

# CBR QUARTERLY REVIEW

Vol. 6, No. 1, July - September 2006

**A Review of Resource Mobilization Efforts of  
Central Board of Revenue**



***CENTRAL BOARD OF REVENUE***

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January: 2007

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## **Foreword**

The Central Board of Revenue has comfortably surpassed the Revenue target of Rs. 178.4 Billion fixed for Q1: 06-07, by a margin of Rs. 5.5 billion. Similarly, progress has also been made in the areas of broadening of tax base, liquidation of refunds and dispute resolution. These achievements have been possible due to wide-ranging tax policy and administrative reforms that have also improved efficiency and transparency of the organization. A congenial environment has been created in the country to boost investment and trade activities.

The CBR Quarterly Review is a regular publication and a prime source of multifaceted analysis carried out on the four taxes administered by CBR. The current issue contains detailed analysis on the revenue collection performance of CBR and other important achievements of goals and targets set by the Prime Minister. The publication also includes impact evaluation of the Budgetary Measures introduced at the time of announcement of Federal Budget 2006-07. An update on the current CBR reforms is also part of the current issue.

We hope that the current issue will generate the expected interest among wide spectrum of readers. We also look forward to your valuable comments/suggestions to improve the contents of next issues.

M. Abdullah Yusuf  
Chairman CBR/Secretary General  
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# I

## **CBR Tax Collection: An Analysis of Revenue of Q1: 06-07<sup>1</sup>**

### **The Economy**

Pakistan's economy has broadly maintained its growth momentum during the first quarter of FY: 06-07, notwithstanding persistence of certain imbalances. While broad macroeconomic indicators continue to move in the right direction, weaknesses have, nonetheless, persisted in the areas of food inflation, current account balance and primary balance. There has been a definite deceleration in import growth, which is good from improvement in CAD position, but it has adversely affected revenue collection during the first quarter. The large-scale manufacturing sector is also showing signs of slowdown partly due to rising cost of borrowing. On the brighter side, revenue collection has remained on target. Thus, the prospects for sustaining high growth during FY: 06-07 remain strong.

### **CBR Revenue Target for FY: 06-07**

Keeping in view the growth momentum of the economy, the revenue target for FY: 06-07 has been budgeted at Rs. 835 billion (Table 1). A 17% growth in tax receipts will be required over the actual collection of FY: 05-06 to meet the target. It may be recalled that the target of Rs. 835 billion was fixed, based on the actual collection of Rs. 713.4 billion during FY: 2005-06. It was further assumed that the economy in nominal terms will grow by about 15%. Since the natural growth will not be sufficient to generate increase of more than Rs. 120 billion, certain budgetary measures were also introduced essentially to widen the tax base. The most important

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<sup>1</sup> The Research Team of the Fiscal Research Wing of CBR has prepared this Chapter. Valuable support has been received from the Budget Wings of Direct & Indirect Taxes and the Directorate of Research & Statistics.

measures relate to tax on banking and franchise services. Similarly, further in-roads have been made in the areas of taxation on capital gains and real estate.<sup>2</sup> The combined effects of these changes are expected to result in improved collection on account of direct taxes. The share of direct taxes in total CBR collection is expected to increase to 31.7% and the remaining amount is projected to be fetched through indirect taxes.

**Table 1: Baseline Collection  
For FY: 05-06 and Projections for FY: 06-07**

*(Rs. Billion)*

	Collection FY 05-06	Projections FY 06-07	Growth (Percent)
Direct Taxes	225.0	264.7	17.6
Sales Tax	294.8	343.8	16.6
Federal Excise	55.2	69.0	13.8
Customs Duties	138.4	157.5	25.0
<b>All Taxes</b>	<b>713.4</b>	<b>835.0</b>	<b>17.0</b>

To further monitor the revenue collection effectively, annual targets have been divided into monthly targets on the basis of historical trends of collection and value judgment. Additional adjustments have been made in view of the most recent outturn and the policy initiatives undertaken during the year (*Table 2*). Accordingly, the target for July-September, 2006 has been set at Rs. 178.4 billion which is 21.4% of the annual target for FY: 06-07. In view of recent trends, it was anticipated that the collection during the first quarter of FY: 06-07 would largely rely on sales tax and direct taxes with their combined expected contribution of 73% in the total collection of CBR. The shares of sales tax and direct taxes during Q1: 06-07 are projected to be around 41% and 32% respectively. The

<sup>2</sup> The details of budgetary measures are provided in Chapter II of current issue of the CBR Quarterly Review.

remaining amount was expected to be realized through customs and federal excise duties.

**Table 2: Monthly Targets of Federal Taxes: Q1: 06-07**

*(Rs. Billion)*

	DT	ST	FED	CD	ALL
July	8.2	18.4	3.2	9.7	39.5
August	10.6	26.8	4.8	10.4	52.6
September	38.1	28.8	6.3	13.1	86.3
<b>First Quarter</b>	<b>56.9</b>	<b>74.0</b>	<b>14.3</b>	<b>33.2</b>	<b>178.4</b>

### **CBR Revenue Position**

It is encouraging that the net collection of federal taxes collected by the CBR has surpassed the 1st quarter target of Rs. 178.4 billion by Rs. 5.5 billion. The gross and net collection realized during July-September 2006 has been Rs. 210 billion and Rs. 184 billion, which confirm growth of 23.3% and 21%, respectively as compared to the corresponding period of PFY. It is evident from Table 3 that except for customs duties, a double-digit growth in the collection of direct taxes, sales tax and federal excise has been recorded. The low growth in customs has been due to significant reduction in dutiable imports. On the other hand, vibrant performance of the economy has been the major source for improved performance of direct taxes, sales tax and federal excise duties. It implies that momentum gained in the previous years has been sustained. Even though a number of contributing factors for the recorded acceleration in the tax revenues could be narrated, nonetheless improved profitability of the banking, telecom and oil & gas sectors has provided the major boost to tax collection. It is re-assuring that due to enabling environment for business, investment in these sectors has flourished and, as a result, the compliance has also improved.

**Table 3: Comparison of Collection: Q1: 06-07 and Q1: 05-06***(Rs. Billion)*

	Collection		Difference	
	Q1: 06-07	Q1: 05-06	Absolute	Percent
Direct Taxes	66.5	48.2	18.3	38.0
Sales Tax	75.6	63.0	12.6	20.0
Federal Excise	14.0	12.2	1.8	14.3
Customs	27.9	28.7	-0.8	-2.6
<b>All Taxes</b>	<b>184.0</b>	<b>152.1</b>	<b>31.8</b>	<b>21.0</b>

### **Analysis of Refunds/ Rebates**

The timely payment of refunds and rebates is a critical area of taxation system to maintain liquidity of the business. The payments of refunds/rebates means reduced net collection. The tax-wise refund /rebates during first quarter of CFY is presented in Table 4. The largest amount of refunds has been paid back to the energy sector under sales tax (domestic) for its higher claim of inputs.

Besides electrical energy, the other recipient has been textile sector. The former received Rs. 6.9 billion during first three months of CFY against only Rs. 0.03 billion in PFY, and the latter received Rs. 2.4 billion as compared to Rs. 4.2 billion in PFY. It is relevant to mention that zero-rating of the textile chain along with four other export oriented industries during FY: 05-06 has reduced the volume of refunds to a great extent. Had refund to the electrical energy not accrued, the net collection would have shot up further during July-September, 2006.

On the other hand, rebate payments in customs have largely reduced by around 33% during Q1: 06-07. In absolute terms, it has declined from Rs. 3.2 billion during PFY to Rs. 2.2 billion in CFY. Like previous years, the textile sector has been the major beneficiary of the rebate payments, as out of the total rebates, this leading export

sector has claimed Rs. 803.5 million. The other major rebate receivers were: the leather sector with Rs. 459.8 million, and vegetable ghee producers Rs. 398.8 million. The volume of rebates claimed by the textile sector has declined by 40.2% while leather and vegetable ghee grew by 35.2% and 94.5% respectively. Within customs, the refund payments amounted to Rs. 2.5 billion, compared to Rs. 2 billion in the corresponding period last year, indicating a growth of around 23%.

**Table 4: Comparative Position of Refunds/ Rebates:  
Q1: 06-07 - Q1: 05-06**

*(Rs. Million)*

	Refunds/ Rebates		Difference	
	Q1: 06-07	Q1: 05-06	Absolute	Growth (%)
Direct Taxes	10,105	5,202	4,880	93.8
Sales Tax	11,260	7,574	3,686	48.7
<i>Imports</i>	20	37	-17	-45.9
<i>Domestic</i>	11,240	7,537	3,703	49.1
Federal Excise	54	150	-96	-64.0
Customs	4,675	5,282	-607	-11.5
<b>All Taxes</b>	<b>26,094</b>	<b>18,208</b>	<b>7,863</b>	<b>43.3</b>

### **Detailed Analysis of Individual Taxes**

The detailed analysis of collection of individual taxes in relation to the economy is important for deeper understanding. This is relevant because each year new budgetary measures are introduced to broaden tax base, boost revenue, promote investment, and rationalize tax and duty rates and to facilitate taxpayers for improved voluntary compliance.

**Direct Taxes:** The direct taxes have exhibited an impressive performance during the 1<sup>st</sup> quarter of CFY. The target of Rs. 56.9 billion set for the 1<sup>st</sup> quarter has been exceeded by a comprehensive margin of Rs. 9.6 billion. The gross and net collection of direct taxes

during the 1<sup>st</sup> quarter of CFY stood at Rs. 76.6 billion and Rs. 66.5 billion, showing an increase of 43.4% and 38.0 % respectively over the collection of corresponding period of last year.

The higher growth in the direct taxes has been possible due to vibrant economic activities in the banking, oil and gas and telecommunication sectors. The boom in the construction sector has also contributed positively towards this end. The improved voluntary compliance has been the result of various policy changes in the income tax regime. Brief review of the components of the direct taxes has been given below.

***Components of Income and Corporate Taxes:***

There are three major components of direct taxes namely; collection on demand (CoD), voluntary payments (VP) and withholding taxes (WHT). The growth in collection on demand (CoD) during 1<sup>st</sup> quarter of CFY has been around 10%. Whereas the current demand has increased by 117.1% as compared to the corresponding period of last year, there has been 18% decline in the collection from arrear demand.

*Voluntary Payments:* On account of VP Rs. 37.2 billion have been generated during the 1<sup>st</sup> quarter of CFY as compared to Rs. 20.3 billion in the corresponding period of last year. The growth has been 83.1%, which indicates that the policy interventions introduced in the income and corporate tax system has been widely productive. It is encouraging to note that both the heads of VP, i.e., the payment with returns and advance payments have registered impressive growth. Resultantly, the share of VP in total gross income tax collection has increased to 50.4% from 39.8% during the same period of last year.

*Withholding Taxes:* This component has been the major contributor of the income tax gross and net collection. The share of

WHT in gross collection has declined from 55.3% in Q1: 05-06 to 44.6% in Q1: 06-07. In absolute terms, Rs. 34.1 billion have been collected from WHT against Rs. 28.5 billion in the corresponding period of last year showing a growth of 19.9%. This declining share of WHT in total gross income tax is not consistent with the sectoral growth of the economy.

Within WHT, the major share in the collection has been from the traditional sources, namely, contracts/supplies (28.9%), Imports (20%), salary (9.3%), telephone use (8.1%), exports (7.4%) and electricity use (3.4%). Among these sources, significant growth has been recorded in the use of telephone (111.4%), followed by electricity with 18.1% growth (Table 5). The growth in WHT collection from exports, salary and imports has been 8.9%, 7% and 2.3%, respectively.

**Table 5: A comparative Position of Withholding Taxes**

*(Rs. Million)*

Tax Heads	Q1: 06-07	Q1: 05-06	Difference	Growth (%)
Contracts/ Supplies	9,882	8,872	1,010	11.4
Imports	6,844	6,687	157	2.3
Salary	3,172	2,965	207	7.0
Exports	2,512	2,306	206	8.9
Telephone use	2,778	1,314	1,464	111.4
Electricity use	1,165	986	179	18.1
Sub-Total	26,352	23,130	3,222	13.9
<b>Total WHT</b>	<b>34,145</b>	<b>28,558</b>	<b>5,587</b>	<b>19.6</b>
Other WHT	7,793	5,428	2,365	-72.7
Share in Gross	44.6	55.3		

The 11.4% growth in deductions at source on account of contracts and supplies has been due to continuously robust economic activities in the country. The 7% growth in the head of salary has to be viewed within the backdrop of reduction in income tax rates and increased tax-free threshold from Rs.100,000/- to Rs.150,000/-. It will not be

out of merit to mention the remarkable growth in collection from securities (89%), dividends (52%), and bank interest (47.1%). Invariably, the increased banking and corporate activities in the country have been instrumental in the collection from these heads.

***Box 1: WHT on Cash Withdrawal & Sale/ Purchase of Stocks***

*During Federal Budget 2006-07, the WHT rate on cash withdrawal was increased from 0.1% to 0.2%. It was anticipated that collection will also double with this change. Similarly, the WHT deduction on stock exchange was raised from 0.005% to 0.01%. The collection from cash withdrawal stood at Rs. 1110.8 million during Q1: CFY against Rs. 380 million in Q1: PFY, in other words around 192% growth. The collection from WHT on stocks has also increased to Rs. 510.9 million from Rs. 331 million in previous year, showing a growth of 54.3%.*

***Tax Contribution of Corporate and Non-Corporate Sectors***

The contribution of corporate sector in income tax has increased from 68.5% to 74.7% during Q1: 06-07 as compared to corresponding period last year. The boost in this growth has been from both factors, namely the self-computed first installment of the advance tax payments and deductions at source (Table 6).

The breakup of the collection from corporate sector reveals that despite the fact that the private corporations are the leading contributors of income tax, their share in total gross income tax has declined to 41% during July-September 2006-07 against 46% in the corresponding period of last year. Similarly, the share of the public corporations has declined from 36% to 33.1% during the same period mainly due to privatization of the public entities. Compared to this, around 7% increase has been recorded in the share of banking sector, which is consistent with improved profitability and expansion of the banking sector.

**Table 6: Sector-wise Income Tax (Gross) Collection***(Rs. Million)*

Heads	July-September			Share (%)	
	2006-07	2005-06	Growth(%)	2006-07	2005-06
<b>Corporate Sector</b>	<b>55,034.5</b>	<b>35,031.8</b>	<b>57.1</b>	<b>74.7</b>	<b>68.5</b>
Advance	20,080.2	13,201.0	52.1	27.2	25.9
Others	34,954.3	21,667.6	61.3	47.4	42.8
<b>Non-Corporate Sector</b>	<b>18,675.9</b>	<b>15,953.0</b>	<b>17.1</b>	<b>25.3</b>	<b>31.5</b>
Advance	1,114.6	900.2	23.8	1.5	1.8
Others	17,561.3	15,052.8	16.7	23.8	29.7
<b>Total</b>	<b>73,710.4</b>	<b>50,984.8</b>	<b>44.6</b>	<b>100.0</b>	<b>100.0</b>
<b>Income Tax Gross Collection by Corporations</b>					
Public	18,195.9	12,596.8	44.4	33.1	36.0
Private	22,535.2	16,227.6	39.8	40.9	46.3
Banking	14,303.4	6,207.4	130.4	26.0	17.7
<b>Total Corporate Sector</b>	<b>55,034.5</b>	<b>35,031.8</b>	<b>57.1</b>	<b>100.0</b>	<b>100.0</b>

***An Analysis of Income Tax Returns***

Another dimension to judge the performance of the reforms initiatives introduced in the income tax structure has been the level of voluntary compliance by the taxpayers. It is encouraging to note that there has been marked improvement in confidence of the taxpayers over the revenue collecting department, which can be viewed that up to 16<sup>th</sup> October, 2006 a total of 1.47 million returns and statements have been filed by the Companies, Association of Persons (AOPs), Salaried and Non-salaried individuals. The comparable figure for Q1: 05-06 has been 1.17 million returns and statements. Thus, a growth of around 26% has been achieved. On the other hand, tax with returns has increased to Rs 14.33 billion in the Q1 of CFY as against Rs. 5.02 billion in the corresponding

period of PFY, indicating a remarkable growth of 185%. The detailed breakup is given in Table 7.

**Table 7: Income Tax Returns and Tax Collection  
During 2006 and 2005**

	Up to October 16 <sup>th</sup> 2006		Up to October 16 <sup>th</sup> 2005		Difference (Absolute)		Growth (%)	
	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid
<b>Returns</b>								
Corporate Cases	798	12,120.6	1,742	3,030.7	-944	9,089.9	-54.2	299.9
AOPs	20,300	99.6	21,826	87.3	-1,526	12.3	-7.0	14.0
Salaried Individuals	61,274	183.5	62,896	154.4	-1,622	29.1	-2.6	18.8
Non-Salaried Individuals	521,644	1,714.7	510,189	1,540.0	11,455	174.7	2.2	11.3
Sub Total Individuals	603,218	1,997.8	594,911	1,781.8	8,307	216.0	1.4	12.1
<b>Sub Total Returns</b>	<b>604,016</b>	<b>14,118.4</b>	<b>596,653</b>	<b>4,812.5</b>	<b>7,363</b>	<b>9,305.9</b>	<b>1.2</b>	<b>193.4</b>
<b>Statements</b>								
Salary certificates/statements	779,073	58.3	495,090	71.25	283,983	-13.0	57.4	-18.2
Importers	13,176	2.6	9,826	2.55	3,350	0.1	34.1	2.0
Exporters	8,261	12.5	8,967	13.92	-706	-1.4	-7.9	-10.2
Contractors/ Suppliers	30,201	10.1	33,993	6.62	-3,792	3.5	-11.2	52.6
Other(including Retailers)	37,547	131.6	36,378	114.43	1,169	17.2	3.2	15.0
Sub Total Statements	868,258	215.1	574,379.0	208.77	293,879	6.3	51.2	3.0
<b>Total</b>	<b>1,472,274</b>	<b>14,333.5</b>	<b>1,171,032</b>	<b>5,021.3</b>	<b>301,242</b>	<b>9,312</b>	<b>25.7</b>	<b>185.5</b>

Note: Tax paid in Million Rupees.

**Sales Tax:** The sales tax (GST) has been a leading tax in terms of tax collection. Its importance can be judged by its 2/5<sup>th</sup> share in the total collection of the federal taxes during Q1: 06-07. The sales tax collection has recorded a growth of 23% and 20% in gross and net collection during July-September, 2006. The gross and net collection stood at Rs. 86.8 billion and Rs. 75.6 billion respectively. The difference between the two is the payment of refunds of Rs. 11.3 billion, showing a growth of 48.7%. Since sales tax is

collected at domestic and import stage therefore, the analysis of both components is presented in the following.

***Domestic Sales Tax Collection:*** The gross and net collection of sales tax domestic has been Rs. 42.1 billion and Rs. 30.8 billion respectively during July-September, 2006. The gross collection of sales tax has mainly been realized from ten major revenue spinners. These commodity groups had around 75% share of the total gross collection of sales tax domestic during 1<sup>st</sup> quarter of CFY. The major revenue spinners are: telecommunication, POL products, electrical energy, natural gas, sugar, cement, cigarettes, aerated waters, services other than telecom, and auto parts. It is encouraging that the gross collection from these major items has increased by 45.6% (Table 8).

The collection of telecommunication is at the top of these ten items by contributing Rs. 8.3 billion with a healthy growth of Rs. 58.1% during July-September, 2006. The better performance in collection is mainly due to the continuous boom in the telecom sector. The hard competition among the telecom companies and better services offer at lower rates has expanded the use of mobile phones. Consequently, the tax collection has also increased by 58%. POL products are the second major source of sales tax (domestic). A growth of 24.1% during July-September FY: 06-07 has been observed. Like telecommunication, POL products have also exhibited double digit growth throughout the quarter. The main reasons for increase in the collection from this source is increased level of sales and a decline in the input adjustment. While, the collection from electrical energy in gross terms has exhibited a strong growth of 322%, but almost entire amount has been refunded to the sector. In fact, the huge payments of refunds to the tune of Rs. 6.9 billion have turned the contribution to negative. As far as the collection from cigarettes is concerned, it has realized enormous growth of 61%. The increased prices of cigarettes in the Budget FY:

**Table 8: Gross Collection of GST (Domestic) from Major Revenue Spinners**

	FY: 06-07	FY: 05-06	Growth (%)		FY: 06-07	FY: 05-06	Growth (%)
<i>Telecommunications</i>				<i>Cement</i>			
July	2,659	1,321	101.3	July	580	363	59.8
August	2,681	1,888	42.0	August	469	358	31.0
September	2,991	2059	45.3	September	438	434	0.9
Q1	8,331	5,268	58.1	Q1	1,487	1,155	28.7
<i>POL Products including LPG</i>				<i>Cigarettes</i>			
July	2,340	1,774	31.9	July	321	110	191.8
August	2,813	2,300	22.3	August	434	220	97.3
September	2,363	1,983	19.2	September	551	483	14.1
Q1	7,516	6,057	24.1	Q1	1,306	813	60.6
<i>Electrical Energy</i>				<i>Services</i>			
July	1,379	25	5416.0	July	371	313	18.5
August	1,920	80	2300.0	August	376	306	22.9
September	1,970	1142	72.5	September	429	345	24.3
Q1	5,269	1,247	322.5	Q1	1,176	964	22.0
<i>Natural Gas</i>				<i>Aerated Waters</i>			
July	449	488	-8.0	July	315	210	50.0
August	1,074	1,174	-8.5	August	346	279	24.0
September	1,074	1,270	-15.4	September	321	262	22.5
Q1	2,597	2,932	-11.4	Q1	982	751	30.8
<i>Sugar</i>				<i>Auto Parts</i>			
July	747	798	-6.4	July	248	202	22.8
August	821	699	17.5	August	186	171	8.8
September	858	519	65.3	September	226	205	10.2
Q1	2,426	2,016	20.3	Q1	660	578	14.2
<i>Major Ten Commodities</i>				<i>All Commodities</i>			
July	9,409	5,604	67.9	July	12,044	8,883	35.6
August	11,120	7,475	48.8	August	11,922	10,744	11.0
September	11,221	8,702	28.9	September	18,118	11,870	52.6
Q1	31,750	21,781	45.8	Q1	42,084	31,497	33.6

06-07 has helped to achieve this growth. These two factors, i.e., higher sale proceeds (due to higher price) and less-adjustments for inputs have largely compensated the loss due to decline in the demand. Starting with a huge growth of around 192% in July, 2006, the collection has recorded 97.3% increase in August, 2006. However, the growth decelerated to only 14.1% in September, 2006.

The collection of sales tax from cement has also increased by 28.7% during Q1: 06-07. The pace of growth has slowed down from 59.8% in July to 31% in August and 0.9% in September, 2006. This low growth in collection is partly due to declining market price of cement. Significant improvement in the collection of beverages is attributable to higher demand during summer months. Similarly, higher sales of auto parts have resulted in the growth of its collection during July-September, 2006. Finally, the only item which has yielded negative growth of 11% is natural gas where input adjustment during Q1: FY: 06-07 has been recorded.

### ***Structure of Imports***

The fluctuation in imports and export influences the trade balance. Beside, the monitoring of imports is vital for collection of import related taxes especially customs and sales tax. The trends of gradual slowdown in the imports and dutiable imports have posed a serious threat for the rest of the period of CFY. This warrants a special attention towards other appropriate remedial measures like plugging the loopholes in customs collection and efficiency gains. The decline in dutiable imports seriously hits the customs duties. Since different rates are applied in customs, any sudden decline in the major commodities with higher *ad valorem* and specific rates of CD like vehicles, edible oils etc can seriously affect the collection of CD. On the other hand, valuation of imported goods is also essential for safeguarding government revenues. The fluctuation of imports can cast straight impact on the collection of sales tax due to a flat rate of 15% on all the imports. However, any decline in the import of raw materials results in the lesser claims of input in sales tax domestic.

It is interesting to find that around 90% of the value of imports has been contributed by only 26 commodities groups during Q1: 06-07. Within this group, nearly 58% of the import value is generated by

POL products (27.1%), machinery (20.3%), vehicles and organic chemicals (5% each).

A detailed review of these commodities confirms that electrical machinery (Ch: 85) has reflected a growth of 14%. The transmission apparatus including mobile phones constituted 57.4% of electrical machinery. The growth in the imports of mobile phones during Q1: 06-07 has been 26.7% while transmission apparatus excluding mobile phone grew by 16%. On the other hand, the import of mechanical machinery has reduced by 3.1%. The major decline in this group has been in textile growth, industrial, construction machinery, data processing machines and agricultural equipments. On the other hand, positive growth has been recorded in the import of engines, pumps and consumer goods.

The import of vehicles and parts (Ch: 87) covers 5.2% of the total imports. Its import value increased by 9% during first three months of CFY. The motor vehicles which dominated the total import of vehicles and parts with about 58% share grew by 9.2%. The total number of completely built units (CBU) of cars increased from 4340 in FY: 05-06 to 7129 in FY: 06-07. Despite this growth in the number of motor vehicles, the value of import increased only by 5% because of higher imports of lower capacity cars, i.e., up to 1000 cc whose value is normally low. The remaining contributors in the imports of vehicles & parts (Ch: 87) were trucks, tractors, motor cycles, and passenger vans.

### ***Sales Tax Collection at Import Stage***

The sales tax on imports contributes a major portion of total collection of sales tax. It has contributed around 3/5<sup>th</sup> of the total net collection of sales tax during Q1: 06-07 as compared to the previous year. An amount of Rs. 44.7 billion has been realized from this source entailing an increase of 14.6%. The growth in the collection of sales tax is in line with total imports. It is evident from Table 9

that fifteen major commodities groups contributed 88.2% of the collection of sales tax and 78.8% of the imports during Q1: 06-07.

POL products have been the top revenue spinner of sales tax during July-September 2006. It contributed 42.2% of the total collection of sales tax at import stage. Vehicles and parts contributed 8.7% in collection. Relatively reduced imports of iron and steel compared to last year by 20.8% have resulted into reduced collection of sales tax by 24.5%. Spurred by the growth in imports, the collection of sales tax on imports has also grown from commodities like sugar, paperboard, and edible oils. On the other hand, the collection from electrical machinery and organic chemicals has declined despite increased imports. The decline in the collection of fertilizer is in line with the decrease in its imports during the 1<sup>st</sup> quarter.

**Table 9: Chapter-Wise Growths in Imports and Sales Tax**

PCT Head	Description	Growth in Import Value	Growth in Sales Tax	Share (%) in Total Sales Tax
27+ 99.28	POL Products	49.7	48.1	42.2
87	Vehicles	9	3.1	8.7
72	Iron & Steel	-20.8	-24.5	5.5
39	Plastic & Articles	3.7	3.8	5.3
15	Edible Oils & Waxes	8.9	27.4	4.8
17	Sugar & Sugar Confectionary	33.3	32.6	4.5
84	Mechanical Machinery	-3.1	50.8	3.7
85	Electrical Machinery	14	-8.6	2.7
29	Organic Chemicals	5.8	-3.4	2.2
48	Paper & Paperboards	14.5	11.5	1.9
9	Coffee, Tea and Spices	8.3	8.9	1.4
31+ 99.36	Fertilizer	-34.4	-23.9	1.3
40	Rubber & Articles	-2.1	-10.7	1.3
12	Oilseeds	1.7	-12.3	1.1
38	Miscellaneous Chemicals	-14.9	-18.8	1.6
	Sub-total	14.2	-19.9	88.2
	Others	16.2	-13.2	11.8
	Grand total	14.6	14.6	100

**Customs Duties:** The collection of Customs Duties (CD) is the 3<sup>rd</sup> major source of tax revenues, collected by CBR. The customs duty collection depends on the volume of dutiable imports. Any decline in the dutiable imports automatically affects the customs duties. During Q1: 06-07, while the imports have grown by 14.6%, there was a decline in dutiable imports by 3.9%. This decline has effectively impeded the growth in the collection of CD. Thus, the gross collection of CD has exhibited a decline by 4%. However, net collection has dropped by 2.6% only, which has been due to reduced payments of refunds/rebates 11.5% (Table 10).

**Table 10: Comparison of Gross and Net collection of Customs Duties and Refund/ Rebate Payments**  
(Rs. Million)

	FY: 06-07	FY: 05-06	Difference	
			Absolute	Percent
<i>Gross Collection</i>				
July	10,156	9,717	439	4.5
August	11,193	11,568	-375	-3.2
September	112,16	12,643	-1,427	-11.3
Q1	32,565	33,928	-1,363	-4.0
<i>Refund/ Rebate</i>				
July	2,080	1,334	746	55.9
August	1,482	2,499	-1,017	-40.7
September	1,113	1,449	-336	-23.2
Q1	4,675	5,282	-607	-11.5
<i>Net Collection</i>				
July	8,076	8,383	-307	-3.7
August	9,711	9,069	642	7.1
September	10,103	11,194	-1,091	-9.7
Q1	27,890	28,646	-756	-2.6

#### *Major Revenue Spinners of Customs*

Major part of the customs duties is contributed by 15 major commodity groups. Hence, the data related to these fifteen leading revenue spinners of CD during Q1: 06-07 is highlighted in Table 11. These commodity groups have yielded around 4/5<sup>th</sup> of customs

receipts, 75% of the total imports and more than 80% of dutiable imports.

**Table: 11 Chapter-Wise Growths of Major Revenue Spinners and Effective Rates**

PCT Ch.	Tariff Description	July-September Growth (%)			Effective Rates (%) With Dutiable Imports	
		Import Value	Dutiable Imports	Customs Duties	Jul-Sep 06-07	Jul-Sep 05-06
87	Vehicles	9.0	4.2	4.7	35.5	35.4
15	Animal or vegetable fats	8.9	8.5	-0.2	30.5	33.1
27	POL Products	49.7	13.5	-7.8	8.3	10.2
84	Mechanical Machinery	-3.1	-14.0	-15.5	6.7	6.8
85	Electrical Machinery	14.0	9.1	1.6	7.1	7.6
39	Plastic & Articles Thereof	3.7	2.0	-6.7	7.8	8.5
72	Iron & Steel	-20.8	-25.5	-27.3	10.5	10.7
29	Organic Chemicals	5.8	-15.2	-18.3	8.0	8.3
48	Paper & Paperboard	14.5	-11.9	-2.9	20.6	18.7
73	Articles of Iron & Steel	52.0	22.0	-10.2	11.0	15.0
38	Misc. Chemical Products	-14.9	-17.4	-19.6	7.7	7.9
54	Man made filaments	-16.2	-14.0	-11.9	8.8	8.6
69	Ceramics Products	4.0	9.2	3.1	21.5	22.7
09	Coffee, Tea, Mate & Spices	8.3	10.2	7.3	9.7	10.0
32	Dyes, paints etc	8.8	4.5	-3.3	12.0	13.0
	Sub-total	15.8	-1.6	-4.6	12.7	13.1
	Others	11.1	-14.2	-1.6	16.7	14.6
	Grand total	14.6	-3.9	-4.0	13.4	13.4

As anticipated, the automobile sector, despite significant change in policy, remains one of the top revenue generators of customs duties. The collection from automobile including parts (Ch: 87) grew from Rs. 7.1 billion in Q1: 05-06 to Rs. 7.5 billion during Q1: 06-07. However, this low growth was mainly due to significant increase in the import of smaller vehicles. This probably is due to the recent restriction in the Federal Budget on the imports of vehicles which are older than 3 years. In addition exemption granted on the import of agricultural tractors has resulted into a loss of CD of around Rs. 145 million. Edible oils grouped in Chapter 15 are the second

important source of CD collection during the first quarter of CFY. Edible oil is subjected to specific duty and almost all the import value is dutiable. The collection of CD from this source has remained stagnant (See Box 2). Despite considerable growth in the imports and dutiable imports, the collection of CD from POL products (Ch: 27) has manifested a decline by 7.8% due to rationalization of tariff and 97% dip in the dutiable import of coals (also included in Ch:27). It is worth emphasizing that the effective rate of POL products with dutiable imports has reduced from 10.2% in July-September, 2005 to 8.3% in Q1: 06-07.

**Box 2: Emerging Scenario of Import of Edible Oils ( July-September)**

*Edible oil (Chapter 15) is one of the leading sources of customs duties. Palm oils contributed around 92% of the total imports & dutiable imports and 96% of the CD of the edible oils. Within the palm oils, there are three major contributors of CD, namely, palm oil, crude oils and RBD palm oil falling under PCT 15.11. The palm oil is the top contributor with 70% of overall collection of CD from edible oils group (Ch:15).The currently applicable specific rates of customs duties are: crude oil (Rs. 9000/MT through SRO 565(I)/2006), RBD Palm Oil (Rs. 10800/M/T), palm oil (Rs. 9050/MT). It means that rate of CD is higher for RBD Palm oil followed by palm oil. It is further added that no tariff rationalization for RBD palm oil, crude palm oil and palm oil falling under (PCT 15.11) has taken place through statutory tariff or SROs in FY: 06-07.*

*Recent change in the composition of imports from RBD Palm oil to crude palm oil is a major shift. This has happened due to setting up and operations of new edible oil refineries in the country. Henceforth, this trend will continue and imports of crude palm oil will continue to grow vis-à-vis import of RBD and palm oil. It means application of duty from comparative higher rate to lower rate. Traditionally, palm oil is the major contributor of CD in Palm oil due to its higher imports. The current position also suggests that a slight decline in the import of palm oil is recorded which has also reduced its collection by 9%. Thanks to the massive growth of 234% in crude palm oils, the colossal loss in the collection of CD in RBD palm oil and palm oil has largely been compensated. Had impressive growth in the crude palm oil not taken place, a huge setback in the collection of CD would have drastically disturbed the overall collection.*

The collection of mechanical machinery has declined due to decrease in imports and dutiable imports. On the other hand, the import of electrical machinery has increased by 14% but the collection has increased by 1.6% during Q1: 06-07 due to exemptions on mobile phones. Finally, the import and dutiable imports from iron and steel, chemicals and man made filaments have resulted into decline in the collection of customs duties. This trend is fraught with the danger of erosion of the customs duties as the base is shrinking.

**Federal Excise:** The net tax receipts from Federal Excise Duty (FED) improved from Rs. 12.2 billion in Q1: FY: 05-06 to Rs.14 billion in Q1: 06-07. It entails a growth of 14.3%. The major portion of FED collection of around 88% continues to originate from top five revenue spinners, namely; cigarettes, cement, natural gas, POL products and beverages & concentrates. These items exhibited an overall growth of 8.6%. The month-wise performance of these major revenue spinners is depicted in Table 12.

Cigarette is the top revenue spinner of FED but its contribution has stagnated at Rs. 4.6 billion during 1<sup>st</sup> quarter of 2005 and 2006. The stagnancy in the collection is mainly attributable to low demand due to increased prices of cigarettes as announced in the Federal budget 2006-07. Nonetheless, the receipts from the cigarettes have exhibited significant growth in July and August, 2006 due to 18.7% and 5.5% growth in the production, but surprisingly, a decline in the collection of September, 2006 was recorded mainly due to sudden drop in production by 17.9%. However, the higher growth in the collection of cigarettes in the first two months has largely compensated for the drop in the collection of September, 2006. The cement is the second major source of revenue generation for FED. The collection of cement has exhibited 14.7% growth in the collection during July-September, 2006 mainly due to growth in the production by around 6% during July-September, 2006. The POL

products have also exhibited a considerable growth of 14.7% in the collection during Q1: 06-07. Finally, for beverages and beverages concentrates, the collection of FED has substantially gone up by 29.4% mainly backed by 28.3% increase in production during July-September, 2006. As far as tax receipts from natural gas are concerned, 4.3% reduction has been noticed during Q1: 06-07 as compared to the corresponding period of last year.

**Table 14: Federal Excise Major Revenue Spinners**

(Rs Million)

	FY 06-07	FY 05-06	Difference	
			Absolute	Percent
<i>Cigarettes</i>				
<i>July</i>	1043.7	536.9	506.8	94.4
<i>August</i>	2713.2	1453.1	1,260.1	86.7
<i>September</i>	826.0	2565.8	-1739.6	-67.8
<i>Q 1</i>	4582.9	4555.8	27.3	0.6
<i>Cement</i>				
<i>July</i>	1139.9	924.6	215.3	23.3
<i>August</i>	1577.2	996.1	581.1	58.3
<i>September</i>	668.0	1030.0	-362.0	-35.2
<i>Q 1</i>	3385.1	2950.7	434.4	14.7
<i>Natural Gas</i>				
<i>July</i>	455.0	366.7	88.3	24.1
<i>August</i>	574.3	466.3	108.0	23.2
<i>September</i>	255.0	508.5	-253.5	-49.9
<i>Q 1</i>	1284.3	1341.5	-57.2	-4.3
<i>POL Products</i>				
<i>July</i>	385.1	279.8	105.3	37.6
<i>August</i>	684.8	364.2	320.6	88.0
<i>September</i>	119.4	392.7	-273.1	-69.5
<i>Q 1</i>	1189.3	1036.7	152.8	14.7
<i>Beverages &amp; Concentrates</i>				
<i>July</i>	562.3	399.4	162.9	40.8
<i>August</i>	853.9	514.1	339.8	66.1
<i>September</i>	391.9	484.2	-92.3	-19.1
<i>Q 1</i>	1808.1	1397.7	410.4	29.4
<b><i>Total (Major Commodities)</i></b>				
<b><i>July</i></b>	<b>3586.0</b>	<b>2507.4</b>	<b>1078.6</b>	<b>43.0</b>
<b><i>August</i></b>	<b>6403.4</b>	<b>3793.8</b>	<b>2,609.6</b>	<b>68.8</b>
<b><i>September</i></b>	<b>2260.3</b>	<b>4981.2</b>	<b>-2720.9</b>	<b>-54.6</b>
<b><i>Q 1</i></b>	<b>12,249.7</b>	<b>11282.4</b>	<b>967.3</b>	<b>8.6</b>
<b><i>Share in Gross CED (%)</i></b>	<b>87.6</b>	<b>92.2</b>		

### **Concluding Observations**

Although CBR has accomplished the assigned target for July-September, 2006, the trend of decreasing imports and dutiable imports, if continued, might create difficulty in achieving the revenue target for the remaining year. There might be a need to search for new avenues for replenishing the erosion of revenues from the existing base. Improved enforcement, systematic audit and efficiency gains from the on-going reforms are some of the options that would have to be exploited. Along with efforts to broaden tax base, it is equally important to reduce leakages as the gap between realized and potential taxes from the existing taxpayers and particularly the corporate sector appears to be quite significant. This difficult task can be accomplished through effective audit, for which the National Audit Plan needs to be completed on priority basis.

## II

### **Impact Evaluation:**

### **An *Ex Post* Analysis of Budgetary Measures During 1<sup>st</sup> Quarter of FY: 06-07<sup>3</sup>**

#### **Background**

It is now well established that a clear direction of tax policy has been instrumental in boosting the growth of economy and attracting Foreign Direct Investment (FDIs). Continuity of incentives for availability of raw materials and machinery has not only helped in expanding industrial base but also brought down the cost of doing business in Pakistan. Bringing uniformity and simplicity in the duty and tax rates in the individual federal taxes is the hallmark of current tax policy that has provided a relief to the taxpayers. Special incentives have also been announced for development of agriculture sector in the budgets. The payments of refunds have been minimized through zero rating of major export oriented industries for sales tax purposes. Tax laws and Procedures have mostly been simplified. The taxpayers have been empowered to assess their due taxes. At the same time, over-hauling of tax machinery and enabling environment in the model units is a clear departure from the past. The establishment of reformed units is ushering CBR into a new era of modern tax administration.

A host of budgetary measures were undertaken during Federal Budget 2006-07 with the broad objectives of simplification of tax system, improvement in resource mobilization, boosting economic activity to ensure robust economic growth, reducing the cost of doing business for trade & industry, broadening of base, reducing tax burden for lower income strata of the society and promoting a taxpayers' friendly culture.

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The purpose of this paper is to provide an assessment through *ex post* impacts of some of the important budgetary measures announced during Federal Budget 2006-07.

## Direct Taxes

***Simplification of Salary Taxation:*** In the recent years, a major thrust of the tax policy has been on the simplification of tax laws to facilitate the taxpayers for improved compliance of their tax obligations. In order to extricate the salary taxpayers from the complex web of tax calculation, a simple system of personal tax calculation has been devised in the Budget 2006-07. The exemptions on perquisite, allowances and benefits have been withdrawn. In order to neutralize the effect of this withdrawal of exemptions, threshold has been increased from Rs. 100,000 to Rs. 1,50,000. Secondly, the personal tax rates operative during FY: 05-06 were in the range of 3.5% and 30%. These rates have been revised downward and are now in the range of 0.25% to 20% during FY: 06-07. Table 1 elucidates that 78% collection of personal income tax is realized from the employees of federal government. The overall collection from salary has increased by Rs. 207 million during July-September, FY: 06-07 yielding an increase of 7% over the collection of last year.

**Table 1: Collection of Personal Tax from Salary during July-September, FY: 06-07 and FY: 05-06**

(Rs. Million)

	FY: 06-07	FY: 05-06	Diff	Growth (%)
1) Federal Government	2,466	2,785	-319	-11.5
2) Government Other than Federal	90	27	63	233.3%
3) Other	616	153	463	302.6
<b>Actual</b>	<b>3,172</b>	<b>2,965</b>	<b>207</b>	<b>7.0</b>

**Enhancing WHT from @ 0.1% to 0.2% on Cash Withdrawals:** The WHT on cash withdrawals was introduced in the Budget 2005-06 making responsible every bank to deduct tax @ 0.1% at the time of cash withdrawal exceeding Rs. 25,000 per transaction. In the Budget 2006-07, the rate has been enhanced from 0.1% to 0.2%. Further, the system of deduction has been changed from per transaction to per day. It is evident from Table 2 that this policy measure has substantially improved the collection from Rs. 380 million in July-September, 2005 to Rs. 1,111 million during July-September, 2006 entailing a significant growth of Rs. 731 million. It implies that initiative has been successful as far as revenue generation is concerned. Even if a higher growth of 134% in the collection of banking companies is taken into account, the total increase in the collection from cash withdrawal for Q1: FY: 06-07 would have stood at Rs. 222 million. The increase in the collection is attributed to both the factors, i.e., increase in rate and deductions per day rather than transaction. The initiative has been helpful in raising collection of WHT.

**Table 2: Impact of Increase of WHT Tax From 0.1% to 0.2% on Cash Withdrawal during July-September**

	(Rs. Million)			
	FY: 06-07	FY: 05-06	Diff	Growth (%)
Actual Collection	1,111	380	731	192.4
With Growth Adjustment (65%)	1,111	889	222	25.0

**Reduction in Corporate Tax Rates:** The corporate rates for banking and private companies are being slashed down to reach the parity among the private, banking and public companies by Tax Year 2007. While this decline has been helpful only partially, the increased profitability of the banking sector has resulted into improved collection. It is evident from Table 3 that huge increase in the collection of both the banking and private companies has been

recorded. An additional collection of Rs. 14.6 billion has been manifested during Q1: 06-07. It is evident that the loss in tax collection due to tax rate reduction has been compensated by increased tax revenues due to huge profits. Higher tax compliance is a clear indication that the business of private and banking companies is thriving at a rapid pace.

**Table 3: Collection of Corporate Tax from Banking and Private Companies during July-September, FY: 06-07 and FY: 05-06**

*(Rs. Million)*

Companies	FY: 06-07	FY: 06-07	Diff	Growth (%)
1. Banking Companies	14,303	6,099	8,204	134.5
2. Private Companies	22,535	16,119	6,416	39.8
Total Collection(1&2)	36,838	22,218	14,620	65.8
With Growth Adjustment (38%)	36,838	30,661	6,177	20.1

***Increase in the WHT on shares in Stock Market:*** In view of vibrant performance of the capital market, the WHT on all trading transactions made in the stock exchange was increased during FY: 06-07 as highlighted below:

**Rate of WHT on Stock Exchange during 2006-07 and FY: 05-06**

	FY: 06-07	FY: 05-06
Purchases of Shares	0.01% of the Share	0.005% of the share
Sales of Shares	0.01% of Sale	0.005% of the sales
Trading of Shares	0.01% of the traded value	0.005% of the traded value

The collection of WHT from stock exchange has increased from Rs. 331 million in Q1: 05-06 to Rs. 511 million during Q1: 06-07 entailing an increase of 180 million.

***Increase in the CVT on Stock Market Activity:***

The rate of CVT on stock exchanges was increased 0.01% to 0.02% on the purchase value of shares during FY: 06-07. The collection of CVT from stock exchanges has increased from Rs. 182.6 million to Rs. 425.7 million during Q1: 06-07. Thus an additional collection of Rs. 243.1 million realized from this source.

***Levying Fixed Tax @5% on Income from Property:*** The income from property was subjected to WHT @ 5% if the annual rent exceeded Rs. 300,000. However, this was applicable in case of property rented to federal or provincial government, local authority, a company, or a non-profit organization or a diplomatic mission. Due to this limited scope, major part of this sector was outside the fold of tax net. In order to augment the scope, fixed tax on gross income has been introduced across the board. The collection from rental income has increased from Rs. 60 million during Q1: 05-06 to Rs. 107 million during Q1: 06-07. Thus, an increase of Rs. 47 million has been recorded.

**Sales Tax and Federal Excise**

***Expanding the Scope of FED on Services:*** More than 50% of national GDP originates from services. However, the share of services in taxation has traditionally been low. During Budget 2006-07, the scope of services in the FED has been augmented so that the growth in taxes from services sector matches with the increase in GDP. This policy was aimed at the generation of additional revenues.

***Levying of FED @5% on Non-Fund Services provided by Financial Services Sector:*** During the last few years, reforms in the financial services have largely improved profitability of this sector. In the Budget 2006-07, FED was levied on Non Fund Services provided by the financial institutions including banking companies. While there

is a large scope of revenue from this source, only a limited sum of Rs. 103.9 million have been realized, which is quite low when compared to the proportionate estimates of Rs. 550 million for Q1: 06-07. It is anticipated that this amount will increase substantially in coming quarters as the necessary spade work has been completed.

*Levying of FED @5% On Franchise Services:* The Franchise service is a service provided to franchisee by the franchiser in relation to the franchise. The franchise business has flourished to a great extent in the last few years especially in the field of food and beverages. In order to expand the taxation of service sector, the franchise services were subjected to FED. However, only a meager amount of Rs. 18.2 million has been realized from this source during July-September, 2006-07.

*Levying of FED @5% on Commission/Brokerage of Foreign Exchange Dealers, Exchange Companies and Money Changers:* In order to bring the foreign exchange dealers in the fold of indirect taxation, FED @5% has been levied on the gross amount of commission/brokerage charged for services provided by the foreign exchange dealers including money changers. A paltry amount of Rs. 0.008 million has been collected during the first three months of CFY.

***Rationalization of Scope of Telecommunication Services in The First Schedule of Federal Excise Act, 2005:*** The current boom in the telecom sector has brought advancement and modernization in the telecom sector. The relevant schedule of Federal Excise Duty was not catering the modern telecommunication regime. Some of the telecom services though became obsolete but still were incorporated in the schedule. By rationalizing the schedule of excisable services, value added telecom services such as vehicles tracking service etc have been brought into the fold of the schedule

of excise duty. An additional collection of Rs. 22 million has been recorded during first three months of CFY.

***Increasing the Rate of FED from 3% to 5% on Gross Premium of Services Provided by Insurance Companies.*** Services provided by the insurance companies excluding life insurance were liable to FED @3% of the premium paid. Due to quite lower rate, the tax collection from insurance companies has been considerably low. So the rate of all insurance companies except dealing life insurance has been enhanced to 5%. This policy initiative has improved the collection from Rs. 205.2 million in July-September, 2005 to Rs. 392.8 million in July-September, 2006. Thus, an additional tax collection of Rs. 187.6 million has been realized.

***Levying of FED @15% on International Air Travel:*** The FED has been extended to international air travel to increase the collection of FED in the Federal Budget 2006-07. The collection fetched from international air travel has been only Rs. 188.7 million during first quarter of CFY. It is pertinent to mention that all the tax collection has been realized in September, 2006 only.

***Levying Sales Tax on Printed Retail Price on Consumer Items:*** According to the present VAT system, tax is paid on value addition attributed to each stage i.e., from manufacturing to retail sale. It was felt that distributors/wholesalers etc. were not paying due sales tax. In order to ensure proper payment, sales tax was levied on printed retail price for consumer items in the budget FY: 06-07. The items include spices, electric bulb including saving lamps and fluorescent tube lights, snacks including potato chips, and shoe polish and shoe cream. All these items have been inserted in the third schedule of Sales Tax Act, 1990 while footwear has been excluded from the schedule. Due to this measure, the collection of these items has exhibited Rs. 5.4 million higher collection during Q1: 06-07 as compared to corresponding period last year (Table 4). On the other hand, if refund payment is taken into account, then an increase of

around Rs. 15 million has been recorded during Q1: 06-07. Refunds payments were mainly related to footwear.

**Table 4: Impact of Levying of Sales Tax on printed retail price during July-Sep.**

Commodities	<i>(Rs Million)</i>		
	FY: 06-07	FY: 05-06	Diff
1.Spices	10.566	5.250	5.316
2. Macaroni	0.102	0.057	0.045
3.Bulb & Tubes	8.310	6.852	1.458
4.Potato Chips	0.422	1.005	-0.583
5.Shoes Polish & Cream	48.142	49.101	0.959
6.Tissue Papers	0.537	0.566	0.029
7.Footwear	21.674	21.476	0.198
<b>Total</b>	<b>89.753</b>	<b>84.307</b>	<b>5.446</b>

***Upward adjustment of FED Due to Increase in Retail Price of Cigarettes:*** Federal Excise Duty is directly influenced by retail prices of cigarette. Despite all odds, like smuggling of cigarettes and counterfeit manufacturing of cigarettes, the legitimate cigarettes manufacturers contribute handsome amount of indirect taxes to the national exchequer. In order to compensate these manufacturers, an upward adjustment in FED was made through increased retail prices of cigarettes by 7%. Further cigarette related announcement in the Federal Budget 2006-07 are as under.

**Upward Adjustment of FED Due to increase in Retail Price of Cigarettes**

Slabs	Threshold FY: 06-07	Threshold FY: 05-06
Upper	63% of the Retail Price	63% of the Retail Price
Medium	Rs.2.63 per 10 cigarettes plus 69% incremental rupee or part thereof	Rs.2.45 per 10 cigarettes plus 69% incremental rupee or part thereof
Lower	Rs.2.63 per ten cigarettes	Rs.2.45 per ten cigarettes

However, despite this change, the collection from cigarettes remained stagnant around Rs. 4.6 billion During Q1: FY: 06-07 and Q1: 05-06 (Table 5). If natural growth factor is estimated at 14%, the total impact of this measure would have meant a loss of around Rs. 0.6 billion in the first quarter, FY: 06-07 as compared to corresponding period last year.

**Table 5: Comparison of the Collection of FED from Cigarettes**

<i>(Rs Million)</i>				
Months	FY: 06-07	FY: 05-06	Diff	Growth (%)
July	1,044	537	507	94.4
August	2,713	1,553	1,260	86.7
September	826	2,566	-1,740	-67.8
Total Actual Collection	4,583	4,556	27	0.6
With Growth Adjustment (14%)	4,583	5,193	-610	-11.7

The growth in the production has been impeded by the increased prices. During July-September, 2006, the production grew by only 1.3% but the sale of cigarettes declined by around 36%.

**Zero Rating of Compost:** The use of compost as fertilizer is comparatively much higher than chemical fertilizer. It is required in bulk quantities for application to agricultural land. In order to increase the usage of compost, sales tax on compost has been zero rated. A loss of around Rs. 29 million has been recorded during first quarter of FY: 06-07.

**Withdrawal of Sales Tax Exemption on Computer and its Parts:** During the budget 2006-07, it was decided to bring the computer and hardware in the sales tax net. The levy of sales tax will support the local industry against imported computer hardware as the local manufacturers would be entitled to claim input adjustment while imported products will be subjected to the upfront incidence of 15%.

Moreover, customs duty has been exempted on computer and hardware. The imports of computer and hardware grew by only 1.5% while the collection of sales tax import has increased substantially by Rs. 521 million during July-September, 2006. On the other hand, an additional collection from sale tax realized, i.e, around Rs. 24 million. Therefore, an additional collection of total sales tax has been Rs. 545 million during Q1: 06-07. Regarding customs duty during 2005-06, the rate of duty on all sort of computer was 5% while PCs and laptops were exempt from CD if brought in baggage. During the budget 2006-07, the import of computers and parts has been exempted across the board. Due to this measure, dutiable import of computer and parts has come down by 88% and loss in CD has been reflected as Rs. 183 million during Q1: 06-07.

The combined effect of the both initiatives has resulted into a gain of Rs. 362 million during FY: 06-07.

### **Customs Duties:**

The budgetary measures were essentially related to rationalization and reduction of tariff rates for different commodities especially to obtain raw material and machinery at competitive rates to accelerate economic activity. Details of some of the initiative is given below.

#### ***Reduction of CD on Import of Plastic Raw Materials/Items:***

During Budget FY: 05-06, duty rates of raw materials of plastics were curtailed for raw materials used in plastics. The incentives have boosted the plastic sector to a great extent in FY: 05-06. The rates ranged from 10% to 25% during FY: 05-06. In order to further spur the plastic sector, the duty on plastic raw materials has been rationalized at 5%, 10%, 15% and 20% in 2006-07. Lower rates have substantially attracted imports which grew by 90%. Substantial improvement in growth has not only compensated for loss due to duty reduction but also increased the collection from Rs. 99.4 million in Q1: 05-06 to Rs. 127.8 million in Q1: 06-07.

***Exemption from CD of Agricultural Tractors (CBU):*** Agriculture is the main sector of economy. Due to its importance, the government has already taken a number of initiatives in the past for boosting this sector. The import of completely knocked down (CKD) Kit for assembly of tractors was exempt from customs duty but import of CBU condition was subjected to 15% customs duty. In order to restore the gap between the demand and availability of agricultural tractors, agricultural tractors were exempted from customs duty. Although the value of import of components for assembly/manufacture of agricultural tractors in any kit form has gone up by 62.5%, it has adversely affected the imports of tractors in CBU condition. Due to exemption of agricultural tractor from CD, a loss of Rs. 144 million has been recorded in the collection of customs duties during July-September FY: 06-07.

***Reduction of CD on Import of Machinery:*** The government is pursuing a conscious policy of increasing the inflow of machinery in the country to expand the industrial sector, bring down the cost of doing business. During the CFY, reduced rates of customs duty from 10% - 25% to 5% - 20% have been announced. It is expected that the benefits of the duty reduction will be enjoyed by a wide spectrum of industries, including textile, cement, agriculture, power generation, boilers, laundry, lifting, handling, loading/unloading sectors etc. As expected, this policy intervention has boosted the import of electrical machinery & equipment by around 78% while the collection of customs duty has gone up by Rs. 7 million. On the other hand, the import of mechanical machinery has reduced by 5.2% and a loss of Rs. 75 million in CD in Q1: 06-07 has been recorded mainly due to lesser imports of cement machinery. Nonetheless, the combined imports of electrical and mechanical machinery have gone up by 12.3%, while total loss has been reduced to Rs. 68 million due to tariff rationalization (Table 6).

**Table 6: Collection of CD from Electrical and Mechanical Machinery  
July-September**

	FY: 06-07	FY: 05-06	Diff	Growth in CD (%)	Growth in Imports (%)
Electrical Machinery(84)	226	301	-75	-24.9	-5.2
Mechanical Machinery(85)	173	166	7	4.2	78.3
<b>Total</b>	<b>399</b>	<b>467</b>	<b>-68</b>	<b>-14.6</b>	<b>12.3</b>

**Reduction of CD on Petro-chemicals:** The spiraling prices of POL products and consequent increase in the prices of byproducts has created a difficult situation for many sectors of the economy. Petro-chemicals which are byproducts of POL are used as inputs in different industries. In order to provide relief to these users, CD was reduced from 10% to 5% and 20% to 15% on specified petro-chemicals. Despite these incentives, the import of these petro-chemicals has continuously declined by 69% and a loss of Rs. 3.5 million has been incurred during Q1: 06-07.

**Reduction of CD on Chemicals:** Many industries depend on the chemicals as raw materials. According to the policy of the government to ensure availability of raw materials at cheaper rate, CD on organic and inorganic has been reduced from 25%, 20%, 15% and 10% to 20%, 15%, 10%, 5%. The rationalization of CD has been taken place in PCT Chapters 28, 29, 34, 35, 38. Due to this tariff reduction on these items, the collection has exhibited a decline of Rs. 74 million during Q1: 06-07. The growth in import of different chemicals has gone up for all the major groups except organic chemicals and essential oils (Table 7).

**Table 7: Comparison of the Collection of Different Chemicals Q1: 06-07**

Chemicals/Substances	Customs Duties				Growth in Imports (%)	Growth in Dutiable Imports (%)
	06-07	05-06	Diff	Growth (%)		
1.Inorganic Chemicals(28)	6.8	9.1	-2.3	-25.3	48.5	47.6
2.Organic Chemicals(29)	31.7	66.1	-34.4	-52.0	-16	-19.7
3.Tanning or Dyeing(32)	17.5	32.4	-14.9	-46.0	4.4	5.7
4.Essential Oils(3301)	1.6	2.6	-1.0	-38.5	-0.2	-0.2
5.Polish & Cream for leather etc(3405)	0.3	0.5	-0.2	-40	55.9	55.9
6.Albuminoidal substances(Starches, glues and enzymes)(35)	10.5	14.9	-4.4	-29.53	0.8	-3.1
7.Misc Chemical Products(38)	81.2	98.0	-16.8	-17.14	20.6	19.4
<b>Total</b>	<b>149.6</b>	<b>223.6</b>	<b>-74.0</b>	<b>-33.09</b>		

***Reduction of CD on Flat Rolled Steel Products and Allied Items:***

Steel industry and construction industry is the pivot for accelerating the various sectors of the economy. The steel products provide raw materials to the host of the industries like construction, engineering, vehicle manufacturing etc. During FY: 05-06, flat roll products were subjected to pay CD @ 10% and 25% on primary and secondary quality products respectively. In order to reduce the gap, CD has been lowered from 25% to 20% for secondary quality steel products. On other allied items of steel where CD was @ 10-25% which has been reduced to 5-20% during budget 2006-07. This tariff reduction has lowered the input cost of steel and construction sectors. Despite these incentives, the overall import of steel products has declined by 4% and resulted in a loss of Rs. 250 million in the collection of CD during FY: 06-07. The decline in the imports of steel items is mainly due to flat steel roll products (Table 8).

**Table 8: Collection of CD from Steel Sector during July-September**

*(Rs Million)*

Steel Products	Rate Reduction in CD	CD FY: 06-07	CD FY: 05-06	Diff	Growth in CD (%)	Growth in Imports (%)
Flat Rolled Steel Products	25% to 20%	519.0	708.1	-189.1	-26.7	-23.8
Other Articles of Steel	(25% - 10%) to (20% - 5%)	57.4	118.8	-61.4	-51.7	40.9
<b>Total</b>		<b>576.4</b>	<b>826.9</b>	<b>-250.5</b>	<b>-30.3</b>	<b>-4.0</b>

**Change in Policy for Import of CBU Cars:** Auto sector is, undoubtedly, one of the prolific contributors in CD collection. Any fluctuation in the import of vehicles seriously affects the overall collection of customs duties. In the Budget 2006-07, the baggage rules have been revised. A restriction has been imposed on the import of old and used vehicles aging more than 3 years. Table 9 reflects that exceedingly higher number of motor cars including jeeps by 64% imported during Q1: 06-07. This increase in the number of cars is mostly due to lower cc cars. Due to this, the value of import has increased by just 5% while customs duty declined by Rs. 131 million during July-September, FY: 06-07. It is expected that import of CBU cars will further decline in coming months.

**Table 9: Number of Cars/Jeeps, Import Value and CD during Q1: 06-07**

*(Quantity in Numbers/Import and CD in Million)*

	FY: 06-07	FY: 05-06	Difference	Growth (%)
Quantity	7,129	4,340	2,789	64.3
Import Value	3,256	3,102	154	5
Customs Duty	1,943	2,074	-131	-6.3

### **Concluding Remarks**

The government has taken a number of steps to further boost the economy on one hand and tax revenues on the other. Special incentives have been introduced for raw materials and machinery to ensure availability of these products at low price. Due to this, revenue loss has also been encountered. On the other hand, the scope of FED has been widened by including a number of services in the tax net. Some of the measures have resulted in increase in the tax collection while for others collection remains below expectation. It is expected that measures undertaken in the Budget 2006-07 would have anticipated influence in the form of improved growth of the economy and tax collection as the year progresses.

### **III**

#### **CBR Performance in the light of Key Performance Indicators**

CBR has followed a focused approach in evaluating its performance. It has set goals and targets in the areas of fixed for revenue generation, broadening of tax base, liquidation of refunds, dispute resolutions and transformation of its field offices. Specifically, the following goals and targets are fixed and regular update on each of them is submitted to Prime Minister Secretariat under the PM Goal-Target Initiative.

1. Collection of Federal Tax Receipts as per budgetary targets;
2. Broadening of Income Tax base by 20% at the end of the year;
3. Broadening of Sales Tax base by 10% at the end of the year;
4. Liquidation of Income Tax refunds by 40% at close of the year;
5. Liquidation of Sales Tax refunds by 40% at close of the year;
6. Effective Dispute Resolution (all taxes) – Reduction of Pending Appeals;
7. Re-organization of CBR Field Offices

#### **Tax Revenue Target**

As stated earlier, CBR has collected Rs. 187.2 billion during the first quarter of FY 06-07 as against the target of Rs 178.4 billion. The collection has been 23.1% higher than Rs. 152.1 billion collected during corresponding of last year. The commendable achievement over the last year has been possible due to multiple factors including the implementation of wide-ranging tax policy and administrative reforms, improvement in macroeconomic environment, and maintaining consistency in policies. CBR tax performance is spread

over all four federal taxes as each of it has performed well. In fact, there has been a double-digit growth in the collection of direct taxes, sales tax and customs duties.

### **Broadening of Tax Base**

**Income Tax:** Expansion of tax base has been a major area of concern for the authorities in CBR. In order to encourage voluntary compliance, a number of reform measures have been initiated in the income tax structure. Promulgation of the Income Tax Ordinance, 2001 was the first step towards this objective. This together with simplified rules has enabled taxpayers to comply relatively easily. At the same time, a much simplified system of self-assessment (USAS) has been introduced. Under the USAS all the taxpayers automatically qualify for self-assessment. The returns filed by them are considered as final unless their cases are selected for audit through pre-announced audit parameters. Consequently, the return filers have substantially increased from only 1 million during 2003-04, to 1.5 million in 2005-06. It is encouraging to note that during the first quarter of CFY, the number of return filers has reached 1.45 million as against 1.16 million in the corresponding period of last year, showing a healthy growth of 25%. The number of tax filers will increase further when the corporate taxpayers are due to file their returns in December 2006.

**Sales Tax (GST):** In order to broaden the tax base, a number of steps have been taken such as allowing single exemption limit of Rs. 5 million, introduction of simplified schemes for small taxpayers, and expanding scope of tax, i.e., increase in the number of services liable to tax. Similarly, legislation to allow presumptive taxation together with improving registration procedures to ensure a more compliant response for new business. Furthermore, an 'outreach' program, in collaboration with trade associations, to educate businessmen about their tax obligations has been developed and launched. With the help of these measures, the number of

registered persons has increased from 101,851 in 2003-04 to 116,686 in 2005-06, showing a growth of 15%. During the first quarter of CFY, 2650 new taxpayers have been registered. The registration of new taxpayers has to grow by 10% at the end of the FY: 2006-07.

### **Liquidation of Refunds (Income Tax and Sales Tax)**

In view of continuous complaints, both from the taxpayers and tax collectors, regarding disposal of refunds, the entire system required revisiting. The major concern of the taxpayers has been delayed disposal of refunds by the tax authorities. On the other hand, the collectors' plea was that fake claims have routinely been submitted by the taxpayers. This situation resulted into adversarial relationship between the taxpayers and tax collectors. The implementation of STARR/STREAMS project under the tax administration reforms program in the sales tax structure made a major break through in this regard. However, since the system was not entirely foolproof, it required further changes and now a new variant based on risk analysis is in place. Meanwhile, it was realized that major refund claims were lodged by the leading export sectors. To facilitate their business transactions, all inputs including raw materials of the units producing leather, textile, surgical, sports and carpets were zero-rated in FY: 2004-05. In effect, 'no duty no refund' policy has been implemented. With vigilant persuasion, the pendency has been reduced to a considerable level. The closing balance of refund of sales tax has reduced to 4.5 billion, whereas the closing balance of income tax refund has been Rs.9.0 billion after addition of fresh institutions.

### **Effective Dispute Resolution: Reduction of Pending Appeals**

Another marked achievement of CBR has been the initiation of an effective dispute resolution of pending appeals related to both direct and indirect taxes. In July 1, 2004, excluding cases filed at Supreme and High Courts and Appellate forums, around 46,537 cases were

pending for decisions. All these pending appeals have been disposed of during the FY 2004-05. FY 2005-06 started with a small target of 6919 new appeals. The new strategy of CBR envisages deciding all new appeals and adjudication cases within 90 days of their filing as per law. This policy has been actively perused to provide relief to the taxpayers. At the end of the first quarter 2006-07 total numbers of 3379 cases have been decided.

### **Re-Organization of Tax Structure**

CBR field structure is being re-organized on functional lines. As a first step three Regional Tax Offices will start operating by the end of 2<sup>nd</sup> quarter. Subsequently, this process will be rolled out to additional ten places. The domestic taxes, i.e., direct taxes, GST, and federal excise will be co-located at these RTOs. As far as international trade taxes are concerned, they will be operated through Model Custom Collectrates (MCCs). The customs processes experimented at CARE will be replicated in these MCCs. It is encouraging that CBR is maintaining timelines with respect to these new tax offices.

## IV

### **CBR Reform Program: An Update<sup>4</sup>**

The Central Board of Revenue, in the recent years, has channeled its efforts towards raising revenues, and bringing equity and efficiency in the tax system. CBR has started to operate on functional lines to render efficient services to the taxpayers by ensuring uniform application of laws with integrity, efficiency and high degree of professionalism. The reform process at CBR has been designed to churn out long term benefits through efficiency again.

The initiatives under the Tax Administration Reform Program (TARP) include, *inter alia*, the implementation of universal self-assessment, creation of a functional organization, building of a taxpayer service function, use of modern work layout for conducting tax administration, creation of database for management reporting, audit selection, statistical analysis, and automation in CBR and its field formations. The following actions have been completed by CBR so far.

1. One Large Taxpayers Unit (LTU) was set up in Karachi on 1<sup>st</sup> July, 2002. Another LTU was also established in June, 2005. All the federal domestic taxes administered by the CBR are being dealt under one roof in LTUs. This is a giant step towards facilitation of the taxpayers. Similarly, to address the issues of medium and small income taxpayers, an MTU at Lahore was established. Acknowledging the success of the MTU Lahore, five more MTUs at Rawalpindi, Peshawar, Karachi, Quetta and Faisalabad have been set up during 2005 and 2006. As indicated earlier, these six MTUs

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<sup>4</sup> The information is provided by the Tax Policy and Reform Wing.

along with the existing Commissionerates will be merged in Regional Tax Offices (RTOs) to be established during 2006 and 2007. The nine additional RTOs will be located at Hyderabad, Sukkur, Multan, Lahore, Gujranwala, Sialkot, Islamabad, Sahiwal and Abbotabad.

2. As a first step towards Electronic Compliance Mechanisms, filing of statements of withholding taxes has been routed through electronic media at LTU, Karachi.
3. CBR has developed a Custom Administration Reform Project (CARE) to modernize customs clearances. In this regard, a pilot project was launched in April, 2005 by the Honorable Prime Minister of Pakistan. The program shall be rolled out at 11 Model Customs Collectorate during FY: 06-07 and FY: 07-08 including four regional hubs.
4. Sales Tax Automated Refund Repository (STARR) software has been developed which has streamlined the process of issuance of sales tax refunds. The system has been upgraded and now refunds claims are processed through Risk-based Refund Analysis System (RRAS).
5. Software has been developed for withholding tax Management. It is capable of preparing withholding statements through recording transactions liable to withholding taxes.
6. Existing sales tax offices located in Karachi have been consolidated in a single unit called Model Sales Tax House, Karachi. It is an open layout office working on functional basis since August, 2003. This new addition to sales tax offices has greatly facilitated taxpayers.
7. M/S Nespak has been appointed as Consultant for design, procurement, support, and supervision of renovation and refurbishment activities at all model tax offices.
8. CBR has awarded the contracts for renovation and refurbishment activities at 13 RTO sites including those at Peshawar, Rawalpindi, Abbotabad, Faisalabad, Gujranwala,

Sialkot, Lahore, Sukkur, Hyderabad, Quetta, Karachi, Multan and Sahiwal.

9. CBR has procured Computer Hardware and allied equipment through International Competitive Bidding (ICB) for the automation of these offices.
10. Technical Staff for Project Management Unit (PMU) has been hired from the private as well government sectors. Selection of program Manager for PMU is in final stage.
11. For selection of firm for supply, customization, and implementation of an Integrated Tax Management System (ITMS), preparation of two stage bidding document is under process.
12. Teams have been appointed for performing BPR work.
13. A Committee has been constituted to establish the workforce requirements in the reformed setup. In order to get feed back of the taxpayers on current reform program, M/S Gallup Pakistan has been assigned the job for conducting country-wide perception survey.

### **Status of on-going Projects under TARP:**

#### **Infrastructure Development:**

An amount of US\$ 24 million will be utilized for establishment of the following projects:

- a) Establishment of 13 Regional Taxpayers Offices (RTOs) at Karachi, Hyderabad, Sukkur, Quetta, Lahore, Faisalabad, Multan, Gujranwala, Sialkot, Rawalpindi, Peshawar, Sahiwal, and Abbotabad.
- b) Establishment of third LTU at Islamabad.
- c) Establishment of 12 Model Customs Collectorates
- d) Establishment of 65 Taxpayers' Facilitation Centers (TFCs) throughout the country

e) Construction of transit accommodation with RTOs.

***Procurement of ITMS (Software)***

As per instructions of the World Bank, draft two stage bidding document for selection of software firms for ITMS is under process.

***Procurement of Hardware***

During the first phase, PCs/other equipment for customs, sales tax and income tax have been procured through ICB.

***Procurement of Vehicles***

In the first year, 43 operational vehicles have been procured to carry out functions of 'reformed' units. During FY: 06-07, additional amount has been earmarked for second stage procurement of vehicles under TARP.

***Hiring of Program Manager***

The selection of Program Manager is at final stage.

***Other Staffing Requirement for PMU***

In order to strengthen the PMU, the CBR has hired specialists in the field of finance and procurement.

***Technical Assistance***

For technical assistance in the fields of HR and Audit, consultants have been appointed. For communication consultant, selection is at final stage.