Papers, Proceedings and Consensus

Second Conference on Resource Mobilisation and Expenditure Planning

Volume 1

CONFERENCE
ON
RESOURCE MOBILISATION AND EXPENDITURE PLANNING

VOLUME: I

PAPERS, PROCEEDINGS

AND

CONSENSUS

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OUTLINE OF REPORT

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First Day

SATURDAY, MARCH 11, 1995

INAUGURAL SESSION

INAUGURAL ADDRESS BY
HER EXCELLENCY MARIE-ANDREE BEAUCHEMIN
HIGH COMMISSIONER FOR CANADA

PAKISTAN'S ECONOMIC AND HUMAN CHALLENGE

FINANCE MINISTER AHMED, MINISTERS, DISTINGUISHED GUESTS, LADIES AND GENTLEMEN.

Let me begin by congratulating (lie Provincial Governments of Pakistan for their willingness to participate in tills Conference at very senior levels. Let me also thank the Government of Punjab and, in particular. Secretary Cheema and the Excise and Taxation Department for serving as host and secretarial for the conference. The fact that you have demonstrated the foresight and determination necessary to tackle the myriad of issues and problems which this conference is to address speaks well for the chances of success of Pakistan's economic and social reform programs.

Tins conference today is the culmination of a three year program of support which the Canadian High Commission has provided to the preparation and implementation of Pakistan's Social Action Program and which has so far resulted in the publication of detailed reports on resource mobilization and spending for each province of Pakistan as well as a series of reports on specific taxation and expenditure issues. I am pleased to say that some of these reports have served as basic planning documents by the Provincial Goverments.

While the financial support may have been Canadian we can all take great encouragement from the fact that the work carried out so far has been done entirely by Pakistanis. I believe (his is an indication of the quality of talent in this country, a talent which will be in increasing demand in the years ahead.

Pakistan has known numerous economic successes since independence and in the decade of the 1980s grew at approximately the same rate as Singapore. This record of performance gives one a certain measure of confidence that the entrepreneurial spirit of Pakistan will continue to carry it forward. There are, however, three factors confronting Pakistan today which temper optimism for the future.

The first and most important factor is that Pakistan's economy has for years been carrying (he burden of a rapidly growing population which suffers further from sub-standard education and health care. with each passing year this burden grows larger and acts as a stronger brake on economic and social progress.

The second factor is that the world is no longer the place it was even five years ago. Now knowledge and the knowledge-based industries hold the key to economic success in the twenty-first century. Nations will increasingly compete through high quality human resources which an they are able to employ productively to meet the economic challenges of both today and tomorrow.

The third (actor is (lie adoption by most of the developing world of a model of development based on an outward oriented, integrationist approach) to economic development and international trade. The formal establishment of the World Trade Organization in January of this year is the most visible indicator that the world of tomorrow will be characterized by an increasingly open and competitive trading environment. Many developing nations are reorienting their economies and will become much more competitive in the near future. As a result, Pakistan must continually increase the quality of its products to stay competitive in tomorrow's world.

These three factors characterize the key long-term economic challenge facing Pakistan. That. is: The need to upgrade its human resources quickly and dramatically. Tills challenge is doubly dimming when one considers that Pakistan is starting from so far behind most developing countries. Tlie fact that under Pakistan's constitution social sector development rests largely with Provincial and Local Governments makes it clear why tins conference is being held in a Provincial Capital this week although it should not obscure the fact that human resource development is just as much a National-level economic issue as a Provincial-level social issue.

A glance at the program reveals that this conference is about raising more money and spending it more efficiently. If Pakistan is to address its critical development needs it must first of all find more resources for all its programs. This need for resources cannot simply be met by borrowing more money today so that it can be repaid tomorrow. We have seen the consequences of too much borrowing in Canada and I can assure you they must be avoided.

But if it is to be successful, tlie search for additional resources must he open, equitable and vigorous. All sectors of the economy and all segments of society should he expected to make their fair contribution to the national purpose of enhancing Pakistan's socio-economic infrastructure, and hence its international competitiveness.

Once more resources have been found the key is not simply to spend them, or even to spend them where they arc needed, but rather to spend them judiciously and effectively where they will have the greatest impact: on development of Pakistan's human resource base. A second focus of the conference, then, is the need for more efficient and effective programming in the social sectors. Tills includes making the current system work better as well as designing and implementing new parts to the system to bring it closer to the people most effected; People far from the capitals of Islamabad, Peshawar, Quetta, Karachi and Lahore, People on the farms and in the villages of rural Pakistan. This need for greater decentralization in Pakistan's social sectors is often talked about. It will be up to people like yourselves to bring it to fruition.

This last challenge will he a daunting one for although Pakistan began to redefine the role of Government in its society and economy several years ago much remains to be done. What is clear is that while Government must allow private enterprise to assume its natural role as the engine of economic growth, it must not shirk its responsibility for creation and maintenance of the enabling environment in which that growth is to occur. One of the key responsibilities of Government in tills regard is the development of llie nation's human resources.

Let me conclude with the observation that Pakistan rededicated itself to improving (lie lives, skills and abilities of its people when it launched the Social Action Program. This program confirms Pakistan's desire to remove the triple burden of illiteracy, ill health and unrestrained population growth and points to a solution. The challenge will be lo Follow that lead and prove that Pakistan is up to the demands of tomorrow's world. It is your Challenge! on the basis of the experience gained in (lie course of forty-four years of cooperation between our two countries, it is a challenge which I believe Pakistan should he able to face.

Thank You

Lahore
1 1 March 995

KEYNOTE SPEECH OF IMT1AZ AIIMED CIIEEAMA
SECRETARY, EXCISE AND TAXATION, PUNJAB

Maklidoom Allaf Ahmad,
Senior rilmster, Punjab.

Ms. Marrie Andree Hcachemin,
Canadian High Comiiii ssi oner.

Ladies & gentlemen.

Assalam-o-A la i.kum.

Before starting my key-note address, I would like to t bank the Senior Minister, Punjab for gracing the occasion and finding time to Inaugurate tills Conference of vital Importance for the Provincial Governments. I would also like to thank the Canadian High Commissioner for her presence in the conference and Canadian Intel national Development Agency In particular for all the support in organizing and arranging tins Conference.

INTRODUCTION:

The present democratic Governments at the Federal and Provincial levels have embarked on the path of rapid development and self-reliance. There are pit falls and difficulties in the way of improving the present position of under-development but the Government have already introduced wide ranging reforms including privatization, liberalization and de-regulation. It is expected that wit hin another couple of years the results of new reforms would be visible in the field. The Provincial Governments have a vital role to play in ensuring that the resultants growth in the national economy is translated into improvements in the economic and social well-being of the people.

Provincial al Governments are responsible for the delivery of basic services like Education, Health, Water-supply, Transport, irrigation etc.which have major impact on I lip quality of life. The success or the Provincial Governments in expanding and improving delivery of services is essential for the process of growth to be combined with greater social justice and welfare. This conference on Resource Mobilization and Expenditure Planning to be attended by Senior Officers of all the Provincial Governments comes at a very right time. It provides an appropriate and informal forum to identify and discuss the problems of the provincial Governments: in these spheres and also inter-governmenta 1.fiscal relation in the country. The Conference will look into the problems in the respective areas and make its recommendations for the better financial health of tlie Provinces and their ability to deliver facilities in future. This will enable fruitful dialogue and a common identification of the problems and potential solutions. It is hoped that the recommendations of the Conference will be useful in redirecting and developing our thinking for the subsequent years. It is important. I hat deliberations of the Conference are carefully recorded and a serious attempt is made to achieve a consensus on the major recommendations.

EXISTING TRENDS IN PROVINCIAL FINANCES:

There has been reliit.i-ve.ly slow growth in provincial revenues during the last couple of decades. One of the major reasons for tlls is that tlie Federal Government has pre-empted the more broad-based and buoyant sources of income. At the same time current expenditures of the Provincial Governments have increased at a much faster pace. This rapid increase .in expenditure: is generally attributable to factors beyond the control of Provincial Governments like inflation, high population growth, increase in salaries and rapid urbanization. Tlie divergence.

between the growth of revenues and expenditures has led lo a situation of chronic revenue deficits in real terms for all the provincial. Governments.

The overall financial scene for the Provincial Governments was further deteriorated due to delay in the National Finance Commission Award for the Provinces which initially was finalised in 1991. The NFC Award of 1991 was. Initially acclaimed as a major step lo improve the financial conditions of the Provinces. However, in retrospect the Award looks to have a number of major flaws and deficiencies and has rather compounded the problems of the Provincial Governments. Some fiscal responses of (lie Federal Government in the wake of the NFC Award have been unfavourabIe to the Provincial Governments. Fiscal effort by the Federal Government is increasingly being concentrated on taxes outside the divisible pool. This is despite the enormous revenue potential that exists in taxes in the divisible pool. The Provincial Governments have never been consulted on the policy issues relating to these taxes most of which belong to them. It is important For the Provinces that they are given an opportunity to formulate proposals for development of taxes in the divisible pool. In any case tin- post-NFC scenario necessitates greater self-reliance by the Provincial Governments on generation of revenue surpluses in the non-development budget for financing their development needs. Concerted efforts are required to restrict growth in non-development expenditures and to mobillise higher revenues. Additional resource mobilization will, however, be meaningful only if non-development expenditures are cm tailed simultaneously, otherwise additional revenues generated would be offset by increased expenditures on non-development side leaving little or no surplus for development. It should be the strict policy of the Provincial Governments to use revenues from additional taxation primarily for increasing development outlays.

The Government of the Punjab has risen to the cha llenges and imperatives of the post-NEC era and bad made serious efforts timing the last 2 years to restrain expenditures and increase revenues. The mobilisation effort; during the current financial year is of tlie order of Rs.70 to 80 crores from additional resources.

RESOURCE MOBILIZATION^

A number of basic issues have arisen in the context of further resource mobilization in the field of Provincial, Taxation. The first and fore-most issue in this regard is that the Provincial Governments have very limited fiscal powers as most of tlie broad-based taxes like Income-tax, Customs Duties and Sales Tax have been pre-empted by the Federal Government leaving Provinces only with residual fiscal powers. Even in tlie very limited taxation sphere of tlie Provinces, tlie Federal Government has been making inroads into the traditional taxation «3reas of the Provinces. With the introduction of taxes and duties which are identical or similar to tlie Provincial Taxes like advance Income-tax and Wealth Tax on Motor Vehicles and Properties and Capital Value Tax on assets etc., tlie revenue pace of tlie Provincial Governments is being further eroded. It was specifically agreed under the NEC Award of 1991 that Retail Sales Tax shall be levied by tlie Provincial Governments. However, tlie Federal Government has encroached into this area also and introduced a Reta il Sales Tax on a number of items during the last couple of years.

Tlie other major problem with regard to Provincial Taxes is that they lack elasticity and buoyancy. As a consequence revenues from Provincial Sources do not increase inline with increases in income or inflation rate. The important reason for tills is that bulk of the Provincial Taxes like Motor Vehicles Tax, Stamp Duty, Land Revenue, Cotton Fee, etc. are specific in character. Despite these limitations, the Government of the Punjab has tried to mobilise additional resources from a number of items during the last few years. Own revenues of the Province currently contribute about 25^ of the total revenue receipts which is the highest among the Provinces.

Another problem faced by the Provincial Governments in tlie administration of revenue receipts is that tlie Provincial Tax Administration has not received due attention. The tax collection system in the Provinces is generally fragmented and lacks innovation. Most of the taxes are administered by part-time administration who perform multiple functions besides revenue collection. Personnel detailed for important levies like Stamp Duty and Registration Fee lack specialisation and opportunities for professional training. There is an inevitable need for institutional strengthening and human resource development in this area. There is a strong case for tlie establishment of a Specialised Provincial Tax Service on the pattern of Federal Revenue Services with better career opportunities and planning. There is also a growing need to improve record keeping and quality of assessments. For this purpose automation of Provincial Tax Administration is required to be given high priority. Some efforts have already been made in this regard and as a first step Property Tax and Motor Vehicles Registration Record in Lahore has been computerised with the financial assistance from tlie Resource Mobilization and Tax Reforms Commission of the Federal Government. The strategy of additional resource mobilization from Provincial Taxes must be liased on (i) principle of progressivity i.e. the additional burden should lie shared by tlie higher income groups:

(ii) Provincial Tax Reforms must enhance the built-in elasticity of the tax system; and (iii) priority must be given to diversification of the revenue base.

User or service charges provide another promising area for further resource mobilisation. Apart from enabling public agencies to recover cost of services provided, there are also possibil itics for cross-subsidization to moot socio-economic objectives. The Government of the Punjab being aware of the resource mobilization potential of user charges has begun to slowly introduce user charges in some areas of public sector activity. We have to educate and persuade the people at large that if we want to have a qualitative and qualitative improvement in services then we must be willing to pay for the costs of such improvements.

It is quite clear that during the next few years it will be essential to mobilize more resources from own revenue potentials of the Provinces if a situation of growing revenue deficits is to be avoided. Simultaneously, there will have to be serious attempts; it restraining tlie growth of current expenditures so as to ensure that the resources generated from additional taxation are primarily used for development.

EXPENDITURE PLANNING:

Expenditure in the Provinces is primarily planned by the Planning & Development Departments of the respective Governments. Success can, however, be achieved in economising the expenditure and improving the utilization of development funds if the nation's building Departments play their key role in this process. It is a very well-known fact that unless there is control on the growth of current. expenditure, the province will be confronted with a huge revenue deficit in the next few years. Current expenditures already account: for over two-thirds of the provincial budget and any economy in this area will release significant additional resources for development. Thus, the cornerstone of an expenditure planning strategy must include measures to economise on current expenditure. Further, expenditures will have to be made more cost-effective. It goes without saying that a rupee saved is equivalent to a rupee earned. Measures aimed at achieving greater cost-effectiveness will include diversion of expenditure from non-productive to productive heads.

There is a need for increasing the involvement at private sectors in areas like Education, Health etc. where significant scope exists for cost recovery by improving the quality of services provided. In case of certain community-based services like water supply and sanitation, efforts should be made for greater involvement of NGOs who can solve the local problems in a much better manner.

Cost-effectiveness of current expenditure can be enhanced significantly by introducing performance budgeting which will link budgetary allocations to achievements of physical targets. The Provincial Governments must move beyond annual budgeting to financial projections for a longer period of time for three to five years so that their financial position and needs for the coining years are known in advance. There is also great need for coordination in expenditure planning between the Provincial and Federal Governments. Steps taken by the Federal Government in a large area of activity either directly or indirectly result frequently in increased provincial liabilities. It is important that such steps are not taken by the Federal Government unllateia 11y.

Debt servicing of federal loans is consuming a growing portion of provincial resources. Part of this burden is one to the fact that the Federal Government has been charging heavy interest- on loans given by International Donors on relatively easy terms. It may be emphasised on the Federal Government for reducing the profit component in the interest rate charged from the Provincial Governments on cash development loans.

In the present fiscal scenario, the level of development expenditure by the Provincial Governments is generally inadequate. It is needed in this regard that not only the development expenditure is increased but also tlie share of social sectors is particularly enhanced. Coupled with the inadequacy of development expenditure is the deterioration in the efficiency of such expenditures, as reflected by the growing inability of the projects to yield increments in coverage. For example, Government of tlie Punjab has increased its expenditure in real terms on primary education at the annual rate of 9% over the last 20 years. As compared to this, enrolments have risen by only 5% per annum during this period. One of the fundamental problems with planning of development expenditure is tlie tendency to carry too large a portfolio of projects within the Provincial Annual Development Programme. This has led to cost overruns, partial implementation frequency, and major lags in the realization of benefits from investments. Simultaneously the tendency to carry too many projects in the pipeline stretches tlie capacity of tlie planning machinery and the executing departments to properly prepare, approve, implement and monitor such schemes. Therefore, one of tlie basic requirements for proper expenditure planning is discipline in the process of project selection and approval, whereby new schemes are included in the ADP only if adequate provisions have already been made for the on-going projects.

The development expenditure planning is certainly in need of serious review to make it not only cost-efficient but also cost-effective. This becomes all the more necessary as we intend to make a big push in the social sectors under the Social Action Programme. Priority must be placed on improving institutional arrangements for delivery services by enhancing implementation capacity of the concerned Departments and Agencies and also exploring the scope for greater involvement of the private sector in the planning and development stages to promote greater community involvement in the choice, execution, management and 1-inaiicing of projects.

At tlie end, 1 would like lo say that this International Conference is being held in the larger interest of all the Provinces, the format of which has been kept as free and informal as possible where more discussions than speeches shall be held so that the participants can fully contribute to tlie deliberations. It is hoped that the recommendations formulated at the end of the Conference shall he seriously taken by tlie Provincial Governments and implemented for improving their fiscal and planning policies.

Thank you.

INAUGURAL ADDRESS BY MAKIIDOOM ALTAF AHMED SENIOR MINISTER, GOVERNMENT OF PUNJAB

Bismillah-ir-Rehman-nir-Rahim
Ms. Marie Andree Beauchemin,
The High Commissioner of Canada,
distinguished participants, ladies and gentlemen,
Assaalam-o-Alaikum

At tile very outset, let me lake this opportunity to convey my appreciation to the. sponsors of the conference, i.e. the Canadian International Development Agenc y, (C1DA) who have since 1991 supported and helped organise such forums aimed at a dialogue between the researcher, the politician and the government servant. Tine timing of the seminar coincides with the preparation of the budget for the next financial year. The provincial government is grateful that this well arranged conference will serve as a preparatory ground for the budget making days ahead.

The issues and strategies to he presented and discussed in (he conference will 1 am sure develop on the conclusions of the first such conference lield in April 1993. The broader focus of last year's conference had set a pattern aimed at using the analysis to come to grips with certain well focused and concrete issues in provincial and local resource mobilisation as well as expenditure planning. The present conference will take us further down this road. Papers on "Resource Mobilsation from Stamp Duties", "Provincial Sales Taxation of Services", and "User Charges in the Social Sector” will 1 am certain build upon the issues highlighted by Dr. Hafiz A. Pasha last year “Recommendation of Octri”, "Development of Properly Taxation", have developed F. Aisha Ghaus's paper on Local Government Resource Mobilisation.

1 would now like to relied upon the efforts of CIDA on Provincial Resource Mobilsalion and expenditure Planning in the context of the financial stale of Punjab government in the backdrop of the MFC award.

NEC AWARD AND I IS IMPLICATIONS.

Prior to the MFC award, the budgetary deficits of the provincial government were picked up by the Federation thereby providing a negative incentive to the provinces to maintain huge deficits. The NFC award has changed that. While transferring resources to the provinces in order to create an atmosphere of autonomy and self-reliance, it has also made it non-obligatory on the Federal Government to pick up our deficits. The award was based on the projection that the current revenue expenditure of the province would grow at a rate of 14%, while the growth of provincial receipts was projected at 8%. The gap in these projections or assumptions was visualised to be met by transfers from the divisible pool taxes which w/ere projected to grow at an average of 16%. These trends, however, did not lake into account the unbridled expenditure regime of the predecessor government, the limited buoyancy in the taxes levied by the provincial governments, the spiraling burden of debt servicing accumulating over the years, the pay increases in 1991 and 1994, the impact of SAP on the non-development expenditure in the years to come and the inability of the previous government to tax at the federal level. Besides, the Slate Bank, with greater autonomy, imposed higher hut stricter limits on our overdraft facility.

RESOURCE MOBILISATION

Histor ically, there has been little growth in provincial revenues during the last two decades, Partly this has been the result of the Federal government's preemption of' the more buoyant and broad based taxes and partly because of tlie excessive reliance of the provincial government on llie deficit grants from the Federal government. The infusions from tlie federal divisible pool also did not show any appreciable increase after the NF'C award as expected, the federal government imposed a ceiling on the revenue de ficit grants; and, oilier fiscal responses of the federal government remained unfavourable to tlie provincial government until only recently. The trends in provincial tax revenues also did not live up to the onerous responsibility laid by llie MFC award on the shoulders of the provincial government. Tlie provincial tax revenue collection in 1992 -93 (Revised estimates) was only Rs. 4744 million as compared to Rs 5325 million in 1991-92. However, after the induction of the present government resource mobil isation became a cornerstone of good governance. With closer monitoring of tile receipts in tlie latter part of the fiscal year, 1993-94 ended with a revised estimate of Rs. 571 1 million for total tax revenue receipts. In the current financial year tlie B udget Intimates for total lax revenue receipts is pitched at Rs.6130 million. This increase over tlie previous year would be possible through closer monitoring of the provincial receipts, a greater realisation by tlie administrative departments that incr eases in expenditure need to be commensurate with increases in revenue generation and a greater resolve of the provincial government to live within its resources. Additionally, [lie provincial government has rationalised and imposed taxes will) a minimum impact on the poor strata of society. These steps are likely lo yield another Rs 75 crores to the provincial exchequer.

Here I would like to acknowledge the contribution given by (lie paper read in last years. seminars on the subject. Initial registration fee (or motor vehicles is now based on the value of the vehicle and therefore has been made ad valorem in character as suggested in Mr. Pasha's article on provincial Government Resource Mobilisation, motor vehicle tax rates have been raised by about 30%, the lack 0!' enhancement of which over tlic past few years was highlighted in the same article, similarly, one of the exemptions in stamp duties was removed *by* the imposition of stamp duty on the gift deed transaction according to the valuation table notified by tlic Collector, the differential treatment on owner occupied houses in tlic assessment process was curtailed by the enhancement of assessment and introduction of surcharge on larger plot sizes or covered area as per an observation in Ms. Aisha Ghaus's article on Local Government Resource Mobilisation, and, an attempt has been made to introduce properly tax outside the existing rating areas on commercial and industrial properties which takes it cue from a recommendation in the same article to expand the rating area. Besides these measures other taxes and revenue generating steps have been taken by the present provincial government including revision of existing charges, levying of taxes on heretofore untapped businesses etc.

The provincial government is therefore mindful of the economic imperatives of controlling inflationary pressures by reducing the deficit and meeting basic obligations to its people through imposition of equitable and economically efficient taxes.

EXI'ENDITURE PLANNING - NON-DEVELOPIMENT

It is sometimes necessary to slate the obvious. The control over (lie overall deficit position cannot be divorced from the expenditures on the non development and development side. It lakes a lot of convincing on my part lo persuade my colleagues that even if their demands are genuine, rational, logical and a responsibility of government, yet they cannot be met from the current budget on account of their low priority. Priorities have to lie fixed in a situation or unlimited wants and limited means. One way out is to increase receipts or user charges. I am of the firm belief that only those increases in expenditure or new expenditures should be undertaken which can be buttressed by a publicly supported policy of imposition of commensurate user charges.

Inspire of this belief, in the existing socio-political realities and framework, it is difficult lo reduce government expenditure. I low/ever, maximum effort should be geared towards fixing priorities of future expenditure to get maximum efficie ncy in resource mobilisation through cost effectiveness.

In the current wave of development rhetoric as well as serious discourse, privatisation has become a symbol of development. However in the wake of privatisation of the scale in Eastern Europe it has restricted its focus to sale of small or large enterprises, hi fact the larger benefits of privatisation can be amassed by privatising independent tasks through contracting arrangements especially where the whole activity cannot be privatised as mailer of policy. In cases where corporations arc totally deficit ridden and there is little likelihood of their improvement for various reasons, which need no dilation, It would be prudent lo disinvest from such activity forthwith after mobilising public opinion in tin's regard.

As earlier mentioned performance budgeting or zero based budgeting can lie a major source of saving in expenditures which continue on the basis of precedence and which have lost then utility Departments and the government as a whole arc reluctant and at times myopic in not envisioning schemes in relation lo the activities of a department as a whole - the piecemeal approach obviously is far less cost effective. I am also aware of the enormous difficulties of zero based budgeting in terms of qualified manpower available, intransigence ol (he departments to retrain people, and sheer magnitude of the task. C'ompulerisation however is expected (o resolve some of tlie constrains and if sufficient commitment is there than it is likely that tills seemingly insurmountable task can be accomplished.

The inter and infra sectoral expenditure patterns need to be reassessed especially on the non development side. Till late inter departmental allocations were never consciously followed in a planned manne r. It is time that we take stock or tbe situation and analyze our existing inter departmental or inter sectoral distribution of expenditure and then consciously determine tlie distribution we need to target. Expenditure increases should then be in accordance with the requirements of such targets. Over tlie past few years tlie percentage of non development expenditure in the social sectors has shown a marginal increase With little more planning, a mutual resolve to achieve a consensus on the direction and requirements of our polity, and an understanding of the issues, we can arrive at mutually agreed targets which can be achieved in a not too distant future. The intra sectoral and intra departmental expenditure also require similar action. There has been a more general observation that the salary components of llie non development budget is disproportionately higher than the non salary component thus raising the specter of schools without Furniture, hospitals without medicine and electricity, and police without mobility. In the social sectors SAP is meeting some of the needs in this regard but the big question still looms whether tlie non development budget will in the years to come meet this increase in the non salary component when llie salary component continues to increase. Here again we must lake stock of the situation today to resolve the problems of the Future by prior targeting and planning.

It is difficult to visualise sustenance of SAP activities without further devolution and decentralisation. Already, provincial governments are undertaking a number of activities which are statutory duties and responsibilities of local governments. The list includes sanitation, water supply, primary education, basic health facilities e(c. '1'lie present administrative and technical ea liability of these local councils do not inspire the confidence for the transfer of' these essential services to them without upgrading them and without restructuring their fundamentals. A beginning can be made by training their stall in hiring of services rather than involving themselves in direct provision or services. Legislation may be necessary to see that such hiring conforms to meeting basic contractual obligations and me services are not sacrificed at the altar of legal chicanery, however decentralisation is essential for meeting the aspirations of the people quickly, efficiently and equitably.

Provincial liabilities have been increased directly or indirectly by actions taken by the Federal Government. There has been a considerable improvement in (he response of the federal government in accepting such liabilities but still there is an acutely felt need for greater coordination It is none the less important (hat such actions which increase the liabilities of the provinces arc not taken unilaterally, and, if there is a requirement. then the federal government should share the liability of such action with the provincial government. Recent examples include the decision of (he federal government to increase the storage requirements of some strategic commodities. In such cases it is legitimate for the provincial governments to request for larger subventions from the Federation.

Debt-servicing or federal loans is consuming an increasing portion of provincial resources In 1993-94, this expense in the Revised Estimates accounted for 24 percent of' provincial expenditures as compared to 19 percent a decade ago. The federal government charges a heavy interest on the Cash Development Loans whereas it obtains them on comparatively easier terms A three fold strategy is required to resolve this burden: one, the federal government .should reduce the profit component in the interest rate charged From the provincial governments on such loans; two, it should reschedule the debt burden with ultimate aim to wipe it off completely and coupling it with the incentive to raise logins directly from llie open market- this step is likely to create greater financial discipline and generate pressure on the provincial governments to economise on development expenditure, and, three, provide :in incentive for the provincial governments to pay back their debts by retiring debt on an equivalent, matching grant basis.

EXPENDU URE PLANNING - DEVELOPMENT

Development expenditure requires the same kind of balancing in terms of planning and prioritising. The expansionist regime of the previous government, has provided a throw forward of enormous magnitude. The ongoing projects, if they follow their planned schedule is likely to absorb most of (lie resources available on the development side. There is an urgent need to review these projects, complete on priority those projects that have adequate returns and those that fell short of sufficient returns need to be rescheduled or shelved altogether.

The higher the cost of funds, the greater is the need to ensure that they are utilised in a cost effective manner and those projects arc undertaken which have sufficiently high social and economic returns. The scrutiny of projects needs to be deeper and rigid. Wastefulness of resources needs to be curbed on war rooting. The process of inclusion of the schemes in the ADP should be made lighter. The basic eligibility for inclusion should be the ability of the line department to present a rigorous scheme within the 1'irsl quarter of the financial year if not earlier The system of provision of unapproved schemes through block allocations sliould lie discouraged. These reflect poorly on the planning machinery of the government.

The analysis of the non development and the development side underscores the need for a broader understanding of our aspirations, goals and requirements. I must frankly admit that at present we are at a preparatory stage to lake head on (.he proposals mooted above. Bill let me assure you that a beginning has been made. The provincial government- has seriously curbed the expenditure regime of' the previous government. This has been achieved through a severe curb on ostentatious and luxurious spending. Supplementary grants have been reduced to minimum inevitable expenditures. Creation of new posts has been discouraged except where developed infrastructure would have remained unutilised for lack of staff input. Increases in telephone, electricity and other miscellaneous expenditures have been kept to minimum necessitated by increases in charges. A further cut has been imposed on approved non development grants creating pressure on (lie departments to economise.

Such guiding principles have had a salutary impact on our budgetary position. The overdraft of the Punjab Government had readied a record low of Rs.(-) 81 1crores on 24.8. 1993. We started the current financial year with a negative balance of Rs. (-) 627.47 crores on 29.6.94. By the grace of Almighty Allah our overdraft with the State Bank of Pakistan has been wiped out. As already indicated this has been possible through considerable amount of frugality and curtailment of expenditure coupled with mobilisation of additional resources. With the inelastic and narrow tax base of the provincial government, additional resources are generated at considerable social and political cost. Therefore the federal Government should provide a matching grant for the resource mobilisation effort of (he provincial government. This would not only encourage the provincial governments to increase (heir resource mobilisation efforts but also reduce their dependence on (lie loans of the federal government. This in the long run is likely to improve the deficit financing requirements of the federal government.

Coming buck to the issues in (lie current conference, we in (he provincial government can assure the participants here that the provincial government will look forward to the emergence of useful recommendations made in this confidence and would continue to benefit from any further developments in this regard. At this juncture 1 would like to underscore the need for the realisation that increased taxation depends not only on the ability to pay but on the realisation by the people that this will result in increased and improved social and economic services. The taxation proposals for increases must be built on tins edifice.

Finally, let me once again thank C1DA and tine department of excise and Taxation in their efforts in arranging this conference. We are particularly grateful to Ms. Marie Andree Bcauchemin lor gracing the conference with her presence as well as to the participants who have spared their valuable time for (lie purpose.

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SECOND SESSION

PROSPECTS FOR PROVINCIAL RESOURCE MOBILISATION

CONFERENCE
ON
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EXPENDITURE PLANNING

PROSPECTS OF RESOURCE MOBILIZATION BY THE PROVINCIAL GOVERNMENTS

by

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PROSPECTS OF RESOURCE MOBILIZATION BY THE PROVINCIAL GOVERNMENTS

INTRODUCTION:

1.1 It is a well known feature of the Federation in Pakistan that the responsibilities of the Provincial Governments have grown at faster pace over the years both on development and maintenance sides particularly in the social sectors. So much so that over 55% of the development expenditure is borne by the Provincial Governments while 25% is financed by the Federal Government and 20% through the Local Councils. The recurring expenditure on projects completed through development budget is shifted to the non-development side as soon as the project is completed resulting in more burden on the regular or non-development budget of the Provincial Governments. Thus, the overall expenditure of the Provincial Governments has increased rapidly while income from different sources has not caught up with this rapid Increase. Resultantly the financial position of the Provincial Governments has deteriorated over the years. The NFC Award of 1991 has put more onus on Provincial Governments of self-financing any revenue deficit during the tenure of the Award. Prior to this Award the general practice for the Federal Government was to allow grants to cover any resource gap in the current account of the Provinces. With the passage of time resource mobilization by the Provincial Governments from their own resources has assumed greater importance. The Provincial Governments are expected to continue generating surplus in their non-development budget and raise the level of development expenditure primarily from the surplus resources.

1.2 The reasons for continuing deterioration in the financial resources of the Provinces are slow moving receipts from the provincial taxes, rising debt service and decline in the share of development expenditure in the total expenditure. There was sizeable jump in the Provincial finances after the 1991 Award but thereafter the Provincial Governments are facing more difficulties in balancing their budgets. The past behaviour of Provincial Governments indicates that higher federal transfers generally had significant stimulatory effect on provincial expenditure and a negative effect on their fiscal efforts. The anticipated increase out of divisible pool of taxes by the Federal Government is not forthcoming due to substantial shift in the fiscal policy of the Federal Government. Thus, the NFC Award which was acclaimed to be historical for Provinces did not have the desired results and the Provincial Governments are likely to face more difficulties in years to come.

OBJECTIVE/THEME OF THE PAPER;

2.1 The basic aim of this paper is to quantify the level of fiscal efforts by the Provincial Governments and indicate the possible areas where provincial receipts can be substantially improved so that the financial conditions of the Provincial Governments are further strengthened for more development activity in the field of social sector. The overall growth in the provincial receipts in the country during the last decade has been of the order of 13%. The growth of revenue receipts in the Punjab which is about 16% is much faster than the other Provinces. This is due to the relative buoyancy of the Provincial Economy and higher fiscal effort by the Provincial Government. But even this increase in revenue still falls short of increase in expenditure which has grown at a faster pace of l8^. There has been a tendency on the part of Provincial Governments not to make much efforts to mobilise their own resources any further clue to fiscal policies of the then Federal Government. This has resulted in a stagnation of efforts on the part of Provincial Governments themselves and it is becoming day by day difficult to change this rather regressive approach towards resource mobilization. Prospects for further revenue generation by the Provincial Governments may be broadly categorised as: -

i) improvements in the existing revenue resources.

ii) additional receipts from new avenues of taxation; and

iii) re-allocation of revenue items among the Federation and the Provinces, including enlargement of divisible pool.

IMPROVEMENT IN TI1E EXISTING RESOURCES:

3.1 Taxes and duties in the country are levied by the Federal and Provincial Governments in accordance with the Constitutional provisions in the respective fields. A List of Federal and Concurrent Items is appended with the Constitution, perusal of which would show that major items of taxation are reserved for the Federal Government. There is very little scope for the Provincial Governments to levy any major tax on residuary items. The primary source of provincial revenue consists of

(i) taxes on physical assets like the Property Tax, Motor Vehicles tax, Stamp Duty and Land Revenue; and

(ii) taxes which are essentially levied in the nature of duty on services like Electricity Duty, Entertainments Duty and Hotel Tax.

The nature of most of these provincial taxes is quite inelastic. It is due to this basic reason that the provincial taxes have generally increased at a low pace. Exception exists in the case of a few levies like Stamp Duty which has increased at a faster pace until late 80's but its growth has also been retarded recently due to .slump in Real Estate business. But: even in items available to the Provincial Governments, the effort has not been enough on the part of the Provincial Governments to exploit these sources fully. Incentive environments have not been conducive to greater fiscal efforts by the Provinces due Co adhoc nature of inter-governmental fiscal relations whereby the Provinces had residual access to deficit grants from the Federal Government which has led to profligacy in expenditures and slackening of fiscal efforts. Tills attitude on the part of the Provincial Governments has to *be* changed which cannot happen unless it has the full support of political structure and the legislature. To exploit the existing resource fully, it is of basic importance that the Provincial Tax Administration is given due attention and brought at par with the Federal Revenue machinery. The Provincial Tax Administration has not received due attention for development because of extreme dependence on federal transfers. Since the collection of taxes is relatively small, the cost of collection is also comparatively higher for the Provincial Governments. The two major Departments administering the Provincial Tax Receipts are the Excise & Taxation Department and the Board of Revenue. The sphere of E&T Department is restricted to mostly taxes of urban nature and its personnels are not very-well trained professionals as they lack indepth preentry training in the field of assessment and collection of taxes. The position of Board of Revenue is much worse as due to multiplicity of functions priority given to tax collection by the field organization under the Board of Revenue is relatively very low. The efforts of Board of Revenue on the revenue side are mostly restricted to rural areas. However, the levy of stamp duty and registration fee which in part is urban based is being dealt with by personnel who are not at all professionally trained for the purpose. Tlie posting of Extra Assistant Commissioners and Tehsildars as Sub-Registrar on part-time basis certainly does not help in good tax administration particuJai-1 y when record of urban property is not available with them. This has certainly hampered the growth of true potential of the major levy. It is of great importance for improvement in the revenue potential of the Provincial Governments that a specialised Provincial Taxation Service is established to look after all the urban as well as rural taxes and duties. The measure is likely to go a long way in improving and exploiting the existing revenue resources to the maximum possible extent.

3.2 In the matter of exploitation of existing resources it is quite important that tlie mode and format of assessment of different levies remains under constant review so that these can be brought up-to-date and rates changed to commensurate with the prevailing conditions in respect of each and every levy. Unfortunately this cannot happen unless it has the support of the legislature and political will to overcome the tax payers who have a growing tendency to agitate against any increase in the existing taxes. Another salient feature of the existing revenue structure is that service charges and non-tax receipts in the social sector like Education, Health, Irrigation etc. are unreasonably low and have not been co-related with the recurring cost which has increased tremendously over the years.

3.3 The up-shot of tlie above discussion is that the Provincial Governments have to make a major effort in improving the existing receipts for which following points are of vital importance: -

i) a Specialised Provincial Taxation Service may be established to look after all Provincial Taxes and Duties;

ii) the rates of existing levies may be kept under constant review and where-ever feasible may be changed from specific to ad-valorem; and

iii) service charges and non-tax receipts may be revised upward and made reasonable, the rates of such charges and receipts should be co-related with tlie recurring cost.

ADDITIONSAL RECIEPTS FROM NEW AVENUES OF TAXATION:

4.1 It is generally argued that there is ve ry *1* it-tie scope for additional provincial resource mobilization because taxes with large and relatively buoyant tax base like Customs Duties, Income Tax, Excise Duties, Sales Tax etc. are levied by the Federal Government. The taking over of Sales Tax by the Federation immediately after Independence is cited as a major encroachment on provincial fiscal powers. Retail Sales Tax almost throughout tlie known economies of the world is administered by tlie provincial or state governments. The field of taxation left for the Provincial Governments in Pakistan is no doubt very narrow and generally of inelastic nature. It however, remains a fact that the scope of generating revenues even within the exiting sources has not been fully exploited by the Provinces. The issue of Agricultural Income Tax which lias been specifically assigned to the Provinces still remains largely unresolved. Capital Gains Tax on immoveable property which falls within the provincial domain has been abolished and substituted by a higher Stamp Duty. This substitution has led to significant losses as it has created serious detortions in the property market and also implies that; the Provinces have not fully benefited from the tremendous boom in real estate business during the last decade. It is also observed from the constitutional provisions that the Federal Government has been limited to the levy of Sales Tax on goods but are not competent to levy any tax of similar nature on services. The later field has been left to the Provincial Governments who have been slow in exploiting tlie vast potential that exists in the taxation of fast growing services in the fields of communication, banking, insurance and tlie like. Instead, the Federal Government lias tapped substantial revenues in recent years from these sources under I lie cover of Excise Duties which certainly looks to lie an over-stepping. The NEC Award of 1991 had also specifically indicated to transfer the responsibility of collection of retail sales taxation to the Provinces. The Provinces have failed to take any concrete steps to finalise the arrangements to levy and (-oiled the retail Sales Tax which has very large potential as a major source of revenue. On tile oilier hand the Federal Government has again encroached in this area by introducing sales tax on a large number of items during the last couple of years. Altogether it appears that while Provincial Governments have been granted limited fiscal powers, they have failed to even exploit effectively the sources available to them.

4.2 In view of the above, there is a strong case for the Provincial Governments to introduce new taxes within its existing fiscal powers to improve their resource position to a large extent in tlie years to come. It is of vital importance for the Provinces that they generate more resources to keep their budgets balanced. In the case of Punjab it looks an essential feature for tlie next few years that additional resources to tlie extent of around Rs. 1 billion are generated annually to at least match tlie increasing expenditure on current side. Tlie Provincial Governments may consider to introduce following new taxes as soon as feasible:-

i) TAX ON PURCHASE AND SALE OF SERVICES:

As mentioned earlier the Federal Government is not competent to levy any tax on sale or purchase of services. The area of tax on services has great potential in view of tlie increasing dependence on services in tlie information age. Tlie Provincial Governments may start with a Sales Tax on Services rendered in the field of communications banking, tourism, hoteling etc. immediately while other areas may be tapped in the next few year's tune. The field has a vast potential for additional receipts for tlie provincial exchequer.

ii) RETAIL SALES TAX:

The 1991 NFC Award provides for collection of retail sales tax by the Provinces. There are well-known difficulties in implementing the Sales Tax at retail level. These difficulties can be overcome by providing fool proof discretion tree system of asessment and collection of this tax through a fully trained and highly specialised administrative machinery. The Provincial Governments may, as an initial step, examine the scope for levy of a pre-sumptive Sales Tax on larger outlets in commercial centres of the bigger towns in the Provinces.

iii) CAPITAL GAINS TAX:

Capital Gains Tax which started as a minor levy in the early 60s could have taken the shape of a major tax for the Provincial Governments had it not been abolished in the year 1986. It was probably the most buoyant and progressive source of revenue for the Provinces. The tax was abolished on the ground that it has vast discretionary powers for the assessing officers which resulted in large scale connived evasion and avoidance of the tax. Instead of removing the flaws in the existing law, which was enacted when the levy had no real impact, the tax was abolished altogether accompanied by an increase in the existing rate of Stamp Duty on transactions. The basic merit of Capital Gains Tax, as opposed to the Stamp Duty, is that it only taxes increments in value resulting from a transaction of property. In view of this position, it is recommended that the Provinces may re-introduce the levy of Capital gains Tax but at the same time reduce the existing rates of Stamp Duty because the present light rates are not only considered regressive but have also proved to be somewhat counter-productive.

iv) AGRICULTURAL INCOME TAX:

The case regarding the desirability or otherwise for the introduction of an agricultural income tax has remained under discussion for a pretty long time. It looks difficult to levy and collect an agricultural income tax of the conventional type in the peculiar circumstances of the Provinces. The issue whether it is desirable to further tax the agricultural sector needs to be finally resolved by explaining whether the rural sector is properly taxed or not and whether the paying capacity of the agricultural sector can permit any such levy. In any case levy of some sort of Income Tax on the feudal elite is desirable due to a number of reasons and should be taken up in the right earnest by the respective Provinces.

v) ADDITIONAL RECEIPTS FROM NON-TAX RESOURCES:

Revenue receipts from economic and social sectors have remained depressed throughout this period while expenditure in these sectors has grown tremendously. There is substantial potential in additional receipts in the following non-tax sectors:-

a) Agriculture.

b) Forestry.

c) Irrigation.

d) Works.

e) Housing and Public Health.

f) Education.

g) Health.

h) Animal Husbandry and Fisheries.

In Punjab existing annual receipts from all the above departments are of the order of Rs. 3 billion. Receipts from these sources are mostly in tlie nature of service or user charges and rates in most of these cases are very low and unreasonable even from the standard of cost of maintaining these sectors. The rates of these service and user charges are required to he made reasonable and at least brought at par with the recurring cost of the projects. It is suggested in this regard that existing receipts from these sources may at least be doubled through a phased programme over a period of about 2 to 3 years by revising the rates of these user charges by a reasonable margin.

RE-ALLOCATION OF REVENUE ITEMS BETWEEN THE FEDERATIONS AND THE PROVINCES.

5.1 This is a basic feature of the Federation that the federating units are allowed financial autonomy and have sufficient fiscal powers to balance their budget. However, in Pakistan the Provinces have not remained autonomous as far as the fiscal authority is concerned because they have always to look towards the federation for more resources to keep the Provinces going. As a matter of tact the situation has deteriorated over the last few decades since independence as some of the tax items entrusted to the Provinces at the time of Independence and then under the 1956 Constitution have been taken away and allocated to the Federal Government. This has naturally affected the financial autonomy of the Provinces in a big way. The most pertinent instance in this regard is divesting the Provinces of their authority to levy the Sales Tax. This was one of the major sources of revenue for the provinces before independence with great potential for improvement over the years. This tax is generally administered by the Provincial or State Governments almost throughout the world and it has been a great blow to the provincial exchequer to divest them from this levy.

Further a number of tax items on the Provincial Legislative List of the 1956 Constitution have been included in the Federal Legislative List of the 1973 Constitution. Following are few of these examples: -

i) Tax on Capital. Value of Agricultural Land.

ii) Duties in respect of Succession to Agricultural Land.

ii) Estate Duty in respect of Agricultural Land.

iv) Taxes on goods and passengers carried by Railway, water ways and roads.

v) State Lotteries.

5.2 It would be observed that the above listed items which were specifically allocated to the provinces under the 1956 Constitution have now been transferred to tlie Federal Legislative List by the 1973 Constitution in a big way. The Federal Government has quite benevolently placed some major taxes in the divisible pool share out of which is transferred to provinces on the basis of agreed formula. Following taxes and duties constitute the divisible pool of taxes:

a) Export duty on Cotton.

b) Sales Tax.

c) Income and corporate tax excluding tax on income consisting of remuneration paid out of the Federal Consolidated Fund; and

d) Excise Duty on Tobacco and Sugar.

In addition to the above items, under the 1991 NFC Award tlie Provincial Governments have also been allowed royalties on natural gas and oil according to production and location of these resources. It is clear from the above that certain major taxes have not been included IJI divisible pool, thus, depriving the Provinces of their legitimate share out of these major levies like Customs Duty on import and export of goods and Excise Duties on very large number of items. It is therefore, imperative to enlarge tlie scope of divisible pool by including the remaining taxes thereon. The Province of Punjab has also been hit by provision of royalties on account of oil and gas as both these items are mostly produced out of this Province but are mainly consumed here.

5.3 In view of the above discussion it is proposed that not only the scope of divisible pool may be enlarged but also the following items may be transferred to the Provinces to make the m financially viable:

a) Levy and collection ot Sales Tax may be entrusted to the Provinces.

b) Capital Value Tax on assets, Succession Duty and Estate Duty may be levied by the Provinces.

c) The Federal Government may abstain to levy any tax on services and • existing levies introduced by them on services under the cover of Excise Duty may be transferred to the Provincial Governments.

d) The scope of divisible taxes may be enlarged to cover all the major taxes collected by the Federal Government.

6. CONCLUSION:

Study of the foregoing submissions would amply establish that presently the Provincial Governments are not financially autonomous and have to largely depend on the Federal Government for their financial needs which is against the basic feature of a true federation. It is, therefore, inevitable that tlie Provinces not only generate additional resources from their existing tax items but also introduce some other avenues of taxation from where further resources may be generated. The Federal Government can help tlie Provinces by strictly following the Constitutional provisions and abstain from levying taxes *in* areas not specifically earmarked for them. The item of retail Sales Tax may be left to the provinces as agreed in the NFC Award of 1991. Tlie focal point for notice is that unless the Provinces arc made financially independent and responsible to generate their own resources it would be difficult to support the recurring expenditure on development as well as on non-development sides.

SUMMARY OF DISCUSSION
ON
PROSPECTS FOR PROVINCIAL RESOURCE MOBILISATION

Mr. Asad Ali Shah, Advisor to Chief Minister Sindh, concurred with the author's suggestion that taxes which had historically been the purview of tlie provinces should be reverted to the provinces, such as sales tax, estate duty etc. lie further stated that despite tlie interest of the provinces in these taxes there exists some constitutional constraints. He also commented that as retail sales tax is a multi-stage tax tlie problem of refund will also arise.

Mr. Muzarfar Ghaffar, Consultant, emphasized that control over growth in expenditure be exercised by preparing in advance exit plans (through contractual arrangements) of staff recruited, rented facilities and contracted services for development projects. He suggested that there is a need for over all improvement in real estate business, this will increase the stamp duty revenue and generate more employment. He concurred with Mr. Cheema's suggestion that a single agency Provincial Taxation Service should be created so that overall tax administration could be improved and that tlie benefits of such a Service could be realised fully only if recruitment is based on-merit, accompanied by specialised training and a result oriented remuneration structure.

Mr. Wamique Zuberi, Editor, Business Recorder, enquired what would be the effect of reducing tlie size of the divisible pool on defence expenditure and debt servicing.

Mr. Zulfiqar Ali Shah, Ex-Penance Secretary, Government of Punjab, said that there exists a provision in legislation that any other tax which the President of Pakistan recommends can be included in the NFC award. Tlie ratio of divisible

THIRD SESSION

RESOURCE MOBILIZATION FROM STAMP DUTIES

CONFERENCE
ON
RESOURCE MOBILISATION AND
EXPENDITURE PLANNING

RATIONALIZATION OF STAMPS ON FINANCIAL ASSETS AND TRANSACTIONS

by

Dr. Aisha Ghause

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CANADIAN INTERNATIONAL DEVELOPMENT AGENCY
and
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RATIONALISATION OF STAMP DUTIES ON FINANCIAL ASSETS AND TRANSACTION

EXECUTIVE SUMMARY

Stamp duty, the largest source (45 percent currently) or lax revenue of provincial governments. The overall buoyancy *of* stamp duty revenues with respect, to the gross domestic product is estimated to be 1.2 for the period 1980-81 to 1992-93. This high buoyancy can be attributed largely lo growth in the component of the tax from property transactions.

Stamp Duty is levied on a variety of financial, legal, properly and shipping related transactions. These can he broadly classified into judicial and non-judicial stamps. About 95 percent of the revenues accrue from (lie sale of non-judicial stamps. The most important component of (Ins is (lie sale of stamps for use in various types of financial, administrative and properly related transactions. The oilier types of non-judicial stamps include duly on oilier documents, fines and penalties, refunds and others. These together account for about 9 percent of total stamp duty revenues. Revenues from judicial stamps currently account for only about 6 percent of stamp duty revenues. These include revenues from court fees, fines and penalties and refunds.

The Stamp Act under which the stamp duly is collected was promulgated in 1899. Thus the 1-iasic structure of stamp duty rates was formulated a longtime ago. Over the years the provincial governments have adopted a strategy of selective, ad-hoc duty rate revisions on particular documents and have not gone in for comprehensive revision of duty rates. As a consequence tlie current structure has a number of peculiar features: first, some of tlie rates have not been revised since the formulation of the act. And arc therefore very low; second, tlie structure is fraught with anomalies where potentially a higher duly rate is charged on a lower volume of transaction (for example reconveyance of properly or appraisement or valuation where a Rs 1000 transaction is liable lo a higher duty than a Rs 1001 transaction); third, duly on some administrative/legal documents, in particular, continues lo be on a flat rate basis, resulting in a low buoyancy in revenues and finally, classification of duty slabs have ceased lo he meaningful. The current rate structure is a combination of specific and advalorem rates, ranging from very low to very high with some intcrprovincial differences.

Some effort has been made in recent years in both tlie provinces to enhance stamp duty rates. Duly rates on some property related and financial instruments, in particular, have been revised in the last few years. Both tlie governments of Sindli and Punjab have improved tlie system of valuation to improve stamp duty collections in recent years from property. However, rates have remained unchanged, particularly on oilier documents, for the last many years highlighting scope for rate revisions, additionally so because of attrition due to inflation.

The objectives of a reform strategy, on (lie one ha nd, should be to remove these anomalies and make the structure up to dale, progressive, and buoyant while, on the other hand, should lie lo exploit more efficiently the full potential of this revenue source. Stamp duty on most administrative/legal documents is currently on specific, flat rate basis. The purpose presumably is to keep the structure simple and minimise discretion. However, (here arc certain documents such as letters of credit, articles and memorandum of association or a company and Idler of allotment of shares, where an advalorem stamp duly is easy to assess and coiled. Switchover in such a case will not only increase the elasticity or revenues and result in higher resource mobilisation but will also make the structure more progressive. The concept of revisions proposed in (lie study is that an advalorem rate in x paisas per Rs 100 is collected upto a maximum amount, beyond which there are economics of scale in tax payment. Also, a reasonable minimum amount of stamp duty is suggested to preserve legality of each document. A higher escalation is proposed in the case of higher value documents involving corporate transactions in view of equity considerations.

Rental income from properties is significantly undertaxed as a whole in the country. Stamp duty rate on rental agreements is also currently very low, at a Hat rate of Rs 10, and lias remained so for many years. In view of the rapid rise in property values in the country during the last two decades, an enhancement in stamp duty rates appeals to he justified. The proposed new rate is Rs 50 per rental document. Stamp duty on transfer of shares is currently 1.5 percent and has remained unchanged for almost a decade or so. It is suggested that the duty that the enhanced to 2.0 percent of (lie face value of the shares. Rates on a multitude of administrative, legal and oilier documents can be enhanced in cither Sindh or Punjab to the maximum level prevailing in tlie two provinces.

Identification of potential new areas like stamp duly on bonds under section 15 of tlie Stamp Duty Act to cover bonds/saving certificates of DFIs, National Investment Trust, National Development Finance Corporation, Pakistan Investment Credit and Investment Corporation, Bankers Equity Ltd., and Water and Power Development Authority. Stamp duty at a rate of 0.5 percent of face value can be collected at the time of sale of bonds. Another potential area of extension is the bill of entry on import, consignments. A minimum duty of Rs 50 plus 5 paisa per Rs 100 [maximum of Rs 500J is proposed. Duty on tlie above two is both easy to assess and collect and will not increase tlic costs of collection significantly.

To maximise tlic absorption capacity of the proposed package, it is suggested that the package be implemented in a phased manner. The implementation of tlic package is recommended to start from 1995-96. Quantification of tlie additional revenue impact of the proposals is done by projecting (lie relevant lax bases at historical growth rates. About 50 percent of these incremental revenues are generated through increase in stamp duly rates some 32 percent through an extension in (lie coverage of stamp duties while (lie remaining 18 percent are through a switchover in tlie nature of the duty from specific to advalorem.

It is expected that if all of these proposals are adopted, tlie potential additional yield accruing to tlie provinces commodity cumulative would be of the order of Rs 1.7 billion by tlie year 2002-03.

RATIONALIZATION OF STAMP DUTIES
ON FINANCIAL ASSETS AND TRANSACTIONS

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RATIONALIZATION OF STAMP DUTIES

There was consensus in the conference on Expenditure Planning and Resource Mobilisation that the process of revenue generation from stamp duties should shift from immovable property to financial and other assets. The general perception was that current duty rates on properties are high while rates on financial, administrative, legal and shipping transactions arc low and as a consequence revenues from the latter component have not shown high buoyancy over time. The purpose of this report is to see if scope exists for enhancing revenues from stamp duties (other than those on property) either through rate enhancement and/or change in the nature of tax levy, that is, by a switchover from specific to ad-valorem taxation. We start first in Chapter 1 with the trend in stamp duty revenues. Chapter 2 gives composition of revenues while chapter 3 discusses the structure of duty rates. Potential areas of reforms and scope for extension in the coverage of stamp duties is presented in chapters 4. Finally, phasing of implementation of proposals and additional revenue generation is given in the last chapter.

CHAPTER ONE
TREND IN STAMP DUTY REVENUES

The Government of India introduced stamps in 1847. After various changes the stamp Act of 1899 was enacted which is still in force, with slight changes. The Stamp Act is purely a fiscal statute. Its sole objective is to increase revenues and all its provisions must be construed as having in view the protection of revenues. It, however, also helps in (he detection of foregery of documents.

Stamp duty is the single largest source of tax revenue of the provincial governments. It currently accounts for about 45 percent of the total provincial tax receipts (see table 1.1). Revenues have increased rapidly from Rs 620 million in 1980-81 to Rs 3942 million in 1992-93 at an average annual rate of about 17 percent. As compared to this total provincial tax receipts have increased at about 12 percent per annum only.

The overall buoyancy of stamp duly revenues with respect to the gross domestic product is estimated to be 1.2 for the period 1980-81 to 1992 93. This high buoyancy can largely be attributed to growth in the property tax component of the tax. In particular, the provincial governments of Sindli and Punjab have put in significant effort to improve the valuation of properties in recent years.

TABLE 1.1

TREND IN STAMP DUTY REVENUES, 19HO-81 TO 1992-93

|Rs in Million'1

Years	Stamp Duty Revenues	Total Tax Revenues	Stamp Duty as % of Total Taxes
1980-81	620	2192	28.3
1981-82	698	2366	29.5
1982-83	759	2586	29.4
1983-84	819	2841	28.8
1984-85	929	3174	29.3
1985-86	943	3374	27.9
1986-87	1285	3581	35.9
1987-88	1395	4036	34.6
1988-89	1709	4547	37.6
1989-90	1789	5023	35.6
1990-91	2522	6764	37.3
1991-92	3526	7761	45.4
1992-93	3942	8788	44.9
ACGR*	16.7	12.3	3.9

Source: Annual Budget Statements of the provinces.

*Annual cumulative growth rate.

CHAPTER TWO

COMPOSITION OF STAMP DUTY REVENUES

Stamp Duty is levies on a variety of financial, legal, properly and shipping related transactions. There can broadly be classified into judicial and non-judicial stamps. A brief description of these is presented below.

2.1 Revenues from Non- Judicial Stamps

The composition of stamp duty revenues is presented in table 2.1. The table shows that about 95 percent of the revenues accrue from (.lie sale of non-judicial stamps. The most important component of this is the sale of stamps for use hi various types of financial, administrative and property related transactions. In 1992-93 total revenues from the sale of non-judicial stamps was about Rs 3.4 billion. The share of this component in total stamp duty revenues has increased over time.

The other types of non-judicial stamps include duty on other documents, fines and penalties, refunds and others. These together account for about 9 percent of total stamp duty revenues.

2.2 Revenues from Judicial Stamps

Revenues from judicial stamps currently account for only about 6 percent of stamp duly revenues. These include revenues from court fees fines and penalties and refunds. The decline in court fees in the late 70s and early 80s and the specific nature of the levy arc the

TABLE 2.1

COMPOSITION OF STAMP DUTY REVENUE IN PAKISTAN

[Rs. in Million]

Years	NON- JUDICIAL							JUDICIAL			
	Stamp Duties	Sale of Stamps.	Duty on Other Documents	Fine & Penalties	Refunds	Miscell - aneous	Total	Court Fees	Fine & Penalities	Refunds	Total
1979-80	450	337	72	0	35	14	389	60	1	0	61
1980-81	620	498	80	0	41	10	547	72	1	0	73
1981-82	698	522	111		46	25	612	84	1	0	85
1982-83	759	569	149	0	80	32	670	88	1	0	89
1983-84	819	606	164	0	80	27	717	100	1	0	101
1984-85	929	715	180	0	89	32	838	90	1	0	91
1985-86	943	751	152	0	79	32	856	86	1	0	87
1986-87	1285	1080	153	1	87	33	1180	103	-;	0	105
1987-88	1395	1189	160	1	96	33	1286	104	^	0	108
1988-89	1709	1489	167	1	104	33	1586	117	5	0	123
1989-90	1789	1546	185	2	106	33	1661	124	4	0	129
1990-91	2522	2051	377	4	84	29	2387	130	6	0	135
1991-92	3526	3071	295	5	23	9	3357	166	5	0	169
1992-93	3942	3398	322	6	2	12	3736	222	5	21	206
					Percentage Share						
1979-80	100	75	16.1	0	7.7	3.1	86.4	13.4	0.18	0	13.6
1992-93	100	86.2	8.2 .	0.1	0.1	0.3	94.8	5.6	0.13	0.54	5.2

Annual Budget Statement.

primary reasons for the low and declining share of this component in overall stamp duty revenues. A study of composition of the sale of stamps in Karachi shows that hulk of the stamps solds are special adhesive stamps which are used in all kinds of financial and legal transactions. These account for 63 percent of total sale of stamps. The second category includes non-judicial stamps or stamp papers which are also used for various types of documentation, accounting for 9 percent of the sale of stamps. Similarly, 9 percent of the sale is accounted for by share transfers, while foreign hills, used for foreign bills of exchange, account for 8 percent of total sale. Oilier types of stamps include revenue insurance and notary stamps etc. (see table 2.2].

2.3 Denomination of Stamps: *Case Study of Sindh*

Total number of stamps sold and their value by denomination is given in table 2.3. The bulk of stamps sold are of 50 paisa denomination accounting for 37 percent of stamps sold. However, given the low denomination, these account for less than 3 percent of the total value of sale of stamps. In terms of value, highest contribution is by stamps of Rs 10,000 denomination. It is not possible to relate the denomination of stamps to the type of document it is used for. Depending on the duty rate, multiple denomination of stamps are generally used in each document.

Stamps with a denomination of less than Re 1 together account for only about 3 percent of tlie sale while (heir share in total number of stamps sold is about 38 percent. Given that these denominations generally have not been revised since the framing of lhe stamp act, some adjustment for inflation is long over-due. It is suggested (hat the minimum value of stamps he raised to Re 1.

TABLE 2.2

COMPOSITION OF SALES OF STAMPS IN KARACHI

	Stamp	Type of Transaction	Share in Total (%)
1.	Non-Judicial Stamps	Stamp paper	9.1
2.	Hundi Stamp*	Business Community, loans, etc.	0.0
3.	Revenue Stamps	Acknowledgement, etc.	3.3
4.	Insurance Stamps*	Insurance policy, etc.	3.2
5.	Share Transfer*	Transactions related to share)	8.8
6.	Foreign Bills*	Foreign bill of exchange	8.2
7.	Special Adhesive Stamps	General	63.4
8.	Brokers Note*	Stock exchange brokage	0.0
9.	Agreement Stamp*	Agreements	0.0
10.	Notarial Stamps	Notary public	0.1
11.	Court Fees	Court Fees	4.0
	TOTAL		**100.0**

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* Transaction is held in Karachi only.

TABLE 2.3

DENOMINATION OF STAMI'S [SINDII 1990-9]

Determin-ation of Stamps *[in Rs]*	Total of Non-Judicial Stamps *[000 Nos]*	Total of Judicial Stamps *[000 Nos]*	Grand Total of Stamps *[000 Nos]*	Sales of Non-Judicial Stamps *[000 Rs]*	Sales of Judicial Stamps *[000 Rs]*	Total sales of Slumps *[000 Ry]*	Share in Total Sales *[%]*
0.05	50.0	0.0	50.0	2.5	0.0	2.5	0.0004
0.25	15.0	23.4	38.4	3.8	5.9	9.6	0.002
0.50	28220.1	169.4	28389.6	14110.1	84.7	14194.8	2.71
0.75	607.5	0.0	607.5	455.6	0.0	455.6	0.09
1.00	4770.3	1622.3	6392.6	4770.3	1622.3	6392.6	1.22
1.50	40.0	40.5	80.6	60.0	60.8	120.9	0.02
2.00	2194.1	801.9	2986.0	4368.2	1603.7	5972.0	1.14
3.00	2363.8	5.1	2369.8	7091.3	15.2	7106.4	1.36
4.00	2715.9	3.2	27191.1	10863.6	12.9	10876.4	2.08
5.00	2393.4	121.2	2514.5	11966.9	605.8	12572.7	2.40
6.00	597.6	0.0	597.6	3585.4	0.0	3585.4	0.69
9.00	5.0	0.0	5.0	45.0	0.0	45.0	0.01
10.00	3804.7	31.9	3836.7	38047.4	319.3	38366.7	7.34
15.00	46.1	0.2	46.4	692.0	3.3	695.3 -	0.13
20.00	79.0	35.8	114.7	1579.1	715.8	2294.9	0.44
25.00	57.6	0.5	58.1	1439.4	13.6	1452.9	0.28
30.00	347.8	0.1	347.9	10432.6	3.1	10435.7	2.00
35.00	2.4	0.5	2.9	84.6	15.9	100.5	0.02
40.00	8.0	0.1	8.1	3)8.2	4.4	322.7	0.06
45.00	33.5	0.1	33.6	1507.6	5.3	1512.9	0.29
50.00	414.3	0.3	414.6	20713.9	16.5	20730.4	3.96
60.00	50.4	0.1	50.5	3025.8	4.5	3030.3	0.58
70.00	0.0	0.0	0.0	0.0	0.3	0.3	0.0001
75.00	14.4	0.3	14.7	1077.3	21.6	1098.9	0.21
80.00	0.0	0.1	0.1	0.0	4.6	4.6	0.001
100.00	160.3	0.4	160.7	16032	37.4'	16069.9	3.07
125.00	0.0	0.1	0.1	0.0	16.0	16.0	0.003
150.00	5.5	0.3	5.8	821.0	52.2	873.2	0.17
200.00	97.0	0.8	97.8	19407.8	150.2	19558.0	3.74
250.00	4.1	0.6	4.6	1013.3	148.0	1161.3	0.22
300.00	10.9	0.6	11.5	3274.8	184.2	3459.0	0.66
400.00	3.0	0.9	4.0	.. 1202.8	379.6	1582.4	0.30
500.00	52.6	4.4	56.9	26282.5	219i.5	28474.0	5.44
750.00	0.0	0.0	0.0	19.5	0.0	19.5	0.004
1000.00	41.6	0.6	42.0	41565.0	449.0	42014.0	8.03
2000.00	4.7	0.4	5.1	9360.0	798.0	10158.0	1.94
3000.00	2.1	4.6	6.7	6267.0	13923.0	20190.0	3.86
5000.00	7.6	0.2	7.7	37780.0	865.0	38645.0	7.39
10000.00	19.9	0.0	19.9	199370.0	0.0	199370.0	38.12

Source: The Provincial Tax Base Study, DIST Consulting Group

CHAPTER THREE

STRUCTURE OF STAMP DUTY RATES

The Stamp Act under which the stamp duty is collected was promulgated in 1899. Thus the basic structure of stamp duty rates was formulated a longtime ago. Over the years the provincial governments have adopted a strategy of selective, ad-hoc duty rate revisions on particular documents and have not gone in for comprehensive revision of duty rates. As a consequence the current structure has a number of peculiar fe atures: first, some of the rates have not been revised since the formulation of the act and are therefore very low; second, the structure is fraught with anomalies where potentially a higher duty rate is charged on a lower volume of transaction, (examples is reconveyance of property or appraisement or valuation where a Rs 1000 transaction is liable to higher duty than a Rs 1001 transaction), third, duty on some administrative/legal documents, in particular, continues to be on a flat rate basis, resulting in a low buoyancy in revenues and finally, classification of duty slabs have ceased to be meaningful. There is need to increase them in line with inflation.

We discuss below the level and structure of stamp duty rates, concentrating our analysis on the two biggest provinces which account for 96.8 percent of stamp duly revenues in the country.

3.1 Rate Structure

Stamp duly rates on major transactions in Punjab and Sindh are presented in table 3.1. The rate structure is a combination of specific and advalorcni rates, ranging from very low to very high with some interprovincial differences. By and large, it appears that duly rates are

TABLE 3.1
STAMP DUTY RATES ON MAJOR DOCUMENTS

Art. #		P U N J A B		S I N D II	
		Type of Tax	Rate	Type of Tax	Rate
	A. NEGOTIABLE INSTRUMENTS				
13	Bill of Exchange	A	0.01	A	0.02
15	Bonds	A	2.0	A	4.5
27	Debentures	A	3.0	A	3.5
49	Promissory Notes	A	0.01-0.2	S	11.25
	B. MORTGAGE/CONVEYANCE/TRANSFER/EXCIIANGE				
	Mortgage				
40	Deed	A	1-6	A	1-9
41	of a Corporation	A	0.15	A	0.125
	With Possession	A	5-10	A	7-9
	Without Possession	A	2	A	4.5
32	**Further Charge**				
	With Possession	A	5-6	A	7-9
	Without Possession	A	2	A	4.5
23	**Conveyance**				
	Agricultural Land & Rural Area	A	5	A	7
	Others (only Urban Area)	A	8.5-10	A	9
54	**Re-conveyance of Mortgage**				
	Less than Rs 1000	A	2	A	4.5
	Otherwise	S	50	S	30
62	**Transfer of:**				
	Shares	A	1.5	A	1.5
	Debentures	A	3	A	3
	Property	S	50	S	30
	Trust Property	S	20	S	20
31	**Exchange of Property**				
	Agricultural Land	A	2	A	7
	Otherwise	A	5	A	9
33	**Gift/Hiring**				
	Legal Hire	A	1-2	A	7-9
	Otherwise	A	5-6	S	10
35	**C. LEASE**				
	Fixed Land Without Advance				
	Upto 3 years	A	2	A	4.5
	Above 3 years	A	3	A	3.5
	Otherwise	A	5-10	A	7-9

63	Transfer of Incase	A	5-10	A	7-9
61	Surrender of Lease	S	30-50	A	3.5-4.5
47	**D. INSURANCE**				
	Sea	A	0.002-0.003	A	0.006-0.009
	Life	A	0.04	A	0.12
	D. ADMINISTRATION/LEGAL				
2	Administration Bond				
	Less than Rs 1000	S	20	A	4.5
	Others	S	50	S	30
3	Adoption Deed	S	50	S	50
4	Affidavit	S	4	S	10
7	Appointment in Execution of				
	Trustee or Property	S	35.70	S	35.70
8	Appraisement or Valuation				
	Less than Rs 1000	S	20	A	4.5
	Others	S	50	S	30
38	Letter of Licence	S	50	S	25
57	Indemnity Bond/Security Bond				
	Less than Rs 1000	A	2	A	4.5
	Other	S	50	S	50
48	Power of Attorney				
	To sell property	A	5-10	A	7-9
	For a Single Transaction	S	10	S	25-50
	For more than one transaction	S	50	S	75-100
5	Agreement or its Memorandum				
	Relating to sale of				
	Bill of Exchange	S	1	S	1
	Government Security	A	0.005	A	0.005
	Share of incorporated				
	or Other Companies	A	0.005	A	0.005
	Others	S	10	S	10
6	**Agreement Related To De - Pawn or Pledge**				
	Less than 3 months	A	0.01	A	0 0)
	Others	A	0.01	A	0.02
46	Instrument/dissolution of Partnership				
	Capital up to Rs 500	S	50	S	10
	Others	S	50	S	50
	Dissolution	S	25	S	25

43	Note Memorandum				
	Any good exceeding Rs 20	S	2	S	0.5
	Stock or security other than				
	Government Security	A	0.04	A	0.005
	Government Security	A	0.01	A	0.0025
	Others	S	2	S	0.5
9	Apprenticeship Deed	S	50	S	25
11	Article of Clerkship	S	750	S	500
29	Divorce	S	15	S	15
42	Notarial Act	S	5	S	4
10	Articles of Association				
	with Share Capital (SC)			S	50
	SC ? 2500	S	100	S	125
	2500 < SC < 100,000	S	200.00	S	500
	100,000 SC < 100,0000	S	1000	S	750
	> 100,00000	S	2500	S	750
39	Memorandum of Association				
	If accompanied by Articles				
	Of association	S	100	S	75
	Otherwise	S	250	S	200
64	Trust	A	2	A	4.5
36	Letter of Allotment of Share	S	2	S	0.5
59	Share Warrants	A	4.5	A	5.25
37	Letter of Credit	S	2	S	10-50
53	Receipts				
	< Rs 100	S	0.15		0
	Rs 100 < value < Rs 2000	S	0.4	S	1
	Rs 2000 to Rs 10000	S	1	S	1
	Rs 10000 and above	S	2	S	1
1	Acknowledge of Debt				
	Rs 20 < x < 100	S	0.15		0
	Above Rs 10000	S	2	S	1
	F. <u>SHIPPING</u>				
14	Bill of Lading	S	1	S	10
16	Bottomry Bond	A	2	A	4.5
20	Charter Party		0	S	5
26	i) Customs Bond	A	2	A	4.5
	ii) > Rs. 1000	S	50	S	40
28	Delivery Order in Respect of Goods	S	2	S	5
44	Note of Protest by the Master of Ship	S	5	S	4
51	Protest by llie Master of a Ship	S	5	S	1
56	Respondent ia Bond	A	2	A	4.5
60	Shipping Order	S	2	S	0.25
65	Warrant for Goods		0	S	2

A = Ad-Valorem Rate in Percent.

S = Specific Rate in Rupees

relatively high on properly related transactions being as high as 6 to 9 percent in (lie two provinces. Rates also appear to he high on negotiable instruments, particularly bonds, in the province of Sindh. As opposed to tills, rates arc rather low on administrative/legal, insuranc e and shipping related documents.

Furthermore, the general pattern appears to be that duty rates are advalorem (or graduated -specific) on properly related document and negotiable instruments. As compared to this rates are, by and large, specific on administrative/legal, insurance and shipping documents. As already mentioned, this is one of the primary reasons why revenues from these documents have relatively low buoyancy.

Even though there are inter-provincial difference in the duty rates, there do not appear to be major differences in the nature of duties charged on different documents across provinces. In general ad valorem rates on negotiable instruments and properties are higher in Sindli than in Punjab. Alternatively, specific rates on some administrative/legal documents are higher in Punjab compared to Sindh. Scope, therefore, exists for selective enhancement in rates in both the provinces.

3.2 Rate Revisions

Some effort has been made in recent years in both the provinces to enhance stamp duty rates. Table 3.2 gives the last year of duty rate escalation in both (lie provinces. As can be seen from the table duty rates on some property related and financial instruments, in particular, have been revised in the last few years. However, rates on oilier documents have remained unchanged for (lie last many years highlighting scope for rate revisions.

TABLE 3.2

YEAR OF EFFECTIVENESS OF PRESENT RATES

Art. #		PUNJAB	SJNDH
	A. NEGOTIABLE INSTRUMENTS		
13	Bill of Exchange	1969	1989
15	Bonds	1969	1991
27	Debentures	1969	1982
49	Promissory Notes	1990	1989
	B. MORTGAGE/CONVEYANCE/TRANSFER/EXCHANGE		
	Mortgage		
40	Deed	1969	1969
41	of a Corporation	1990	1991
	With Possession	1992	1990
	Without Possession	1969	1969
32	Further Charge		
	With Possession	1992	1990
	Without Possession	1969	1969
23	Conveyance		
	Agricultural Land & Rural Area	1990	1990
	Others (only Urban Area)	1992	1990
54	Reconveyance of Mortgage		
	Less than Rs 1000	1969	1969
	Otherwise	1990	1969
62	Transfer of:		
	Shares	1990	1981
	Debentures	1990	1981
	Property	1990	1969
	Trust Property	1990	1969
31	Exchange of Property		
	Agricultural Land	1990	1990
	Otherwise	1990	1990
33	Gift/Hiring		
	Legal Hire	1975	1990
	Otherwise	1975	1989
35	**C. LEASE**		
	Fixed Land Without Advance		
	Upto 3 years	1969	1969
	Above 3 years	1969	1969
	Otherwise	1992	1990

CHAPTER FOUR
POTENTIAL AREAS OF REFORMS

4.1 Strategy of Reforms

Our analysis in the previous chapter highlights the existence of certain anomalies problems in the stamp duties structure in the two largest provinces. As such, the objectives of a reform strategy should be is on one hand to remove these anomalies and make the structure up to date, progressive, and buoyant while on the other hand to exploit more efficiently the full potential of this revenue source. The latter is indeed the primary objective for the collection of stamp duties. In line with the above the main components of the proposed reform strategy are the following: (1) adjustment of some of the duty slabs for inflation to make them more update and meaningful; (2) enhancement of duty rates which arc currently very low and have not been revised for tlie last few years; (3) change in the basis of levy, from specific to ad valorem rates structure wherever feasible and with substantial revenue gains (4) removal of imbalance in the duty revenue structure by putting in a higher effort in non-property documents; (5) extension of the coverage of stamp duties to feasible new areas.

Based on the above criteria a number of recommendations arc made below.

4.2 Switchover from Specific to Ad Valorem Rates

As already mentioned, stamp duly on most administrative/legal documents is currently on specific, flat rate basis. The purpose presumably is to keep the structure simple and minimise discretion. Also in some cases an advalorem structure is cither not possible due to absence of values or it is administratively infeasible. Example includes affidavits, divorce, adoption deeds etc. where only specific duly can be collected.

However, there arc certain documents where an advalorcm stamp duly is easy to assess and coiled. Switchover in such a case will not only increase the elasticity of revenues and result in higher resource mobilisation hut will also make the structure more progressive. A switchover is recommended in the following cases:

Potential Areas of
Switchover from Specific to Ad valorem Rates

Section	Description of Document
37	Letters of Credit
10	Articles of Association of a company
39	Memorandum of Association of a company
36	Letter of Allotment of Shares

It may lie mentioned here that switchover in the above cases is easy because the relevant documents have a statement of valuation and therefore, the problem of discretion in. assessment does nut arise and the duly structure continues to remain simple. The proposed rate structures are presented in table 4.1. Tlie concept of revisions proposed is that an advabrcni rate in x paisas per 100 Rs is collected upto a maximum amount, beyond which there are economics of scale in tax payment. Also, a reasonable minimum amount of stamp duly is suggested to preserve legality of each document. A higher escalation is proposed in the case of higher value documents involving corporate transactions in view of equity considerations.

TABLE 4.1

EXISTING AND PROPOSED STAMP DUTY RATES

	EXISTNG		
	Punjab	**Sindh**	**Proposed**
A. Letter of Credit			
Amount of			
0 - 50000	Rs 2	10	Rs 10 plus
50000 - 500000	"	25	5 paisas per Rs 100
500000 and above	"	50	(maximum of Rs 500)
B. Articles of Association of a Company			
Share Capital of:			
0 - 2500	100	50	Rs 100 plus
2500 - 100000	200	125	10 paisas per Rs 100
100000 - 1000000	300	500	(maximum Rs 5000)
1000000 – 5000000	1000	750	
C. Memorandum of Association of a Company			
If accompanied by articles of Association	100	75	Rs 100 plus 100 pnisas per Rs 100
Otherwise	250	200	(maximum of Rs 5000)
D. Letter of Allotment of Shares	2	0.50	Rs 5 plus 10 paisas per Rs 100 (maximum Rs 200)

4.3 Enhancement in Rates

Enhancement in rates is justified incases where current duty rates are low and have not been revised for the last many years. Furthermore, inter provincial variations in duty, rates also provide easy identification of areas where enhancement is justified on grounds of harmonisation of rates across provinces.

Immediate enhancement in stamp duty rates in justified in view of both undertaxation of relatively buoyant bases and rapid inflation in the following cases:

1) Property rental documents and
2) Transfer of shares

Rental income from properties is significantly undertaxed as a whole in the country. Stamp duty rate is also currently very low, at a flat Rs 10, and has remained so for many years. In view of the rapid rise in property values in the country during the last two decades, an enhancement in stamp duty rates appears to be justified. The proposed new rate is Rs 50 per rental document.

Similarly significant buoyancy has been witnessed in the share market during the Inst few years which has not benefited the public exchequer in view of the exemption of capital gains from income lax. Stamp duly on transfer of shares is currently 1.5 percent and has remained unchanged for almost a decade or so. It is suggested that the duty rate be enhanced to 2.0 percent of the face value of the stamps.

Finally, stamp duty rates on a multitude of administrative, legal and other documents can be enhanced in either Sindh or Punjab to the maximum level prevailing in the two province. Tills process alongwith enhancement of minimum stamp value to Re 1 can generate substantial revenues for the provincial governments.

4.4 Extension in the Coverage of Stamp Duties

We move next to the identification of potential new areas for (lie levy of stamp duties through cither broadening the definition of stamp duly base or extension to easily tepable new areas with significant revenue potential. Two such potential areas include first, levy of stamp duty on bonds under section 15 of the stamp duty act to cover bonds/saving certificates of DFIs, National Investment Trust, National Development Finance Corporation, Pakistan Investment Credit Corporation, Banker Equity and Water and Power Development Authority. Stamp duty at a rate of 1/2% of face value can be collected at the time of sale of bonds. Many of these bonds are bearer in character and carry relatively low rate (fixed at 10 percent) of income tax.

Another potential area of extension is the bill of entry on import consignment. The ongoing process of tariff reforms whereby custom duty rates arc being sealed down substantially open up the possibility of a small imposition by financial governments. A minimum duty of Rs 50 plus 5 paisa per Rs 100 maximum of Rs 500] is proposed. Duly on the above two is both easy lo assess and collect and will not increase the costs of collection significantly. Also, these are buoyant sources with minimum distortionary consequences.

CHAPTER FIVE
PHASING OF IMPLEMENTATION OF PROPOSALS AND ADDITIONAL REVENUE GENERATION

To maximise tlie absorption capacity of the proposed package, it is suggested that the package be implemented in a phased manner. The implementation of the package is recommended to start from 1995-96, with implementation of the suggested increase in duty rates and a transition from specific to advalorcm rate in the case of letters of credit only. In the following year it is suggested that memorandum and articles of association of a company and letter of allotment of shares be made ad valorem along with the extension in the definition of section 15 to include bonds of DFI, BFL etc. Finally, in the subsequent year, hill of entry may be brought into stamp duty net.

Quantification of (lie additional revenue impact of the proposals is done by projecting the relevant tax bases at historical growth rates. For example, gains from switchover to advalorem rules is estimated by projecting the number of letter-of credit, (LC) and the number of new companies being established each year in the case of switchover etc. (For detailed quantifications see the appendix].

Year wise additional revenue generation from the package is presented in table 5.1. In the first year of its introduction the package is likely to generate Rs 400 million. Incremental revenues from the package increase as additional proposals are implemented and in the last year of the analysis, 2002-03, additional revenues of Rs 1708 million arc projected. This implies that revenues from stamp duly would be higher by about 10 percent over their projected level, i.e. in the absence of any proposals. About 50 percent of these incremental

TABLE 5.1
PHASING OF PROPOSALS AND ADDITIONAL REVENUE

|Rs in Million]

	Proposal/year	1995-96	1996-97	1997-9S	1998-99	1999-2000	2000-01	2001-02	2002-03
A	Switchover to advolorem	85	131	149	169	193	220	251	287
	• Letter of Credit	85	96	107	121	136	153	172	194
	• Articles & Memoradum of Association	—	12	14	16	19	22	26	31
	• Allotment Letter of Share	—	23	2S	32	38	45	53	62
B	Increase in Duty Rates	315	364	421	4S7	563	652	756	876
	• Transfer of Share	85	10U	117	13S	162	190	224	264
	• Rental Documents	30	34	40	45	52	60	69	80
	• Humonisation across Province/Increase in Minimum Stamp	200	230	264	304	349	402	463	532
C	Extension in Coverage	0	69	292	331	375	425	481	545
	• Bonds	—	69	79	91	105	121	139	160
	• Bill of Entry	—	—	213	240	270	304	342	385
D	**Total**	**400**	**564**	**S62**	**9S7**	**1131**	**1277**	**1488**	**1708**
E	Project Stamp Duty Revenue (In the absence of any Proposal)	6453	7137	8279	9604	11141	12923	14991	17390
F	Additional Revenue as % of Projected Revenues	6.5	7.9	10.4	10.3	10.2	10.0	9.9	9.8
G	Total Revenues (with proposal)	6553	7701	9141	10591	12272	14190	15479	19098

revenues are generated through increase in stamp duty rates, some 32 percent through an extens ion in the coverage of stamp duties while (lie remaining 18 percent are through a switchover in the nature of the duty from specific to advalorem.

63	Transfer of Lease	1992	1990
61	Surrender of Lease	1990	1991
47	**D. INSURANCE**		
	Sea	1969	1990
	Life	1969	1990
	E. ADMINISTRATION/LEGAL		
2	Administration Bond		
	Less than Rs 1000	1969	1969
	Others	1990	1969
3	Adoption Deed	1969	1969
4	Affidavit	1990	1989,
7	Appointment in Execution of Trustee or Property	1969	1969
8	Appraisement or Valuation		
	Less than Rs 1000	1969	1969
	Others	1990	1969
38	Letter of Licence	1990	1969
57	Indemnity Bond/Security Bond		
	Less than Rs 1000	1969	1969
	Others	1990	1991
48	Power of Attorney		
	To sell property	1992	1990
	For a Single Transaction	1969	1989
	For more than one transaction	1990	1982
5	Agreement or its Memorandum Relating to sale of		
	Bill of Exchange	1969	1969
	Government Security	1969	1991
	Share of incorporated or Other Companies	1990	1991
	Others	1990	1977
6	Agreement related to De-Pawn or Pledge		
	Less than 3 months	1969	1969
	Others	1969	1969
46	Instrument / dissolution of Partnership		
	Capital upto Rs 500	1990	1969
	Others	1969	1969
	Dissolution	1990	1969

43	Note Memorandum		
	Any good exceeding Rs 20	1990	1969
	Stock or security other than Government Security	1990	1969
	Government Security	1990	1969
	Others	1990	1969
9	Apprenticeship Deed	1990	1991
11	Article of Clerkship	1990	1991
29	Divorce	1969	1969
42	Notarial Act	1990	1991
10	Articles of Association with Share Capital (SC)		
	SC < 2500	1990	1969
	2500 < SC < 100,000	1990	1977
	100,000 SC < 100,0000	1990	1977
	> 100,00000	1990	1977
39	Memorandum of Association If accompanied by Articles:		
	Of association	1990	1969
	Otherwise	1990	1969
64	Trust	1990	1982
36	Letter of Allotment of Share	1990	1969
59	Share Warrants	1969	1969
37	letter of Credit	1990	1981
53	Receipts		
	< Rs 100	1969	--
	Rs 100 < value < Rs 2000	1990	1991
	Rs 2000 to Rs 10000	1990	1991
	Rs 10000 and above	1969	1991
1	Acknowledge of Debt		
	Rs 20 < x < 100	1990	--
	Above Rs 10000	1990	1991
	F. <u>SHIIT1NG</u>		
14	Bill of Lading	1969	1977
16	Bottomry Bond	1969	1969
20	Charier Party	--	1969
26	i) Customs Bond	1969	1969
	ii) > Rs. 1000	! 990	1982
28	Delivery Order in Respect of Goods	1990	1990
44	Note of 1'rolest by (he Master of Ship	1990	1969
5!	Protest by (he Master of a Ship	1990	1969
56	Rcspondentia Bond	1969	1969
60	Shipping Order	1990	1969
65	Warrant for Goods	--	1969

OVERHEADS FOR PRESENTATION ON RATIONALISATION OF STAMP DUTIES

A-5 <u>CONSTRAINED OPTIMIZATION:</u>

The constrained optimization problem of the health system assumes that the urban health facility has sufficient infrastructure and it is more than that of the Standard optimal. Thus additional infrasturucture is not needed in the urban health facility and therefore the development expenditure in this case will be zero for *UHFs*. In order to derive optimal solution for the constrained strategy, the budget constraint for *UHFs* (C,,) should be modified as follows:

$$
\begin{aligned}
\overline{C} &= C_1 + C_2 & \text{-------}(2.I)\\
C_1 &= W_{D_1}D_1 + W_{N_1}N_1 + W_{P_1}P_1 + m_1\overline{B} \\
C_2 &= W_{D_2}D_2 + W_{P_2}P_2 + m_2R + c_2\ R
\end{aligned}
$$

The input supply function for UHFs and RHFs are still the same, but tile lagrangian of the new optimization process can be written as:

$$
\begin{aligned}
\mathfrak{L}(W_{D_1}, W_{N_1}, W_{P_1}, W_{D_2}, W_{P_2}, R, \lambda) = &\Big[\Phi_{10}\ \overline{B}^{\Phi_{14}} \left(\alpha_{10}\ W_{D_1}^{\alpha_{11}}\ Z_D^{\alpha_{12}}\right)^{\Phi_{11}} \\
&\left(\alpha_{20}\ W_{N_1}^{\alpha_{21}}\ Z_N^{\alpha_{22}}\right)^{\Phi_{12}} \left(\alpha_{30}\ W_{P_1}^{\alpha_{31}}\ Z_{P_1}^{\alpha_{32}}\right)^{\Phi_{31}}\Big]^{\delta} \Big[\Phi_{20}\ R^{\Phi_{23}} \left(\beta_{10}\ W_{D_2}^{\beta_{11}}\ Z_D^{\beta_{12}}\right)^{\Phi_{21}} \\
&\left(\beta_{20}\ W_{P_2}^{\beta_{21}}\ Z_{P_2}^{\beta_{22}}\right)^{\Phi_{22}}\Big]^{(1-\delta)} + \lambda\Big[\overline{C} - W_{D_1}\left(\alpha_{10}\ W_{D_1}^{\alpha_{11}}\ Z_D^{\alpha_{12}}\right) - W_{N_1} \\
&\left(\alpha_{20}\ W_{N_1}^{\alpha_{21}}\ Z_N^{\alpha_{22}}\right) - W_{P_1}\left(\alpha_{30}\ W_{P_1}^{\alpha_{31}}\ Z_{P_1}^{\alpha_{32}}\right) - m_1\ \overline{B} - W_{D_2} \\
&\left(\beta_{10}\ W_{D_2}^{\beta_{11}}\ Z_D^{\beta_{12}}\right) - W_{P_2}\left(\beta_{20}\ W_{P_2}^{\beta_{21}}\ Z_P^{\beta_{22}}\right) - m_2\ R - c_2\ R
\end{aligned}
$$

First order conditions for the above system can written as

$$
\frac{\partial \mathfrak{L}}{\partial W_{D_1}} = \alpha_{11}\ \phi_{11}\delta\ \frac{O_T}{W_{D_1}} - \lambda(\alpha_{11}D_1 + D_1) = 0
$$

OUTLINE
OF THEP RESENTATION
ON STAMP DUTIES

? INTRODUCTION

- ✍ REVENUE SIGNIFICANCE
- ✍ COMPOSITION AND STRUCTURE OF STAMP DUTIES
- ✍ STAMP DUTY RATE STRUCTURE

? ISSUES IN STAMP DUTIES

? STRATEGY OF REFORMS

TABLE 1

REVENUE SIGNIFICANCE OF STAMPDUTIES

	Share in Provincial Tax Revenues (%)
PUNJAB	50.7
SINDH	32.5
NWFP	26.8
BALOCHISTYAN	14.8
PAKISTAN	**44.9**

AVERAGE ANNUAL GROWTH RATE (%) [1984-85 TO 1992-93]

PUNJAB	23.6
SINDH	11.6
NWFP	6.0
BALOCHISTAN	11.3
PAKISTAN	**17.1**

TABLE 2

MAJOR ISSUES IN STAMP DUTIES

? High Rates on Immovable Property-Related Documents

? Under valuation of Properties for Assessment of Stamp Duty

? Low Rates on Administrative and other Non-property-related documents

? Low Buoyancy of Revenues from Documents other than property-related.

? Erosion of Tax Base of Properties due to Exemptions

? Erosion of Tax Base due to the Levy of Federal Capital Value Tax

TABLE 3
DOCUMENTS ON WHICH STAMP DUTY HAS NOT BEEN REVISED FOR THE LAST FIVE YEARS

Article No.	Description	Article No.	Description
	A. NEGOTIABLE INSTRUMENTS		B. MORTGAGE/CONVEYANCE. TRANSFER/EXCHANGE
13	Hill or exchange		
15	Bonds		Mortgage
27	Debentures	40	Deed
		41	of a Corporation
			Without Possession
		32	Further Charge
		62	Transfer of:
			Shares
			Debentures
			Properly
			Trust Property
		33	Gift/Hiring
			Legal Hire
			Otherwise
35	C.LEASE		D. INSURANCE AND SHIPPING
	Fixed Land Without Advance	77	Sea and Life
	Uplo 3 years	14	Bill of Lading
	Above 3 years		
	E. ADMINISTRATION/LEGAL		
3	Adoption Deed	48	Power of Attorney
7	Appointment in Execution or		For a Single Transaction
	Trustee or Properly	5	Agreement or its Memorandum
8	Appraisement or Valuation		Relating to Sale of
	Less than Rs 1000		Bill of exchange
	Others		Government Security
6	Agreement related to De-Pawn or	46	Instrument/dissolution of Partnership
	Pledge		Capital uplo Rs 500
	Less than 3 months		Others
	Others	39	Memorandum of Association
43	Note Memorandum		If accompanied by Articles:
	Stock or security other than		01 association
	Government Security	59	Share Warrants
	Government Security	37	Letter of Credit
	Olliers	53	Receipts
			Rs 10000 and above

TABLE 4

DIRECTIONS OF REFORMS

? Kate Reduction and better valuation of Properties for taxation

? Hhigher Reliance on Non-property Related documents

? Rate escalation on Non-property Related documents

? Switchover from specific to Ad Valorem Rates

? Broadening of tax Base

SUMMARY OF DISCUSSIONS
ON
RESOURCE MOBILISATION FROM RATIONALISATION OF STAMP DUTY

Mr. Initial Ahmad Clieeiua, Secretary Excise & Taxation Punjab, suggested that there exists a need to increase the rate of stamp duty on non-property related transactions. Secondly, rates of stamp Duty (alongwith local levies) on property transfers are too high and need to be rationalised, while exemptions granted, particularly on mutations and transfers in areas within the jurisdiction of development authorities and co-operative societies, should be removed.

Mr. Meher Jewan Khan, Senior Member, Board of Revenue, Sindh, suggested that in Ills experience suggested that there was a need to educate people with respect to the scope and applicability of stamp duty. Citing an example, lie said that most people were not aware that stamp duty is also leviable on transaction like bonds, debentures, etc.

Mr. Wamique Zuberi, Editor, Business Recorder, stated tliat tlie very purpose of the stamp duty was defeated if an ad valorem structure were to be introduced. He, therefore, suggested that stamp duty should be low and specific in nature and that greater emphasis should be placed on non-property related transactions.

FOURTH SESSION

PROVINCIAL SALES TAXATION OF SERVICE

CONFERENCE
ON
RESOURCE MOBILISATION AND
EXPENDITURE PLANNING

SALES TAXATION OF SERVICES BY PROVINCIAL GOVERNMENTS

by
Dr. Hafiz A. Pasha

SPONSORED
hy
CANADIAN INTERNATIONAL DEVELOPMENT AGENCY
and
GOVERNMENT OF THE PUNJAB

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Avari Hotel, Lahore

SALES TAXATION OF SERVICES BY PROVINCIAL GOVERNMENTS

EXECUTIVE SUMMARY

Allocation of Fiscal Powers (Chapter 1)

The 1973 Constitution (inclusive of amendments upto date) gives the allocation of fiscal powers between the federation and the provinces. Direct taxes which falls under the domain of the federal government are: income tax, wealth tax, capital value tax and corporation tax. The indirect taxes of the federal government are customs duties, sales tax and excise duty. The coverage of the federal sales tax is restricted to the following: sales and purchases of goods imported, exported, produced, manufactured or consumed. Therefore, the federal coverage is restricted to goods, which implies that sales tax on services falls within the fiscal powers of provincial governments.

The 1991 NFC award represents a major step forward in rationalising the system of intergovernmental fiscal relations. The award represents a large expansion in tlie size of tlie divisible pool. The total transfers in 1992-93 is estimated at over Rs 72 billion compared to Rs 44 billion as per the 1974 NFC. Also, the award provides for provincial collection of retail sales tax of goods, following its introduction.

The federal government is expected to introduce comprehensive value added taxation on goods in Pakistan. Accordingly, the approach may be for provincial government's to levy a sales tax on services, in view of the implicit allocation of fiscal powers according to the Constitution.

Incidence of Indirect Taxes on Services (Chapter 2)

The objective of this chapter is to quantify the nominal incidence of different federal and provincial indirect taxes on the various service sectors of the economy. For all services combined the nominal incidence of federal and provincial taxes is estimated at 2.3 percent of the value added. Effective incidence excluding provincial taxes are generally much higher than estimates of nominal incidence. Banking and insurance and transport and communications sectors appear to be relatively overtaxed while the wholesale and retail trade and entertainment sectors are undertaxed.

Provincial Surcharge on Federal Excise Duties (Chapter 3)

The possibility exists for separate levy by the two governments on effectively the same tax base. A rational arrangement would be one in which even though there is more than one tax on a particular tax base, joint collection responsibility is handed over to one agency. This will create economies of scale in tax collection and reduce compliance costs.

Strategy for Provincial Resource Mobilisation (Chapter 4)

As there is a need for provincial resource mobilisation therefore, a number of criteria have been developed fur this purpose. The criteria relate to the undertaxation; extent of incidence on richer households; case for integration with national VAT; level of compliance and ease of collection; buoyancy of the lax base; ease of apportionment and lastly absence of distortionary effects. Based on the criteria we can identify target sectors for resource mobilisation through sales taxation by provincial governments.

Provincial Taxation of Services (Cliapter 5)

In this chapter we present specific taxation proposals in each sector. In the case of banking and insurance sector a provincial sales tax at a rate of Rs 0.50 per cheque, with collection responsibility of the federal excise department may be levied. As in the case of wholesale and retail trade sector the federal government stands committed to extending GST to the retail level as part of the agreement with the IMF. Therefore, a presumptive sales tax on trading sector can be introduced by enhancing the electricity duty on commercial consumers from 5 percent currently to 7.5 percent. A more conventional sales tax can be developed, with payments by taxpayers, on selective trades like electronics, jewellery, cosmetics, garments, etc. The tax will have to retain a presumptive character with flat rates (charged on quarterly basis) linked to municipal status of city/town. Sales tax on gas distribution be levied at tlie rate of 5 percent on a selective basis. Lastly in the case of professional services it is suggested that tlie rate be set initially at 2.5 percent.

Implementation Program (Chapter 6)

In the first phase we propose that electricity duty on commercial consumers be enhanced, sales tax on gas distribution be introduced, a provincial sales tax on professional services and the federal excise license fees be transferred to the provincial governments. In the second phase tlie provincial governments may concentrate on development of presumptive sales tax on selective trades.

Additional Revenue Generation (Chapter 7)

In view of the proposals mentioned above we have estimated the resources that can be mobilised by the provincial sales tax for the four provinces combined. Revenues in the first year are estimated at Rs 550 million raising to Rs 2800 million by the 2002-03.

Required Improvements in Tax Administration (Chapter 8)

Since the sales tax on services is implicitly a provincial responsibility under tlie Constitution of Pakistan, we do not foresee any legal difficulties in the introduction of such a tax. As for the case for separate sales tax wing in the E&T department and survey and registration they will not be needed in the initial stage of implementation. As far as computerisation is concerned already an on-going process financed by tlie federal government.

O U T L I N E

SALES TAXATION OF SERVICES BY

PROVINCIAL GOVERNMENTS

Chapter 6 : **IMPLEMENTATION PROGRAM**

Chapter 7 : **ADDITIONAL REVENUE GENERATION**

Chapter 8 : **REQUIRED IMPROVEMENTS IN TAX ADMINISTRATION**

LIST OF TABLES

CHAPTER ONE

ALLOCATION OF FISCAL POWERS

As a preamble to the study, we outline first the allocation of fiscal powers between the federal and provincial governments in Pakistan.

1.1 Constitutional Provisions

Federal Government

The 1973 Constitution (inclusive of amendments up-to-date) gives the allocation of fiscal powers between the federation and the provinces. Accordingly, the federal government can levy the following taxes: duties of customs, including export duties; duties of excise, including duties on salt, but not including duties on alcoholic liquors, opium and other narcotics; duties in respect of succession to property; estate duty in respect of property; taxes on income other than agricultural income; taxes on corporations; taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed; taxes on capital value of the assets not including taxes on capital gains on immoveable property; taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy; taxes and duties on the production capacity of any plant, machinery, undertaking, establishment or installation; terminal taxes on goods or passengers carried by railway, sea or air, taxes on their fares and freights.

Income Tax is administered under Income Tax Ordinance, 1979 as amended from time to lime. However for the purpose of computation of total income, all income is classified under the following heads: -

a) Salaries;

b) Interest on securities;

c) Income from house property;

d) Income from business or profession;

e) Capital gains; and

f) Income from other sources.

Wealth tax, like the income tax this is also an annual levy on net wealth of persons, effective in Pakistan since 1963. However, since the introduction of Zakat and Ushr, the tax is collected from persons and types of properties which falls outside the ambit of these two.

The federal government also has the power to collect tax on capital value of assets which is payable by every individual, association of persons, firm or a company which acquires by purchase an asset or right to use thereof. The capital value tax was levied with effect from July 1989. .

Customs duties are prescribed in the Pakistan Customs Tariff. The Customs Duties are collected under tlie following heads: -

a) Import duty

b) Iqra surcharge

c) Export duties

Import duties are generally used as a tool firstly, to provide protection to domestic industries, secondly, to curb speculative and unnecessary import and, lastly, to raise revenue. The revenue from import duties depends upon the slabs or the rates at which imports are taxed and on the government's import policy.

The First Schedule of the Central Excise and Salt Act, 1944 shows the rates set forth for the central excise duties leviable on goods produced or manufactured, and on all excisable services provided or rendered, in Pakistan. However, in all 78 commodities including 14 services are leviable to excise duty, out which 30 commodities are exempted. Eighteen excisable items are charged at the specific rates, 14 on ad valorem and the remaining 7 items rates are linked to their retail prices.

According to the Sales Tax legislation the federal government is authorised to levy tax on imports, domestic production and consumption of any goods or class of goods or any taxable supplies made in the country from the payment of tax chargeable thereon. Historically, Sales Tax used to be a provincial tax (known as the 'bikri' tax) but, in 1948, the Constituent Assembly of Pakistan transferred it to the Federal List of subjects. However, parliament passed a new law according to which Sales Tax Act 1990 came into force. The Act prescribed a VAT type system in which the value added component at each stage of business transaction is taxed. At present, the new tax is restricted to import and local manufacturing stage only.

Provincial Governments

Exclusions from the federal list of taxes like excise duties on alcoholic liquors, opium and other narcotics; taxes on agricultural income; and taxes on capital gains on immovable property fall within the purview of provincial governments. The limitation of fiscal powers in sales taxation to goods tends to indicate that the levy of this tax on services has been made a responsibility of provincial governments. In addition, these governments can levy taxes not included in t-he above list.

Major indirect taxes of the provincial governments include the stamp duty, motor vehicle tax, entertainment tax, and electricity duty. Apart, from sources of revenue assigned exclusively to the provinces, the federal government shares the proceeds of certain taxes with the provincial governments. These include export duty on raw cotton, income tax, sales tax, excise duty on sugar, tobacco and gas.

1.2 The 1991 NFC Award

The history of the inter-governmental fiscal relations between the federation and provinces goes back to pre-partition time. The NFC Award is designed to achieve the following objectives: to review the relationship between the federation and (lie provinces to promote the process of decentralisation, to expand the availability of resources of lower levels of government and to improve generally the efficiency in the mobilisation and utilization of resources.

According to Article 160 of the constitution, the President of Pakistan is expected to constitute a NFC every five years to make recommendations on the distribution between the federal government and provinces of the net proceeds of divisible pool taxes, the making of grant-in-aid and exercise of borrowing powers by the provinces.

The 1991 NFC Award has considerably enhanced the divisible pool of taxes, although the distribution pattern among provinces is the same as the 1974 NFC Award. The federation and provinces will continue to share divisible pool taxes on the basis of 20:80, while the distribution among the provinces will continue to be on the basis of population.

New taxes like excise duties on tobacco and sugar will also be shared on the basis of population. Surcharge on natural gas and royalty on crude oil are now distributed among the provinces on the basis of collection. The total transfer in 1992-93 is estimated at over 72 billion compared to Rs 44 billion as per the 1974 NFC award (see Table 1.1). Transfer from divisible pool by federal government to each provincial government is given in Table 1.2. On the whole, because of NFC Award, it is estimated that the increase in transfer in 1992-93 was about 30 percent for Punjab, 57 percent for Sindh, 149 percent for NWFP and 160 percent for Balochistan in relation to transfer according to the previous NFC Award.

Previously only Balochistan and NWFP were entitled to special grants, however, this discretionary element in non-development grants has been eliminated and a system of fixed, special grants to each province has been instituted. Special grants for three years of Rs 1000 million, Rs 200 million and Rs 100 million have been given to Punjab, NWFP and Balochistan respectively. A grant of Rs 700 million has been proposed for Sindh for five years.

TABLE 1.1

REVENUES SOURCES AND MAGNITUDE OF TRANSFERS TO PROVINCES (COMBINED) WITH AND WITHOUT NFC AWARD OF 1992

IN 1992-93

[Rs in Billion]

		Without 1992 NFC Award		With 1992 NFC Award	
		Transfer	**Share (%)**	**Transfer**	**Share (%)**
A)	**Revenue sources shared on the basis of population**	**41.8**	**95.2**	**54.0**	**75.2**
	Income Tax	21.7	49.4	21.7	30.2
	Sales Tax	18.4	41.9	18.4	25.6
	Export Duty on Cotton Excise	1.7	3.9	1.7	2.4
	Excise Duty on Tobacco Manufactures	---	---	8.1	11.3
	Excise Duty on Sugar	—	—	4.1	5.7
B)	**Revenue sources shared on the basis of collection**	**2.1**	**4.8**	**17.8**	**24.8**
	Excise Duty & Royalty on Gas	2.1	4.8	2.1	2.9
	Surcharge on Gas	—	—	7.6	10.6
	Royalty on Crude Oil	—	—	1.2	1.7
	Profits on Hydro-Electricity	—	—	6.9	9.6
	TOTAL	**43.9**	**100.0**	**71.8**	**100.0**

Source: Annual Budget Statements of Provincial Governments

TABLE 1.2

TRANSFER FROM DIVISIBLE POOL BY FEDERALGOVERNMENT TO THE PROVINCIAL GOVERNMENTS OF PAKISTAN

[Rs in Billion]

		Punjab	Sindh	NWFP	Balochistan	Pakistan
A)	**1991-92 (Revised)**	**28.8**	**15.0**	**12.4**	**7.8**	**64.0**
	Revenues shared on the basis of population	27.5	11.1	6.4	2.5	47.5
	Revenues shared on the basis of collection	1.3	3.9	6.0	5.3	16.5
B)	**1992-93 (Budgeted) (Without NFC Award)**	**24.4**	**10.5**	**5.7**	**3.4**	**44.0**
	Revenues shared on the basis of population	24.2	9.7	5.7	2.2	41.8
	Revenues shared on the basis of collection	0.2	0.8	—	1.2	2.2
C)	**1992-93 (Budgeted) (With NFC Award)***	**32.4**	**16.5**	**14.1**	**8.7**	**71.7**
	Revenues shared on the basis of population	31.2	12.6	7.3	2.8	53.9
	Revenues shared on the basis of collection	1.2	3.9	6.8	5.9	17.8
	% Increase					
1.	C in relation to A	12.5	10.1	13.7	11.1	12.0
2.	C in relation to B	32.8	57.1	147.4	156.1	63.0

• Including (lie transfer of profit from hydro- electricity by WAPDA.

Source: Paslia and Gliaus [ ]

On aspect of significance in the 1991 NFC award is that application of sales tax at the retail level has been handed over to the provincial governments. This is an explicit recognition of the fact that sales taxation of services is a provincial subject.

1.3 Implications of a National VAT

The federal government is expected to introduce comprehensive value added taxation in Pakistan as part of the agreement reached with the International Monetary Fund on the Extended Structural Adjustment Facility (ESAF). The existing general sales tax (GST) will be developed into a full-fledged VAT. In the first phase, in the budget of 1994-95, GST will be extended at the import and manufacturing stage by withdrawal of most of the current exemptions. This will be followed in the next phase by large-scale introduction of the VAT at the wholesale and retail stage in the subsequent two federal budgets, although this seems to be in conflict with the provisions of the 1991 NFC award, referred to above.

One direct implication of the introduction of a broad-based VAT is that since the GST is part of the divisible pool of taxes (80 percent of net revenue shared among provinces on the basis of population) there will be a significant jump in revenue transfers to the provinces of upto 1.5 percent of the GDP in the next three years (total divisible pool transfers are about 4.5 percent of GDP currently). The increase of about one thirds in transfers should help in improving significantly the fiscal status of the provincial governments.

However, one of the constraints to the development of a comprehensive VAT is the fact that, as highlighted earlier, the GST can only he applied on goods and not on services. Intermediate inputs of services like electricity, gas, transport, telecommunications, etc.

currently account for about 15 percent of the total value of intermediate inputs into the different sectors of the economy. Therefore, the absence of a GST on services is likely to introduce a major distortion in the VAT. As such, it is essential that the introduction of sales taxation of services by the provinc ial governments is integrated with the move towards a national VAT.

Accordingly, the approach may be for provincial governments to levy a sales tax on services supplied within their jurisdictions ultimately at the standard rate of 15 percent, which is equivalent to the current GST rate. This tax. could be applied for example on electricity, gas telephone billings, etc., and be tax invoicable as input tax at the manufacturing stage for payments of the national VAT on output. This will make the GST correspond more closely to a VAT.

One of the implications of the integrated strategy is that overall revenues from the provincial sales tax on services and from the GST will cease to be distributed purely on a population basis and will begin to reflect actual collection. Also, the imposition of the some tax rate on goods and services at all locations will obviate the need for harmonisation of rates among jurisdictions. This has proved to be a, more or less, intractable problem in the Indian case where the fiscal powers to levy a sales tax (on goods or services) rest with the states and not with the union.

CHAPTER TWO

INCIDENCE OF INDIRECT TAXES ON SERVICES

The objective of this chapter is to quantify the nominal incidence of different federal and provincial indirect taxes on the various service sectors of the economy.

2.1 Federal Excise Duties on Services

In Pakistan Central Excise Duty is leviable on goods produced or manufactured, and on all services provided or rendered, at rates set forth in the First Schedule of Central Excise and Salt Act, 1944. Excise duty is leviable to 78 commodities including 14 services, however, 30 commodities and five services are exempted. As far as, the collection of duty in the services sector is concerned, the agency providing these services is responsible. Services liable to excise duty are charged for the services at specific or advalorem rates. Duty at specific rates are relatively easy to administer but are inelastic to fluctuations in the value.

In 1992-93 central excise duty contributed about 22 percent in federal tax revenue. However, the share of services sector in total excise duty has been about 9 percent only. As Table 2.1 indicates excise duty on telephone calls generated the highest revenue under (he services head which amounts to Rs 4000 million in tlie year 1992-93.

2.2 Provincial Taxes on Services

As far as, the Provincial Governments are concerned (lie primary source of revenue consists of taxes like stamp duty, motor vehicle tax. etc. The stamp duty is tlie largest provincial tax in Punjab and Sindh, while motor vehicle tax is the major source of tax revenue in NWFP

TABLE 2.1
INDIRECT TAXES ON SERVICE SECTORS OF FEDERAL AND PROVINCIAL GOVERNMENTS
1992-93 [Revised Estimate]

[Rs in Million]

		Sector/Tax	
1.	**TRANSPORT & COMMUNICATIONS**		**1659**
		Federal Taxes	351
	a)	Excise Duty on Air Travel and Railway	291
	b)	Excise Duty on Courier Services	60
		Provincial Taxes	1308
	a)	Motor Vehicle Tax	1308
2.	**BANKING AND INSURANCE**		**4122**
		Federal Taxes	2545
	a)	Excise Duty on Bank Advances	2300
	b)	Excise Duty on Bank Cheques	150
	c)	Excise Duty on Insurance Premia	95
		Provincial Taxes	1577
	a)	Stamp Duty on Financial Transactions	1577
3.	**ELECTRICITY AND GAS DISTRIBUTION**		**779**
		Federal Taxes	0
		Provincial Taxes	779
	a)	Electricity Duty	779
4.	**TELECOMMUNICATIONS**		**4000**
		Federal Taxes	4000
	a)	Excise Duty on Telephone Services	4000
		Provincial Taxes	0
5.	**HOTELS, RECREATION AND ENTERTAINMENT**		**884**
		Federal Taxes	575
	a)	Excise Duty on Hotels & Services (Telex, etc) and Restaurants	420
	b)	Excise Duty on TV and Radio Ads	155
		Provincial Taxes	309
	a)	Entertainment Tax	220
	b)	Hotel Tax	89
6.	**PROFESSIONAL SERVICES**		**41**
		Federal Taxes	41
	a)	Licence Fees on Various Professions	41
		Provincial Taxes	0

Sources: Explanatory Memorandum on Budget, Ministry of Finance, GDP.
Annual Budget Statement, Provincial Governments.

and Balochistan. In 1992-93, tax revenue amounting to Rs 1577 million and Rs 1308 million has been collected under the heads of stamps duty on financial transactions and motor vehicle tax, respectively.

Motor vehicle tax is levied on owners largely at specific rates; however, the rates vary across the provinces. As far as, the stamp duty is concerned, this tax is levied on most civil, judicial and commercial documents. However, the biggest share of revenue is generated from property transaction.

Other provincial taxes on services (essentially in the nature of a excise duty) are electricity duty, entertainment tax and the hotel tax. The entertainment tax applies to movies, theatricals plays, etc. It was originally in the nature of a (seating) capacity tax and has been linked to admission fees. The hotel tax is levied on large hotels with higher tariffs on the basis of capacity. The electricity duty is levied at the varying rates by type of consumers on an ad volerm basis. Revenue generated through electricity duty amounted to Rs 779 million in the year 1992-93.

2.3 Local Taxes on Services

Local taxes on the service sectors basically consist of tax on advertisements, cinema tax etc. The revenue generated from these sources is generally low and represents a very small proportion of total local tax revenues.

2.4 Size of Tax Bases

Table 2.2 indicates an increasing trend in (lie value added of (lie services sector. Total value added has increased from Rs 122 billion in 1982-83 to Rs 494 billion in 1992-93. These sectors currently constitute 36 percent of the GDP, with wholesale and retail trade being the largest sector followed by transport and communications and professional services. As far as the individual sectors are concerned, the percentage share in GDP of electricity and gas distribution sector has more then doubled during the last twenty years. Prominent growth in the share of transport, storage and communication sector has also been observed. However, there has been a relatively slow growth wholesale and retail trade, finance and insurance and services.

2.5 Nominal Incidence of Taxes by Sector

Table 2.3 indicates the overall incidence of federal and provincial indirect taxes in each service sector as of 1992-93. For all services sectors combined the nominal incidence of such taxes is slightly more than 2 percent of the value added. This is very low in relation to the overall incidence of indirect taxes of about 12 percent of the GDP. This demonstrates that there is a high component of undertaxation of the services sectors of the economy.

Substantial variation is observed currently in the nominal incidence among sectors. The burden of taxation is relatively high on the banking, insurance and financial services sector due to the federal excise duty on bank advances and provincial stamp duties on financial transactions. This is followed by the transport and communications sector with a high rate of taxation in the form of federal excise duty on telecommunications services and the

TABLE 2.2

TREND IN VALUE ADDED IN SERVICES SECTORS OF THE ECONOMY [At current Prices]

[Rs in Million]

Sector	1972-73	1982-83	Annual Growth Rate (%)	1992-93	Annual Growth Rate (%)
Electricity & Gas Distribution	955	7284	22.5	44774	19.9
Transport, Storage & Communication	4268	31092	22.0	125219	14.9
Wholesale & Retail Trade	8926	49957	18.8	196315	14.7
Finance & Insurance	1408	9383	20.9	34995	14.1
Services	4636	23907	17.8	93000	14.6
TOTAL	**20193**	**121623**	**19.7**	**494303**	**15.1**
	S H A R E (%)				
Electricity & Gas Distribution	4.7	6.0		9.1	
Transport, Storage & Communication	21.1	25.6		25.3	
Wholesale & Retail Trade	44.2	41.1		39.7	
Finance & Insurance	7.0	7.7		7.1	
Services	23.0	19.7		18.8	
TOTAL	**100.0**	**100.0**		**100.0**	

Source: Pakistan Economic Survey, OOP.

TABLE 2.3
NOMINAL INCIDENCE OF INDIRECTTAXES
BY SERVICES SECTOR 1992-93

[Rs in Million]

Sector	**Total Taxes (Federal + Provincial)**	**Sectoral Value Added**	**Taxes as % of Value Added**
Transport & Communication	5659	125219	4.5
Banking, Insurance and Financial Services	4122	34995	11.8
Electricity and Gas Distribution	779	44774	1.7
Hotels, Recreation & Entertainment	309 ?	93000	0.4
Professional Services	14 ?		
Wholesale & Retail Trade	0	196315	0.0
TOTAL	**11485**	**494303**	**2.3**

Source: Table 2.2 and Table 2.3.

provincial MVT on transport vehicles. Nominal incidence is very low on sectors like wholesale and retail trade, electricity and gas distribution and services.

Table 2.4 demonstrates that 65 percent of revenues collected from services is by the federal government and the remainder, 35 percent, by the four provincial governments combined. The former dominates in sectors like telecommunications, banking and insurance and hotels and entertainment while the latter generates most of the revenues from transport.

2.6.1 Effective Incidence of Taxes by Sector

It is important to realise that analysis of nominal incidence may give an incomplete picture of the overall incidence of taxes on a sector. For this purpose, quantification of effective incidence is essential. This approach includes the component of indirect taxation on inputs used by the sector and not just taxes on output. For example, it has been shown above that the nominal incidence of taxes on the electricity and gas distribution sector is low. However, to the extent that electricity is generated by thermal power there is significant taxation of furnace oil and gas. Also, at the stage of extraction of gas a sizeable development surcharge is levied.

Computation of effective tax incidence requires knowledge of the input-output relationship among different sectors of the economy. The Applied Economics Research Centre (AERC) has estimated the effective incidence of federal indirect taxes (import duties and surcharges, development surcharges, excise duties and general sales tax) for 1992-93 with the help of an updated input-output matrix for the national economy. Estimates of effective incidence (defined as total tax component of the price) arc given in Table 2.5. Even though these

TABLE 2.4

SHARE OF INDIRECT TAX REVENUES OF FEDERAL AND PROVINCIAL GOVERNMENTS FROM SERVICES

1992-93

[Rs in Million]

Sector	Federal	Provincial	Total
Transport and Communications	351	1308	1659
Banking and Insurance	2545	1577	4122
Electricity and Gas Distribution	0	779	779
Telecommunications	4000	0	4000
Hotels, Recreation and Entertainment	575	309	884
Professional Services	41	0	41
TOTAL	**7512**	**3973**	**11485**

S H A R E (%)

Sector	Federal	Provincial	Total
Transport and Communications	21	79	100
Banking and Insurance	62	38	100
Electricity and Gas Distribution	0	0	100
Telecommunications	100	0	100
Hotels, Recreation and Entertainment	65	35	100
Professional Services	100	0	100
TOTAL	**65**	**35**	**100**

Source: Derived from Table 2.1.

TARLE 2.5

EFFECTIVE INCIDENCE OF FEDERAL INDIRECT TAXES BY SERVICE SECTOR IN 1992-93

	Effective Tax Incidence [%]		
Sector	**Import Taxes**	**Domestic Taxes**	**All Taxes**
Electricity	3.1	7.6	10.8
Gas	4.8	27.5	32.3
Wholesale & Retail Trade	0.9	0.2	1.0
Road Transport	10.3	0.7	10.9
Railway Transport	7.2	11.3	18.5
Air Transport	9.0	2.2	11.2
Water Transport	2.9	0.1	3.0
Television	3.2	11.6	14.8
Telephone & Telegraph	1.8	19.6	21.4
Banking & Insurance	2.4	8.2	10.5
Radio	2.0	7.1	9.2
Services n.e.s.	1.1	0.5	1.6

Note: n.e.s. stands for not elsewhere specified.

Source: AERC - CBR Collaborative Research Program Report.

estimates exclude provincial taxes they are generally much higher than estimates of nominal incidence. For example, we observed earlier that (lie nominal incidence on the electricity and gas distribution sector was low. Effective incidence, however, is high at over 32 percent in the gas sector and about 11 percent for electricity. Similarly, effective burden of taxation appears to be relatively high in road and railway transport.

CHAPTER THREE

PROVINCIAL SURCHARGE ON FEDERAL EXCISE DUTIES

Given the fact that the federal government how already levied excise duties on a number of services the question which arises is (since implicitly the domain of sales tax on services is with provincial governments) whether there is scope for levy of a provincial surcharge on federal excise duties in lieu of a sales tax on services. Resort to this strategy, of course, hinges on legal feasibility of imposition of surcharges.

3.1 Legal Aspects

As mentioned in Chapter 1 the Constitution of Pakistan delineates the allocation of fiscal powers between the federal and provincial governments of Pakistan. The implicit assumption is that taxes not mentioned in the Federal Legislative List belong to the provincial governments. Although the Constitution does not say this explicitly, it also follows that a tax which has been allocated to a particular government can be exploited only by it. In effect this rules out the possibility either of a federal surcharge on a provincial tax or a provincial surcharge on a federal tax. Currently, there are no examples of surcharges of this type in Pakistan. It appears that there are, therefore, legal constraints to the imposition of provincial surcharges (as proxy for sales tax) on federal excise duties on services.

3.2 Possible Arrangements

The possibility exists, however, of separate levy by the two governments on effectively the same tax base. Numerous examples of this already exist, as shown in Table 3.1. In the area

TABLE 3.1

EXISTING EXAMPLES OF JOINT TAXATION BY FEDERAL AND PROVINCIAL GOVERNMENTS OF SAME TAX BASES

TAX BASES	T A X RS	COLLECTION BY
Sales by Hold	• Federal Excise Duty on Hotels	Federal Excise Department
	• Provincial Hotel Tax	Provincial Excise& Taxation Department
Sale Value of Immoveable Property	• Federal Capital Value Tax on Persons without NTN	Federal Wealth Tax Department
	• Provincial Stamp Duty	Registrar/Controller of Stamps
Electricity Sales	• Federal Withholding Tax on Income of Commercial and Industrial Consumers • Provincial Electricity Duly	? ? ? ? WAPDA/KESC
Motor Vehicles	• Federal Capital Value Tax on Second Hand Cars • Withholding Income Tax on Private Cars • Motor Vehicle Registration Fee/Tax	? ? ? ? ? Provincial Excise and Taxation Department
Rented Properties	• Withholding Wealth Tax on Rented Properties • Property Tax	? ? ? ? Provincial Excise and Taxation Department

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Sources: Central Board of Revenue, GOP.
Provincial E&T department.

of services, one such example is the taxation of hotels. The federal government levies on excise duty on hotels and on services (fax, telex, etc.) provided by them while the provincial governments have imposed a hotel tax which is linked either to billing or capacity (adjusted for occupancy). The former is collected by the federal excise department and the latter by the provincial excise and taxation department. Other common tax bases observed are property transactions, electricity billing, ownership of motor vehicles and rented properties.

Separate levy of taxes on the same tax base does surmount the legal problem. It, however, raises overall costs of collection and compliance costs of tax payers and creates perceptions of multiplicity of taxes and overtaxation. It also leads to complaints by one level of government against the other that its tax base has been eroded by the increase in tax burden due to double taxation. A rational arrangement would be one in which even though there is more than one tax on a particular tax base, joint collection responsibility is handed over to one agency. This will create economies of sale in tax collection and reduce compliance costs (especially bribes to different tax departments). The agency chosen should have a comparative advantage in collection in terms of knowledge of the tax base, track record in the area and greater acceptability to taxpayers.

A good example of this is in the area of taxation of motor vehicles. Historically, motor vehicle registration fee/tax has been collected by the provincial E&T department. Records of vehicle ownership and transactions have also been maintained by this department. In the 90s, the federal government introduced a capital value tax on the sale of second hand cars and a withholding income tax on private cars. Collection responsibility of these two taxes has been handed over to the provincial E&T departments in view of their greater capability

for tax administration in this area. It is important, however, to ensure that incentives are provided to the collecting agency by allowing it to charge an appropriate collection fee, which at least covers its costs of collection. The federal government charges 5 percent of revenue as costs of collection of divisible pool taxes, although actual costs of collection are lower. Provincial governments may be given the same rate on taxes collected on behalf of the federal government.

CHAPTER FOUR

STRATEGY FOR PROVINCIAL RESOURCE MOBILISATION

Based on our description of the existing situation regarding indirect taxation of service sectors in the previous chapters we now proceed to set up the strategy for provincial resource mobilisation in these sectors.

4.1 Criteria for Incremental Taxation

The key policy question is which services are candidates for incremental taxation through imposition of a provincial sales tax. A number of criteria have been developed us for this purpose. The first criterion relates to the extent of undertaxation. This depends on the current level of effective incidence of indirect taxes on a particular sector. If this level is low, then other things being equal, the sector is a stronger candidate for higher taxation. The second criterion is the extent of incidence on richer households. If the incremental burden of taxation on a particular sector falls largely on households with greater ability-to-pay then from the viewpoint of equity the sector can be subjected to more taxation.

The third criterion is the case for integration with national VAT. We have argued earlier that the constitutional ban on imposition of tlie federal GST on services is likely to have a distortionary effect on the implementation of a VAT in Pakistan. Therefore, provincial taxation of services at the same rate needs to be introduced especially in the case of major intermediate inputs to minimise these effects. Tlie fourth criterion relates to level of compliance and ease of collection. If economic activity in a particular sector is. largely by informal, small-scale private sector then (lie sector is likely to be difficult to lax with high levels of evas ion. The next criterion is <u>buoyancy of the tax base.</u> Clearly an effort must be made to target incremental taxation towards sectors which are fast growing to increase the elasticity of the tax system.

The sixth criterion is <u>ease of apportionment.</u> This is a potentially important problem if perceptions of a skewed distribution of the tax base are to be avoided. The last criterion is <u>absence (or not) of distortionary effects.</u> If deadweight losses from increased taxation are to be minimised then this factor must be considered in formulation of provincial taxation proposals.

Results of application of the criteria to each sector are given in Table 4.1. We discuss these separately for each sector below.

Electricity Distribution:

Power input is a major input into the production process and, therefore, this sector scores highly on the criterion relating to case for integration with national VAT. Given the presence of large public utilities (WAPDA and KESC) in the sector tax collection on electricity billing is relatively easy and low cost. Also, given the nature of power consumption and billing there is little apportionment problem.

Gas Distribution:

This sector is already subject to relatively high taxation due to the development surcharge and excise duty. However, in terms of energy equivalents, gas is relatively underpriced in

CRITERIA FOR IDENTIFICATION OF SERVICE SECTORS

FOR INCREMENTAL TAXATION

Sector	Extent of Undertaxation	Incidence on Richer Households	Case for Integration with National VAT	Level of Compliance & Ease of Collection	Degree of Buoyancy of Tax Base	Ease of Apportionment	Absence of Distortionary Effects	Overall Score
Electricity Distribution	M	M	H	H	M	H	M	3
Gas Distribution	L	M	H	H	M	H	M	2
Wholesale & Retail Trade	H	L	H	L	M	H	H	2
Road Transport	M	L	H	L	M	H	M	0
Railway Transport	L	L	H	H	L	M	L	-2
Air Transport	M	H	M	H	H	M	M	3
Television	M	H	M	H	H	M	M	3
Telephone & Telegraphs	L	H	H	H	H	H	M	4
Banking & Insurance	L	M	M	M	M	L	H	-1
Hotels	M	H	L.	M	H	H	M	2
Professional Services	H	M	M	L	H	H	H	3

L = Low, score of-1
M = Medium, score of 0
H = High, score of

Pakistan and, therefore, on this basis there is still some scope for additional taxation. In this sector also tax collection is facilitated by the presence of large distribution companies.

Wholesale and Retail Trade:

Tins sector currently is undertaxed. However, given the multitude of relatively small tax payers, level of compliance is likely to be low and costs of collection high. Also, unless selective taxation is resorted to, the burden of incremental taxation is likely to fall disproportionately on poorer households.

Road Transport:

Effective taxation of the sector is moderate. Problems are similar to those in the trade sector with potentially large number of small taxpayers and regressive incidence. However, transport costs are an important ingredient of cost of intermediate inputs and there is a case for integration with national VAT in this area.

Railway Transport:

This sector is already subject to significant taxation. Further taxation is likely to create distortionary effects as traffic gets diverted to other modes and lead to an increase in prices of essential commodities.

Air Transport:

Tins sector scores high on (lie criteria of incidence, level of compliance and case of collection and degree of buoyancy of the tax base.

Television:

This sector also scores highly on the same criteria as air transport.

Telephones:

This sector is currently subject to relatively high taxation. It is a prime candidate for taxation because of the progressive nature of incidence, importance as an intermediate input in some activities and the need for tax invoicing of this cost, ease of collection and fast growth in demand.

Banking and Financial Services:

This is also a relatively overtaxed sector. There is also a serious apportionment problem in tins sector. Given the location of head offices mostly in Karachi, bulk of the revenues from a sales tax linked to advances will accrue to the province of Sindh even though the effective incidence falls elsewhere in the country.

Hotels:

This sector is characterised by a moderately high rate of taxation. It scores highly or. criteria related to the nature of incidence and buoyancy of tax base.

Professional Services:

Services provided by doctors, lawyers, accountants, architects and oilier professions are subject only to minimal taxation. The case for incremental taxation is further enhanced by fast growth in incomes in the sector, ease of apportionment, relative absence of distortions and tendency for incidence of taxation to fall on richer households.

4.2 Target Sectors for Resource Mobilisation

Based on the ranking on different criteria and the composite score given in Table 4.1, we can proceed to identify target sectors for resource mobilisation through sales taxation by provincial governments. In the first phase the strategy must be to select sectors which are relatively undertaxed and have a moderate to high composite score. On this basis, the prime candidate sectors are wholesale and retail trade, gas distribution and professional services. In the second phase sectors with a high composite score may be targeted. These are electricity distribution, air transport and television.

CHAPTER FIVE

PROVINCIAL TAXATION OF SERVICES

Based on the recommended strategy for provincial resource mobilisation in the previous chapter, we now present the specific taxation proposals in each sector.

5.1 Taxation of Banking and Insurance

We have already indicated in Chapter 2 that the banking sector is an overtaxed sector of the economy. This is primarily due to the excise duty on bank advances. However, given the relatively high interest rates currently (marginal rate on loans of 19 percent), it is likely that the federal government may grant a relief generally or to some special sectors (like exports) from payment of the excise duty on outstanding loans. If this happens then the sector" may cease to be overtaxed. This may be an opportune time for introducing a small provincial sales tax on banking services.

However, this should clearly not be charged on bank advances but elsewhere in the process of banking transactions. The federal government also charges a small excise duty at the time of issuance of cheque books at the rate of Re 1 per cheque. This is the appropriate point for levy of the provincial sales tax at a rate, say, of Rs 0.50 per cheque, with collection responsibility of the federal excise department. Levy of the sales tax will avoid problems of apportionment, as the distribution of revenues among [lie provinces is less likely to be skewed than in the case of a tax on bank advances. Also, there is less likelihood of the exporting of the tax burden from one province to another.

We do not recommend any sales tax on insurance services in the short run given the depressed state of the sector currently. The federal government already has an excise duty on insurance premia.

5.2 Taxation of Wholesale and Retail Trade

Tile trade sector is a large sector of the national economy and, as, highlighted earlier, is one of the most undertaxed sectors. Provincial taxation of services will have to lay great emphasis on development of sales tax on the trade sector (especially retail).

This will close one of the major gaps in the taxation system of Pakistan and make the overall regime of sales lax (federal GST + provincial sales tax) correspond more closely to a consumption tax. In fact, the 1991 NFC award explicitly recognises the. right of provincial governments to levy a retail sales tax. However, as part of the agreement on the Extended Structural Adjustment Facility (ESAF) with the IMF, the federal government stands committed to extending GST to the retail level by June 1995. Therefore, there is some ambiguity in this area and it is important that the provincial governments take a decision quickly on whether they want to move into the area of sales taxation of retail trade on not.

One of the principal reasons why retail trade remains undertaxed is that it is a very difficult-to-tax sector, given the large number of small taxpayers with little or no documentation of transactions. We are currently witnessing strong protests to the broad-basing of the federal GST at the stage of manufacturing, where if at all documentation is more widespread. Also, there are political constraints because sales taxes arc generally perceived as regressive in character and hitting the common man. Therefore, given the stale of underdevelopment of the provincial tax administration and the historical lack of political will of provincial governments to levy taxes, the basic question is whether there will be any motivation to move into this area especially since the federal government is already committed to doing so next year.

An alternative short term strategy which recognises these constraints is to access to the retail trade sector through more indirect and less visible mechanisms. As it happens, provincial governments currently levy an electricity duty which is levied on bills charged by WAPDA and KESC on domestic, commercial, industrial, agricultural and other consumers. Bulk of the commercial consumers belong to the trade sector. Therefore, this is an effective way of taxing the trade sector with, more or less, full coverage. Also, the level of electricity consumption is likely to be a good proxy of the magnitude of sales. In fact, the federal government has already introduced a withholding income tax on electricity billing to bring small to medium-sized commercial and industrial entities into the tax net. This tax is working well and is likely to yield almost Rs 800 million to the federal government during the current fiscal year. Therefore, a presumptive sales tax on the trading sector can be introduced in the short-run by enhancing the electricity duty on commercial consumers from 5 percent currently to, say, $7\frac{1}{2}$ percent.

This strategy has a number of advantages. First, there will be no need for new legislation and political constraints can be largely circumvented. Second, survey of tlie large number of traders and their registration can be avoided, as almost all of them are electricity consumers and already covered by (he billing network of the power utilities. Third, costs of collection will be minimal as this responsibility will rest largely with WAPDA and KESC.

Fourth, significant revenues could be generated in the short run, at a minimum of Rs 150 million.

At a later stage, an effort can be made to build the sales tax on trade on top of the electricity duty on commercial consumers by adopting a policy of differential taxation of different trades, so as to mitigate against regressiveity of the tax system. A more conventional sales tax can be developed, with payments by each taxpayer, on selective trades like electronics, jewellery, cosmetics, garments, etc., with sales largely to the upper income groups. However, given the problems of documentation and voluntary compliance it is difficult to see an invoicing based sales tax being introduced in the foreseeable future. The tax will have to retain a presumptive character with flat rates (charged on a quarterly basis) linked to municipal status of city/town, classification of neighbourhod (as is done for commercial properties by E&T), location on main road or not and frontage.

The system should be kept simple to permit self-assessment by taxpayers. Tax payments can be made to bank branches, which may be authorised to issue tokens (in different colors) that can be displayed (like the MVT) on shops to indicate that payment has been made. This will minimise any harassment by lower level officials of E&T. A similar scheme of fixed income tax was introduced recently by the federal Income Tax department. However, the scheme has not taken off due to lack of effort and publicity by the department. Also, there is very little rate variation in the federal scheme and there are perceptions of inequity in its application. If the proposed sales tax scheme succeeds, then the provincial governments can extend it over time to oilier trades.

5.3 Taxation of Transport and Communications

This is a somewhat under-taxed sector. However, there are legal impediments to the levy of a provincial sales tax on the transport sector. According to the Constitution, the fiscal power to levy taxes on transport (of all kinds) at terminal points (origin or destination) rests with tlie federal government. This has been exploited by the introduction of an excise duty on air travel, ACC passenger railway travel, etc.

We also have that in the telecommunications sector, telephone services are relatively overtaxed due to the presence of a 35 percent federal excise duty on inland calls. Given this high rate, there is little scope for introducing a provincial sales tax without creating further distortions.

One area where some potential still exists is in the area of advertising. Entertainment is traditionally in the provincial domain of taxation and a provincial tax on cinema tickets already exists. However, the federal government has moved into this area also and introduced an excise duty on television advertisements at the basic rate of 10 percent, with higher rate of 15 percent on ads of cigarettes, cosmetics, beverages, etc. This is a very fast growing sector catering more to tlie needs of middle and upper income groups. It is, therefore, a good candidate for levy of a provincial sales tax. As such, TV ads telecast from stations located within a particular province can be subjected to sales tax at the rate of about 5 percent on top of the federal excise duty. Collection responsibility can be handed over to the federal excise department.

Another medium of advertisement (including classified ads, tender notices, job advertisements) which completely escapes tax is newspapers. This is potentially a large tax base and levy of a small provincial sales tax in tills area would essentially fall on upper income households. Each provincial government can collect this tax from newspapers which are published within its boundaries. There will, of course, be some spillovers of the tax burden as some newspapers arc published from one location and have a nationwide coverage. Given (he apportionment problem and the strong lobbying power of newspaper owners it is suggested that a small rate of 5 percent or so may initially be applied.

5.4 Taxation of Electricity and Gas Distribution

We have already developed the case for taxation of electricity consumption by commercial consumers as a surrogate for provincial sales tax on trade. Beyond this, the rate of electricity duty currently is low at 5 percent and there is some scope for increasing tlie rate without creating severe distortionary effects. Revenues from the tax have been fast growing, due to the ad valorem nature of the tax and rapid increases in power tariffs. Therefore, development of electricity duty will contribute to making the provincial tax system more buoyant.

The gas extraction production sector is relatively overtaxed due to tlie presence of a development surcharge and an excise duty. Despite these taxes, however, tlie price of gas is low in Pakistan in relation to its thermal equivalent and there is a case for conserving the rapidly depleting gas reserves by raising the price. In fact, there is no tax at the stage of gas distribution.

Therefore, a provincial sales tax on gas billing, similar to the electricity duty, can be introduced at this stage. It is recommended, however, that this tax be applied only on sales to domestic and commercial consumers, and not on industrial consumers. The two major industries using gas are Fertilizer and cement. Imposition of a sales tax on industrial consumers will tend to make the burden regressive. As such, we propose that the sales tax on gas distribution be levied initially at the rate of 5 percent on a selective basis.

5.5 Taxation of Professional Services

Professional services provided by doctors, lawyers, accountants, architects, etc., are undertaxcd in Pakistan. Given the self-employment nature of these services, it is felt that there is a lot of income tax evasion by such occupations. These services cater largely to the corporate sector and to the upper income groups and are growing rapidly, especially in the large cities of Pakistan. There is a strong case for increasing the component of taxation on such services. In the Finance Bill of 1991, the federal government introduced a fixed and final tax [under Section 50(4) of the Income Tax Ordinance] at the rate of 5 percent on payments for professional services rendered. This is analogous to a sales tax. Therefore, provincial governments can use the same mechanism to levy their sales tax. It is suggested that the rate be set initially at 2'/2 percent (half the federal rate) with collection responsibility of the federal income tax department.

This proposal could fetch sizeable revenues, impose minimum costs of collection, create few distortions and constitute a fast rising source of income to tlie provincial governments. There is a strong case for implementing this proposal immediately.

The federal government has levied licence fees on a number of professions including stevedores, construction contractors, real estate agents, etc. However, collection has been poor due to the low priority attached by the excise department. It seems natural that these licence fees be handed over to the provincial governments.

A summary of the taxation proposals for provincial sales taxation of services is given in Table 5.1. Phasing of and revenue generation from these proposals is given in the next Chapter. Most of these proposals involve broad-basing of the provincial tax system by imposition of the tax initially at a small rate. This will minimise the distortionary efforts, make the tax structure more progressive and potentially increase the elasticity of the tax system. Most of the proposals are also administratively easy to implement involving the use either of simple, presumptive taxes or of some other collecting agency. Therefore, major improvements in the quality of provincial tax administration will not be required.

TABLE 5.1
TAXATION PROPOSALS FOR
PROVINCIAL TAXATION OF SERVICES

SECTOR	TAXATION PROPOSAL	PHASE
Banking and Insurance	Sales Tax on Cheques; Collection by Federal Government; 1/3rd of Revenue to Provincial Governments	II
Taxation of Trade	Partially through Enhancement of Electricity Duty on Commercial Consumers to 7 '/2%, with exemption limit of Rs 150 Partially through Selective taxation of Selected Trades like Electronics, Jewellery, Cosmetics, Garments and Footwear on a Presumptive Basis.	I
Taxation of Transport and Communications	Sales Tax on TV Ads telecast from provincial TV Stations at 5%; Collection by Federal Government Sales Tax on Newspaper Ads in newspapers published within the province	II II
Taxation of electricity and Gas Distribution	5% tax on sale of gas to domestic and commercial consumers	I
Taxation of Professional Services	2'/2 % lax on value of profession services collected alongwith the deduction at source under section 50 of the ITO Licence Fees on Particular Services	I I

CHAPTER SIX

IMPLEMENTATION PROGRAM

The previous chapter has presented proposals in the area of provincial sales taxation of services. The implementation program of these proposals is given in tins chapter.

6.1 Phasing of Program

The strategy underlying the implementation program is initially to levy taxes in sectors which are relatively undertaxed followed in the later stage by extension to areas where there is a strong case for sales taxation despite the presence of other taxes or of proposals winch are relatively difficult to implement. As such, in the first phase we propose that the rate of electricity duty on commercial consumers be enhanced, a sales tax at tlie gas distribution stage be introduced, a provincial sales tax be collected on professional services along with federal income tax deductions at source and the federal excise licence fees be transferred to tlie provincial governments.

In tlie second stage, tlie provincial governments may concentrate on development of a presumptive sales tax on selective trades, impose a sales tax (side by side to tlie federal excise duly) on TV ads and bank cheques and introduce a sales tax on newspaper ads.

6.2 Changes in Tax Rates

As a strategy we have recommended that the provincial sales tax on services be introduced initially at small rates, so that tlie tax gets accepted and there are minimum distortions. In the long run, the target must be to increase the rates gradually so that the nominal burden of any provincial sales tax plus federal excise duty is at least equal to the prevailing rate of federal GST, which is currently 15 percent.

CHAPTER SEVEN

ADDITIONAL REVENUE GENERATION

We turn now to estimation of resources that can be mobilised by the provincial sales tax for the four provinces combined. The estimates in some cases are of a ball park nature given the absence of relevant data. We make revenue projections upto the end of the perspective plan period, that is, 2002-03.

7.1 Projected Size of Tax Bases

We project the tax bases for the sales tax in different sectors on the basis of a nominal GDP growth rate of 15 percent. Based on past trends and our expectations about future growth we project the tax bases as follows:

Tax Base		Size of Tax Base 1992-93 (Rs in Million) [%]	Projected Annual Growth Rate of Tax Base [%]	Projected Annual Growth Rate of Tax Revenue* [%]
1.	Number of Bank Cheques [Million Number]	150	10	10
2.	Electricity Billing of Commercial Consumers	4000	15	17.5
3.	Billing of TV Ads	500	17.5	20
4.	Billing of Newspaper Ads	3000	12.5	15
5.	Gas Billing of Commercial and Domestic Consumers	5000	12.5	15
6.	Value of Professional Services	5000	17.5	20

* Tax Revenue in some cases are projected to grow faster than Hie tax base in lieu of periodic

increases in tax rates.

7.2 Level of Compliance

Given the presumptive nature of most of the taxes and relatively small tax rates with collection at source or at the stage of billing we do not foresee any major problems with taxpayer compliance.

7.3 Projected Additional Revenue Generation

Projected additional revenues from the different proposals in the area of provincial sales taxation of services are given in Table 7.1. We assume that implementation will start from 1995-96. Revenues in the first year are estimated at Rs 550 million rising to Rs 2800 million by the terminal year, 2002-03. Therefore, provincial sales taxes on services have the potential of generating sizeable additional revenues and demonstrating rapid growth in coming years. This will help in improving tlie financial position of provincial governments and enable more resources to be devoted to the social sectors.

TABLE 7.1
PROJECTED ADDITIONAL REVENUE GENERATION FROM THE PROVINCIAL SALES TAX ON SERVICES

[Rs in Million]

	Tax	1995-96	1996-97	1997-98	1998-99	1999-2000	2001-02	2002-03
1.	Sales Tax on Gas Distribution	355	408	469	540	621	714	82)
2.	Sales Tax on Professional Services	203	244	292	351	421	505	606
3.	Licence Fees on Particular Services	---	100	115	132	152	175	201
4.	Electricity Duty	---	152	179	210	247	290	340
	Enhancement on Commercial Consumers							
5.	Sales Tax on TV Ads	---	—	56	67	81	97	116
6.	Sales Tax on Newspaper Ads	---	—	270	310	357	411	472
7.	Sales Tax on Cheques	---	—	—	133	146	161	177
8.	Presumptive Sales Tax on Selective Trades	---	—	—	50	55	60	65
	TOTAL REVENUE GENERATION*	550	900	1400	1800	2100	2400	2800

On the basis of some rounding off of (lie estimates.

CHAPTER EIGHT

REQUIRED IMPROVEMENTS IN TAX ADMINISTRATION

This chapter derives the implications for provincial (ax administration of extending the sales tax net to services. In this context we discuss tlie need for establishment of a separate sales lax wing in tlie provincial excise and taxation departments and the requirements of legislation, survey and registration procedures and computerisation.

8.1 Sales Tax Wing in Provincial E&T

In tlie initial stages of extension of the provincial sales tax to services, there does not seem to be a strong case for establishment of a separate sales tax wing within tlie provincial excise and taxation departments. There are a number of reasons why tills will not be required. First, it is proposed (see Chapter 5) in most cases to introduce simple, presumptive taxes on sectors like retail trade with minimal assessment load and greater ease of collection. Second, in sectors like banking, gas distribution, etc., the number of potential taxpayers is small and since many of the entities arc in (lie public sector, collection can largely be decentralised based on the principle of self-assessment.

Third, the provincial excise and taxation departments currently have offices in each rating area (down to the Town Committee level) with a standard complement of functionaries at each location. There appears to be considerable excess capacity especially in the smaller rating areas and inclusion of sales tax on services in the responsibility of existing staff will help in achieving greater economies of scale and reducing costs of collection as a proportion of revenues. It is, of course, possible that in the jurisdictions with relatively large number of assessable properties, like the metropolitan municipal corporations and the larger municipal committees, there will be need to recruit additional staff under the ETOs to ensure effective administration of the sales tax.

8.2 Survey and Registration

The job of survey and registration of potential taxpayers is important in the context of administration of the provincial sales tax in sectors where the tax base consists, of a large number of small, dispersed taxpayers who may otherwise prove difficult to detect. This is the case with the sales tax on retail trade. Fortunately, the task is simplified, first, by the fact that trade establishments already have to register under the provincial Shops Act. E and T can obtain access to the list of registered establishments in each city/town. Second, since it is proposed that initially collection of sales tax ^.'ill be the responsibility of officials who currently collect the property tax, the data base for the latter tax on commercial properties will also enable quick identification of taxpayers to: the sales tax on retail trade. Therefore, it appears that in the short-run elaborate registration and survey procedures will not need to be set up to administer the sales tax on services.

8.3 Legislation

Since tlie sales tax on services is implicitly a provincial responsibility under (lie Constitution of Pakistan, we do not foresee any serious legal difficulties in tlie introduction of such a tax. Taxation proposals in this area can as such be included in the annual Finance Bills presented to the provincial assemblies for approval. Also, if necessary, appropriate amendments can he made in existing provincial ads like the Shops Act.

8.4 Computerisation

The requirement of computerisation, to ensure proper record keeping and management control, is significant in areas where (lie number of potential taxpayers is likely to be large, e.g. , the sales tax on retail trade. Here again, there is already an on-going process of computerisation of property tax in the provincial E&T departments of Punjab and Sindh. It should be possible to use the existing hardware and software capability to meet the computerisation needs of the sales tax on services. A similar program of computerisation (which is being financed by the federal government through the Resource Mobilisation and Tax Reforms Commission) can be extended to the provinces of NWFP and Balochistan.

OVERHEADS FOR PRESENTATION ON

SALES TAXATION OF SERVICES BY
PROVINCIAL GOVERNMENTS

CONFERENCE
ON
RESOURCE MOBILISATION AND
EXPENDITURE PLANNING

OVERHEADS FOR PRESENTATION ON

SALES TAXATION OF SERVICES BY PROVINCIAL GOVERNMENTS

by

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by

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

And

GOVERNMENT OF THE PUNJAB

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FEDERAL FISCAL POWERS IN INDIRECT TAXES

(i) DUTIES OF CUSTOMS, INCLUDING EXPORT DUTIES

(ii) DUTIES OF EXCISE, INCLUDING DUTIES ON SALT, BUT NOT INCLUDING DUTIES ON ALCOHOLIC LIQUORS. OPIUM FOR OTHER NARCOTICS

(iii) TAXES ON THE SALES AND PURCHASES OF GOODS IMPORTED, EXPORTED, PRODUCED, MANUFACTURED OR CONSUMED

(iv) TAXES AND DUTIES ON THE PRODUCTION CAPACITY OF ANY PLANT, MACHINERY, UNDERTAKING, ESTABLISHMENT OR INSTALLATION

(v) TERMINAL TAXES ON GOODS OR PASSENGERS CARRIED BY RAILWAY, SEA OR AIR; TAXES ON THEIR FARES AND FREIGHTS

IMPORTANCE OR SERVICES SECTORS IN THE GDP

	Share of GDP (%) 1992-93	Annual Nominal Growth Rate (%) 1972-73 to 1992-93
Transport and Communications	10.4	14.9
Electricity & Gas Distribution	3.7	19.9
Wholesale & Retail Trade	16.4	14.7
Finance	2.9	14.1
Miscellaneous Services	7.7	14.6
TOTAL	14.1	15.1

REVENUES FROM INDIRECT TAXES

ON SERVICES SECTORS

1992-93

(Rs in Million)

Sector	Federal[a]	Provincial	Total
Transport and Communications	351	13081 [b]	1659
Finance	2545	1577 [c]	422
Electricity and Gas Distribution	---	779 [d]	779
Telecommunications	4000	----	4000
Hotels, Recreation and Entertainment	575	309 [e]	884
Professional Services	41	----	41
TOTAL	7512	3973	11485

a Most excise duties

b Motor vehicle tax

c Stamp duties on financial transactions e Electricity duly

e Entertainment and hotel taxes

NOMINAL INCIDENCE OF

INDIRECT TAXES ON SERVICE SECTORS

Sector	Federal+ Provincial Taxes as % of Value Added
Transport & Communications	4.5
Finance	11.8
Electricity & Gas Distribution	1.7
Hotels, Recreation and Professional Services	0.4
Wholesale and Retail Trade	0.0
TOTAL	2.3

EFFECTIVE INCIDENCE OF FEDERAL

INDIRECT TAXES BY SERVICES SECTOR

Sector	Import + Domestic Taxes us % of Value Added
Electricity	10.8
Gas	32.3
Wholesale and Retail Trade	1.0
Road Transport	10.9
Railway Transport	18.5
Air Transport	11.2
Television	14.8
Telephone and Telegraph	21.4
Banking and Insurance	10.5
Services N.E.S.	1.6

EXISTING EXAMPLES OF JOINT TAXATION BY FEDERAL AND PROVINCIAL GOVERNMENTS OF SAME TAX BASES

TAX BASES	TAXES	COLLECTION BY
Sales by Hotel	• Federal Excise Duty on Hotels • Provincial Hotel Tax	Federal Excise Department Provincial Excise & Taxation Department
Sale Value of Immoveable Property	• Federal Capital Value Tax on Persons without NTN • Provincial Stamp Duly	Federal Wealth Tax Department Registrar/Controller of Stamps
Electricity Sales	• Federal Withholding Tax on Income of Commercial and Industrial Consumers • Provincial Electricity Duty	? ? ? ? WAPDA/KESC
Motor Vehicles	• Federal Capital Value Tax on Second Hand Cars • Withholding Income Tax on Private Cars • Motor Vehicle Registration Fee/Tax	? ? ? ? ? ? Provincial Excise and Taxation Department
Rented Properties	• Withholding Wealth Tax on Rented Properties • Property Tax	? ? ? Provincial Excise and Taxation Department

Sources: Central Board *of* Revenue, GOP.
Provincial E&T department.

TABLE
INCREAMENTAL
TAXATION
Landscape

TAXATION PROPOSALS FOR

PROVINCIAL TAXATION OF SERVICES

SECTOR	TAXATION PROPOSAL	PHASE
Banking and Insurance	Sales Tax on Cheques; Collection by Federal Government; 1/3rd of Revenue to Provincial Governments	II
Ttaxation of Trade	Partially through Enh ancement of Electricity Duly on Commercial Consumers to 7 '/2%, with exemption limit or Rs 150	I
	Partially through Selective taxation of Selected Trades like Electronics, Jewellery, Cosmetics, Garments and Footwear on a Presumptive Basis.	
Taxation or Transport and Communications	Sales Tax on TV Ads telecast from provincial TV Stations at 5%; Collection by Federal Government	II
	Sales Tax on Newspaper Ads in newspapers published within (lie province	II
Taxation or electricity and Gas Distribution	5% tax on sale of gas to domestic and commercial consumers	I
Taxation of Professional Services	2½% lax on value of profession services collected along with the deduction at source under section 50 of (lie 110	I
	Licence Fees on Particular Services	I

PROJECTED ADDITIONAL REVENUE GENERATION FROM THE PROVINCIAL SALES TAX ON SERVICES

[Rs in Million]

	Tax	1995-96	1996-97	1997-98	1998-99	1999-2000	2001-02	2002-03
1.	Sales Tax on Gas Distribution	355	408	469	540	621	714	821
2.	Sales Tax on Professional Services	203	244	292	351	421	505	6U6
3.	Licence rocs on Particular Services	---	100	115	132	152	175	201
4.	Electricity Duty Enhancement on Commercial Consumers	---	152	179	210	247	290	340
5.	Sales Tax on TV Ads	---	—	56	67	81	97	116
6.	Sales Tax on Newspaper Ads	---	—	270	310	357	411	472
7.	Sales lax on Cheques	---	—	—	133	146	161	177
8.	Presumptive Sales Tax on Selective Trades	---	—	—	50	55	60	65
	TOTAL REVENUE GENERATION*	**550**	**900**	**1400**	**1800**	**2100**	**2400**	**2800**

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* On the basis of some rounding off of the estimates.

SUMMARY OF DISCUSSIONS
ON
PROVINCIAL SALES TAXATION OF SERVICES

Mr. Wamiq Zuberi, Editor, Business Recorder recommended that sales tax should be imposed on classified advertisement in newspaper. He further stated tliat sales taxation through electricity bill would not be not feasible as this would tend to increase inequity. In addition, he said that resource mobilisation through additional taxation will lead to an increase in inflation; therefore, there is a need to increase resources through proper tax administration.

Mr. Muzaffar Gliaffar, Consultant, while supporting the idea of sales tax on newspaper advertisements, suggested that this should be on non-classified advertisements. he also, stated that low buoyancy of provincial revenues can be over come by improving the overall tax collecting mechanism.

Dr. Shaheen Malik, Chief Economist, Punjab, reflected on the importance of human resource development. She suggested that people within the institution should be trained and there should be some additional training before promotions. She further, stressed that more importance be given to direct taxes as compared to the indirect taxes.

There was a consensus amongst the Conference delegates that an expansion in the taxes should be accompanied by an overall improvement in tlie tax administration of provincial governments generally through tlie creation of a Taxation Service and staff training.