

An Equitable Tax System For a Educated, Healthier & Prosperous Pakistan



TAX JUSTICE COALITION
PAKISTAN



EQUITY IN TAX LAWS

Pakistan needs equity-based tax system and a rational revenue mobilisation strategy. The best thing in the forthcoming budget for fiscal year 2014-15 would be to devise and implement equity in tax laws that alone could ensure rapid growth and investment. It should be the top most priority—taxes will automatically increase with higher growth but collecting taxes not due in an ailing economy is not only counterproductive but can lead to further deterioration. Presently, the incidence of taxes is more on the poor and less on the rich. The culture of exemptions, concessions, waivers, amnesties, immunities, tax-free perks and benefits should be abolished—it creates inequity and non-compliance. Waiver of taxes or reduction in rates through issuance of statutory regulatory orders (SROs) is against Article 77 and 162 of the Constitution and this practice needs to be stopped as held by the Supreme Court in in Engineer Iqbal Zafar Jhagra and Senator Rukhsana Zuberi v Federation of Pakistan and Others (2013) 108 TAX 1 (S.C. Pak) [Page 18, Para 20]. In order to conform to Article 3 and 25 of the Constitution of Pakistan, the following measures are suggested to achieve vertical and horizontal equity in all tax laws, administered both at federal and provincial levels:

- The equitable tax system have simple equation that the distribution of taxes should be on “progressive” basis with regard to income and consequently, individuals having higher income should pay proportionally more taxes whereas the poorest households pay little or

no tax. The taxpayers with the same income or tax base should pay equal taxes. Thus in income tax laws all provisions relating to presumptive and minimum tax regimes should be reviewed.

- There should be judicious balance between direct and indirect taxes. The main reliance on regressive taxes (presently about 70% of total collection) is taking larger share of meagre income of the poor and meagre share of large income of the rich. The existing ratio between direct and indirect taxes needs to be reversed.
- Consensus may be forged amongst all provinces and federation for a common method of taxing agricultural and non-agricultural income in the most equitable and efficient manner. The poor collection of agricultural income tax at the provincial level is a significant tax equity issue of Pakistan tax policy. Provincial laws on Agricultural Income Tax are required to be amended (by the respective Assemblies) to remove the anomaly in the tax rates.
- There is need to review the local and provincial laws relating to transfer of immovable properties so as to provide for payment of transfer-related taxes on the basis of fair valuation of the properties at the time of sale and not on the declared value. Also, the Income tax authorities should scrutinize the transactions relating to immovable properties to identify those who are in the business of selling such properties and escaping tax on

such gains under the garb of income tax exemption. These transactions should be taxed as business income as envisaged in law as “adventure in the nature of business”.

- Immunity available on remittances should be only for those who can prove the purpose and relationship with the remitter as it is being misused for tax evasion.
- Equitable taxation of all economic sectors—some sectors e.g. agriculture, wholesalers, distributors and retailers, real estate, stock exchanges, are not contributing towards the tax revenue in proportion to their share in economy. There is a need to make necessary corrections in the tax system to have equitable distribution of tax incidence on all sectors of the economy rather than a concentration on some selective sectors as the same results in achievement of horizontal equity. It should not, therefore, be surprising that according to 2013 estimates, the overall tax gap for Pakistan was more than PKR 800 billion.
- The taxation of all economic sectors on equitable basis would automatically remove the present distortions in the tax system whereby the honest taxpayers are being compelled to pay more than their ability, which instigates even the compliant taxpayers to adopt tax avoidance measures. Services' sector contributes almost 53 per cent of the country's GDP and comprises various sub-sectors including wholesale and retail trade, transport, storage and communication, finance and Insurance, etc. Out of the above, the biggest contributor is the Wholesale and Retail Trade, which constitutes almost 32 per cent of the total services' sector. The tax contribution by Services' sector is, however, minimal. Various measures have been taken by in the past, such as Universal Self-Assessment Schemes for income tax and minimum/fixed tax regimes for retail sector; however, no significant improvement has been achieved. Even for GST, varied regimes were introduced; however, it appears that there is no significant contribution of taxes from this sector.

There is, therefore, a need for the federal government to bring retail sector in the ambit of GST and all the provinces to jointly formulate a policy framework to extend the scope of GST on those services, which are not presently taxed either due to expressed exemptions or due to evasions. It is, however, important that the scope of GST should not be extended to essential public services, such as education and health.

- Steps should be taken by the all the governments (federal and provincial) to ensure that the taxpayers are satisfied that their contributions to the Government Exchequer are being pooled to fund essential shared services, such as education, health care, law and order, social services, etc.
- In low-income countries like Pakistan, the most important aspect of the equitable taxation lies in improved tax administration. All the governments must recognise the importance of better tax administration and take practical measures to facilitate the people and ensure all having taxable income are registered and file income tax returns. Presently, the people have to deal with a number of tax authorities at federal, provincial and local levels. For harnessing the full tax potential at federal, provincial and local government levels (to be established under Article 140A of the Constitution), National Tax Authority (NTA) is the need of the hour. Through consensus and democratic process, all the parliaments can enact laws for establishing autonomous NTA that will facilitate people to deal with single Revenue Authority rather than multiple agencies at national, provincial and local levels. The mode and working of NTA can be discussed and finalised under Council of Common Interest [Article 153] and its control can be placed under National Economic Council [Article 156]. This will not only ensure facilitation of taxpayers but better tax collection through participation of all the stakeholders as ultimately provinces and federal government have to get share as per formula determined under National Finance Commission [Article 160].

