



IMF and Taxation Reforms

The fiscal challenges faced by Pakistan, including insufficient tax revenue to meet debt servicing and defense needs, have prompted the government to initiate significant reforms in tax administration. The Tax Administration Reforms Program (TARP), launched in 2005 by the Federal Board of Revenue (FBR), aimed to enhance revenue collection, broaden the tax base, strengthen audit and enforcement procedures, and ensure equitable and transparent application of tax laws.

Background and Initiation of TARP

The roots of TARP can be traced back to the appointment of a Task Force on Reforming the Tax Administration by the Government of Pakistan in June 2000. Following extensive discussions with stakeholders and input from the International Monetary Fund (IMF) mission in August 2001, the government approved a comprehensive tax reform strategy in November 2001. This strategy encompassed policy, administrative, and organizational reforms aimed at simplifying laws, promoting self-assessment, reducing exemptions, and enhancing the effectiveness of FBR.

Supplementing Skills and Financial Support

To supplement the skills within FBR, the government appointed professional members from the private sector in March-April 2002, focusing on human resource management, information management, audit, facilitation, taxpayers' education, and fiscal research. Additionally, the World Bank provided financial support through the Project Preparation Facility and the Public Sector Capacity Building Project, enabling the establishment of Large Taxpayer Units (LTUs), Medium Taxpayer Units (MTUs), and a Dispute Resolution Complex.

Main Phase of TARP

TARP's main phase, approved by the Executive Committee of the National Economic Council in February 2005, focused on enhancing FBR's capabilities through IT

systems, automation, and professional training. Despite initial challenges with IT system development, the project progressed, leading to improved performance, a business-friendly environment, and increased tax revenue collection.

Achievements of TARP

By December 2011, TARP had achieved its objectives, including the establishment of 57 Regional Tax Offices, Model Customs Collectorate, Taxpayers Education Centers, and Transit accommodations. The successful completion of TARP, within the allocated budget, underscored the enhanced professional capabilities within FBR and paved the way for future project development objectives.

Conclusion: Significance of TARP's Closure

Overall, TARP's closure marked a significant milestone in Pakistan's tax administration reforms, signaling a move towards professionalism, integrity, and responsiveness in tax collection, thereby reducing the cost of doing business and instilling confidence among taxpayers and tax collectors alike.

The Income Tax Ordinance of 2001: Challenges and Recommendations

The News on Sunday [Political Economy] reported on October 08, 2017, that in response to pressure from the International Monetary Fund (IMF), the General Pervez Musharraf-Shaukat Aziz government introduced a new income tax law, thereby nullifying the long-standing Income Tax Ordinance of 1979, which had been upheld and accepted for 22 years through judicial review until September 13, 2001.



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This new legislation, titled the Income Tax Ordinance of 2001, was hastily drafted by Lee Burns, an Australian Assistant Professor, due to the urgency prompted by an IMF Stand-By Arrangement. Regrettably, the drafting process was hurried, leaving typographical errors uncorrected and prompting concerns regarding the thoroughness of review and debate.

Critics argue that the 2001 ordinance required numerous revisions to function effectively and has remained vulnerable to legal challenges. Despite this, successive elected parliaments have failed to address its shortcomings, as highlighted by the Supreme Court in the case of CIT v Eli Lily (Pvt) Ltd (2009) (2).

Since 2002, this Ordinance has been amended over 2500 times, resulting in significant litigation and revenue losses, as the law remains loaded with contradictions and ambiguities.

The Supreme Court's observations in (2009) 100 Tax 81 (S.C. Pak) underscore the hurried nature of the drafting process and the subsequent amendments, which have further complicated the legal framework.

Despite these criticisms from the judiciary, there has been little effort to revise the law comprehensively. The lack of academic research and political will to address these issues reflects a broader apathy towards the reform of tax legislation in Pakistan.

In conclusion, the Income Tax Ordinance of 2001 stands as a testament to the challenges of policy-making under external pressure and the consequences of inadequate review and debate. Its continued flaws underscore the urgent need for comprehensive reform to ensure a fair and effective tax regime in Pakistan.

Need for Comprehensive Tax Reforms in Pakistan

Pakistan has a significant opportunity to enhance its tax collections, which could potentially amount to approximately Rs. 12 trillion at both the national and provincial levels. To achieve this objective, the country urgently needs to implement fundamental reforms, which should be undertaken collectively under the umbrella of the Council of Common Interests (CCI) and the National Economic Council (NEC).

A critical component of these reforms involves the establishment of a modern, professional, and fully automated National Tax Authority. Such an authority would play a pivotal role in enhancing tax compliance and effectiveness by leveraging advanced tax intelligence systems to identify and address tax avoidance and evasion practices.

To ensure the success of these reforms, it is essential to foster consensus and engage in a democratic process to enact legislation that establishes an autonomous tax

authority. This authority should be staffed with specialists in taxation and governance, rather than traditional bureaucrats. By centralizing tax administration under a single entity, individuals and businesses would benefit from streamlined processes and enhanced accountability at the national, provincial, and local levels.

The modalities and operations of the proposed tax authority can be deliberated and finalized through the CCI, as outlined in Article 153 of the constitution. Furthermore, the authority's oversight and governance can be entrusted to the NEC, in accordance with Article 156.



Guiding Principles for Tax Reforms

A key principle guiding these tax reforms should be alignment with broader economic policies aimed at fostering sustainable economic growth. By allowing market forces to operate freely and efficiently, the reforms seek to unlock the full potential of Pakistan's economy. Moreover, the ultimate goal of taxation should be to redistribute the benefits of economic growth equitably, thereby promoting social well-being and cohesion.

In essence, the successful implementation of these reforms would empower citizens to recognize the tangible benefits of tax compliance. By promoting transparency, fairness, and accountability in taxation, Pakistan can create a more inclusive and prosperous society for all its citizens.

IMF Recommendations

The International Monetary Fund (IMF) has been actively involved in providing extensive assistance to countries undertaking the introduction or restructuring of Value Added Taxes (VATs). Many nations, particularly those in transition economies, have implemented VATs in recent years, while others have reformed and simplified existing VAT structures, especially in the Western Hemisphere.

The IMF often relies on the experiences of European Union (EU) countries as a reference point when formulating recommendations.

IMF Recommendations on Value Added Taxes (VATs)

In its recommendations, the IMF generally advocates for VATs to have a single rate ranging from 10 percent to 20 percent, with a zero-rate applied to exports. The IMF emphasizes minimizing exemptions to maintain the simplicity and effectiveness of the tax system. In cases where a single-rate VAT is not feasible, the IMF suggests a dual-rate structure, comprising a normal rate alongside a reduced rate for specific items. However, the IMF strongly opposes VATs with more than three rates and urges against taxing essential goods at low rates or exempting them altogether.

Regarding the base of the VAT, the IMF recommends limiting exemptions to a few standard items that are difficult to administer under a VAT, such as rental incomes from housing, financial services, and the agricultural sector. The IMF suggests applying the VAT to all other goods and services, including construction materials, professional and personal services, and government purchases.

In some transition economies, the IMF has recommended applying the VAT to farmers, considering the relatively large size and small number of farms compared to other countries. The IMF suggests taxing essential items at reduced rates rather than exempting them entirely. It also encourages adopting a consumption-type VAT to promote capital formation and maintaining international competitiveness by adopting a destination-based VAT.

The IMF recommends that the VAT cover the manufacturing stage initially and, in countries with strong administrative capacities, extend to the retailing stage eventually. The IMF advocates using the invoice-credit method of accounting and setting a threshold level based on turnover to exempt small traders from the VAT, thus easing the administrative burden.

The IMF recognizes that introducing a VAT requires significant effort in educating taxpayers and training tax administrators. Therefore, it sometimes recommends reforming existing turnover or sales taxes before introducing the VAT, focusing on broadening the base and simplifying the rate structure.

In addition to VAT recommendations, the IMF provides advice on excise taxes, which are prevalent in most countries. It suggests limiting excisable goods to traditional items like tobacco products, alcoholic beverages, and petroleum products. The IMF encourages replacing specific rates with ad valorem rates to prevent



revenue erosion due to inflation and ensuring that import and domestic production are taxed equally.

IMF Recommendations on International Trade Taxes

The IMF discourages reliance on international trade taxes, particularly export taxes, as they are often shifted back to producers and can distort trade. Instead, the IMF recommends outward-oriented trade policies to promote economic growth.

IMF Recommendations on Income and Corporate Taxes

Regarding income taxes, the IMF recommends reforms such as reducing the graduation of marginal rate schedules, broadening the tax base by limiting deductions and exemptions, and adopting a global income tax for equity goals. For corporate taxes, the IMF advocates for a single, proportional rate, eliminating tax incentives, and ensuring uniform treatment of domestic and foreign enterprises.

In summary, the IMF's recommendations aim to create efficient, equitable, and transparent tax systems that support economic growth and development across countries and regions.

References:

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