EGAT/EG, PUBLIC FINANCIAL MANAGEMENT PROJECT

PAKISTAN'S TAX SYSTEM FROM 30,000 FEET

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Overview

Outlook: Weak Revenue Mobilization

Revenue Collection: Low by regional, income group, and world standards

Problems: Low GST and PIT collections; high CIT rates; CIT and GST exemptions; and weaknesses in tax administration

This document provides a high-level profile of the structure and performance of Pakistan's tax system. Specifically, it examines tax system revenue effort, tax structure, and revenue performance based on a series of quantitative and qualitative indicators, and compares Pakistan with other countries in South Asia, other low-income economies, and the rest of the world.

The analysis is supplemented by several tables that provide information about the tax structure and revenue performance of three major taxes: corporate income tax (CIT), personal income tax (PIT), and the General Sales Tax (GST) which broadly functions like a value-added tax. All Pakistan tax data are from Fiscal Year (FY) 2008-09.[1] A comprehensive database of comparative data for nearly 200 countries can be found at www.collectingtaxes.net.

Revenue Effort

"Revenue Effort" provides a comparative measure of the amount of revenue from income and general sales taxes that a government collects as a share of GDP. From this perspective, Pakistan's revenue effort in 2008-09 (9.8[2] percent of GDP) and that of South Asian countries in general (10.6 percent of GDP) is low compared to low-income country (14.8 percent of GDP) and world (19.8 percent of GDP) averages. The reasons for this include: exemptions and low-rates of tax for some sectors; narrow coverage and exemptions in the GST; poor voluntary compliance with current tax provisions; and weaknesses in tax administration.

Over the last 5 fiscal years, Pakistan's revenue effort has averaged about 10 percent of GDP. Sales taxes and excise duties have remained roughly constant over the period averaging about 3.7 and 0.8 percent of GDP, respectively. Declines in customs duties over the period have been offset by an increase of direct tax revenue from 2.8 percent of GDP in 2004/05 to 3.5 percent of GDP in 2008/09 and petroleum surcharges from 0.4 percent of GDP in 2004/05 to 1.0 percent of GDP in 2008/09.

Tax Structure

Pakistan's Corporate Income Tax (CIT) rate, at 35 percent, is high compared to the regional, income group and world averages. But this rate is an imperfect measure of the influence of taxes on investment decisions. Effective corporate tax rates provide a better indication of the amount of tax to be paid on a new investment. By this measure, Pakistan's effective corporate tax rate, at 25 percent, is also higher than the regional, income group, and world averages. While other factors certainly weigh heavily in foreign investment decision-making, this higher effective CIT detracts from the country's ability to compete for foreign investment.

The Personal Income Tax (PIT) structure in Pakistan is progressive. Income below 3 times per capita income is not taxed. Once applied, the rate at which marginal income is taxed is only .50 percent. Similarly, the highest tax rates do not provide a strong disincentive to work. The maximum tax rate of 20 percent, for people earning 130 times the per capita

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income in Pakistan, is lower than the regional, income group, and world averages.

The “tax wedge” or amount of tax imposed on labor at 17 percent[3] is higher than regional and low-income comparator countries, but lower than the global average of 20.61 percent. A large tax wedge would encourage capital intensive investment and growth in employment would be less than with a smaller tax wedge.

Pakistan’s GST rate at 16 percent is comparable to that of the average VAT rate in the South Asia region, at 14.1 percent, and the international average VAT rate, at 15.7 percent. In US dollar terms, the GST threshold, or the level of annual turnover at which taxpayers must register and file regular GST returns is $59,240, which is roughly double the average VAT threshold in the South Asia region and roughly 50 percent higher than low-income and worldwide averages. This could be one contributing factor to weaker GST performance relative to regional, low-income group and world measures of VAT performance.

Revenue Performance and Productivity

Tax revenue performance in Pakistan is weak when compared to the regional and the worldwide averages. Within the South Asia region, Pakistan has among the lowest tax effort ratios—the ratio of taxes collected to GDP—at 9.8 percent.

Despite high statutory tax rates relative to comparator countries, revenues from CIT, at 2.7 percent of GDP are at similar levels to regional, low-income, and world averages. Measured on a revenue productivity basis--the portion of GDP in revenue that is mobilized for each point of tax rate--Pakistan’s CIT revenue productivity is 0.08. This is similar to the region and income group, but lower than the world average value of 0.14, reflecting the large number of exemptions, privileges and weak compliance.

PIT collections, at 0.80 percent of GDP, is weaker than regional and low-income group averages and is well below the world average. PIT revenue productivity, at 0.04, is below regional and low income country averages, and significantly below world average values. The mandatory combined social contribution at 17 percent is higher than regional, income group, and world averages.

Collections of GST at 3.5 percent of GDP are roughly equivalent to regional and income group averages for VAT but below the world average of 6.33 percent of GDP. However, Pakistan’s GST performance is weak. A recognized measure of GST performance is the Gross Compliance Rate (GCR) which is the ratio of potential GST collections—if all final household consumption had been taxed at the standard rate-- to actual GST collections. The average GCR for VAT in the world is 63.11 percent, but for the GST in Pakistan it is only 28.3 percent. Pakistan’s GCR is also below the regional average VAT GCR of 32.3 percent and well below the low income group average of 40.02 percent.

Tax Administration Organization and Efficiency

There are no current year data for tax administration costs, number of tax officials per 1,000 national population, and number of active taxpayers per tax official.

ANNEX: Pakistan’s Collecting Taxes Tables

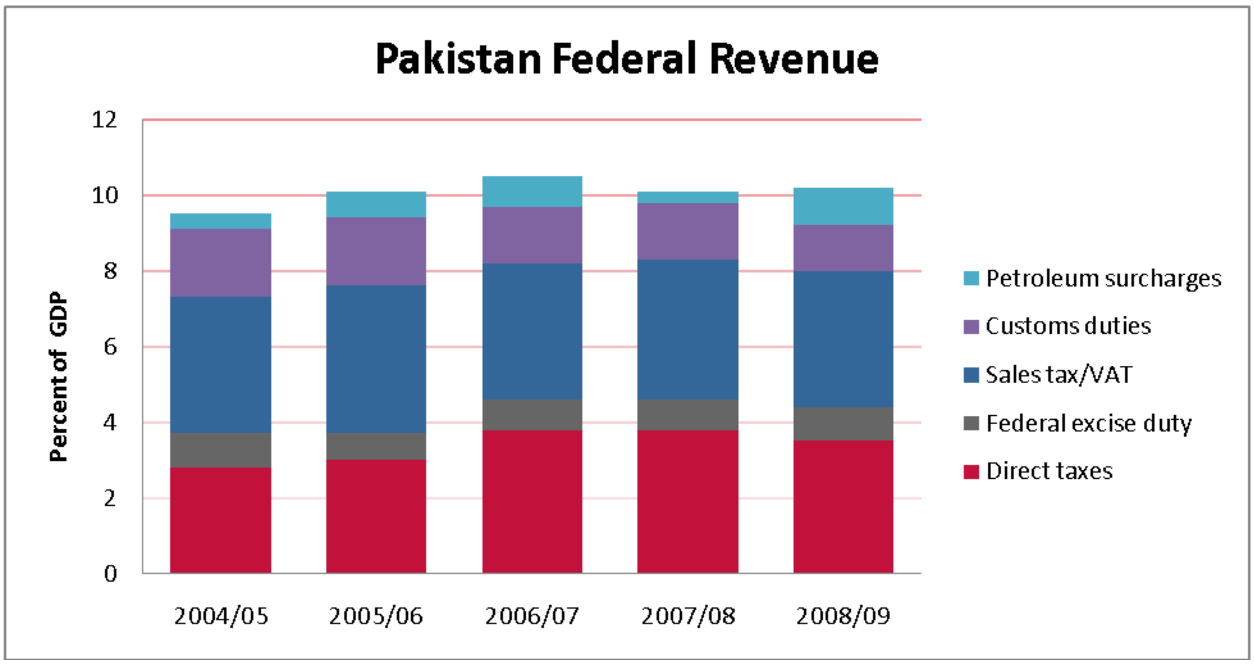
Company Income Tax	CITR Tax Rate	CITY Revenue as % GDP	CITPROD Revenue Productivity	CETR Effective Tax Rates[4]
Pakistan	35.00	2.70	0.08	25.00
South Asia Region	30.36	2.42	0.09	23.80
Low-Income Economies	28.20	2.12	0.10	18.83
World	25.32	3.33	0.14	18.20

Income Taxes on People	PITMINR Minimum Tax Rate	PITMINL Minimum Income Level (Multiples of GDP_{pc})	PITMAXR Maximum Tax Rate	PITMAXL Maximum Income Level (Multiples of GDP_{pc})
Pakistan	0.50	2.82	20.00	135.39
South Asia Region	8.64	3.22	25.71	34.17
Low-Income Economies	9.52	3.00	30.95	25.33
World	11.69	0.86	29.63	9.78

Income Taxes on People	PITY Revenue as % GDP	PITPROD Revenue Productivity	SSR Mandatory Combined Social Contribution Rates	WEDGE Combined Rate of Personal and Labor Taxation
Pakistan	0.80	0.04	17.00	17.00
South Asia Region	1.35	0.06	15.12	15.12
Low-Income Economies	2.02	0.07	11.80	13.98
World	3.36	0.13	16.16	20.61

Value Added Tax	VATR VAT rate	VATY Revenue as % GDP	GCR Gross Compliance Ratio	VATPROD Revenue Productivity	THRESHOLD Mandatory Registration/ Filing (annual Turnover in USD)
Pakistan (GST)	15.00	3.50	28.30	0.23	59,240.00
South Asia Region	14.10	3.57	32.30	0.25	29,587.40
Low-Income Economies	15.12	4.51	40.02	0.29	49,103.00
World	15.67	6.33	63.11	0.41	40,552.18

Note: All data from www.collectingtaxes.net



Source: Various IMF Reports

[1] Source Note: PIT Rates and brackets from Pakistan's Central Board of Revenue, at: http://www.cbr.gov.pk/ Revenue collection data from Pakistan's Ministry of Finance, at: http://www.finance.gov.pk/

[2] This figure represents total federal revenue collections. Revenues collected by the Federal Bureau of Revenue (FBR) are 8.9 percent of GDP, which does not include about 1% of GDP of Federal revenue from petroleum taxes.

[3] The World Bank Doing Business project estimates this at 12.1 percent.

[4] Source Note: Chen, D and Mintz, J. "U.S. Effective Corporate Tax Rate on New Investments: Highest in the OECD," available at: http://www.cato.org/pubs/tbb/tbb_62.pdf and author's calculations.