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



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Abbreviations

AOPs	Association of Persons
ATT	Air Travel Tax
BPR	Business Process Reengineering
CD	Customs Duties
CFY	Current Fiscal Year
CoD	Collection on Demand
DT	Direct Taxes
FBR	Federal Board of Revenue
FED	Federal Excise Duties
FY	Fiscal Year
GST	General Sales Tax
LTU	Large Tax Payers' Unit
MCC	Model Customs Collectorate
NFS	Non-Fund Services
NTN	National Tax Number
PCT	Pakistan Customs Tariff
PFY	Previous Fiscal Year
Q1CFY	Quarter 1 Current Fiscal Year
Q1PFY	Quarter 1 Previous Fiscal Year
QIM	Quantum Index of Manufacturing
RTO	Regional Tax Office
STARR	Sales Tax Automated Refund Repository
STD	Sales Tax Domestic
STM	Sales Tax Import
TARP	Tax Administration Reform Project
USAS	Universal Self-Assessment Scheme
VP	Voluntary Payments
WHT	Withholding Taxes

Foreword

It is encouraging that despite severe economic crisis in the country, the FBR has exceeded the 1st quarter target of Rs. 250.8 billion by about Rs. 11 billion. The gross and net collection realized during July-September 2008 has been Rs. 279.4 billion and Rs. 262.1 billion respectively, reflecting a double-digit growth of 27.2% and 27.8% over the corresponding period of last Fiscal Year. The current issue of FBR Quarterly Review presents a detailed analysis of federal taxes collected during the first quarter of FY: 08-9.

Besides detailed revenue analysis, the current issue includes two articles; one on the property taxation in Pakistan and the other on Strengthening Local Tax Revenues through Fiscal Decentralization. The paper on property taxation provides in-depth analysis of property taxation, its theoretical aspects and experience around the globe and its scope in Pakistan. In the paper on Strengthening Local Tax Revenues through Fiscal Decentralization, issues have been discussed in the global environment so as to strengthen the revenues at the lower tiers of local governments, thus reducing burden on the federal revenue authority.

I appreciate the commendable efforts put in by the team of Fiscal Research and Statistics Wing, FBR in bringing out the FBR Quarterly Review. It is hoped that the current issue will be of great interest to our esteemed readers. I also look forward to receive valuable comments and suggestions for the improvement of this publication.

(Ahmad Waqar)
Secretary Revenue Division/Chairman, FBR

I

FBR Tax Collection: An Analysis of Q1: 08-09 Outturn¹

The Economy

The world economy, including developing and advanced countries, is facing serious financial crisis. Unfortunately, Pakistan economy is going through one of the worst times in its economic history. The country faced economic turmoil on one hand and aggravating situation of law and order on the other hand. The rising trade gap, energy shortage and worst ever depreciation of rupee have jolted largely the economic fundamentals. Unfavorable exchange rate and international mounting prices have vastly fueled the trade deficit. Electricity crisis has been extremely severe. Not only it has affected the general consumer but it has badly hampered industrial and manufacturing activities. In an era of economic progress, energy shortage will land the country nowhere. Pakistan can lose the competitive edge in the world market if energy crisis is not properly dealt. With acute shortage and very costly energy supplies it would be further difficult for the export oriented local industry to compete its close competitors amid growing trade liberalization and free trade regimes.

Despite multiple shocks to the economy, the tax revenue generation is encouraging. It is expected with the IMF support and concerted efforts, the economy of Pakistan will again be on the track of growth, development and prosperity.

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

FBR Revenue Target for FY: 07-08

The revenue target for FY: 08-09 has been fixed at Rs. 1,250 billion (Table 1). It is 24.1% higher than the realized collection of last year. In order to achieve this huge target the government introduced a host of measures for additional revenue generation.

Table 1: Baseline Collection FY: 07-08 viz-a-viz Projections for FY: 08-09

(Rs. Billion)

Tax Heads	Collection FY: 07-08	Projections FY: 08-09	Growth (Percent)
Direct Taxes	388.5	499	28.8
Sales Tax (A+B)	377.0	470	24.7
A. Sales Tax (M)	195.4	233	19.2
B. Sales Tax (D)	181.6	237	30.5
Federal Excise	92.2	112	21.5
Customs Duties	150.6	169	12.2
All Taxes	1,007.3	1,250	24.1

To further monitor the revenue collection effectively, annual targets have been divided into monthly and quarterly targets on the basis of historical trends of collection (Table 2). Accordingly, the target for July-September, 2008 has been set at Rs. 250.8 billion which is 20.1% of the annual target for FY: 08-09.

Table 2: Monthly and First Quarter Targets of Federal Taxes FY: 08-09

(Rs. Billion)

	DT	ST	FED	CD	ALL
July	16.6	31.5	6.7	9.6	64.4
August	18.7	33.9	7.5	10.3	70.4
September	61.2	35.2	8.7	10.9	116
First Quarter	96.5	100.6	22.9	30.8	250.8

FBR Revenue Position

It is highly encouraging that despite all economic odds, FBR has successfully achieved the revenue target in the first quarter of CFY. The overall net collection stood at Rs. 262.1 billion against Rs. 205.1 billion in the corresponding period of last year (Table 3). The

collection grew by 27.8% during Q1: CFY, in other words, the amount collected was higher by around Rs. 57 billion.

Table 3: Collection during Q1: 08-09 Vs. Q1: 07-08

(Rs. Billion)

	Collection Q1: 08-09	Collection Q1: 07-08	Growth (Absolute)	Growth (Percent)
Direct Taxes	88.2	77.5	10.7	13.8
Sales Tax	110.2	82.7	27.5	33.2
Federal Excise	25.5	15.9	9.6	60.4
Customs Duties	38.2	29.0	9.2	31.7
All Taxes	262.1	205.1	57.0	27.8

All the federal taxes have recorded a double digit growth. However, a huge growth of around 60% in FED is due to one month lag in collection during July 2007, against an insignificant collection of only Rs. 1.8 billion made during July PFY. The growth witnessed in the FED collection during August and September has been 36.4% and 11.7% respectively. By excluding the month of July, the overall growth in remaining two months was 23.4%. Similarly around 33% growth in GST is also significant, as it has compensated for slow growth in direct taxes revenues. Nearly 32% growth in the collection of customs duties is also attributed to unprecedented depreciation in the value of rupee during the recent months. Tax-wise monthly performance has been shown in Table 4.

Table 4: Head-wise Monthly Collection of Federal Taxes

(Rs. Billion)

	DT	ST	FED	CD	ALL
July	18.5	33.5	8.2	12.3	72.4
August	22.2	36.6	8.9	11.1	78.8
September	47.6	40.1	8.3	14.7	110.8
First Quarter	88.3	110.2	25.4	38.2	262.1

Refunds/Rebates

FBR has paid around Rs. 3 billion higher refunds/rebates as compared to last year. The head-wise details have been shown in table 5.

Table 5: Comparative Position of Refunds/ Rebates Payments
(Rs. Billion)

	Refunds/ Rebates		Difference	
	Q1: 08-09	Q1: 07-08	Absolute	Growth (%)
Direct Taxes	5.8	4.2	1.7	40
Sales Tax	8.1	7.7	0.4	5.4
Federal Excise	0	0	0	0
Customs	3.4	2.6	0.8	29.9
All Taxes	14.4	17.3	2.9	19.8

Head-wise Analysis of Federal Taxes

A detailed analysis of collection of individual taxes in relation to the economic activities for understanding is important. This is also helpful to monitor the monthly and quarterly revenue performance of FBR.

Direct Taxes:

The gross, refund and net collection of direct taxes during the 1st quarter of CFY has been Rs. 94.1 billion, Rs. 5.9 billion and Rs. 88.2 billion, against Rs. 81.7 billion, Rs. 4.2 billion and Rs. 77.5 billion respectively, in the comparable period of PFY, indicating a growth of 15.2% in gross and 13.8% in net term. As indicated, there has been a positive growth of 40.1% in DT related refund payments (Table 6). The overall growth in direct taxes is almost aligned with the growth in the tax base, which is non-agriculture GDP. The assigned target of Rs.96.5 billion fixed for 1st quarter of CFY has been missed by a margin of Rs. 8.3 billion.

Table 6: Direct Taxes Collection*(Rs. in Million)*

Heads	Collection during Quarter-1		Growth (%)
	FY: 08-09	FY:07-08	
Gross	94,079	81,704	15.2
Refund	5,844	4,172	40.1
Net	88,235	77,532	13.8

Components of Income and Corporate Taxes:

The major components of direct taxes are; collection on demand (CoD), voluntary payments (VP) and withholding taxes (WHT). The WHT contributed 55.2% of gross income tax, followed by VP with 34.4% and CoD by 10.4%. The WHT has registered a sizable growth of 22.3%, CoD has yielded a gain of Rs. 5 billion. Moreover, within the voluntary compliance, the advance tax paid by the taxpayers were to the tune of Rs. 29.6 billion against Rs. 26.2 billion received during the corresponding period of last year, reflecting a growth of 13.2%. Since the advance tax is paid by the taxpayers on the basis of expected profitability, this outcome serves as an indicator that the economy is maintaining its strength and the profitability of the corporate sector remains intact. A detailed analysis of three components is presented below.

Collection on Demand (CoD): The collection on account of demand creation has increased during the 1st quarter of CFY by 118.0%. Of the two components of CoD, the collection under current demand has significantly increased by 383.4% over the PFY, where as arrear demand has increased by 3.8%. This growth is mainly due to tax drive initiatives by the income tax department against tax defaulters and partially due to the disposal of the ‘Brought Forward’ cases respectively. It is expected that collection under demand will further increase during the 2nd quarter of the year when desk audit of the returns will be completed and cases will be selected for detailed audit through the requisite selection criteria.

Voluntary Payments: VP comprises of payments with returns and advance tax payments on the basis of self-assessed expected income within the PAYE regime. On the whole, Rs. 31.8 billion has been generated during the 1st quarter of CFY on account of VP as compared to Rs. 30.3 billion in the corresponding period of last year. Thus, there has been a modest growth of 5.09%. On the other hand, the second component i.e., advance taxes has registered a healthy growth of 13.26% over PFY, reflecting sustained profitability of the corporate sector.

Withholding Taxes: This component has been the major contributor of the income tax gross collection. As indicated, the share of WHT in gross has declined to 55.2% in Q1: 08-09 from 56.2% in Q1: 07-08 partly due to enhanced receipts on account of COD, which has registered a share of 10.4% in total gross income tax as compared to around 5% during Q1: PFY.

Within WHT, the major share in the collection has been from the traditional sources, namely, contracts/supplies (33.2%), Imports (15.4%), salary (10.4%), telephone use (9.6%), exports (7.0%) and bank interest/ securities (6.2%). Among these sources, significant growth of 71.0% in collection has been recorded in cash withdrawal. Similarly, 54.6% growth in the export category and 45.9% in dividends has been instrumental in hefty increase in the overall WHT receipts. Some of the additional contributors to WHT growth are salary, electricity and imports where the quarterly increase in collection has been 26.2%, 25.9% and 23.5%, respectively (Table 7).

Table 7: A comparative Position of Withholding Taxes*(Rs. Million)*

Tax Heads	Q1: 08-09	Q1: 07-08	Difference	Growth (%)
Contracts/ Supplies	17,159	13,921	3,238	23.3
Imports	7,961	6,448	1,513	23.5
Salary	5,379	4,268	1,117	26.2
Exports	3,606	2,333	1,273	54.6
Telephone use	4,948	4,386	563	12.8
Electricity use	1,594	1,266	328	25.9
Bank Interest/Securities	3,216	3,251	-35	-1.1
Cash withdrawal	2,226	1,302	924	71.0
Dividends	1,566	1,073	493	45.9
Sub-Total	47,655	38,248	9,407	24.6
Other WHT	4,094	4,052	42	1.0
Total WHT	51,749	42,300	9,449	22.3
Share in Gross	55.2	56.2		

Further analysis indicates that 71.0% growth in deductions at source on account of cash withdrawal has been observed partly due to increase the rate of withdrawal from 0.1% to 0.2% in the CFY and also dollarization on account of adverse speculation about the economy has induced accountholders to withdraw cash and buy dollars. This phenomenon has increased the revenue realization from this head but has also adversely affected the liquidity position of the banking sector. Similarly, the boom in the export sector has helped the income tax department to collect an additional amount of Rs. 1.3 billion from this source over last year. Like wise the vibrant performance exhibited by dividends has pushed the profitability of the corporate sector. Resultantly, substantially higher amount of income tax from dividends was possible during the first quarter. The 26.2% growth in the head of salary has to be viewed within the backdrop of reduction in income tax rates for salaried persons and increased tax-free threshold from Rs.150,000/- to Rs.180,000/-. Finally, it will not be out of merit to mention the remarkable growth

in collection from electricity (25.9%), imports (23.5%), and contracts (23.3%).

Box 1: New WHT Initiatives:

Rationalization of withholding tax rates on Imports and electricity bills

In order to address the complaints of the taxpayers regarding misuse of the facility of exemption certificate of low withholding tax @1% for manufactures, a uniform rate of 2% withholding tax has been levied on commercial as well as manufactures importers. This measure will not only curb the tendency of misuse of the facilities but would also ensure a level playing field to all stakeholders.

In order to rationalize the tax structure for the retailers and whole sellers and remove rate disparity in different slabs of electricity bill a 10% withholding tax on the electricity bill amount exceeding Rs. 20,000 per month in respect of all commercial and industrial consumers has been levied. For bill amount up to Rs. 20,000 per month the existing treatment should continue. However no collection of Tax on electricity bill will be charged for the following five major zero- rated sectors of exporters-cum- manufactures:

- a) Carpets;*
- b) Leather and articles thereof including artificial leather footwear;*
- c) Surgical goods;*
- d) Sports goods; and*
- e) Textile and articles thereof.*

Analysis of Income Tax Returns

There has been a negative growth in returns/statements filed during Q1: 08-09 (Table 7). The initial scrutiny of income and corporate tax returns highlights the following points.

- A total of 1,585,361 returns and statements have been received from Companies, Association of Persons (AOPs), Salaried and Non-salaried individuals; Importers, Exporters, and Contractors etc. At the aggregate level, the number of returns/ statements shows a negative growth of 6.5% over the preceding year;
- Even though the number of returns filed by the taxpayers has gone down, but tax paid with returns has shown a positive growth of 28.7%. The largest increase of over 100% has been recorded by the salary taxpayers. This section has paid Rs. 160.2 million as against Rs. 79.2 million during the corresponding period of last year, followed by AOPs where an amount of Rs. 96.5 million has been received with returns, showing a positive growth of 35%. It is relevant to mention that the corporate sector has exhibited dismal performance during the period under review. The corporate sector as a whole has paid Rs 2276.5 million during CFY as against 2373.6 million in the corresponding period of last year showing a decline of 4%.
- The low tax receipts from corporate sector have been encountered in the jurisdiction of LTUs at Karachi and Islamabad where major corporate hubs are located. Both the numbers of returns filed by the taxpayers and payment with returns have declined. LTU Karachi had received only Rs. 1484 million from 134 corporate returns filed during CFY as against Rs. 1918.1 million from 135 corporate returns filed during the corresponding period of last year; LTU Islamabad has received Rs. 66 million from 30 returns filed during CFY, as against Rs. 158.1 from 100 corporate returns filed during PFY.
- A further analysis confirms that 96.1% of income and corporate tax has been received with returns during FY 08-09 and the rest is submitted with the statements, whereas last year nearly 95.6% of the collection came with the returns.

Table 7: Income Tax Returns and Tax Collection during 2008 and 2007

	Q1: 08-09		Q1: 07-08		Growth (%)	
	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid
Returns						
Corporate Cases	554	2,276.5	1,159	2,373.6	-52.2	-4.1
AOPs	22,207	96.5	22,597	71.5	-1.7	35.0
Salaried Individuals	126,453	160.2	94,078	79.2	34.4	102.3
Non-Salaried Individuals	508,456	1,012.1	589,651	1,336.2	-13.8	-24.3
Sub Total Returns	657,670	3,545.2	707,485	3,860.6	-7.0	-8.2
Statements						
Salary certificates/statements	18,464	4.4	64,266	14.2	-71.3	-69.0
No of employees in the statement	830,583		816,478		1.7	
Importers	11,443	0.2	14,985	0.6	-23.6	-66.7
Exporters	7,813	0.0	8,569	1.0	-8.8	-100.0
Retailers up to 5m turnover	18,524	78.1	33,725	88.8	-45.1	-12.1
Above 5m turnover	788	4.1	2,292	11.2	-65.6	-63.4
Contractors/ Suppliers	25,471	3.6	30,356	6.2	-19.1	-41.9
Other(including Retailers)	14,605	51.7	17,944	54.1	-18.6	-4.4
Sub Total Statements	927,691	1,42.2	988,615	176.1	-6.2	19.3
Total	1,585,361	3,687.3	1,696,100	4,036.7	-6.5	-8.7

Note: Tax paid in Million Rupees.

Sales Tax: The sales tax (GST) is an important source of federal tax revenue. Its share in total federal tax collection has been 38.2% during first quarter of FY: 2008-09. Sales tax is liable on domestic supplies of goods and services as well as on imports, except those included in the 6th Schedule of Sales tax. The standard rate of sales tax has been increased, across the board, by 1% i.e., from 15% to 16% in the budget FY: 08-09. During Q1: 08-09 the gross collection of sales tax has been Rs.118.3 billion and net collection reached at Rs. 110.2 billion showing a growth of 30.9% and 33.2% respectively over the corresponding period last year. The collection has exceeded the target of Rs. 100.6 billion fixed for the first quarter of FY: 08-09 by Rs.9.6 billion. It has two components (i) sales tax imports and (ii) sales tax domestic. The share of sales tax collection at imports has been 47.2% during the reference period as compared to 52.6% during the corresponding period last year. The sales tax

collection performance by components is presented in the following Table 9.

Table 9: Collection of Sales Tax during July-September: FY: 08-09

(Rs. Million)

Tax-Head	Collection Quarter 1			Growth (%)		
	Gross	Refund	Net	Gross	Refund	Net
Sales Tax Imports	55,789	53	55,736	17.2	51.4	17.2
Sales Tax Domestic	62,510	8,015	54,495	46.0	5.2	54.8
Sales Tax (Total)	118,299	8,068	110,231	30.9	5.4	33.2

Sales Tax (Domestic) Collection: The gross collection of sales tax (domestic) has been Rs. 62.5 billion and net at Rs. 54.5 billion respectively during July-September, 2008 showing the growth of 46% and 54.8% respectively. This unprecedented performance has emanated from the huge growth in collection from POL products. The second considerable contribution is made by electrical energy.

The sales tax collection from ten major commodities continued to contribute a major proportion i.e. 84.5%, in overall sales tax domestic collection. The major commodities include POL products, telecommunication, natural gas, sugar, electrical energy, cigarettes, services other than telecom, cement and iron & steel products.

Table 10: Gross Collection of GST (Domestic) from Major Revenue Spinners
(Rs. Million)

	FY: 08-09	FY:07-08	Growth (%)		FY: 08-09	FY:07-08	Growth (%)
<i>POL Products</i>				<i>Cigarettes</i>			
July	7,364	2,428	203.3	July	479	331	44.7
August	9,168	3,066	199.0	August	639	478	33.7
September	10,549	3,042	246.8	September	758	623	21.7
Q1	27,081	8,536	217.3	Q1	1,876	1,432	31.0
<i>Telecommunications</i>				<i>Services</i>			
July	2,884	3,767	-23.4	July	471	555	-15.1
August	4,460	3,546	25.8	August	514	421	22.1
September	4,080	3,618	12.8	September	492	504	-2.4
Q1	11,424	10,931	4.5	Q1	1,477	1,480	-0.2
<i>Natural Gas</i>				<i>Aerated Waters/Beverages</i>			
July	1373	817	68.1	July	414	314	31.8
August	1,630	1,250	30.4	August	378	402	-6.0
September	1684	1,693	-0.5	September	390	438	-11.0
Q1	4,687	3,760	24.7	Q1	1,182	1,154	2.4
<i>Sugar</i>				<i>Cement</i>			
July	700	853	-17.9	July	250	261	-4.2
August	951	828	14.9	August	331	276	19.9
September	615	778	-21.0	September	302	318	-5.0
Q1	2,266	2,459	-7.8	Q1	883	855	3.3
<i>Electrical Energy</i>				<i>Iron & Steel Products</i>			
July	672	142	373.2	July	137	123	11.4
August	609	111	448.6	August	212	891	-76.2
September	732	501	46.1	September	145	378	-61.6
Q1	2,013	754	167.0	Q1	494	1,392	-64.5
<i>Major Ten Commodities</i>				<i>All Commodities</i>			
July	14,744	9,591	53.7	July	18,986	13,947	36.1
August	18,892	11,269	67.6	August	21,479	14,455	48.6
September	19,747	11,893	66.0	September	22,045	14,414	52.9
Q1	53,383	32,753	63.0	Q1	62,510	42,816	46.0

Sectoral Analysis: The collection from POL products has exhibited a growth of 263% as compared to collection of same period last year. This phenomenal outcome is attributed to the higher international oil prices as well as policy intervention. The sales tax collection on imports of crude oil was zero rated from November 2007 and the sales tax got liable to be collected at the sales of final products of

crude oil at domestic stage. Earlier, the sales tax paid at import stage was claimed as input adjustment against the sales tax domestic collection. Now not only that source of input adjustment does not exist anymore rather additional collection is being made. In addition, the opportunity of tax evasion through increased input adjustments claims has also been minimized. Its share in STD collection has increased from 19.9% in Q1:2007-08 to 43.3% in Q1:2008-09

The telecommunication sector which had maintained its growth tempo at above 25% for the last several years has dropped to single digit growth i.e., at 4.4% during Q1:2008-09. This fall in growth tempo is expected to be based on three different factors. First, the tax rate has been increased from 15% to 21% during the budget 2008-09 which may have a negative effect on demand factor. Second, the continued government's drive for strict implementation of procedures for all issued 'Mobile SIMS' in order to organize the telecom sector has its natural impact on the sales tax collection. Lastly, the inflationary pressure has also caused shifting of consumption from telecom to the most needed heads of personal/family expenditure. As a result, the telecom share in sales tax collection has also been reduced from 31.1% last year to 20.9% during the reference period.

The collection from natural gas has exhibited a healthy growth of 24.7%. The better performance by the major units has contributed significantly in increased collection. Increase in price structure seems to be the major factor that has its positive impact in better outcome. Significant increase in taxable sales and output tax confirm this argument. The collection from sugar has declined slightly i.e., by 4.5%. Reasons for this decline include higher exports of the commodity and increased input adjustment. A modest growth in collection from cigarettes is almost reasonable for the first quarter. The collection from electrical energy has increased by 10.3%, however, a sharp decline in refund payments has

significantly affected the net collection showing a growth of 150% in net term. The collection from services (other than telecom) indicated a slight decline in collection. This phenomenon is attributed to the fall in collection from hotel industry, airlines and courier services. The beverages industry with a decline in taxable sales has exhibited a marginal increase of 2.4% in collection. This less than expected is understandable under the ongoing inflation's impact on non-essential commodities. On the other hand, a nominal increase in collection from cement despite a healthy growth in taxable sales is attributed to significant increase in exports and the input adjustments.

Box2: Telecommunication Sector –A need for close monitoring

The collection from telecom services has been one of the leading sources of sales tax domestic for the last several years. The tempo of growth in the sector provided enough confidence to increase the tax rate and get a due share for increase in collection of STD. Therefore, the tax rate was increased from 15% to 21% in the budget FY: 08-09. However, the collection during the first quarter of CFY indicates a significant decline in growth tempo as the growth has come down to 4.5% only whereas it has been above 25% during the previous years even on monthly basis High fluctuation in collection during the first three months of current quarter invites attention for close monitoring of the sector as the on-going competitive consumer packages supports the existence of congenial environment and room for the expansion in the industry. The teledensity is still hovering around 60%. Thus the need for close monitoring of the sector with latest evaluation tools will increase the revenue manifold.

The collection from Iron and steel has decreased significantly. A sharp decline in collection from the major unit, having above 40% share in collection, although, seems to be the major source of decline, however, reduced collection from a considerable number of Iron & Steel units is indicative of overall slowdown in allied

industrial activities. The QIM² for Q1:2008-09 has also declined by 6.2% and is indicative of an overall fall in manufacturing activities during the reference period.

Sales Tax Collection at Import Stage

The collection from sales tax imports has increased in double digit when compared with same period last year. However, the share of sales tax imports in total sales tax collection has declined by 5.4 percentage points mainly due to shifting of sales tax payment of crude oil from import stage to domestic stage. The gross and net collection of sales tax imports has been Rs. 55.8 billion and 55.7 billion respectively, indicating a growth of 17.2% in collection when compared with last year. The collection from top 15 commodities groups has been presented in Table 10. Almost 88.4% of the sales tax collection at imports has been generated by these major commodities groups.

The sectoral analysis indicates that POL products have been the leading revenue source of sales tax during July-September 2008. It has the highest contribution of 41.6% of the total collection of sales tax at import stage. The collection has increased by 16.7% despite the fact that the base of the commodity group has been contracted due to zero rating of crude oil at imports. The collection from edible oil has registered a significant growth of 38.7% as its import value has increased by 54% which, in turn, is attributed to increase in international prices. The collection from plastic products has increased by 41% which is in line with 38% growth in its value of imports (Table 11).

² Quantum Index of Manufacturing is prepared and published by Federal Bureau of Statistics on monthly basis. It is based on production activities of 100 major industries.

Table 11: Chapter-Wise Growth in Imports and Sales Tax Collection

PCT Code	Description	Growth (%) in Import Value	Growth (%) in Sales Taxable Value	Growth (%) in Sales Tax Collection	Share (%) in Total Sales Tax
27	POL Products	137.7	139.5	16.7	41.6
15	Edible Oils & Waxes	54.3	43.0	38.7	8.5
39	Plastic & Articles	37.7	37.3	41.2	8.3
87	Vehicles	1.8	-0.6	3.1	6.0
72	Iron & Steel	-7.7	-7.1	3.7	4.9
84	Mechanical Machinery	36.6	35.9	20.0	3.3
29	Organic Chemicals	52.2	51.8	46.7	3.0
85	Electrical Machinery	31.2	31.3	9.1	2.9
48	Paper & Paperboards	12.8	10.7	16.5	2.3
9	Coffee, Tea and Spices	65.6	65.4	77.1	1.7
12	Oilseeds	-34.0	-33.9	-28.2	1.3
48	Ores, Slag and Ash	145.7	145.7	161.7	1.3
38	Miscellaneous Chemicals	39.8	38.6	-10.4	1.2
40	Rubber & Articles	21.9	19.1	0.6	1.1
76	Aluminum and Articles	3.9	5.0	8.7	1.0
	Sub-total	66.2	63.9	19.0	88.4
	Others	58.7	57.7	5.2	11.6
	Grand total	64.5	62.5	17.2	100.0

A nominal increase in collection from vehicles is the expected scenario. The duty slab of the vehicles with capacity 1800 cc and above has been increased from 90% to 100% during the budget 2008-09 and an additional levy of 50% regulatory duty has also been imposed. Resultantly the imports of higher capacity vehicles have dropped and the over all vehicles import value has increased by only 1.8%. The collection from iron and steel has increased by 3.7% whereas its value has declined by 7%.The imports of major iron products has declined however, significant increase in specially Flat-rolled products of iron or non iron alloy steel clad -rolled (not clad plated or coated) has compensated for the decline to some extent. A healthy growth in imports of mechanical machinery has fetched 20% additional sales tax collection from this head. Similarly, the sales tax collection from organic chemicals has witnessed above 45% growth

as its imports has also increased in the same tune. Sharp increase in the import value of tea and ores has resulted into a healthy growth in sales tax collection from these commodity groups. The imports of electrical machinery, paper & paper board and aluminum products have shown a moderate growth in sales tax collection. The collection from oil seeds has declined on account of lesser imports of rape/colza seeds. However, decline in collection from miscellaneous chemicals is attributed to significant increase in zero rated agricultural insecticides. The import of rubber products although increased by 21.9% but has registered a growth of only 0.6% in the sales tax collection. The reason for this outcome is the higher imports of zero rated rubber products

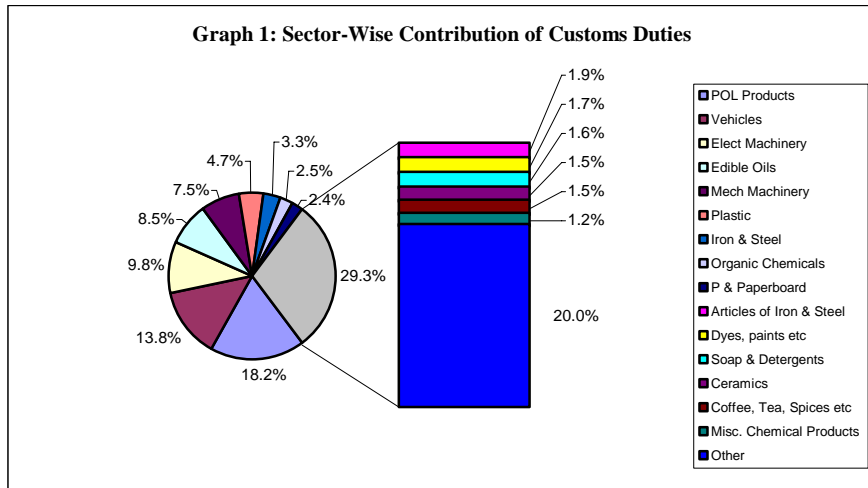
Customs Duties: The strong growth in the imports by 64.5% during the first quarter of 2008-09 has been of significant implication. The international prices especially, petroleum products during July-September, 2008-09 have been significantly higher than the corresponding period last year. The dollar viz-a-viz rupee has touched new heights in the first quarter of 2008-09 and has been exceedingly higher than the previous year. These two key factors have been instrumental in intensifying the burden of import on national exchequer. On the other hand, this phenomenon of higher value of imports is extremely favorable for the growth of import related taxes. Accordingly, the net collection of customs duties has improved considerably by 31.7% during Q1:08-09(Table 12).

Table-12: Collection of Customs Duties and Refund/Rebate during Q1: 08-09
(Rs. Million)

	FY: 08-09	FY: 07-08	Difference	
			Absolute	Percent
Gross	41,545	31,579	9,966	31.6
Refund/Rebate	3,382	2,603	779	29.9
Net	38,163	28,976	9187	31.7

Major Sectors of Revenue Generation

It is evident from the Table that around 80% of the gross customs duties has been realized from only 15 commodities grouped in PCT Chapters. The rest of the collection of customs emanated from remaining groups (Chapters), defense, warehouse surcharge, export development surcharge, auctions etc. Moreover, these items contribute 78% of total imports and 83% of dutiable imports. The details of the sector-wise contribution of customs duties are depicted in Graph 1.



Petroleum products (Ch:27) has emerged as the top revenue generation source of customs duties. Its share in the overall collection of customs duties has jumped from only 6.9% in Q1:07-08 to 18.2% in Q1:08-09. In fact, it is a significant jump from 5th position in terms of revenue generation in Q1: 07-08 to 1st position in Q1: 08-09. Interestingly, except High Speed Diesel (HSD), most of the major POL products are exempt from customs duty. Thus, around 29% of the imported petroleum products are dutiable. The major contributor of customs duties from petroleum products has been HSD. A sizeable growth of 246% in collection of customs duties from petroleum products has been recorded during July-September, 2008-09 against the corresponding period last year, is mainly due to the following factors:

- a) Rupee has been depreciated enormously in Q1:08-09 as compared to Q1:07-08.
- b) International price of petroleum products has been quite lower in Q1:07-08 against Q1:2008-09 despite significant reduction in the CFY.
- c) The quantity imported of HSD has also increased by 18.7%.

It is also pertinent to mention that customs duty rate of HSD has been reduced from 10% to 7.5% w.e.f. 04.09.2008. Despite this rate reduction, the collection of customs duties has grown by 154% during September 2008 against corresponding period last year. This also validates that huge collection from POL products has been mainly driven by depreciation of currency and to some extent, by prices.

Historically, auto sector has been the leading source of generation of collection from customs duties. Due to robust collection in customs duties by POL products, the collection of auto sector has plummeted from top in Q1:07-08 to second position in Q1:08-09. However, the collection of customs duties from auto sector has also dropped by 8% in July-September, 2008-09. The collection of customs duties depends mainly on the import of motor cars/jeeps under PCT (8703). Dutiable imports under this head come down by 11% and accordingly, collection of customs duties has also dropped by 14%.

The collection of customs duty from electrical machinery exhibited a significant growth of 34% in the first quarter of FY: 08-09. The main factor behind this growth was additional collection of customs duty from mobile phones due to imposition of customs duty in the Budget 2008-09. As far as mechanical machinery (CH:84) is

concerned, a growth of 23.3% in the collection of customs duties is consistent with the growth of 21.4% in its dutiable import. Significant growth in the value of imports of engines and industrial goods has substantially contributed in improved collection of customs duty from mechanical machinery.

The collection of customs duties from edible oil (CH:15) has declined by 17.8% during Q1:08-09 while its imports have increased considerably by 54.3%. The conspicuous mismatch between the growth of realization of customs duties and imports is due to application of specific duty rates. The collection of customs duty from edible oil depends on the imports of palm oil (PCT 15.11) i.e. palm oil, R.B.D palm oil and crude palm oil. Imported quantity of palm oil has declined by 68% during Q1:08-09 reflecting a enormous decline of 70% in the collection of CD. Since, palm oil is the top major contributor in the collection of edible oils, the decline in its collection has vastly affected overall collection of customs duties from edible oil. On the other hand, there is a massive growth of more than 10,000% in the imported quantity of R.B.D palm oil in Q1:08-09 as compared to corresponding period last year. It implies that within the imports of palm oils, imports have drifted to, a large extent, from palm oil to R.B.D palm oil in the first quarter of FY: 08-09. Despite huge increase in the import of R.B.D palm oil, it could not compensate the loss in CD due to lesser imported quantity of palm oil.

Table 13: Sector-Wise Gross Collection of Customs Duties*(Rs. Million)*

PCT Ch.	Sectors	CD Collection July-September		
		FY:08-09	FY:07-08	Growth
27	POL Products	7,572	2,183	246.9
87	Vehicles	5,729	6,226	-8.0
85	Electrical Machinery	4,078	3,041	34.1
15	Edible Oils & Fats	3,544	4,313	-17.8
84	Mechanical Machinery	3,115	2,526	23.3
39	Plastic & Articles	1,942	1,469	32.2
72	Iron & Steel	1,360	1,310	3.9
29	Organic Chemicals	1,037	741	40.1
48	Paper & Paperboard	985	1,003	-1.8
73	Articles of Iron & Steel	785	541	45.1
32	Dyes, paints etc	687	459	49.5
34	Soap & Detergents	658	395	66.6
69	Ceramics	627	293	114.4
9	Coffee, Tea, Mate & Spices	608	371	64.0
38	Misc. Chemical Products	508	416	22.1
	Sub Total	33,235	25,287	31.4
	Other	8,310	6,292	32.1
	Grand Total(Gross)	41,545	31,579	31.6

Despite significant increase in the effective rates of CD for iron and steel (CH:72), its collection reflected a low growth of only 3.9%. This phenomenon is mainly attributable to the decline in imports by 7.7%. On the other hand, articles of iron and steel (CH:73) have exhibited huge growth of 90.5% in its imports leading to strong growth of 45% in customs duties. This shift implies that the country tends to heavily rely on imported articles of iron and steel as compared to imports used in the production of steel industry. This is further confirmed by 4% decline in the production of Pakistan Steel Mills during Q1:2008-09. The growths in customs duties from organic chemicals and plastics have been, to an extent, consistent with their imports.

Federal Excise Duties: Due to expansion of base of FED during last few years, the share of FED collection in total federal taxes has also risen. These include non-fund banking services, Air Travel (ATT) and franchise services. The FED collection in Q1 CFY

confirms its growing share. It has been noted that the share of FED in total federal collection has increased from 7.7% in the Q1 PFY to 9.7% in Q1 CFY. During first quarter of CFY, Rs. 25.4 billion has been collected against Rs. 15.9 billion in the corresponding period of PFY (Table 14). The FED collection has grown by 60.4% and in absolute terms Rs. 9.9 billion more revenue has been collected as compared to Q1 PFY. The FED performance has been commendable as healthy growth in the quarter 1 revenue has made possible to surpass the target by Rs. 2.5 billion.

Table 14: Federal Excise Month-wise Revenue Performance

(Rs. Million)

Months	Collection		Increase/Decrease	
	Q1:08-09	Q1:07-08	Absolute	%
July	8,187	1,859	6,328	340.4
August	8,940	6,555	2,385	36.4
September	8,334	7,462	872	11.7
<i>August-September</i>	<i>17,274</i>	<i>14,017</i>	<i>3,257</i>	<i>23.2</i>
1st Quarter	25,461	15,876	9,585	60.4

Around 92% of FED collection is being generated by top six revenue spinners, namely; cigarettes, cement, natural gas, POL products, beverages and services. The month-wise performance of these major revenue spinners is depicted in Table 15.

Table 15: Federal Excise Major Revenue Spinners

(Rs. Million)

Commodities	Collection		Difference	
	FY: 08-9	FY: 07-08	Abs	Percent
Cigarettes				
July	1,963	0	1,963	0.0
August	2,376	1,970	406	20.6
September	2,693	2,442	251	10.3
Quarter 1	7,031	4,412	2,619	59.4
Cement				
July	1,380	98	1,282	1308.2
August	1,557	1,303	254	19.5
September	1,333	1,431	-98	-6.8
Quarter 1	4,270	2,832	1,438	50.8
Natural Gas				
July	530	285	245	86.0
August	517	620	-103	-16.6
September	473	643	-170	-26.4
Quarter 1	1,520	1,548	-28	-1.8
POL Products				
July	340	2	338	16900.0
August	294	192	102	53.1
September	229	213	16	7.5
Quarter 1	863	407	456	112.0
Beverages				
July	870	14	856	6114.3
August	844	676	168	24.9
September	891	754	137	18.2
Quarter 1	2,605	1,444	1161	80.4
Services				
July	1,353	548	805	146.9
August	1,557	375	1,182	315.2
September	672	879	-207	-23.5
Quarter 1	3,582	1,802	1,780	98.8
Sub Total	19,871	12,445	7,426	59.7
Domestic Total	21,499	13,172	8,327	63.2
Imports Total	3,962	2,704	1,258	46.5
Grand Total	25,461	15,876	9,585	60.4

Cigarette is the top FED revenue contributor with around 28% share in total collection. The collection has recorded a growth of 59% during the Q1 CFY. In absolute terms Rs. 2.6 billion additional has been collected as compared to corresponding period of last year. Barring the month of July, a healthy growth of 20.6% and 10.3% has been recorded in August and September 2008. It is relevant to mention here that the taxable sales of cigarettes have recorded a significant growth of 47% during July-September 2008 as compared to the corresponding period last year. Similarly, the production of

cigarettes has also witnessed more than 9% growth during the same period.

The second major revenue generator is the cement with 17% share in total FED collection. Overall growth in the collection of cement has been healthy; nonetheless, after attaining nearly 20% growth in August it has plummeted by 6.8% in September 2008. The possible reason behind this decline would be the slowdown of construction activities in the month of Ramazan.

The collection from beverages have also shown a healthy growth. Similarly, POL products have recorded a remarkable growth in Q1 CFY as compared to corresponding period last year. The increase in POL products is also due to the price effect. However, the collection from natural gas has shown a negative growth of about 2%. In the months of August and September the negative growth was 16.6% and 26.4% respectively.

FED on Services: With the levy of FED on services, particularly ATT and NFS, the composition of share of major commodities has also changed. Services have captured a considerable share in total FED revenue. The share of services has increased from 14% in the Q1 PFY to 17% during the Q1 CFY.

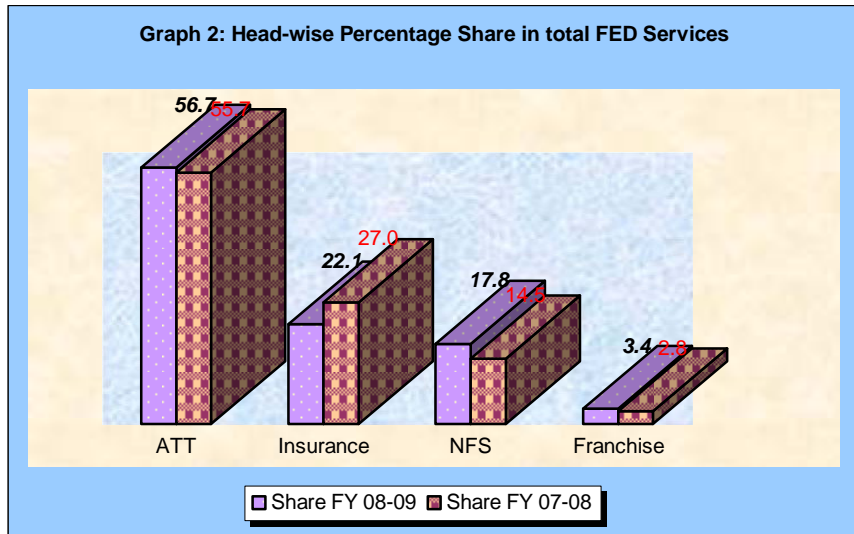
In absolute terms Rs. 3582 million has been collected during Q1 CFY against Rs. 1802 million in the Q1 PFY, entailing a growth of 99% (Table 16). The extension of scope and enhancement of rate of excise duty from 5% to 10% on financial services in the recent budget has been helpful to enhance further the FED revenues from services.

Table 16: FED Collection from Services During Quarter 1

(Rs. Million)

Services	Collection		Difference	
	FY: 08-09	FY: 07-08	Abs	Percent
A T T	2,032	1,004	1,028	102.4
N F S	636	261	375	143.7
Franchise	123	51	72	141.2
Insurance	791	486	305	62.8
Overall	3,582	1,802	1,780	98.8

Within services, the major source of revenue has been air travel with 57% share, followed by insurance (22%), non-fund services (18%), and franchise (3%). Graph 2 reveals a comparative position of services.



It is evident from the graph that except insurance the share of remaining three services has increased as compared to corresponding period last year. This is due to vibrant performance by these services in terms of revenue generation.

1% Special Excise Duty: It was a first time levy in budget FY: 2007-08 both at domestic and import stages. An overall amount of Rs. 3.4 billion has been collected from this head during Q1 CFY (Table 17). The performance as compared to its year of inception has improved significantly. The collection recorded a growth of 152.9% in the first quarter of CFY as compared to corresponding period last year.

Table 17: Collection from 1% Special Excise Duty

(Rs. Million)

1% SED Domestic	Collection		Growth (%)
	FY: 08-9	FY: 07-08	
July	543	0	0.0
August	435	258	68.6
September	333	258	29.1
Quarter 1	1,311	516	154.1
1% SED Imports			
July	677	269	151.7
August	669	302	121.5
September	754	262	187.8
Quarter 1	2,100	833	152.1
Overall 1%	3,411	1,349	152.9

The SED 1% both at import and domestic stage increased significantly by more than 152%.

In the federal budget FY: 2008-09 a 5% FED on the import and locally manufactured motorcars with engine capacity exceeding 850cc was levied. According to the details total of Rs. 262 million have been realized from this newly introduced tax in the first quarter of CFY. Further bifurcation reveals that Rs. 154 million and Rs. 108 million FED were collected at import and domestic levels respectively. Normally in the beginning there are enforcement issues regarding a new levy and same seems true in respect of FED on

motorcars. However, with better efforts and vigilance hopefully the collection from this head can be enhanced significantly.

Concluding Observations

FBR has successfully surpassed the revenue target for the first quarter of CFY. Some of the factors which contributed substantially in the improved collection are the depreciation of rupee and increased rates of GST. It is expected that the collection of taxes would sustain buoyant pace, however, extra efforts and monitoring would also be required to meet the huge revenue target set for the FY: 08-09.

II

Property Taxation - Exploring the Possibilities to Enhance the Scope in Pakistan

By: Naeem Ahmed ³

Historical Background

Property taxes are as old as the human civilization. They existed in Egypt, Babylon, Persia, and China and throughout the ancient world about 5,000 B.C., with primary focus on land and its production value⁴. This oldest tax may have taken various shapes but remained in vogue during all times. In the modern history the property taxation is one of the significant sources of tax revenue for the local governments in the United States, United Kingdom⁵, the Netherlands, New Zealand and Australia. In the United States before the introduction of income and sales tax, local governments relied on property-based taxation to finance most of their needs. Even with the emergence of other sources of tax revenues, property taxes remained a principal source of revenue. According to Bahl (1999) property tax is the most appropriate source of local government revenue in most of the countries. Property tax is a good local tax because it is immobile, less distortionary, relatively stable and a visible base.

Nonetheless, at the same time there are some disadvantages of property taxes as well. They are difficult and costly to administer, particularly, in developing countries, where the assessments are usually made on judgments. Major causes are the lack of political

³ Second Secretary (FRS), Federal Board of Revenue. (The opinions expressed are personal to the author and do not necessarily correspond to those of FBR).

The Author is highly grateful to Professor Sally Wallace (Andrew Young School of Policy Studies, Georgia State University, Atlanta, USA) for her valuable comments.

⁴ A Brief History of Property Tax By Richard Henry Carlson, September, 2004.

⁵ The major types of property taxes in UK are Stamp duty (about 300 years old tax which was introduced as a tax on written documents that needed a physical stamp to be attached. These days it exists primarily as a tax on the transfer of shares and securities, and in a different form, as a property tax. People pay stamp duty land tax when they buy a house or other property). Capital gains tax (is a property tax that is paid when he or she sells house). Inheritance tax (also called death tax, liable to pay when you inherit something from someone who has died).www.propertytoday.co.uk

stability and will, untrained staff, lack of proper information, illiteracy and mal practices.

Objective of this article is to discuss various theoretical and practical aspects of property taxation. It includes the discussion on the issues of valuation, cadastral, revenue assignments, tax rates. The study also suggests some short run and long run policy and administrative measures to enhance the revenue collection from property taxes in Pakistan.

Literature Review and Practices around the Globe

There is a voluminous literature on property tax highlighting various issues and problems faced by the property tax administration in developing and advanced countries. The available literature discusses the issues like incidence of property taxation and its economic effects, historical perspective, valuation and re-valuation, behavioral impacts, taxing property ownership vs. transactions, reform in the property taxes etc.

William (2002), states that property taxes in New Zealand were introduced in 1840 and currently they are around 50% of revenue for the local governments. There are some studies which estimated efficiency cost of the property taxation, these include Arnott and Petrova (2006), Nechyba (1998) and Wallace (2007). Arnott and Petrova (2006) have estimated the deadweight loss linked with property taxation. Nechyba (1998) finds that the elasticity of substitution between land and capital also plays a key role. Sennoga, Sjoquist and Wallace (2007) have analyzed the economic effects of property tax in the context of developing countries. Zodrow and Muthitacharoen (2008) find that the imposition of property tax raises the cost of capital and derives capital out of the taxing jurisdiction, reducing the productivity of other local factors.

Bahl and Wallace (2008) argue that valuation and revaluation become very costly and beyond the reach of most sub-national governments. This issue is more critical in poor and developing countries where governments find it difficult to manage a cadastre due to lack of skilled workers, financial resources and training facilities on modern lines. Sexton (2008) discusses various aspects of the tax rate structure in USA. Jerome F. Heavy (1983) says if

property value grows at different rates within same jurisdiction then assessments can create systematic inequalities. Pagano and Jacob (2008) have discussed in detail the political economy of the property taxation by highlighting its various aspects.

It is one of the most critical questions faced by the local governments that what is the best choice of tax instruments to be used to finance local expenditures. Certainly there could be more than one choice available, but in most of the advanced countries property taxes are the major source of local government revenues. In the US during 1970 and 2006 the property tax accounted for 65%-76% of local government revenue, however the reliance on sales tax and personal income tax has increased during the same period⁶.

Valuation of Property

The property taxes utilize a wide variety of tax bases like capital value, annual rental value, original purchase price, area based or flat fees (Youngman and Malme, 2004). Every country adopted different way of taxing property depending on local political and economic conditions and historical background. The countries like Singapore, Malaysia, New Zealand, Bermuda, Trinidad, Barbados, India and Nigeria introduced property tax system based upon British ‘annual rental value’ system. Whereas, Canada, United States, Brazil, Mexico, Japan, Sweden, and Chile preferred to adopt the capital improved⁷ value system for the objective of property tax. Nonetheless, over time many countries have moved away from their original system. New Zealand shifted from annual rental value to capital unimproved⁸ value, Jamaica from capital improved to capital unimproved and Barbados from annual rental value to capital improved, whereas India moved from annual rental value to area-based system.

There are also examples where residential and commercial properties are taxed in different ways. In UK and Northern Ireland residential property is valued using capital improved value and commercial and industrial properties are valued to annual rental value (McCluskey, 1991). Within Western Australia majority of

⁶ Athiphat Muthitacharoen, The Efficiency Cost of a Local Property Tax

⁷ Improved capital value, values both land and buildings or improvements

⁸ Unimproved capital value, values land ignoring any improvements and its objective is to encourage developments.

property is valued to annual rental value while properties located in small rural townships are valued on capital unimproved. As a whole fifty two countries, including US, use capital improved value as the base of their property tax and 16 countries have some form of unimproved value system. The area based is the next most popular approach used in more than 40 countries. The third approach is annual rental value to determine the base of property tax and currently 37 countries, including Pakistan, are using this approach.

Box 1: Capital Improved Vs. Capital Unimproved Tax bases

The Notion of capital value can be considered from two perspectives i.e. improved capital value and unimproved capital value. The former values both land and buildings or improvements to land, whereas latter only values the land ignoring the improvements for the purpose of property tax base.

Both the methods have positive and negative aspects. The capital improved valuation method has the advantage of more closely approximating a tax on real property but at the same time it discourages the development. It is therefore, many countries levy property tax on property unimproved.

Stamp Duty⁹ and Property Transfer Taxes

Stamp duty is a form of tax that is levied on documents. Major forms of duty include the transfer duty on the sale of land, businesses, shares and other forms of dutiable property; mortgage duty; lease duty and duty on the hire of goods.

The history of stamp duty dates back to 1624 when it was first time introduced in Holland and then in UK in 1694¹⁰. The taxation of property transfers in United States started in 1898¹¹. The transfer tax rates range from 0.01 percent to 4 percent in various states. The authority to collect transfer tax varies across the states. In Jamaica both stamp duty and a property transfer tax are levied on the sale of

⁹ See http://en.wikipedia.org/wiki/Stamp_duty

¹⁰ Basically to collect money to pay for the war with France. Although initially only planned for four years, it proved such a good earner for the government that it was never repealed. The tax's range was extended during the 18th and 19th century to cover a range of goods, including insurance policies, gold and silver plate and even hair powder.

¹¹ See Terri A. Sexton, Taxing Property Transactions versus Taxing Property Ownership

real estate. Bangladesh imposes a transfer tax, stamp duty and a registration fee. The property transfer rates in selected countries range from 1 percent of value to 10 percent (Bahl, 2004). Portugal, Slovakia, Mauritius, Swaziland and Al Salvador have graduated rates increase with value. In Canada the rate of transfer taxes range between 0.5%-2.0%. Some countries apply single transfer rates like Taiwan (7.5%), the Netherlands (6%), Bhutan (5%), Kenya (4%), Germany (3.5%), the Czech Republic (3%), Pakistan (5%) and Costa Rica (1.5%). Exemption policies also vary from country to country. However, being an easy way to raise revenue it is popular both in developing and developed countries.

In Australia stamp duty is levied by the states on various written documents and transactions and the rates of stamp duty vary from State to State. Some jurisdictions even do not require a physical document which is now called as "transaction duty." In Singapore stamp duty applies to documents relating to immovable property, stocks and shares traded on the Singapore Exchange. In Ireland Stamp duty is charged on Credit/ Debit cards, ATM cards, Cheques, Property transfers. In the United Kingdom stamp duty is a form of self-assessed transfer tax charged on land transactions. In the United States stamp taxes on deeds, notes and other transactional documents are imposed by states. When real estate is transferred or sold, a real estate transfer tax is collected at the time of registration of the deed in the public records. In addition, many states impose a tax on mortgages or other instruments securing loans against real property. This tax, known variously as a *mortgage tax*, *intangibles tax*, or *documentary stamp tax*, is also usually collected at the time of registration of the mortgage or deed of trust with the recording authority

Box-2

For the tax purpose property is divided into real and personal property. The real property includes land and anything attached to land like houses, shops, plazas, offices, farms, hotels etc. whereas, personal property is any movable (tangible or intangible) property. The personal property includes the items like cars, boats, livestock, personal effects and household goods, tools, inventories, computers etc. The intangible property includes assets, such as trademarks, patents, copyrights, franchises, stocks, notes, deeds of trust, and bonds. Generally the base for real property taxes are Annual Rental Income, Capital Value, Site Value and Physical value.

Property Taxation in Pakistan

The land property in Pakistan is costly and a source of huge rental incomes and profits for the owners, but unfortunately revenue realization remained meager rather dismal. In 1996 the property tax base was Rs. 70 billion and if the statutory rate were only 10%, the national collection would have been Rs. 7 billion¹². Nonetheless, the collection was only Rs. 506 million, in other words the realized revenue was only 0.72% of the potential revenue. In 2002-03 it had increased to Rs. 2.8 billion but still much lower than the potential revenue. The low collection from property taxes has also been confirmed by other studies. Currently the ratio of property taxation to GDP is 0.03% only, which is very low as compared to average 0.5% of GDP in developing economies (Bahl and Martinez).

Property taxation in Pakistan is the subject of provinces and local governments with authority to set rates and administer to collect. In terms of law and administration like many other countries there are shortcomings in the system of property taxation in Pakistan. Unfortunately, it has been an ignored area for a long time and could not gain the required attention from the concerned quarters. Currently, there are a large number of special treatments which reduce the tax revenue significantly. The major exemptions and concessions are: owner-occupied residential properties, retired government employees, widows, orphans and disabled persons, government properties and properties in cantonments, vacant lands, moreover, a 10% reduction in taxable value is allowed for every property for depreciation¹³. The administrative, economic and political constraints have jeopardized the provincial and local tax resources drastically. The major issues which need to be addressed are low taxable capacity, weak tax administration, out dated record keeping methods, undervalued and incomplete tax bases, unskilled and insufficient staff.¹⁴

During last few years a sufficient research work has been carried out in the general sales tax, income and corporate taxes, federal excises

¹² see Bahl, Wallace and Cyan (2008), "Pakistan: Provincial Government Taxation"

¹³ *ibid*

¹⁴ There is also the important issue of local autonomy—do local governments want to collect this tax? Under current circumstances, may be not because they get most of their revenue from the center

and international trade taxes in the Federal Board of Revenue. However, the recent World Bank study by (Bahl, Wallace and Cyan, 2008) is a good start and hopefully it will pave the way for further research and improvement in this area.

Role of Property Tax in Fiscal Decentralization - Revenue Assignments

There is no uniform revenue assignment policy in the world. Nevertheless, most of the countries assign the property tax exclusively to sub-national governments (Martinez and Rider 2008). Their study finds ten countries in the sample of 38 assigning revenues to the central governments; including China, Latvia, Russia, Tunisia and Ukraine. A smaller number of countries share revenues between central and sub-national governments. Out of sample 16 countries assign powers exclusively to the sub-national governments and sharing of the powers is more common between two levels of governments. The study also finds that in terms of administration, cadastre, registration and evaluation functions tend to be quite centralized and 45% of countries making it a central responsibility. Regarding the assessment method most countries follow the market based assessment, 8 countries use rental based assessment and 9 use a combination of different methods.

In Pakistan the taxes on immovable properties, property transfers and stamp duties are collected by the Provincial Board of Revenues and Excise & Taxation Departments. The legal base for property taxation is annual rental value and area based. In Punjab property tax is levied under Urban Immovable Property Tax Act 1958 and following the Local Government Ordinance 2001 it is a designated local government tax and the city government and TMAs have the authority to set the rate¹⁵. Practically the Urban Immovable Property Tax (UIPT) is a provincial level tax subject to revenue sharing with city districts and TMAs and it is administered by the Excise & Taxation Department. The tax is levied on a base of annual rental value at a flat rate of 20 percent on properties with an annual value of Rs. 20,000 or less and on higher values the rate would be 25%. A

¹⁵ See Public Financial Management Report 2004-05, Planning & Development Department, Government of Punjab and World Bank report on Pakistan's Provincial Taxes

5 percent rebate of the amount of annual tax for a financial year is allowed if the tax is paid in lump sum on or before 31st August.

In NWFP the property tax is a provincial tax like Punjab. The TMAs have the taxing powers including power to set rates and to administer the tax. The UIPT is an area based system in NWFP and the province is divided into four location classes based on factors like availability of amenities. The rates are different for residential and commercial areas (Table 1). The vacant properties are not taxable as they do not have rental value. The valuation is the responsibility of Excise and Taxation Department

Table -1: Property tax rates in NWFP

(Rs. Per square yard/feet)

Location	Residential	Commercial
A	1.5	9
B	1.25	7
C	1.0	5
D	0.75	3

Source: World Bank report (Bahl, Wallace, Cyan)

Lessons for Pakistan

Sufficient evidence exists in the contemporary world and in the literature, advocating the fiscal decentralization with significant local expenditure responsibility and taxing powers. In advanced countries like US, UK, Australia, New Zealand where the political system is quite stable, the things are well settled and local and state governments with sufficient constitutional and legal support are strong enough to collect ample revenues to finance their expenditures. Nonetheless, in developing countries due to weak and unstable political system the revenue collection at all levels and particularly at local levels remains a tough job. Due to decentralization move in the past couple of decades the importance of property taxes have increased further and many public finance experts recommend it as one of the major sources of local government revenues.

However, there is also a school of thought which favors more fiscal centralization. The centralization is supported on the argument of better macroeconomic control, stable policies, direction of investment in social overhead and equalization potential (Bahl 2008). Decentralization may lack these characteristics. Bahl and

Martinez (2008) argue that the confidence in property tax as the main source of own local revenue may be misplaced. Many developing countries that have assigned the property tax to local governments have not been able to realize the potential of this tax as a source of local revenue. What are the reasons behind this poor performance? According to Martinez and Rider (2008) these are narrow tax bases, low tax rates, poor administration and infrequent re-assessments. Similarly the low revenue performance by local governments has also been confirmed by other economists. According to (Bahl, Wallace, and Cyan, 2008) despite all of the good work that has been done in designing more efficient property tax structures and administrations, the property tax revenues account for less than one percent of GDP and less than 4 percent of all tax revenues in developing countries. One argument for the low level of revenues on account of property tax is that efficient administration is very costly; both in terms of fixed costs and operating costs and specifically valuation and revaluation are thought to be beyond the reach of most local government tax administrations. The current local tax administration cannot be efficient without introducing significant changes in the system. It needs to be strengthened through training, fresh recruitments, proper offices, equipments and cadastral surveys. Or we may say major problem is that there is no cost of NOT collecting the property tax!¹⁶.

Pakistan is no exception and property tax revenues are very low than the potential. The possible reasons are overall prevailing tax evasion culture in the country further aggravated by weak capacity of local governments and more dependence on transfers. Another possible reason for the low revenues could be the higher property tax rates.

Way Forward

What should be the best method and policy to collect potential property tax revenues? Currently provincial/local governments have the authority to collect but unfortunately the revenue realization has been very low. The provincial/local governments have not been able to collect a huge chunk of revenue due to one or other reasons. The situation demands immediate policy and administrative measures to

¹⁶ It is also perceived that local governments are least interested in collecting property taxes because there is no cost to NOT collecting the property tax as they receive grants from central governments and locals having very little accountability.

tap the potential property tax revenues direly needed for poverty alleviation and to gain the self-sufficiency. Some short term and long term measures are suggested to address the issues.

Short Term Measures

It is proposed to revisit the revenue assignments in Pakistan. For a period of 5 years FBR should be assigned the task of setting the tax rates and collection on urban immovable properties. The argument is that the FBR is a reformed and organized revenue collecting authority with its offices located all over the country and neither the provinces nor local governments have such a huge and efficient organization to perform this chaotic job. In this regard there is a need to develop a consensus among central and provincial governments to settle the legal/constitutional issues. It will be win-win situation for federal government, provinces and in fact whole the nation. The revenue can be shared according to any formula agreed by the governments. It is further added that on experimental bases at the first stage only few big cities like Karachi, Lahore, Islamabad, Rawalpindi, Peshawar, Sialkot, Faisalabad, Multan and Gujranwala be handed over to the FBR concerned Regional Tax Offices (RTOs). These RTOs shall coordinate with local governments and provincials revenue boards for further action and enforcement. If possible the local government officials working on property taxes should be attached to the FBR/RTOs. To strengthen the local governments and to keep intact the recent fiscal decentralization efforts it can be an alternative that the LGs be authorized to set rates and effectively contract with FBR to do the collection. FBR could charge an administration fee of maybe 5% of revenues collected—something that would be akin to a collection cost and not to generate significant additional revenue at the central level. If the property tax is to be a local tax, FBR could help manage the collection and assist with capacity development.

As already mentioned; in terms of administration, cadastre, registration and evaluation functions tend to be quite centralized in the world and nearly 50 percent countries make it a central responsibility. Therefore, it will not be wrong policy if central government in Pakistan takes the responsibility of cadastral survey and evaluation functions under its control. The central government should make arrangements for a fresh cadastral survey at least for the big cities. Create a cadastral survey wing in FBS to carry out

surveys on regular basis. The coordination among FBS, FBR and provincial/local governments can produce better results.

Tax rates always play a key role and normally higher rates encourage the tax evasions. As pointed out in the World Bank report these rates are on the higher side. A significant reduction in the tax rates on immovable property and on property transfers can be helpful to enlarge the tax base and to rein in the evasion.

Currently there are a large number of special treatments which reduce the tax revenue significantly. The major exemptions and concessions are owner-occupied residential properties, retired government employee owners, widows, orphans and disabled persons, government properties and properties in cantonments, moreover, a 10% reduction in taxable value is allowed for every property for depreciation. The vacant lands in NWFP are not taxed. There is a need to re-examine the existing exemption policy and it would not be unjustified if exemption on government properties, properties in cantonments, owner-occupied houses of size more than 5 Marla are withdrawn. There is no reason not to tax the vacant lands and similarly, a 10% reduction for depreciation should also be reduced to 5%. The levy of tax on vacant lands shall encourage new constructions which will generate economic activities in the country.

Method of collection is also important. Presumptive taxation is considered an optimal method of curtailing widespread non-compliance without employing excessive government resources because it addresses the concerns of both taxpayer and tax authority. Presumptive taxation provides taxpayers with a simplified option for the tax compliance without requiring full financial transparency. In various countries it is a common practice to tax the Hard-to-Tax on presumptive basis. According to Thuronyi (2003), in France farmers with a turnover of 500,000 or less are eligible for presumptive basis of taxation. The taxable agricultural income is determined according to area of land, type of crop and the region.

Therefore, on experimental basis it can be a policy choice that property taxes may be attached to electricity bills on monthly, quarterly, bi-annually or annual bases or as designed at the first stage in the aforementioned big cities. This method of collection will reduce the compliance and administrative costs. A proper

coordination among tax collectors/FBR and WAPDA/KESC can provide a good beginning¹⁷.

Long Term Measures

Most of the countries have adopted the policy of fiscal decentralization and resultantly local governments have been empowered and granted more fiscal and political autonomies. In Pakistan a recent effort was done in 2001 to install a new integrated local government system. The new system gave more fiscal autonomy to the local governments including the collection of property tax. However, the performance of local governments regarding property taxes has not been impressive. Still there is a lot of work to be done to reap the benefits of decentralization perfectly.

As discussed above, during the interim period, may be five years, the FBR should be made responsible to *collect* property taxes. Nonetheless, during this transitional period the provincial/local government revenue collecting departments should be reformed and staff should be trained and equipped with latest skills and techniques. In this regard a separate revenue department like FBR, a *Provincial Board of Revenue* by merging the existing revenue collecting organizations like Excise & Taxation and Revenue Boards, should be created to deal with all provincial and local government revenues. The Provincial Board of Revenue will have sub-offices at all the district headquarters as the revenue collecting field formations. The replication of current model of FBR in provinces can bring efficiency and desired outcome. Once the arrangements are complete and provincial/local governments are well equipped and trained, the property taxes should be handed over to LGs/provinces, to the extent the central government wants decentralization and autonomy of provinces and local governments. After proper training and necessary preparation there should be no reason for poor performance anymore on the part of provincial/local governments.

¹⁷ Nonetheless one may argue that the presumptive method only works if the imputed values are roughly correct and if there is a valid adjustment process if taxes are overpaid. Given how extensive the current presumptive system is for other taxes in Pakistan—this may not be a great thing to do to the property tax. Why not put some real effort into collection, using the expertise of FBR.

Once again it is asserted that there is a lot of potential of tax revenue from properties but only condition is that we need much organized efforts like advance countries. The appropriate and well thought fiscal policies and strong resolve is the way towards real economic independence, growth, development and prosperity of the nation.

III

STRENGTHENING LOCAL TAX REVENUES THROUGH FISCAL DECENTRALIZATION

By: Waseem Bajwa¹⁸

1. Introduction:

Fiscal decentralization is an important constituent of the decentralization process and generally considered to be a pre-requisite for the success of other two components i.e. political and administrative. However, to tread through this so-called labyrinth of fiscal decentralization (Bird, 1999) is a difficult task particularly for the developing countries. This labyrinth is associated with the problems of federal finance and fiscal federalism on one hand and appropriate choice and assignment of local revenue sources on the other. By limiting this study to the latter issue of local tax assignment, which is also called ‘agency’ versus the ‘local autonomy’ approach (Messere, Kam, Heady, 2003), an analysis of the owned and shared sources of revenue is an issue of particular importance.

In this regard, the ‘Devolution Plan of 2000’ in Pakistan is no doubt a big step forward in decentralizing further the powers of center and provinces to the local governments. This plan has also envisaged the fiscal aspect, whereby as far as the intergovernmental transfers are concerned, the government is on its way to strengthen it through the National Finance Commission (NFC) pertaining to the center and provinces and Provincial Finance Commission (PFC) relating to provinces and local governments. Nevertheless, regarding the issue of local tax assignments, till now the focus remained on decentralizing the administrative and expenditure functions and the local tax assignments has received very little attention. In this regard, the existing local tax assignments are not only overlapping in jurisdiction at the upper levels but also have poor revenue generation source at the lower levels. The problem is further aggravated by the poor mechanism of implementation and

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administration. Then, the situation is even worse at the lowest tier of local governments dealing with the rural areas. Here the issue of taxation is more challenging as the rural population because of their low income and absence of tax culture may not be willing to pay taxes. Thus the revenue resource base may be the weakest among all the tiers. Therefore, the gap between fiscal aspects concerning local tax assignments and other components of decentralization is very wide. Thus, the fragile revenues sources of the local governments not only stumble the whole system of the existing devolution plan to the ground, but also put an additional strain on the federal revenue source.

It is true that the new Local Government Ordinance of 2001 does contain some concrete measures to give fiscal resource to the local governments, but what matters the most is how and what is to be given? Depending on how it is given, the implication of the newly allocated resource could be different for the local governments. From this viewpoint, the fiscal decentralization in Pakistan might require some analysis to assess how the local governments could be empowered financially, so that it contributes most to the benefit of local government. In this perspective, an analysis of the tax reassignments at provincial level in general and local level in particular is very important. To make this analysis useful and having sufficient depth, I would look into the devolution history of Pakistan, current problems, theories and other countries' experiences to explore what could make the fiscal decentralization in Pakistan the most successful.

2. Historical Overview of Local Governments in Pakistan

In order to understand how the current problem has arisen, it might be useful to look into the historical aspect of fiscal decentralization in Pakistan.

Prior to the British rule in India, there existed a rudimentary sort of local government in the rural areas comprising of village elders called "Panchayat" (Council of Five), performing administrative, judicial and sometimes development functions (Mjumdar 1960, Basham 1954). The foundation stone of the prevailing system of local government in Indo-Pak sub-continent was said to be laid down by Lord Rippon in 1882 through a resolution calling for local

self-government, which established municipal bodies in cities and towns and Talukas (sub districts) in the rural areas. The 1935 act was the first concrete attempt in the pre-independence period regarding fiscal decentralization, mainly inspired from the Australian Otto Niemeyer Award of 1937 (Kumar 1982). The fiscal arrangement through Government of India Act, 1935 envisaged 'divisible pool' i.e. taxes like export duties, and income tax other than agriculture to be divided among the center and the provinces. The exclusive jurisdiction of levy and collection with the provinces include taxes like land tax, sales tax, professional tax, entertainment tax and irrigation charges.

At the time of independence, Pakistan comprising of West and East Pakistan (now Bangladesh), adopted the Government of India Act, 1935, but deviated even from the basic principles enunciated in it regarding decentralization. The first decade after independence witnessed a political turmoil with a tilt towards centralization and excessive control of civil and military bureaucracy at the center (Jalal, 1995, Talbot 1998). The first sign of this tilt also observed in the fiscal arrangement, whereby the sharing of income tax with the provinces was suspended and the Sales Tax was federalized with 50% divisible share to the provinces in accordance to the Raisman Award, 1951 (First NFC Award).

It is generally viewed that the revival of local governments by the military regimes of General Ayub in 1960s, General Zia in 1980s and even General Musharaf in 2000 was to weaken the civil bureaucracy, gain legitimacy to their rule and create a power base for themselves with spurious intentions of actual devolution of power. (Zahid 2000, Dr Rizvi 2005). Despite lacking the real will to devolve powers, another major flaw was that none of these efforts were adequately supported by the primary constituent of decentralization i.e. fiscal. In the era of **General Ayub** (1958 to 1969), despite the assignment of some regulatory and development functions at the lowest tiers of villages and districts, the delivery and performance was highly hampered due to the limited fiscal capacities of local governments (Siddiqui, 1992). The major change brought in during the **General Zia-ul-haq** (1977 to 1987) period was the separation of rural and urban areas, whereby the introduction of octroi fee from one district to another became a major source of revenue for the local governments. In the absence of

appropriate intergovernmental transfer system and limited local revenue resource of the rural areas, the financial position of the rural local councils started deteriorating and thus started becoming heavily dependent on the provincial governments for even the basic service delivery.

The party-based elected political governments from **1988 to 1999** did not bring about any substantial change as far as the structure of local governments is concerned. However, the centre started encroaching over the resources of provinces to strengthen their power and combat the threat of military return to power. This in turn created problems at the lower tiers i.e. provinces and the local governments. Majority of the financial resources and the discretion to execute the development projects rested with the center and the provinces, thus further eroding the financial capacity of the local governments. The financial resources in terms of own source revenue (OSR) of the local governments got a major setback with the abolition of octroi fee concerning movement of goods from one district to another. Though, it was welcome by the general public as a major relief from the excessiveness and unfairness of this system particularly from the local contractors collecting the levy, oblivious of any check, but by not reciprocating for this source constrained the revenues of local governments.

3. Literature Review

In this part, by narrating the related literature, An effort is made to draw on relevant theories and ideas on fiscal decentralization that could act as a yardstick to analyze the lingering and ongoing issues in the local government system of Pakistan.

3.1 Importance of fiscal decentralization

Fiscal decentralization is an important tool in facilitating revenue mobilization, innovation in economic activity, accountability of elected officials and grassroots participation in governance. In addition, it also helps in overall revenue mobilization because decentralization can broaden the tax net (Bahl, 1999). In most of the developing countries due to administrative weaknesses the management of the two important taxes i.e. Income and Sales tax is always poor, particularly regarding capturing the tax base of all those with taxpaying power. The sub-national governments being in

close proximity and familiarity with the tax base can be quite instrumental in capturing this base.

The framework of fiscal decentralization is mainly driven by the Musgravian principles of efficiency, equity and stability (Musgrave, 1983). It is generally expected that decentralization improves efficiency in the use of resources, because residents in the local governments can choose the desired mix of public services and revenues that best suits them. So, a number of services with the exception of large scale services or those generating externalities should be in the purview of sub-national governments (Bahl 1992, World Bank 1994, Schroeder 1999). The countries mainly follow this simple logic and failure results because of vagueness in service assignments (Smoke, 2000).

3.2 Modern Concepts of Local Self Government

The two successful models of local self governments are taken into consideration, one is the 'European Charter of Local Self Government' and the other is the Japanese local government system in the form of 'Shoup Recommendation' emanating from the American context and embedded in the Asian setting.

3.3 Basic principles of Revenue Assignments

There should be a clear definition regarding assignment of revenues to the various tiers of government. In this regard economic and administrative efficiency demands that the mobile sources of taxes like corporate, personal income tax, VAT / Sales Tax, Custom and excise duties should be assigned to the federal government (World Bank, 1999). Similarly, immobile sources should form the revenue base of local governments like property tax, land tax, user charges, various fees and licenses (Bahl & Linn, Shah 1998, World Bank, 1999). This principle is also adopted by a number of developing countries, but the problems crop up due to other reasons. This may include exceeding the expenditures than the assigned revenues and also because of complex structures and ineffective administration.

In choosing the most appropriate sources of revenues for the local governments, there are generally three widely accepted principles (McLure, 1998, Bahl & Linn, 1992). These principles are i) revenue adequacy, ii) correspondence and iii) effective administration of the

levied taxes. By revenue adequacy it is meant that the local revenue assignment function should match the expenditure responsibility. Correspondence implies that the taxes with a potential to export the burden should not be given to the local governments. The third criteria regarding effective administration means at a reasonable cost and in an easy way. The fourth principle may be added to this i.e. discretion to set the tax rates by the local governments (Bahl, 1999).

3.3.1 Overview of Property and Income taxes at local level

In a Tiebout world, with large number of local communities offering a range of services the households choose their residence in accordance to their preferences. These services are usually financed by the local taxes, so a lot depend on the nature of these local taxes (Oates & Schwab, 2004). Extending the Tiebout model, Bruce Hamilton (1975) argued that by introducing local zoning rule with a minimum level of housing consumption can convert the local property tax into a sort of head tax to have an efficient Tiebout outcome. But, this zoning ordinance of Hamilton cannot restore efficiency in the case of local income tax, as it sets a ceiling on the consumption of housing (Oates & Schwab, 2004).

Then there is another difference in the property and income tax, whereby the former also includes the commercial and industrial properties in the tax base, thus the firms have to pay the marginal cost of services that they receive from the local government (Oates & Schwab, 1991). On the other hand the income tax on residents completely misses this part of the local public finance. The supporters of property taxes at local level also take their plea on the doctrine of 'separation of sources'. The argument here is that the income tax results in overlapping of the governments taxing it at three different levels.

As far as the proponents of local income tax is concerned, they build their case on the principle of 'ability to pay', by citing the progressive nature of income tax as compared to local property taxes. The main argument also in the favor of the developing countries for the local income tax is the issue of cost, administration and broadening of tax base making it more convenient and as an efficient source of local tax. In the era of 'Universal Self Assessment' and withholding tax regime it is easy to administer the

local income tax in the form of ‘piggyback’ by simply extending the structure to the lower level and making some add-ons to the prevailing system. As both these taxes have their own advantages, so combination may be used at different tiers of local government.

3.3.2 Tax Sharing & Tax assignment

Another issue where scholars have differing point of views is, whether there should be tax sharing among various tiers or absolute / separate assignment of revenues to various governments. Regarding tax assignment, some scholars have argued that there are less problems if different levels of government are assigned separate tax bases rather receiving a share of joint tax (Lavrov et al; 2000; Shleifer and Treisman, 2000). In support, it is further argued that a government having an exclusive right to a particular tax base will have the discretion to set the preferred tax rates thus resulting in efficiency and less corruption. Regarding tax sharing it is argued that a government that gets a large share of revenue is likely to invest more in the infrastructure than it would under tax assignment (Treisman, 2006). In the case of developing countries, where there is a limited capacity to administer some of the mobile taxes like personal income tax and sales tax in the form of sur-taxes which may be devolved, tax sharing may be a better arrangement than tax assignment. Normally, a mix of both of these approaches is used to have an appropriate link and stability among various tiers of government.

3. Decentralization in Pakistan & its Analysis

The latest attempts regarding decentralization and improvement of local governments were by General Pervez Mushraf government in 2000 under the name of “Devolution of Power Plan” and implemented after the local government elections in August, 2001. Through this devolution plan, the sub-provincial (district and below) government has also been restructured. Prior to this, majority of the functions and powers were concentrated with the provincial governments. Under this plan, not only new elected governments were established at the district level but a link was also provided with the sub-district (Tehsil & Union council) governments. However, this decentralization has been mainly from the province to the local government and as such, no concrete measures have been

taken to devolve and decentralize the functions from federal to province and local level.

4.1 Analysis of the Local Government System in Pakistan

It can be seen from the above overview of the evolution and existing system of local government, that the process of decentralization in Pakistan is confronted with deep-rooted problems and challenges. The process can be successful only if all the three components i.e. political, administrative and fiscal are devolved simultaneously. Nevertheless, here the concentration has been around political and administrative decentralization in one pretext or the other. As far as the fiscal decentralization is concerned, the extent is limited; rather it has been more centralized than following the same pattern.

4.2. Identification of issues regarding Local Tax Assignments

In this section, a brief analysis of the issues pertaining to the fiscal aspects of decentralization has been given with regard to the appropriateness of revenue assignments to the local governments. The basis of this analysis is deduced from the historical aspects and the literature review. The major issues and problems in this regard are identified as under:

4.2.1 Weak revenue base of the provinces: The historical aspect clearly reveals to us that there has been a trend towards fiscal centralization than decentralization. So by the federalization of sales tax on one hand and devolution of UIPT and agriculture income tax (AIT) on the other to the lower tiers of local government the provinces have been left with little own source revenue base. Thus, the provinces have started encroaching upon the powers and resources of the local governments to cover up their sources to some extent. The provincial government is the main link and facilitator to the successful implementation of this fiscal decentralization, but its own weakness is hampering the existing system.

4.2.2 Limited power to tax: This pertains to the powers to introduce new taxes and fees and deciding about the tax rates. As all the powers of legislation are with the provincial assemblies, so the local governments do not have any power even in the matters pertaining to local taxes in term of levy, rate and jurisdiction. This is against the principle of local autonomy.

4.2.3 Overdependence on Intergovernmental Transfers: The upper tiers of the local government like City District Governments, District Governments and Tehsil Municipal Administrations (TMAs) have also been unable to generate enough revenues to cater even for their bare minimum needs.

4.2.4 Limited sources of tax at the lowest tiers (Union Councils): The situation is even worse at the lowest tier, because of the inappropriate division of tax sources among various tiers as identified in the Shoup Recommendations. For example the Local Government Ordinance 2001, assign the tax sources at the local level, but majority of these are either not revenue potential or lack the requisite mechanism of implementation to generate revenue. The taxes at Union Council Level are only on the statute book without any mechanism of implementation and thus almost non-functional. For instance out of the 7 taxes / user charges at the disposal of union councils except for 'fees on registration of births, marriages and deaths', all other user charges neither have any utility or base to get revenue. For example, charges like 'fee for licensing of professions and vacations', 'charges for specific services' and 'rent for land, building, equipment, vehicles' as such do not have any base with the rural areas from where revenue could be generated (Semiotics consultants / DSP, NPSO Pakistan, 2008).

4.2.5 Overlapping jurisdiction of taxes among lower tiers: This involves the Urban Immovable Property Tax (UIPT) and Tax on Transfer of property (TTIP), being handled at two tiers and there is no uniformity in this regard. Mostly encroached by the provincial and district governments though it is the function of Tehsil Municipal Administration (TMA). This is also not in line with the basic parameters as enunciated in Article 9 of the European Charter advocating for the responsibilities in accordance to the law and constitution.

4.2.6 Low User Charges: The major issues faced both by the urban and rural areas are poor infrastructure and public facilities for the residents. For instance in the urban areas, the local authorities performing municipal functions like water supply, solid waste management, waste water disposal, street lights, repair of minor roads, provision of parks and playgrounds have to spend a lot on

these services and are recovering very little in terms of user charges. Also people are taking these services for granted as they are paying a nominal charge, thus not only the civic sense is dissipating but the quality of services eroding.

4.2.7 Limited capacity to administer the taxes: The administrative control is in the hands of bureaucrats from the federal and provincial services, so their interest is nominal as far as proper implementation and desired generation of local tax revenue is concerned. The local governments do not have their own trained human resource to manage the affairs properly. Also, there are conflicts among the local governments and provinces regarding the posting and transfers of officers, whereby at present all the discretion is with the provinces. The major reason can be associated by referring to the Shoup Recommendations that the local governments should have priority in functions and revenue assignments, which comes in their domain. Then the tax sharing procedure also lacks the proper mechanism and procedure of implementation.

4.2.8 Ineffective accountability: The internal and external check on the local bodies is flawed, resulting in malpractices on one part and tax evasions on the other.

4.2.9 Lack of tax culture at the lower levels: Majority of the rural population know almost nothing about their tax obligations. As such, no effort by the provincial or local governments initiated to facilitate and educate the taxpayers. Majority of the taxpayers at the lowest tier take it as a huge burden and the lack of basic services and facilities has further eroded their concept to fulfill their obligation of tax payment. It is an old issue deriving its basis from the history because as such throughout the history the taxpayers in the jurisdiction of local governments have not been subjected and acquainted with taxes very little, so not being unaware of its benefit side they are reluctant to pay.

4. Country Experiences

In this section, decentralization efforts particularly in terms of fiscal decentralization in various developing and developed countries have been analyzed. The main aim is to overview their success and

failures with reference to their decentralization policies regarding tax assignments, administration and efficiency at the various tiers.

5.1 South Africa – local tax assignments

South Africa has also started decentralization process recently and showed some improvements with regard to fiscal decentralization, particularly the assignment of local tax revenues to the local governments. There are three types of local government in South Africa with different powers and responsibilities. The metros, six in number, govern the metropolitan areas of South Africa. Then, there are 231 municipalities outside the metros, varying in size and capacity. The last tier involves District Councils referred to as C municipalities, which are 49 in number, providing services to the rural areas.

Regarding the revenue aspect, the metros and large municipalities are financed by their own sources, which are property taxes, other local taxes and user charges. The smaller municipalities mainly dependent on conditional grants and general purpose grant known as 'equitable share'. The District councils receive revenues from grant and a local payroll system known as RSC levy similar to local income tax. Similar to Pakistan, the urban local councils are comparatively more self-sufficient as compared to the rural councils. In this regard, the property tax is the second largest local revenue source (behind revenues from municipal electricity undertakings) accounts for 20% of total local government revenue (Bahl, Department of Finance, 1999). The property tax meets the basic criteria of autonomy test, as local governments have enough liberty in formulating property tax policy. It basically operates under the provincial legislation whereby either tax land only or both land and improvements thereon. The local governments can choose tax rates, give exemptions, make assessments and collections. As such majority of the features of the South African property taxation are in consonance with the fiscal decentralization. Still the major issues under review are uniformity of tax rates, what base to tax etc.

5.2 The Kenyan Experience

The efforts made by the Ministry of Local Government after 2000 are commendable and the pilot projects paid the way for the decentralization process. The systematic approach by the Ministry of

Local Government also involved the Ministry of Finance to assist the reform process so as to enhance the revenue generation and financial management. After the success of the pilot projects, the reform components are being integrated, for instance the property tax has been implemented in accordance to the broad financial management reforms. The setup of Local Authority Transfer Fund is another step towards the smooth and systematic set up of the local government system. At present the political scenario is not favorable, but still as compared to the previous efforts, these reforms have made some progress. So the major lesson that could be drawn here is adoption of a systematic and phased approach to implement the reform process.

5.3 Ghana – effective fiscal decentralization program

In Ghana the decentralization efforts started in early 1990s, by enacting it in the 1992 Constitution and through Local Government Act, 1993. Local taxes in Ghana can be grouped into three categories namely: taxes on income, taxes on property and taxes on expenditure. The local government law empowers Sub-National Governments (SNGs) to generate revenue from levies, fees and licenses for specified activities. The law provides that such revenue shall be taxed or collected exclusively by SNGs, although they may authorize other government bodies to collect revenue on their behalf. Some revenues (land and tribunal fees) are collected by central government on their behalf.

In Ghana, most SNGs collect the basic tax. The basic rate is the poll tax levied on all adults in the local area. The basic rate is currently among the least important own source revenues to SNGs. The cost effectiveness of collecting the basic rate, especially at its current low level, is a matter of concern for efficiency purposes. The regressive nature of the tax also raises equity issues. These tax assignments to SNGs indicate a wider scope according to the provisions of the law.

In the administration of taxes at the SNG level, tax collection is actually done through the fee fixing resolutions approved by the assembly through the finance and administrative sub-committee and collected by revenue collectors. The deficiency identified with this system is the lack of an established database of rateable people. Another major problem besetting the administration of taxes at the

SNG level is corruption and lack of transparency in revenue management. The result is that most SNGs cannot cover their recurrent expenditures. Then, there is lack of capacity for establishing an effective system for revenue collection and monitoring in most assemblies. Besides, they lack the necessary manpower and infrastructure to cope with the demands of revenue collection (World Bank, 2000).

5.4 India – Strengthening the states / Provinces:

At the time of independence both India and Pakistan inherited the same structure of governance from the British. But India moved ahead by making its own constitution deriving the basis from the Government of India Act, 1935. Realizing the requirement of administration and in order to address the ethnic issues, the center created more states by division of the existing states. Thus, constitution of India created 25 sub-national governments and seven union governments and gave powers to the states to establish local governments. With respect to the division of sources of revenue, the sources with mobile tax bases were assigned to the center and with immobile tax base to the states (provinces). For instance, import/export duties, excise duties, taxes on non-agricultural wealth, gifts tax, estate duty and corporate income tax are completely assigned to the center. Whereas, localized sources like land tax, agriculture income tax, Sales/consumption tax, liquor tax, professional tax, octroi, stamp duties and registration fees were assigned to the provincial governments (Thimmaiah, 2000).

The major difference here between India and Pakistan regarding assignment of revenues to the states is of the Sales / Consumption tax. In India it is exclusively a provincial subject or source of revenue, whereas in Pakistan also initially it was with the states, but later completely federalized.

5.5 Japan – Efficiency of prefecture and municipal taxes:

Japan has evolved its system of local governance on the principle of 'local autonomy' through a reform process under Shoup (called Shoup recommendations, 1949). It has a 'two-tier' system of local governments, consisting of prefectures and municipalities (cities, towns and villages), and likewise the taxes are called prefectural and municipal taxes. Also the taxes have been divided into the general

purpose and special purpose category (City Planning, Automobile etc.). Then the local governments have some discretionary powers to levy local taxes if they obtain the agreement of the Minister of Internal Affairs and Communication.

As far as the proportion of the local and national taxes is concerned, if compared with Pakistan there is huge difference in this regard. For instance, in the case of Pakistan the local tax revenue to the national exchequer stands at only 5% in comparison to Japan at 40%, which is very poor even by the standards of developing countries. The main features of the local tax system of Japan, which may be relevant to Pakistan are personal income tax, consumption tax and fixed asset tax.

5. Recommendations and Conclusion

The major issues are adequate provision of sustainable revenue source to the local governments and their fiscal empowerment. By trying to resolve these issues, the main objectives are to have efficient, stable and autonomous local governments in Pakistan. Thus in the light of the specified issues, the literature review and the country experiences, certain recommendations have been given, whereby the general issues have been taken care of first and then the specific issues concerning the proper revenue assignments have been dealt. Here the recommendations appear to be too many but these are interrelated and aim to resolve the major issues.

6.1 Some General Recommendations:

6.1.1 Phased and Systematic implementation: In this regard, lesson may be drawn from the African experience as done by the Kenyan and Ugandan government involving pilot projects and after their success replicating it to other parts. Drastic changes are normally not acceptable and also confuses the masses.

6.1.2 Implementation of LGO, 2001: There should be a proper implementation of the Local Government Ordinance, 2001 after removing the conflict areas through mutual consultations. Then, coordination among the various ministries at federal and provincial level such as Ministry of Finance, Revenue Boards and services

ministries, for instance, health, education etc is very important to make it successful and implementable.

6.1.3 Capacity building regarding tax administration at the local level: In the beginning officers from the federal and provincial cadre should be appointed. This should be followed by development of an independent local cadre to manage the local taxes at their own.

6.1.4 Introducing Poll Tax: The introduction of poll tax or basic rate, in the form of resident tax, can also be a useful source of revenue for the tiers of local government. The tax or charge should be very nominal, only to cater for the basic services. The experiences in this regard may be drawn from the poll tax or basic rate of Uganda and resident tax of Japan..

6.1.5 City Planning Tax: In the urban areas with population of more than 5 million, a city planning tax may also be introduced similar to Japan.

6.2 Specific Recommendations:

6.2.1 Strengthening the provincial taxes: The present devolution plan tries to strengthen the local governments' revenue at the expense of provincial governments. For instance, by devolving the Agriculture Income Tax and Property Tax to the local governments from the provinces and without compensating for this major revenue loss to the provinces. So, in the present system the provinces have started encroaching upon the revenue and functions of local governments.

One way to strengthen the revenue base of provinces is by devolving the sales tax to the provinces from the center. In this regard the examples of Japan and India could be followed, where in Japan consumption tax is taxed at 5% rate, 2% is transferred to the prefecture level, and in India it is a state (provincial) tax. It may not be possible to follow the Indian example at this stage, but similar to Japan may be followed. In Pakistan, Sales tax is presently taxed @16% by the center, and if 8% is transferred to the provinces, it will be a real boost in the revenue of the provinces. Then, the provinces can further transfer 3 to 4% amount to the local governments after collection through intergovernmental transfer of PFC, which is

already being done. The transfer may be on the basis of population, area, backwardness and collection criteria.

6.2.2 Legislative powers to local assemblies: The principle of local autonomy pertaining to fiscal decentralization can only be adhered if the local authorities are given some legislative powers, particularly regarding introduction of local taxes and adjustment of tax rates. In Pakistan, it may be little early to implement such an option straight away owing to the immaturity of local governments, but it could be done in a phased manner by devolving some powers in the beginning from the provincial assemblies to local assemblies. In this regard, lesson could be drawn from the Shoup recommendations, where in the interest of local autonomy, the local bodies were allowed to levy taxes termed as non-legalized taxes only if not against the national interest. It was done to let the local governments mature over time and the check was placed in the form of counseling and correction through effective judicial process.

6.2.3 Strengthening local taxes through introduction of personal income tax: At present the income tax is completely managed by the center. This present system of income tax has improved a lot owing to the ongoing reform, thus has geared the revenue generation from this source. The major problem faced by the center is the low tax to GDP ratio and limited tax base. By devolving it to the lower tiers, it will not only address these issues to a greater extent, but would also act as an important source of revenue for the local governments. In this regard, the pertinent experiences are of Japan and South Africa. In the case of Japan, the personal income tax is collected at the prefecture and local levels effectively, thus acting as an important source of revenue for them. Similarly in South Africa the RSC levy is supplementing the local revenues to a greater extent.

The major issue is the capacity to manage the personal income tax by the local governments and at present it is beyond their capacity to manage it. So, for the time being it could be managed completely by the center by simply stretching the existing infrastructure to the lower levels and remitting the collected portion to the local governments by deducting the requisite administration and collection charges. The structure of personal income tax should be simple in the form of some add-ons or surcharges to the prevalent

federal tax system, and then major reliance should be on the withholding income tax.

6.2.4 Strengthening the third tier – Union Councils by devolving Agriculture Income Tax (AIT): The financial position of the Union Councils operating in the rural areas is very precarious, because majority of the population is living below the poverty line with per capita income extremely low. The taxes or fees given to this tier according to the LGO, 2001 as discussed above are the least revenue potential and even does not fulfill the bare minimum of the administration cost. Further, there is no appropriate mechanism or capable staff to levy and collect these taxes at the disposal of this tier. So, the union councils depend a lot on the intergovernmental transfers, which are also not transferred in due course of time.

One of the viable solutions to make the union councils sustainable is to devolve a part of Agriculture Income Tax (AIT) to this tier, owing to the proximity to tax this source with the Union Councils. Then also this arrangement is in consonance with principle of close relationship between those paying and benefiting. The AIT is on the decline due to neglect and less attention by earlier the provincial government and now by the district governments. Again, the major issue for the Union Council is the lack of capacity to administer it; this issue can be resolved in the similar way as regarding personal income tax. The Federal Government should manage this tax along with personal income tax at the lowest tier for the time being and in the medium term after building the capacity may be transferred. This arrangement will not only improve this neglected but potential revenue source with proper streamlining by the federal government, but would also be an important source of revenue for the Union Councils.

6.2.5 Clear delineation / assignment of Taxes – strengthening UIPT at TMA level: The major overlapping of jurisdiction regarding local taxes is regarding Urban Immovable Property Tax (UIPT). In this regard, according to the section 117 of the Local Government Ordinance, 2001, is TMA tax that has to be collected by the District Governments on behalf of TMAs as per section 118. This tax has been collected by the Excise and Taxation Departments, which are still under provincial control despite the fact that legislatively its administration has been devolved to the District

Governments. As this source generates major revenue, so provincial governments are not willing to give up this source of revenue.

In this respect, ideally the TMAs should manage the UIPT independently, but owing to their capacity constraint, at present it is being managed by the District Governments through the Excise & Taxation department, which should be fully devolved to the district government as envisaged. In this regard the District Governments may retain 10% as per the arrangement and rest to be remitted to the TMAs. In the medium term, the TMAs should evolve its own administrative structure to manage the UIPT through capacity building with the help of provincial or federal government.

6.2.6 Extending and improving the user charges and fees:

These are important and very useful source of supplementing revenue for the local governments. For instance, the urban councils may be given road users charges of the internal roads and bridges, traffic violations, environmental pollution, solid waste management, etc. Similar the buildings of historical heritage in various areas can be an important source. In the rural areas a limited octroi on the movement of agricultural goods can also be quite beneficial to the union councils. In the rural areas the water use charges for irrigation purposes may shared with the local councils by the irrigation department to add the revenue of the local councils.

6.2.7 Effective Accountability system: The system of accountability should be strengthened regarding the internal and external audits. Also the ongoing process of Citizens Committees to have a check on the local governments should be improved through a mechanism and powers of monitoring. An automatic check would be regular elections in a fair manner in accordance with the democratic norms and principles.

6.3 Recommendations in Nutshell

In order to put possibly into practice those recommendations mentioned in the preceding section 6, here I ll give some concrete measures. So in the first instance, the revenue sources of the provinces need to be strengthened so that they may act as facilitators to the lower tiers of local government through transfer of GST, as

shown at 1 in the figure mentioned below and thus would realize the recommendation at 6.2.1.

To strengthen the local taxes, the matters of pivotal importance are proper choice of taxes at various tiers and their management. The choice depends upon the provision of basic public goods on one hand and derivation of benefit on the other (Gramlich, 1999). In the Pakistani context, the benefit principle is more applicable to the urban areas where there are more business activities and higher per capita income as compared to the rural areas. So, by introduction of new taxes like personal income tax, corporation taxes and resident tax, the revenue of local governments in urban areas could be improved a lot. This is shown at No. 3 in the figure (presented at the end) and would realize recommendations at 6.2.3 and some of the general recommendations at 6.1.4 and 6.1.5.

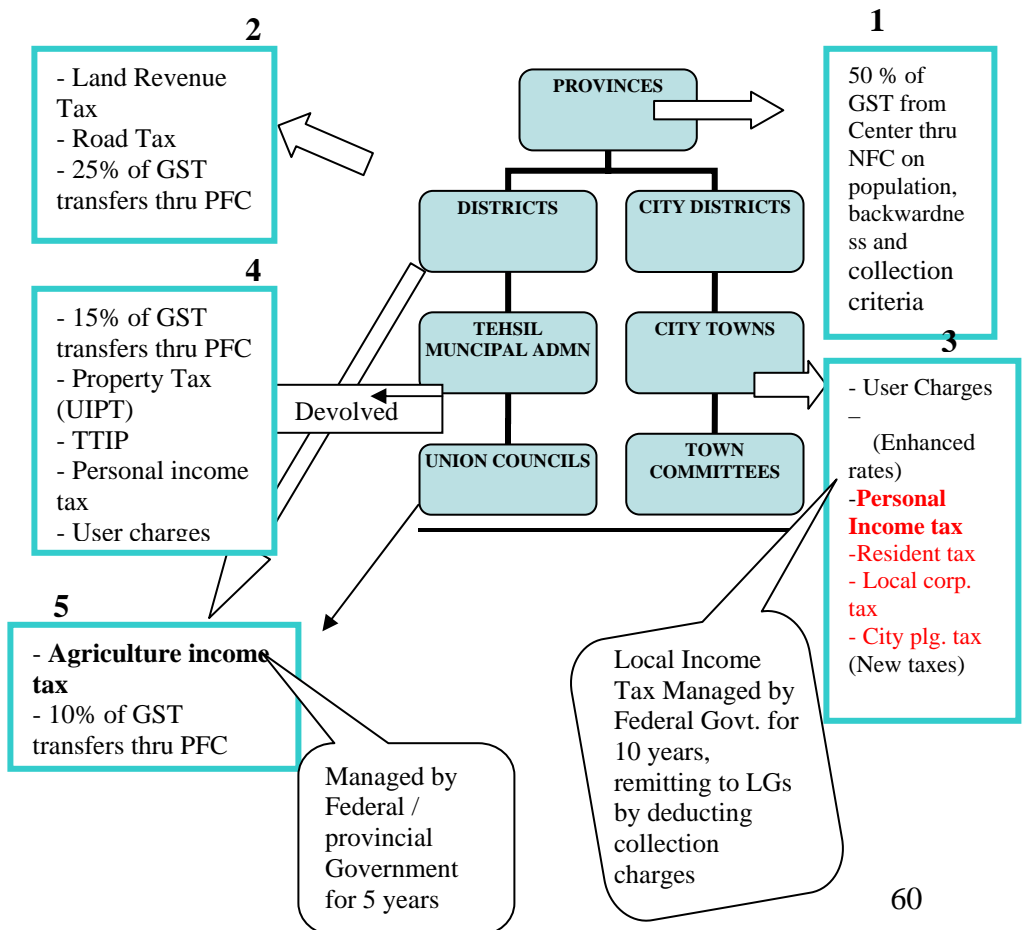
Then at the District Council and Tehsil Municipal Administration (TMA), to give stability to these local governments in the initial phase, the GST share from the provinces through PFC should be given as shown at 3 and 4 in the figure, thus realizing the recommendation at 6.2.1 completely. For the TMAs, the major source of revenue would be UIPT, so the requisite data base of properties and proper collection mechanism with the help of district governments is important. Then by introducing personal income tax, streamlining the user charges and strengthening the TTIP would further add to the Own Source Revenue (OSR) of these councils. This is shown at No. 4 and would realize the recommendations at 6.2.5, & 6.2.6.

As far as the rural areas are concerned, owing to their poor capita income the introduction of new taxes with high rates would be an additional burden on the local population. So by devolving the existing Agriculture Income Tax (AIT) at lowest level of Union Councils having close proximity to the agriculture business, their revenue base could be strengthened. The problem of management and administration can be solved with the help of federal or provincial governments, by extending their infrastructure to the lowest tier. One option is that the federal government manages it along with the personal income tax and other is to be managed by the provincial authorities having the prior experience in this regard. But in the long run through capacity building this tax should be

devolved completely to the lowest tier in all respects. This is shown at No. 5 and would help in the realization of recommendation at 6.2.4.

To bring the existing devolution close to the principles of fiscal federalism and decentralization, it would be appropriate to give some legislative powers to the lower tiers of local government like the power to change the tax rates and introduce local taxes not in clash with the national economy as contained in the two basic models i.e. EU Charter and Shoup Recommendations. This will not only improve the administration but also make them accountable to their respective local population. As far as the implementation is concerned the existing devolution plan can draw a lesson from the successful implementation of Tax Reform process by the Federal Board of Revenue and some developing countries like Kenya, whereby the implementation was done in phases in the form of various pilot projects.

PROPOSED MAJOR TAX ASSIGNMENTS AT THE LOWER TIERS



6.4 Conclusion:

In the nutshell, the process of fiscal decentralization can only be successful by an appropriate mix of intergovernmental transfers and local tax assignments, where the latter provides sustainability and the former corrects the ‘vertical imbalance problem’ (Bird, 1999). The existing ‘devolution plan’ of Pakistan is also suffering from the same dilemma of vertical imbalance, i.e. the spending programs are predominantly conducted by the lower level of governments and taxes with revenue potential are being assessed by the higher level of government. So, the local governments find it almost impossible to finance themselves without the aid of center. To tackle this issue and the make the local governments sustainable in the broader context, there should be a trickle down effect and clear assignment of taxes, so that no tier of local government may encroach upon the function of another government.

I conclude here by deriving an important lesson from the Shoup Recommendations in Japan, that human resource is the most important asset of any country and to get the maximum out of this asset their basic needs should be satisfied. The most appropriate and easy way of doing this is through the local governments and this objective can only be met by fiscally strengthening the local governments, so they can deliver the basic public facilities by relying predominantly on their own resources. I also hope that with having appropriate sources of revenue potential taxes at the disposal of local governments in Pakistan and their proper management would not only make the existing plan successful but add to the stability and better working of the lower tiers of local government.

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