ü	ü
39(I)/2017	ü				ü
533(I)/2021					zero
73(I)/2023					ü
1638(I)/2022					ü
450(I)/2001		ü	ü	ü	ü
327(I)/2008		ü	ü		ü
326(I)/2008					zero
492(I)/2009		ü	ü		ü
659(I)/2007	ü	ü	ü	zero	
30(I)/2017				zero	
235(I)/2020		ü	ü		
318(I)/2020		ü	ü		
556(I)/2020		ü	ü		
558(I)/2020		ü	ü		
559(I)/2020		zero	zero		
1251(I)/2020			ü		
450(I)/2008	ü		ü		
121(I)2014		ü			
630(I)/2018	ü				
108(I)/2019	ü				
640(I)/2018	ü				

Notes: An empty sell mean that the SRO did not appear, tick means some tax expenditures were noted under particular SRO whereas 'zero' means it was mentioned in the Tax Expenditure Report however, no tax expenditure was reported in this.
Sources: Authors' calculations and GOP (various issues).

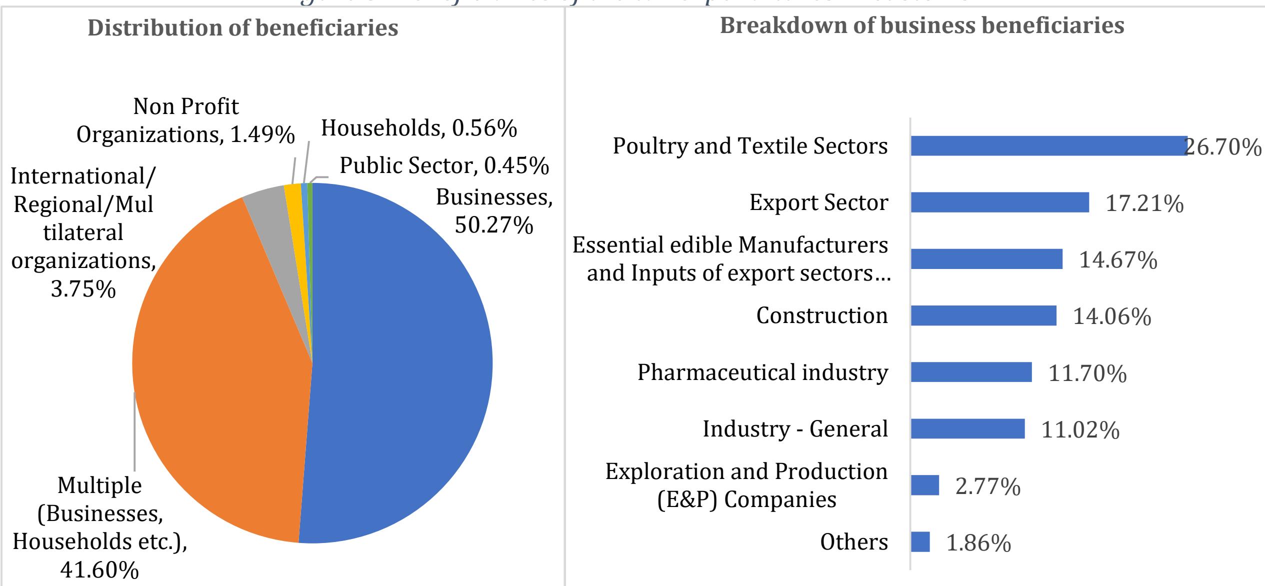
5.1.2 Beneficiaries of Customs Tax Expenditures

We used global tax expenditures data to match the kind of tax expenditures with the beneficiaries. The beneficiaries are divided into various categories such as households, businesses, international organizations, public sector, non-profit organizations and a mix category of multiple beneficiaries including persons making donations to the listed organizations, investors investing in debt or money market mutual funds and collective investment schemes, importers of old and used cars, foreign currency account holders, diplomats and diplomatic mission, manufacturing (industrial inputs), sports boards and general masses (households).

In line with the expectations, businesses, followed by the households, are the major beneficiaries of the tax expenditures. Together these two sectors are the beneficiaries of more than 90% share.

Within businesses, poultry and textile sectors, food product manufacturers, export sector, construction and pharmaceutical sectors are the major beneficiaries.

Figure 3: Beneficiaries of the tax expenditures in customs



Source: Authors' calculations.

5.2 Tax Expenditures on Sales Tax on Goods

Sales tax includes the tax collected on the supply, import or production of taxable goods and services. After 18th amendment, sales tax on services falls under the provision of the provinces. Therefore, we shall discuss the sales tax on goods here and cover the sales tax on services separately.

The sales tax paid at purchase stage (no matter if the purchased good or raw material is either locally manufactured or imported) can be adjusted as input tax against the output tax (that is, based on value added principle, called value added tax, VAT) given that the goods produced by these purchases are taxable.

The primary objective of implementing a value-added tax (VAT) system is to generate revenue consistently and effectively. Its foundation is robust, rooted in end-user consumption, which ensures a reliable stream of income that is least affected by the economic ups and downs. Moreover, VAT maintains a neutral stance, not influencing individual economic choices as it is uniformly imposed on both domestic and imported merchandise, therefore, it does not disrupt international trade patterns as well. Additionally, VAT is distinct from income taxes or corporate profit taxes, which have implications for income redistribution or corporate investment strategies. Consequently, an optimal VAT system would levy taxes equitably on all products and services, adhering to the destination-based taxation model.

5.2.1 Kind of Expenditures Allowed on Sales Tax on Goods

As per common practice in other countries, exports are zero rated, however, there are other goods which are zero rated as well. Moreover, several exemptions and concessionary rates are introduced via fifth, sixth, eighth, and ninth schedule of Sales Tax Act, 1990. A detailed discussion on all these expenditures is given below whereas a list of all these tax expenditure provisions is given in the appendix.

5.2.1.1 Zero Rating

Generally, exports are zero rated, that is, zero percent sales tax is charged on these goods whereas the sellers are allowed to claim input tax. Other than exports, the goods that government feels carry significant importance for national law and order security, food security or to carry relief operations in case of natural disasters such as floods, may also be zero rated. Other than this, goods covered under bilateral or multilateral trade agreements may also be classified as zero rated.

Section 4 of the Sales Tax Act 1990 and Fifth schedule deal with zero rated provisions. The goods under these sections include consumption goods for diplomats, raw material for exporters in the export processing zones, and Gwadar Free Zone, stationary items, art and drawing items, food items such as milk and petroleum items.

5.2.1.2 Exemptions

The sales tax on the goods covered by exemptions is also charged at zero rate, however, the sellers are not allowed to adjust for input taxes. Therefore, the contribution to tax expenditures in case of exemptions is less than zero rating case particularly in case of locally manufactured goods.

Sales tax exemptions are mentioned under section 13 of the Sales Tax Act 1990 and the Sixth schedule. Exemptions are also allowed for purposes of national law and order security, food security, tackling some natural calamity or because of trade agreements with trading partner countries.

5.2.1.3 Reduced Rates

Keeping in view national interests and the needs of the country, the Federal Government may also reduce the sales tax on selected items (it can also charge items at a higher rate but that does not make a case of tax expenditures). Section 3(2) of the Sales Tax Act 1990 provides a provision for such treatments. Therefore, the amount of sales tax foregone because of reduced rates as compared to the standard benchmark rate is classified as tax expenditure.

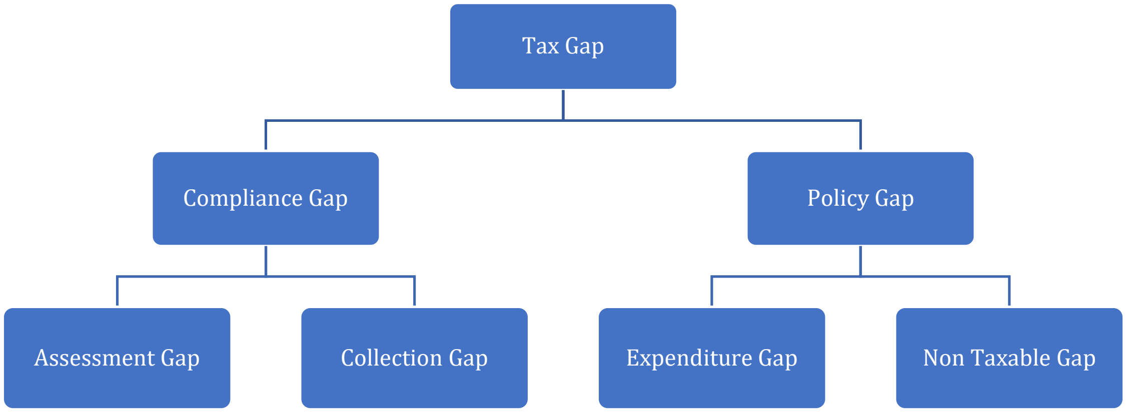
5.2.1.4 Exclusions

The Sales Tax Act 1990 under 12th schedule, provides provisions for the exclusions from the levy of 3% minimum value addition sales tax on commercial imports. Therefore, the revenue foregone because of this exclusion comes under tax expenditures.

5.2.2 Measurement Methodology

Despite many attempts, we were not able to get data from Federal Board of Revenue (FBR), hence, we could not calculate sales tax expenditures from the sales tax returns data. Therefore, for calculating sales tax expenditure on domestically produced goods and services, we opted to alternative methodology Revenue Administration Gap (RA-Gap) model developed by International Monetary Fund (IMF). This methodology is used to calculate VAT tax gap. Tax gap is the difference between potential collection that would result if all relevant activities, incomes or assets were taxed at standard rate, with all taxpayers fully compliant and the actual collection measured on a accrual basis (Hutton, 2017; Kloeden, 2014). This tax gap is further divided into categories shown in the figure below:

Figure 4: Categories of tax gap



Assessment gap refers to tax gap because of inability to make an assessment of the economic activity, collection gap is because of the non-payment of the VAT from those whose tax liabilities can assessed.

The expenditure gap arises because of the difference between current policy structure related to tax rates and the normative policy structure whereas the non-taxable gap arises because of the difference between normative policy structure and the comprehensive policy structure.

Normative policy structure is one that captures all elements of tax base which could be taxed in practice whereas the comprehensive policy structure covers all elements that are taxable in theory (Thackray, 2017).

So, we have,

PV_1 – potential VAT collection using current tax structure

PV_2 – potential or possible VAT collection using normative tax structure, and

PV_3 – possible or potential VAT collection using comprehensive tax structure.

And

Tax Gap = PV_3 – accrued VAT

Compliance Gap = PV_1 – accrued VAT

Assessment Gap = PV_1 – VAT assessed

Collection Gap = VAT Assessment – accrued VAT

Policy Gap = $PV_3 - PV_1$

Non-taxable Gap = $PV_3 - PV_2$

Expenditure Gap = $PV_2 - PV_1$

For the purpose of this study, we are concerned with the expenditure gap only.

There are two approaches, Top-Down Approach and Bottom-Up approach. We are using top-down approach in which potential tax is measured first and then actual tax is subtracted to get a measure of tax gap.

Using basic macroeconomic identity for GDP

$$Gross\ Value\ Added = Y = O - N$$
$$Y = C + I + G + X - M$$
$$C = M + (O - X) - (N + I)$$

Where, O represents output, N is for intermediate consumption, C, I, G, X and M have their usual economic meanings. The last equation of consumptions gives an estimate of potential VAT base.

So for any specific sector, s, we have potential VAT base (PVB) and potential net VAT (PV)

$$PVB_s = M_s + (O_s - X_s) - (N_s + I_s)$$

$$PV_s = \sum_c M_{s,c}.t_c + \left(OM_{s,c} - X_{s,c}\right)t_c r_s - \left(N_{s,c} - OO_{s,c} + I_{s,c}\right).t_c.\rho_{s,c}.r_s(1 - e_s).\lambda_c$$

Here

$M_{s,c}$ is imports by sector s for commodity c

$OM_{s,c}$ is market output by sector s for commodity c

$N_{s,c}$ is intermediate demand (consumption) by sector s of commodity c

$OO_{s,c}$ is output for own use by sector s for commodity c

$I_{s,c}$ is investment by sector s of commodity c

t_c is the VAT rate applied to commodity c

$\rho_{s,c}$ the proportion of input tax credit for commodity c by sector s allowed to be claimed

r_s is the proportion of output for a sector produced by a registered business

e_s is the proportion of output for a sector which is exempt output

λ_c the proportion of input for a commodity purchased by taxpayers sold by taxpayers.

5.2.3 Data

To measure sales tax expenditures using the RA-VAT Tax Gap methodology, the Supply-and-Use tables data is preferred. Alternatively, we can use input-output (IO) table data as well. For this study, we used IO tables data as complied by Asian Development Bank (ADB).

The I–O model uses a table of inter-industry transactions and a table of final demand. The rows represent sales to other industries and final demand that includes households, government, and exports (the rest of the world). The columns represent the purchases of inputs of each industry from other industries, labor and capital, and imports whereas the rows represent the sale. Thus, sales minus purchases by industry provides a detailed prediction of the VAT base. The inter-industry sales and purchases have to be adjusted for purchases and sales of exempt goods. An I–O-based VAT simulation model would consist of a parameter file that includes VAT rates, exemption shares, and share of zero-rated goods and services.

Due to their base in rich data, the I-O tables offer valuable resource for analyzing how changes in one industry ripple through the economy. When an industry receives a tax benefit, its production costs decrease, leading to increased sales to and purchases from other sectors. Compared to microsimulation models based on tax returns, they better capture the tax system's payment flow, where tax charged is offset by VAT paid on inputs. Additionally, revenue loss from an exemption depends not just on the exempted taxpayer, but also on the buyer. To accurately estimate revenue loss from exemptions, zero-rating or preferential tax rate input-output models are particularly well-suited. They estimate revenue loss by comparing the tax liability under a standard scenario to the liability without the specific tax exemption in question.

Given the comprehensive detail captured in I-O tables regarding the supply, use, and final consumption of goods and services within Pakistan's economy, I-O modeling emerges as a powerful tool for VAT analysis, especially to study potential sales tax revenue, tax gap and revenue cost of the exemptions (Ahmed & Ather, 2014; Jenkins & Kuo, 2000; Ahmed & Rider, 2013; GOP, 2022).

Latest I-O table developed by Asian Development Bank is a 35 x 35 table based on 2022 data. We updated it for FY2023 using ratios and relationships based in national accounts data, calculate potential sales tax and adjust for threshold, input tax and exempted sectors to find the tax expenditures.

For sales tax expenditures on imports, we used customs data. The standard rates of sales tax and additional sales tax are taken as benchmark and the deviation from that is calculated and reported as tax expenditures. This estimate is then subtracted from the one calculated using IO table to get tax expenditures in sales tax for domestically produced goods and services.

An important point to note is that the standard sales tax rate was changed from 17% from July 1, 2022, and was revised upward to 18% from February 14, 2023. Therefore, we used effective rate based on the weighted average of the two rates.

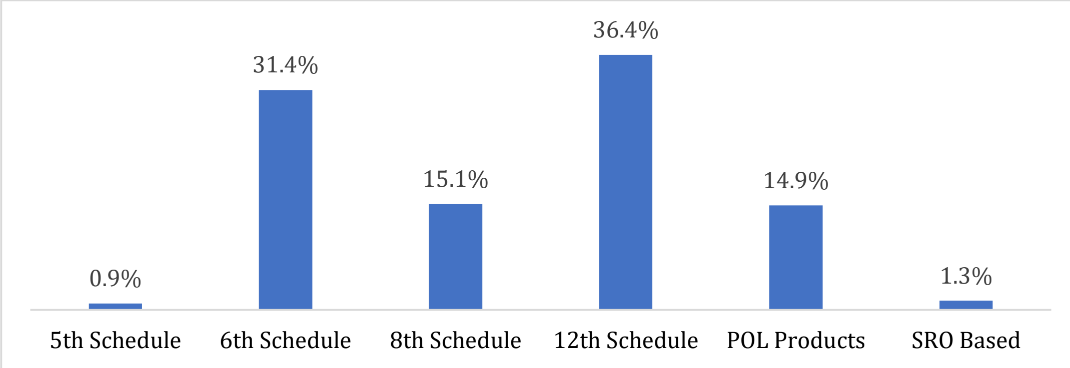
5.2.4 Results

We first report the results of sales tax expenditures on imported goods, followed by the sales tax expenditures on domestically produced goods.

5.2.4.1 Sales Tax Expenditures on Imported Goods

The sales tax expenditures (including additional sales tax expenditures as well) calculated from the import data are Rs 872,964.95 million. This includes Rs. 638,813.7 million worth of sales tax expenditures and rest are the expenditures in additional sales tax at import stage. The distribution of these expenditures under various heads is given below:

Figure 5: Distribution of sales tax expenditures on imported goods

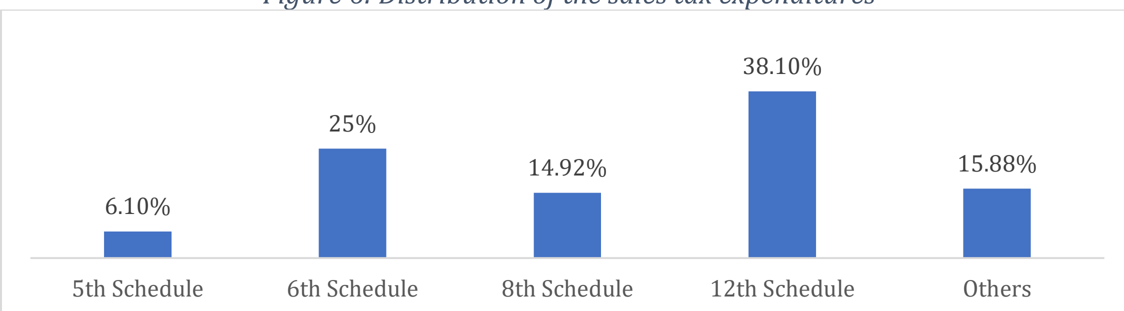


Source: Authors' calculations.

5.2.4.2 Sales Tax Expenditures on Domestic Goods

As per estimates using I-O table data and RA-Gap model, the sales tax expenditures on domestic goods is measured as Rs. 2,663,709.41 million. An important point to note is that under RA-Gap Model we assume no assessment or collection gap. The distribution of these tax expenditures is given as follows:

Figure 6: Distribution of the sales tax expenditures

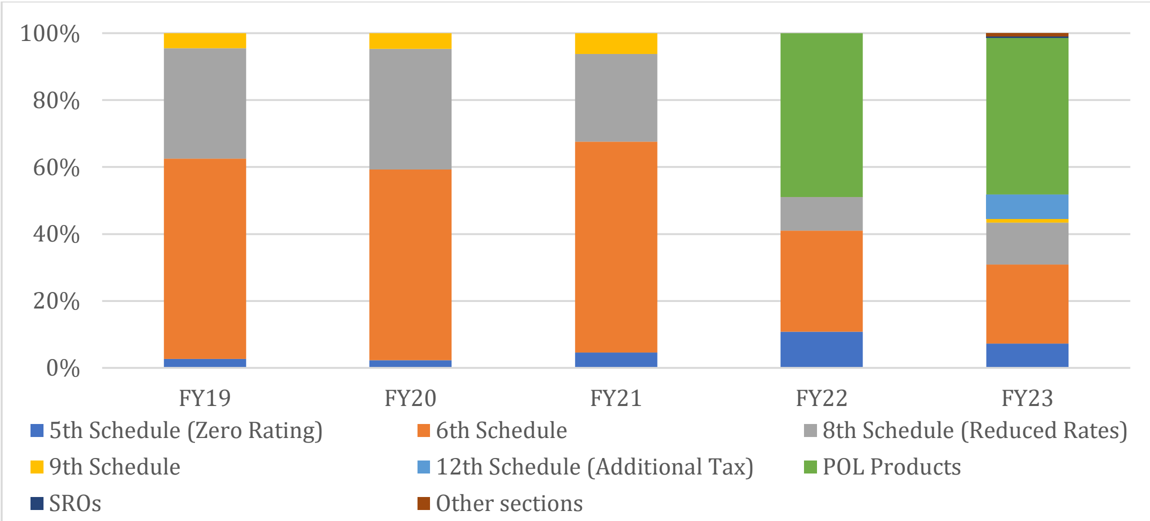


Source: Authors' calculations.

Among various sales tax expenditures heads, around 47% of the expenditures are on the petroleum products (POL), including both locally produced as well as imported. This could be because under the National Finance Commission (NFC) awards, a big chunk of the tax revenues collected by FBR is transferred to the provinces. Since sales tax on petroleum products represents a major share in the tax collection, therefore, the federal government prefers collecting revenues through other means such as petroleum development levy rather than through sales tax so that the revenues could be retained at federal level.

An overview of the share of sales tax expenditures under different heads is given below:

Figure 7: Historical overview of the sales tax expenditures



Sources: Authors' calculation and GOP (various issues).

5.3 Sales Tax Expenditures on Services at Provincial Level

After 18th amendment, the provinces are empowered with the legislative and administrative powers to decide about and collect the sales tax on services and some other taxes as well. Following this, revenue authorities have been set up in the provinces which now decide about the rate of sales taxes on various services, its base, rate, exemptions and are responsible for collecting it. Since the services sector makes up the largest share of the GDP therefore, we intended to study the tax expenditures in sales tax on services for one of the two economically big provinces, Punjab and Sindh.

The Sindh Revenue Board (SRB) was formed in 2010 whereas the Punjab Revenue Authority (PRA) was formed two years later in 2012. Both these authorities deviate from the FBR practice as then positive list, that is, only the activities described in the act will be taxed at the specified rate. Therefore, the activities that are exempted are fully exempted without any discrimination between the participants on those activities. For example, health and education services are among fully exempted services so no matter where these services are located in the respective province or being provided to whom, these are exempted. The reduced rate is however optional is some cases. Where available, the taxpayer has an option to avail it provided no input tax adjustment will be given, or (s)he may pay the tax at statutory rate and claim the input tax adjustment. Now taxpayers make at their own end, make calculations for both and choses the option which is more suitable and less costly. This can be seen in the table below which is produced from the second schedule of the Sindh Sales Tax of Services Act 2011.

Table 3: Statutory and reduced tax rate for sales tax in Sindh

Tariff Heading	Description	Statutory Rate of Tax	Effective/existing rate(s) of tax/exemption subject to T&Cs	Terms and Conditions (T&Cs)
98.12	Telecommunication Services	19.5%		
98.01	Services Provided or rendered by hotels, motels, guest houses etc.	13%		
98.02	Advertisement	13%		
98.05	Services provided or rendered by persons authorized to transact business	13%		
9805.5000	Travel Agents	13%	5%	Input tax credit/adjustment shall not be admissible
9805.5100	Tour Operators	13%	5%	Input tax credit/adjustment shall not be admissible
98.06	Services provided or rendered in the matter of sale, purchase or Hire	13%		
9806.1000	Purchase or sale or hire or immovable property	13%	10%	Input tax credit/adjustment shall not be admissible
9806.2000	Property dealers	13%	10%	Input tax credit/adjustment shall not be admissible
9806.3000	Renting of immovable property services	13%	3%	Input tax credit/adjustment shall not be admissible
9806.4000	Car or automobile dealer	13%	10%	Input tax credit/adjustment shall not be admissible
9807.000	Services by property developers or promoters	13%	a) Rs. 100/sq yard of land, and b) Rs 50/sq foot of constructed covered area	Input tax credit/adjustment shall not be admissible
9808.0000	Courier Service	13%		
9809.0000	Services provided by persons engaged in contractual execution of work or furnishing supplies	13%		
9810.0000	Personal care services	13%	10%	Input tax credit/adjustment shall not be admissible

Notes: Adapted from second schedule of the Sindh Sales Tax of Services Act 2011. This list presents the sample and is not exhaustive covering all the activities liable to tax.

The structure of the sales tax on services in Punjab is also the same (a list of the rates on specified services is given in the appendix). Therefore, following the definition of the tax expenditures used in the study, such treatments do not fall in the tax expenditures. However, this creates other kinds of problems like making tax system complex, giving advantage to specific sectors by charging low taxes or not included in the positive list, or people opt to lower tax rate which is conditioned with non-adjustment of input taxes but then claim the input tax and exploit the weakness of the system. These are the important challenges that need to be addressed; however, these are beyond the scope of this study.

5.4 Tax Expenditures in Income Tax

Income tax includes all heads of income i.e., income from salaries, business, investment (dividends, interests, rent, royalties), employment-related benefits and capital gains as taxable income.

Under the income tax law various tax expenditures exist for individual, Association of Persons (AOP) and corporate taxpayers. These include exemptions, concessions, deductible allowances, tax credits, zero rate income bracket, special provisions and certain withholding taxes. Based on authentic tax data retrieved from actual income and corporate tax filings, an estimation reveals tax exemptions totalling Rs. 423,894 million sanctioned during 2022-23. The corporate sector accounts for approximately three-quarters of this sum, while the remainder is attributed to individuals and AOPs.

The Second Schedule of the Income Tax Ordinance 2001 presents an extensive list of exemptions and tax concessions that take up almost ninety pages of the Income Tax Manual. A summary of the different incidents of tax expenditures in income tax is given in appendix.

Unfortunately, despite repeated efforts, we were not able to get data of the income tax returns from the FBR and therefore, we were not able to calculate tax expenditures for FY2023 and had to rely solely on the tax expenditures reported by the FBR. The table below gives the breakdown of the tax expenditures under income tax under different heads over the last five years.

Table 4: Tax expenditures under income tax (in Rs. millions)

Category	FY19	FY20	FY21	FY22	FY23
Exemptions under Part VII of Ch III	18,934	32,620	26,164	26,834	57,517
Deductible Allowances	36,435	37,318	10,625	14,506	5,912
Tax Credits	104,498	105,342	65,465	52,133	24,374
Exemptions from Total Income	212,070	267,115	232,852	232,398	293,460
Reduction in Tax Rates	128	124	195	24,444	25,492
Reduction in Tax Liability	2,986	2,839	3,285	4,738	4,270
Exemption from Specific Provisions	2,975	2,687	61,076	68,841	62,756
SRO Related Exemptions					3,197
Total	378,026	448,045	399,661	423,895	476,978

Source: GOP (various issues)

CONCLUSION AND POLICY RECOMMENDATIONS

Tax expenditures represent the concession in the form of reduced rates, exemptions, tax credits, and allowances etc. which add complexity to the tax system and create a class of beneficiaries who enjoy less taxes as compared to their fellow countrymen. These tax expenditures further result in reducing the tax revenue and thereby increasing the fiscal deficit. Moreover, tax expenditures also distort markets by making some of the products or income streams more attractive than others. Therefore, this study aimed to study the tax expenditures under income, customs and sales tax heads, including sales tax of services which are now in the domain of provinces. However, because of data availability issues, we were not able to study the income tax expenditures at all, and to study sales tax expenditures, we had to use the Input-Output data.

The study shows that the size of tax expenditures is significant and is increasing year by year. Over Rs 4000 billion tax expenditures only in the sales tax and custom duty are being offered. Major beneficiaries of these tax expenditures include businesses, like export sector, food, edible oil and textile etc. These expenditures are mostly introduced through SROs which itself add to the complexity of the tax system.

Keeping this in view we present the following policy recommendations:

I. Data must be made public for better research and analysis.
II. SRO based exemptions should be discouraged as they not only impact tax collection negatively but also makes the system complex.
III. The tax expenditures introduced in any form, concession, exemption, reduced rate etc., should state clearly the purpose of their introduction. This will make it possible to evaluate the given expenditure and do a cost-benefit analysis.
IV. The industries or businesses to benefit from the tax expenditures should be selected based on some productivity benchmarks with clear targets and sunset clauses.
V. The tax exemptions for the sectors that have been enjoying protectionism since years and are still lacking behind in productivity (for example automobile), must be withdrawn immediately.

REFERENCES

Ahmed, A. M., & Ather, R. (2014). *Study on tax expenditures in Pakistan* [Working paper 44]. The World Bank. https://fid4sa-repository.ub.uni-heidelberg.de/3821/

Ahmed, Q. M. (2001). A test of relative efficacy of tax expenditures and direct expenditures: A neo-classical approach. *Journal of Development Economics*, *65*(2), 477-489.

Ahmed, R. A., & Rider, M. (2013). Using microdata to estimate Pakistan's tax gap by type of tax. *Public Finance Review*, *41*(3), 334-359.

Altshuler, R., & Dietz, R. D. (2008). *Reconsidering tax expenditure estimation: challenges and reforms* (Working Paper No. 2008-04). Rutgers University, Department of Economics, New Brunswick, NJ.

Arauzo-Carod, J. M., Liviano-Solis, D., & Manjón-Antolín, M. (2010). Empirical studies in industrial location: An assessment of their methods and results. *Journal of Regional Science*, *50*(3), 685-711.

Auerbach, A. J., & Hassett, K. (1992). Tax policy and business fixed investment in the United States. *Journal of Public Economics*, *47*(2), 141-170.

Bratić, V. (2006). Tax expenditures: A theoretical review. *Financial Theory and Practice*, *30*(2), 113-127.

Brixi, H. P., & Swift, Z. L. (2004). *Tax expenditures--Shedding light on government spending through the tax system*. World Bank Publications.

Brys, B., de Mooij, R., de Melo, G., Hebous, S., Kennedy, S., Schatan, R., & Vellutini, C. (2020). *Tax expenditures and corrective taxes in Chile: A joint IMF/OECD assessment*. IMF Staff Country Reports, 2020(305).

Button, P. (2021). Can tax incentives create a local film industry? Evidence from Louisiana and New Mexico. *Journal of Urban Affairs*, *43*(5), 658-684.

Collins, M. L., & Walsh, M. (2010). *Ireland's tax expenditure system: International comparisons and a reform agenda*. Policy Institute at Trinity College Dublin.

Craig, J., Craig, J., & Allan, W. (2001, January). Fiscal transparency, tax expenditures, and budget processes: An international perspective. In *Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association* (Vol. 94, pp. 258-264). National Tax Association.

Dharmapala, D. (1999). Comparing tax expenditures and direct subsidies: The role of legislative committee structure. *Journal of Public Economics*, *72*(3), 421-454.

Fuest, C., & Riedel, N. (2009). *Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the literature*. Report prepared for the UK Department for International Development (DFID), 44, 2009.

Galle, B. (2012). The tragedy of the carrots: Economics and politics in the choice of price instruments. *Stan. L. Rev.*, *64*, 797.

GOP (Government of Pakistan). (2022). *Tax gap report 2022*. Federal Board of Revenue (FBR).

GOP (Government of Pakistan). (Various issues). *Tax expenditure reports (2020, 2021,2022, 2023, 2024)*. Federal Board of Revenue (FBR).

Gupta, A. P. (1984). Management of tax expenditures in India. *Economic and Political Weekly*, M122-M132.

Howard, C. (1995). Testing the tools approach: Tax expenditures versus direct expenditures. *Public Administration Review*, 439-447.

Hutton, M. E. (2017). *The revenue administration–gap analysis program: Model and methodology for value-added tax gap estimation*. International Monetary Fund.

Jen, K. I. (2002). Tax expenditures in Michigan: A comparison to federal findings. *Public Budgeting & Finance*, *22*(1), 31-45.

Jenkins, G. P., & Kuo, C. Y. (2000). A VAT revenue simulation model for tax reform in developing countries. *World Development*, *28*(4), 763-774.

Kahn, D. A. (1979). Accelerated depreciation--Tax expenditure or proper allowance for measuring net income. *Mich. L. Rev.*, *78*, 1.

Kloeden, D. (2014, April 21-23). *Revenue administration—Gap analysis program (RAGAP)* [Conference paper]. 5th IMF-Japan High-Level Tax Conference for Asian Countries. https://www.imf.org/external/np/seminars/eng/2014/asiatax/pdf/Kloeden%20(3).pdf

Kraan, D. J. (2004). Off-budget and tax expenditures. *OECD Journal on Budgeting*, *4*(1), 121-142.

Metcalf, G. E. (2008). Using tax expenditures to achieve energy policy goals. *American Economic Review*, *98*(2), 90-94.

OECD (Organisation for Economic Co-operation and Development) (2004). Best practice guidelines – Off budget and tax expenditures. Paris: OECD.

Redonda, A. (2016). *Tax expenditures and sustainability. An overview* [Discussion Note 2016/3]. Council on Economic Policies.

Shabbar, S., Ahmed, Q. M., & Pasha, F. (2019). An evaluation of tax expenditures and direct expenditures: case study of Pakistan. *Global Business & Economics Anthology*, *1*.

Surrey, S. S. (1970). Federal income tax reform: the varied approaches necessary to replace tax expenditures with direct governmental assistance. *Harv. L. Rev.*, *84*, 352.

Swift, Z. L. (2006). *Managing the effects of tax expenditures on the national budget*. World Bank Policy Research Working Paper, (3927).

Thackray, M. M. (2017). *The Revenue administration–gap analysis program: An analytical framework for excise duty gap estimation*. International Monetary Fund.

Thuronyi, V. (1988). Tax expenditures: A reassessment. *Duke LJ*, 1155.

APPENDIX

Table 5: Tax expenditures for customs through SROs

Sr. No.	SRO	Description	Issue Date
1	502(I)/2023	Pakistan - Turkiye Trade in Goods Agreement	Apr 20, 2023
2	329(I)/2023	Pakistan-Uzbekistan Preferential Trade Agreement (PTA)	Mar 10, 2023
3	73(I)/2023	Exemption of Custom Duty on Import of Donation Consignments and Relief Items	Jan 25, 2023
	1638(I)/2022	Exemption of Custom Duty on Import of goods for flood relief activities	Aug 30, 2022
4	968(I)/2022	Exemption of Customs Duty on import of certain goods imported from Afghanistan	Jun 30, 2022
	967(I)/2022	Import of certain items at lower rate	Jun 30, 2022
	966(I)/2022	Change in Custom duty, regulatory duty and additional custom duty on certain items	Jun 30, 2022
	545(I)/2022		Apr 22,2022
5	488(I)/2022	Uninterrupted Supply of Oxygen Gas in the Country for Medical Purposes	Apr 05, 2022
6	322(I)/2022	Amendment in SRO 840(I)/2021 dated 30.06.2021	Mar 01, 2022
7	1640(I)/2019	China Pakistan FTA	Dec 31, 2019
8	40(I)/2017	Customs Duties exemption for Orange Line Project	Jan 25, 2017
9	642(I)/2016	Exemption of customs duty on import of equipment and construction machinery, if not manufactured locally, imported by M/s China State Construction Engineering Corporation Ltd., (M/s CSCECL) for the construction of Karachi – Peshawar Motorway (Sukkur-Multan Section) and M/s China Communication Construction Company (M/s CCCC) for construction of Karakorum Highway (KKH) Phase-II (Thakot – Havelian Section) vide SRO 642(I)/2016, dated 27th July, 2016.	Jul 27, 2016
10	268(I)/2015	Exemption of Customs duty on import of coal mining equipment and machinery including vehicles for site use.	Apr 02, 2015
11	280(I)/2014	Pakistan - Sri Lanka Free Trade Agreement (FTA)	Apr 08, 2014
	121(I)/2014		Feb. 24, 2014
12	741(I)/2013	Import into Pakistan from Indonesia of the specified goods.	Sep 06, 2013
	499 (I)/2013	Import of Hybrid Electric Cars	Jun 12, 2013
	39(I)/2017	Exemption from Customs duty on import of goods	Jan 23, 2013
13	277(I)/2010	Duty free import of new car of engine capacity not exceeding 1350cc by a Pakistani disable national.	Apr 27, 2010
	492(I)/2009	Exemption of Customs Duty and Sales tax on temporary imports for exports	Jun 13, 2009
14	497(I)/2009	Exemption of Customs duties beyond specified rates on items of No concession list imported from China.	Jun 13, 2009
15	41(I)/2009	Incentive Package for special industrial Zones/Economics	Jan 19, 2009
16	42(I)/2009	Incentive Package for the development of Pak-China Investment Zones	Jan 19, 2009

17	1261(I)/2007	Free Trade Agreement with Malaysia	Dec 31, 2007
18	1151(I)/2007	Preferential Trade Agreement between Pakistan and Mauritius	Nov 26, 2007
19	395(I)/2007	Exemption from customs duty on import of vehicles by war-disabled defense force personnel or by civil disabled personnel	May 14, 2007
20	327(I)/2007	The materials and equipments, not manufactured locally, if imported for Construction and Operation of Gwadar Port and development of Free Zone for Gwadar Port and Ship Bunker Oils bought and sold to th	Apr 18, 2007
21	316(I)/2007	Exemption on customs duty and sales tax on import of Plant and machinery for development of special industrial and economic zones	Apr 12, 2007
22	1274(I)/2006	Exemption of Customs duty on import of goods into Pakistan from SAARC countries under SAFTA agreement	Dec 29, 2006
23	894(I)/2006	Exemption from customs duty on import from Iran under Pak-Iran PTA.	Aug 31, 2006
24	655(I)/2006	Exemption of customs duty for vendors of Automotive sector.	Jun 22, 2006
25	656(I)/2006	Exemption of customs duty for OEMs of Automotive sector.	Jun 22, 2006
26	577(I)/2006	Exemption of duty and taxes on vehicles' imported by diplomatic representatives / mission at the stage of the disposal	Jun 05, 2006
27	565(I)/2006	Exemption from customs duty on import of raw materials, sub-components, components, sub-assemblies and assemblies, for manufacture of specified goods (Survey based).	Jun 05, 2006
28	576(I)/2006	Exemption of duty and taxes on vehicle imported by privileged person /organization / office at the stage of their disposal.	Jun 05, 2006
29	1298(I)/2005	Exemption from duty under PAK Malaysia early harvest programme (EHP)	Dec 31, 2005
30	1296(I)/2005	Exemption from duty under PAK-CHINA early harvest programme (EHP).	Dec 31, 2005
31	678(I)/2004	Exemption from customs duty and sales tax to Exploration and production (E&P) companies on import of machinery, equipment, specialized vehicles/vessels and helicopter etc.	Aug 07, 2004
32	558(I)/2004	Exemption from customs duty on goods imported from SAARC and Eco Countries.	Jul 01, 2004
33	450(I)/2001	Customs Rules, 2001.	Jun 18, 2001

The list of special classification provisions in chapter 99 of Pakistan Customs Tariff is given below:

Table 6: Tax expenditures for customs given in Pakistan customs tariff

Sr. No.	PTC Code	Description
1	9901	Imports by Various Agencies of UN
2	9902	Imports by Diplomats
3	9903	Imports by privileged persons/organizations
4	9904	Vehicles in CKD condition
5	9905	Imports by Dignitaries of UAE, Qatar, Bahrain and Kingdon of Saudi Arabia
6	9906	Goods imported under President/Prime Minister and Ministers' salary
7	9907	Imports under Afghan Refugees funds
8	9908	Gifts/Donations
9	9909	Articles, value of which does not exceed Rs.30,000/- per parcel,
10	9910	Samples of no commercial value
11	9911	Relief goods donated for free distribution among the victims of natural disaster or other catastrophe
12	9912	Imports by Edhi Foundation
13	9913	Gifts or donations received by a charitable non-profit making hospital or institution
14	9914	Imports by Charitable Institutions and Hospitals
15	9915	Goods imported by or donated to non -profit making educational and research institutions
16	9916	Goods supplied free of cost as replacement of identical goods previously imported
17	9917	Goods imported into and exported from the Export Processing Zones
18	9918	Re-imported machinery, equipment, apparatus, appliances, components, sub-components, Supported Palladium Catalyst and parts
19	9919	Goods imported temporarily for a period not exceeding 6 months
20	9920	Temporary Imports
21	9921	Container for transportation of cargo
22	9922	Ship spares, stores and equipment imported for use in ships
23	9923	Currency Notes, unused stamps
24	9924	Eye cornea
25	9925	Artificial kidneys, hemodialysis machines, hemodialyzers, etc.
26	9926	Machinery for fishing
27	9927	Pharmaceutical raw materials
28	9929	Gold and Stones
29	9930	Goods imported by Federal/Provincial/ Local Government Departments, Municipal bodies and Development authorities
30	9931	Ground handling equipment, service, and operation vehicles, etc. by Civil Aviation Authority
31	9932	Medical herbs
32	9937	Items related to disabled persons

33	9938	Disposables for Cardiology/cardiac surgery, Neurovascular, Electrophysiology, Endosurgery, Endoscopy, Oncology, Urology, Gynecology
34	9939	Diagnostic kits for HIV, Hepatitis. Cancer and Corona Virus
35	9940	Re-import of the Contingent Owned Equipment (COE) of the Mission deployed abroad
36	9941	goods imported by or donated to municipal authorities
37	9942	Imports by federal or provincial govt

Table 7: Tax expenditures in sales tax based on Fifth and Sixth Schedule

Schedule	Schedule Serial #	Description
Fifth Schedule	2	Supply to Diplomats etc.
Fifth Schedule	5	Supplies of Raw Material to Manufacturers in EPZs
Fifth Schedule	7	Supplies to Exports under Duty and Tax Remission Rules, 2001
Fifth Schedule	8	Imports or supplies made to Gawadar Special Economic Zone
Fifth Schedule	8A	Imports or supplies made by, for or to a qualified investment as specified at Serial No.1 of the First Schedule to the Foreign Investment (Promotion and Protection) Act, 2022
Fifth Schedule	12	Specific goods and their raw materials for local manufacturing (list given in the schedule)
Fifth Schedule	13	Supplies of raw materials etc. for goods manufacturing in the Gwadar Free Zone and export
Fifth Schedule	14	Supplies of locally manufactured plant and machinery of the given specifications, to manufacturers in the Gwadar Free Zone (specification is given in the schedule)
Fifth Schedule	15	Milk (PCT 04.01)
Fifth Schedule	17	Fat filled milk (PCT 1901.9090)
Fifth Schedule	20	Petroleum Crude Oil (PCT heading 2709.0000)
Fifth Schedule	21	Local supplies of raw materials and plant and machinery etc. to registered exporters authorized under Export Facilitation Scheme, 2021
Sixth Schedule (Table 1)	13	Edible Vegetables imported from Afghanistan
Sixth Schedule (Table 1)	14	Pulses
Sixth Schedule (Table 1)	15	Fruit imported from Afghanistan excluding apples (PCT 0808.1000)
Sixth Schedule (Table 1)	16	Red chillies excluding those sold under brand names and trademarks
Sixth Schedule (Table 1)	17	Ginger excluding those sold under brand names and trademarks
Sixth Schedule (Table 1)	18	Turmeric excluding those sold under brand names and trademarks
Sixth Schedule (Table 1)	19	Rice, wheat, wheat and meslin flour
Sixth Schedule (Table 1)	31	Holy Quran, Recording of Quranic Verses and other Holy books
Sixth Schedule (Table 1)	32	Newsprint and books
Sixth Schedule (Table 1)	33	Currency notes, bank notes, shares, stocks and bonds
Sixth Schedule (Table 1)	38	Monetary gold.
Sixth Schedule (Table 1)	45	Dextrose and saline infusion giving sets
Sixth Schedule (Table 1)	47	Import of articles of household and personal effects by UAE dignitaries
Sixth Schedule (Table 1)	48	Goods imported or supplied under grants-in-aid
Sixth Schedule (Table 1)	59	Artificial kidneys, eye cornea, hemodialysis machines and other medical equipment
Sixth Schedule (Table 1)	86	Colors in sets (Poster colors)
Sixth Schedule (Table 1)	87	Writing, drawing and making inks
Sixth Schedule (Table 1)	88	Erasers
Sixth Schedule (Table 1)	89	Exercise books
Sixth Schedule (Table 1)	90	Pencil sharpeners
Sixth Schedule (Table 1)	94	Wheelchairs
Sixth Schedule (Table 1)	96	Other drawing, marking out or mathematical calculating instruments
Sixth Schedule (Table 1)	97	Pens, ball pens, markers etc.
Sixth Schedule (Table 1)	98	Pencils including color pencils
Sixth Schedule (Table 1)	100	Construction materials to Gwadar EPZ's investors and to EPZ

Sixth Schedule (Table 1)	100(A)	Materials and equipment for construction and operation of Gwadar Port and development of Free Zone for Gwadar Port
Sixth Schedule (Table 1)	100(B)	Supplies made by the businesses to be established in the Gwadar Free Zone
Sixth Schedule (Table 1)	100(C)	Vehicles imported by China Overseas Ports Holding Company Limited (COPHCL) and its operating companies
Sixth Schedule (Table 1)	100(D)	Machinery, equipment, materials and goods imported either for exclusive use within the limits of Gwadar Free Zone, or for making exports therefrom
Sixth Schedule (Table 1)	107	Import and supply of iodized salt bearing brand names and trademarks
Sixth Schedule (Table 1)	112	cardiology/cardiac surgery related medial equipment (list given in the schedule)
Sixth Schedule (Table 1)	120	Diagnostic kits (Medical equipment)
Sixth Schedule (Table 1)	121	Blood Bag and its mertial
Sixth Schedule (Table 1)	122	Urine drainage bags
Sixth Schedule (Table 1)	133	Pesticides and their active ingredients
Sixth Schedule (Table 1)	137	Paper weighing 60 g/m2, art paper, printing paper and art card for printing of Holy Quran
Sixth Schedule (Table 1)	143	Hearing aids etc.
Sixth Schedule (Table 1)	144	LNG imported by fertilizer manufacturers
Sixth Schedule (Table 1)	145	Plant, machinery, equipment and special purpose motor vehicles imported by M/s China State Construction Engineering Corporation Limited (M/s CSCECL) for the construction of Motorways
Sixth Schedule (Table 1)	147	Goods supplied to German Development Agency
Sixth Schedule (Table 1)	148	Imported construction materials and goods imported by M/s China State Construction Engineering Corporation Limited (M/s CSCECL)
Sixth Schedule (Table 1)	151	Supplies; and imports of plant, machinery, equipment for installation in tribal areas and industries located there.
Sixth Schedule (Table 1)	152	Supplies of electricity, as made from the day of assent to the Constitution to all residential and commercial consumers in tribal areas
Sixth Schedule (Table 1)	154	Dietetic foods
Sixth Schedule (Table 1)	156	Import of CKD kits by local manufacturers
Sixth Schedule (Table 1)	157	Import of CKD (in kit form)
Sixth Schedule (Table 1)	161	Import of plant, machinery, equipment and raw materials for consumption of these items within Special Technology Zone
Sixth Schedule (Table 1)	162	Import of raw materials, components, parts and plant and machinery by registered persons authorized under Export Facilitation Scheme
Sixth Schedule (Table 1)	163	Goods imported by various agencies of the United Nations, diplomats, diplomatic missions, privileged persons and privileged organizations
Sixth Schedule (Table 1)	164	Photovoltaic cells
Sixth Schedule (Table 1)	165	Goods imported by or donated to hospitals run by the non-profit making institutions
Sixth Schedule (Table 1)	166	Goods excluding electricity and natural gas supplied to hospitals run by the charitable hospitals
Sixth Schedule (Table 1)	167	Goods temporarily imported into Pakistan, meant for subsequent exportation charged to zero-rate
Sixth Schedule (Table 1)	168	Fertilizers excluding DAP
Sixth Schedule (Table 1)	169	Oil cake and other solid residues
Sixth Schedule (Table 1)	170	Tractor

Sixth Schedule (Table 1)	171	Seed for Sowing
Sixth Schedule (Table 1)	172	Machinery, equipment and materials imported either for exclusive use within the limits of EPZ or for making exports therefrom
Sixth Schedule (Table 1)	173	Goods produced or manufactured in and exported from Pakistan subsequently imported
Sixth Schedule (Table 1)	174	Machinery and equipment as listed at serial number 32 of the Table of Part-I of Fifth Schedule to the Customs Act, 1969.
Sixth Schedule (Table 2)	6	Supply of fixed assets against which input tax adjustment is not available
Sixth Schedule (Table 2)	7	Sheer mal and Bun etc.
Sixth Schedule (Table 2)	8	Foodstuff cooked or prepared in-house and served in messes
Sixth Schedule (Table 2)	10	Agricultural produce of Pakistan
Sixth Schedule (Table 2)	21	Poultry feed, cattle feed etc.
Sixth Schedule (Table 2)	26	Supply of locally produced silos
Sixth Schedule (Table 2)	27	Wheat Bran
Sixth Schedule (Table 2)	28	Sugar Beet
Sixth Schedule (Table 2)	29	Fruit juices
Sixth Schedule (Table 2)	30	Milk and cream
Sixth Schedule (Table 2)	31	Flavored Milk
Sixth Schedule (Table 2)	32	Yogurt excluding that sold under a brand name
Sixth Schedule (Table 2)	34	Butter excluding that sold under a brand name
Sixth Schedule (Table 2)	35	Desi ghee excluding that sold under a brand name
Sixth Schedule (Table 2)	36	Cheese excluding that sold under a brand name
Sixth Schedule (Table 2)	37	Processed Cheese
Sixth Schedule (Table 2)	38	Meat products
Sixth Schedule (Table 2)	40	Live Animals and live poultry
Sixth Schedule (Table 2)	41	Meat of bovine animals
Sixth Schedule (Table 2)	42	Fish and crustaceans
Sixth Schedule (Table 2)	43	Live plants
Sixth Schedule (Table 2)	44	Cereals other than rice, wheat, wheat and meslin flour
Sixth Schedule (Table 2)	45	Edible vegetables
Sixth Schedule (Table 2)	46	Edible Fruits
Sixth Schedule (Table 2)	47	Sugar cane
Sixth Schedule (Table 2)	48	Eggs
Sixth Schedule (Table 2)	49	Compost
Sixth Schedule (Table 2)	50	Locally manufactured laptops and computers
Sixth Schedule (Table 2)	51	Newspapers
Sixth Schedule (Table 2)	52	Raw hides and Skins
Sixth Schedule (Table 2)	53	Prepared food or foodstuff supplied by Restaurants and caterers
Sixth Schedule (Table 2)	54	All types of breads, nans and chapattis
Sixth Schedule (Table 2)	55	Single cylinder agriculture diesel engines

Table 8: Tax expenditures in sales tax under 8th Schedule

Sr No in the schedule	Description	Rate
23	Second hand and worn clothing or footwear	5%
43	Natural gas	5%
44	Phosphoric acid	5%
47	Locally produced coal	Rs. 700 per metric tonne or 18% ad valorem, whichever is higher
53	cinematographic equipment	5%
56	Potassium Chlorate (KCLO3)	18% alongwith rupees 60 per kilogram
57	Rock phosphate	10%
66	Supplies as made from retail outlets as are integrated with Board's computerized system for real-time reporting of sales	15%
70	locally manufactured electric vehicles	1%
71	locally manufactured or assembled electric vehicles (4 wheelers)	1%
72	Motorcars	12.5%
73	Locally manufactured Hybrid electric vehicle	8.5%
74	Goods supplied from tax-exempt areas of erstwhile FATA/PATA to the taxable areas	16%
77	Personal computers and laptops etc.	5%
78	Supply of locally manufactured articles of jewellery, stones	3%
79	Electric vehicle in CBU condition of 50 kwh battery	12.5%
80	EV transport buses of 25 seats or more in CBU condition	1%
81	Substances registered as drugs	1%
82	Raw materials for the basic manufacture of pharmaceutical	1%
83	DAP	5%

Table 9: Tax expenditures in sales tax under 9th Schedule

Serial No in Schedule	Description	Rate
1 (Table 1)	Subscriber Identification Module (SIM) Cards	Rs. 250
1(Table 2)	Cellular mobile phones or satellite phones	Various rates as per price are given in the schedule

Table 10: Sales tax on services in Punjab

Tariff Heading	Description	Rate of Tax with T&Cs, if any
9801.1000	Hotels, motels and guest houses.	5% without input tax adjustment for non-corporate, non-franchise, non-chain businesses with less than 20 rooms.
9801.3000	Marriage halls and lawns including pandal and shamiana services	5% without input tax adjustment
9801.4000	Clubs including race clubs and their membership services	16%
9801.5000	Catering services	5% without input tax adjustment
9802.1000, 9802.2000	Advertisement on television and radio or advertisement services	16%
9805.4000, 9805.8000, 9805.2000	Services provided by persons authorized to transact business on behalf of others– (a) customs agents; (b) ship chandlers; and (c) stevedores.	16%
9808.0000, 9804.9000	Courier services	16%
9802.5000	Advertisement on a cable television.	16%
9857.0000, 9858.0000	Telecommunication services	19%
98.13	Services provided in respect of insurance to a policy holder	0% Input tax credit/adjustment shall not be admissible
98.13	Services provided by banking and nonbanking financial institutions.	16%
9819.1000	Services provided by the stockbrokers	16%
9805.1000	Services provided by shipping agents	16%

Notes: Adapted from second schedule of the Punjab Sales Tax of Services Act 2012. This list presents the sample.