

Pakistan's Taxation System: A Critical Appraisal

Maria Inam*, Shah Khan**

Introduction

The constitution empowers the Federal Government to collect taxes on income other than agricultural income, taxes on capital value, customs, excise duties and sales taxes. The Central Board of Revenue (CBR) and its subordinate departments administer the tax system. Each of the three principal taxes has a different history and different set of issues. For a large number of income tax payers the core of the business process is pre-audit and assessment by a tax official. This process gives considerable discretion to tax officials, with potential for abuse. Moreover, this process is also not tenable as the number of taxpayers increase. The report is focused on a total overhaul of the process and organization of income tax. Sales tax is recent and its process and organization is adjusted to the needs of an expanding tax base. These are based on self-assessment and selective audit. Similarly, in customs the accent is on accelerating and broadening the changes begun in recent years. Before long, central excise will be subsumed in sales tax.

During the nineties, despite many changes in the tax regime and introduction of withholding and presumptive taxes, Federal Government tax to GDP ratio has varied narrowly around eleven percent. The tax base has grown but still remains narrow and skewed. The number of income tax filers is around one million. At less than one per cent of the population, it is a lower proportion than in many developing countries.

* Maria Inam, Business Graduate form IMS, Peshawar and presently pursuing her PhD from New Zealand,

** Shah Khan, PhD Research Scholar, Dept. of Management Science, Qurtuba University of Science and IT, Peshawar campus, Peshawar, Pakistan

Pakistan's fiscal crisis is deep and cannot be easily resolved. Taxes are insufficient for debt service and defense. If the tax to GDP ratio does not increase significantly, Pakistan cannot be governed effectively, essential public services cannot be delivered and high inflation is inevitable.

The Reforms to improve our taxation system need to be focused on human resources, business process and organization, corruption and information management. An effective revenue organization must be comprised of trained and dedicated persons with integrity, transparent processes, a comprehensive information system, and taxpayer education. The paper recommends self-assessment, selective audit, and expansion and upgrading of information management, emphasizes reduction of discretion and direct contact between tax collector and taxpayer

Pakistan's Taxation System

Federal taxes in Pakistan like most of the taxation systems in the world are classified into two broad categories, viz., direct and indirect taxes. A broad description regarding the nature of administration of these taxes is explained below:

Direct Taxes

Direct taxes primarily comprise income tax, along with supplementary role of wealth tax. For the purpose of the charge of tax and the computation of total income, all income is classified under the following heads:

- Salaries
- Interest on securities;
- Income from property;
- Income from business or professions
- Capital gains; and

- Income from other sources.

Personal Tax

All individuals, unregistered firms, associations of persons, etc., are liable to tax, at the rates ranging from 10 to 35 per cent.

Tax on Companies

All public companies (other than banking companies) incorporated in Pakistan are assessed for tax at corporate rate of 39%. However, the effective rate is likely to differ on account of allowances and exemptions related to industry, location, exports, etc.

Inter-Corporate Dividend Tax

Tax on the dividends received by a public company from a Pakistan company is payable at the rate of 5% and at the rate of 15% in case dividends are received by a foreign company. Intra-corporate dividends declared or distributed by power generation companies is subject to reduced rate of tax i.e., 7.5%. Other companies are taxed at the rate of 20%. Dividends paid to all non-company shareholders by the companies are subject to withholding tax of 10% which is treated as a full and final discharge of tax liability in respect of this source of income.

Treatment of Dividend Income: Dividend income received as below enjoys tax exemption, provided it does not exceed Rs. 10,000/-.

- Dividend received by non-resident from the state enterprises Mutual Fund set by the Investment Corporation of Pakistan.
- Dividends received from a domestic company out of income earned abroad provided it is engaged abroad exclusively in rendering technical services in accordance with an agreement approved by the Central Board of Revenue.

Unilateral Relief: A person resident in Pakistan is entitled to a relief in tax on any income earned abroad, if such income has already been

subjected to tax outside Pakistan. Proportionate relief is allowed on such income at an average rate of tax in Pakistan or abroad, whichever is lower.

Agreement for avoidance of double taxation: The Government of Pakistan has so far signed agreements to avoid double taxation with 39 countries including almost all the developed countries of the world. These agreements lay down the ceilings on tax rates applicable to different types of income arising in Pakistan. They also lay down some basic principles of taxation which cannot be modified unilaterally.

Customs

Goods imported and exported from Pakistan are liable to rates of Customs duties as prescribed in Pakistan Customs Tariff. Customs duties in the form of import duties and export duties constitute about 37% of the total tax receipts. The rate structure of customs duty is determined by a large number of socio-economic factors. However, the general scheme envisages higher rates on luxury items as well as on less essential goods. The import tariff has been given an industrial bias by keeping the duties on industrial plants and machinery and raw material lower than those on consumer goods.

Central Excise

Central Excise duties are leviable on a limited number of goods produced or manufactured, and services provided or rendered in Pakistan. On most of the items Central Excise duty is charged on the basis of value or retail price. Some items are, however, chargeable to duty on the basis of weight or quantity. Classification of goods is done in accordance with the Harmonized Commodity Description and Coding system which is being used all over the world. All exports are exempted from Central Excise Duty.

Sales Tax

Sales Tax is levied at various stages of economic activity at the rate of 15 per cent on:

- All goods imported into Pakistan, payable by the importers;
- All supplies made in Pakistan by a registered person in the course of furtherance of any business carried on by him;
- There is an in-built system of input tax adjustment and a registered person can make adjustment of tax paid at earlier stages against
- The tax payable by him on his supplies. Thus the tax paid at any stage does not exceed 15% of the total sales price of the supplies;

Analysis of Existing Taxation System

Income Tax

In the last decade income tax, together with sales tax, has become the principal source of revenue for the federal government. Its contribution to total tax revenue stands at 28 percent, and its share in GDP has increased from less than 2 percent of GDP in the early 1990s to 3.6 percent of GDP by the end of the decade. The inflation adjusted annual increase in income tax revenue was 10.7 percent between 1990-91 and 1999-2000, which compares with the real increase in non-agricultural GDP of 4.2 percent.¹ The revenue is raised at a cost that amounts to less than 1 percent of the revenue collected.² Despite these reassuring statistics, there is widespread disaffection with the functioning of the income tax department and its performance. There are several factors that have resulted in this state of affairs. Some of these are rooted in the income tax legislation, others are an outcome of the constitutional structure of the country, others are the result of a complex web of

lobbying and political compromises, and still others are dictated by the revenue crunch that is faced by the country.

The number of active tax-filers in Pakistan is about 1.05 million, which is 0.07 percent of the population. The number of persons in the registers of the income tax department is about 2.0 million, out of which about 1.2 million have been assigned national tax numbers. The percent of population on national tax register is 1.4 percent of the population which compares with 2.2 percent in India, 13.6 percent in Argentina, 53 percent in France and 82.5 percent in Canada. The cross-country comparison is usually not very useful because of considerable differences in 'the economic structures, tax laws and administrative procedures'.

Among tax filers the number of companies was 18,000 in 1997, which paid 53 percent of the total tax revenue. The salaried taxpayers, who numbered 410,000, contributed about 7 percent of the total revenue. The number of taxpayers who filed under the self-assessment scheme was 359,000.³

In any given year only a very small percentage of salaried taxpayers are assessed for income tax purposes, as is the case of taxpayers who qualify under self-assessment scheme. Effectively only about 250,000 or 25 percent of tax-filers are subject to any degree of tax assessment. This includes all company cases, which are subject to 100 percent tax audit unless the entire income of a company is subject to presumptive tax. These taxpayers are not chosen on the basis of their risk profile nor because there is a prima facie inconsistency in their accounts but because these are the residual group once the salaried persons and self-assessment group are effectively excluded for detailed audit. The 250,000 audits/assessments are handled by an officer cadre in grade 16-

18, who number about 650. This means a workload of about 400 audits/assessments per officer per year. Therefore, it is not surprising that an overwhelming number of tax audits are conducted in haste and are perfunctory.

For income tax purposes, the population of the country could be categorised as: (1) cases with no incomes or whose incomes are below the income tax threshold, (2) cases which fall within the taxable bracket but are exempt from payment of income tax under Schedule II of ITO, 1979, (3) cases which fall within the taxable bracket but have successfully avoided entering the tax net, (4) cases which are within the tax net but under-report their incomes, (5) cases which are within the tax net and correctly report their incomes but where there is the possibility of differences with the tax department on the extent of their taxable income.

A measure of the extent of tax evasion is provided by the value of assets declared under the recent tax amnesty scheme. Under this scheme, assets of Rs120 billion were declared, which could not be explained through known income sources. A tax at the rate of 10 percent on these assets raised Rs12 billion in revenues. Assuming that 10 percent was a low tax rate and that under normal course of events a marginal tax rate of 20 percent would have applied, the extent of tax evasion could be taken as Rs24 billion. If these assets had been created within the last 10 years, the annual tax evasion would amount to Rs2.4 billion. This is about 2.27 percent of the income tax revenue raised in 1999-2000.

While property and commercial surveys, if conducted frequently can identify individuals and businesses that are outside the tax net and also limit the scope of tax evasion, these do not address one important source of tax leakage, namely 'flight of capital'. If tax that is evaded and reinvested back in the form of domestic assets is easily detected through

surveys, tax evaders could start investing in foreign assets. The extent of this leakage may already be significant and could gain momentum if local avenues of evading taxes are effectively plugged. This is a strong case for detecting evasion primarily through effective tax audit and supplementing it with regular surveys to identify non-filers and cases of under-declaration and false declaration. If tax evasion is detected at the audit stage, then it can be caught before it finds its way out of the country. The reforms I am suggesting focus on tax administration and tax processes. A good tax system requires a good tax policy but more importantly, an administrative system that can put these policies into practice. Tax reform efforts in the past have concentrated primarily on issues of policy; the issue of improvement of tax administration and of processes has not been given the importance it deserved. The core subject of this reform effort is the improvement in tax administrative structure and simplification of processes. We begin by looking at the organisational structure of the tax department.

Sales Tax

The sale tax is evolving into Pakistan's key revenue earner is beyond any doubt. What is even more impressive is the growth of sales tax revenue during the latter half of the nineties. During this period, real sales tax growth was 2.9% per annum faster than the growth of direct taxes, a true testimony to its buoyancy. Although the performance of the sales tax has been impressive, it still remains short of the potential achieved by high performing developing countries, where its contribution to the GDP ranges between 4% and 9%⁴. The Proposed Reforms shall be driven by four broad objectives:

- To increase the long-term revenue generation capacity of the administration

- To lower compliance costs of taxpayers through process reform
- To reduce the misuse of discretion by reducing the points of contact between the taxpayers and the tax officials.
- To create an impartial and judicious adjudication system, which gives relief when faced with excesses

Customs

Pakistan Customs is one of the oldest organisations of the Federal Government. Customs regulatory framework was first consolidated under the Sea Customs Act 1878. Over the years, as international trade grew, Customs administration gained importance, both as a major source of federal tax revenues and as a regulator of the economy. Nevertheless, the Customs administration and its regulatory framework did not fully keep pace with the developments in international trade and the requirements of domestic economy. The Sea Customs Act, 1878 was replaced by the Customs Act, 1969, but it did not contain any substantial changes. Pakistan was one of the first few developing countries to join the Customs Cooperation Council (now called World Customs Organisation) and adopt the internationally applied classification system (then referred to as Customs Cooperation Councils Nomenclature). However, Customs procedures, in general, did not keep pace with the changing requirements of international trade. The customs operations initially revolved around imports by sea and were codified and published in a document called Appraising Manual. It contained operating procedures, which envisaged 100% scrutiny of import and export documents and examination of all goods, imported or exported. This document spelt out standard operating procedures (SOPs) for various Customs tasks. With the passage of time, the use of this document as a reference guide diminished; now it is hardly available.

Essentially, Customs procedures are based on a manual system with multiple checks and verifications of every transaction, hallmarks of a defensive and time-consuming system. These procedures were devised at a time when the volume of international trade and the number of import and export transactions were small and import tariffs were prohibitively high. The analysis of Customs business processes highlights that they involve numerous steps, handling officials, signatures and verifications, and are cumbersome and irritating. A summary of the basic characteristics of Customs business processes is presented below:

- The existing business processes of Customs are fundamentally manual, devised to handle a small volume of transactions. Besides being tedious and time consuming they lend themselves to collusive malpractice.
- Clearing agents carry documents from desk to desk for completing various steps in each process. They move with documents from one official to the next, as they follow the process.
- Existing work methods and processes allow excessive interfacing between Customs employees and clearing agents/clients. The clearing agent has become an integral part of the processes.
- A large number of Customs officials are involved in completion of business processes and various steps, verifications and signatures for completing processes are rather large.
- The client has to travel considerable distance to complete formalities as Customs offices are awkwardly and distantly located.

- There are a number of unnecessary steps which involve office support staff and sepoys for recording the movement of documents and affixing stamps. This results in further interfacing and delays.
- There are no time standards for the completion of various activities/sub-processes. There is no effective monitoring system in place to check delays on part of the Customs employees.
- In the absence of universally applicable operating procedures and weak post-audit function, there are ample opportunities to misuse discretion by officials at functional levels. This is particularly true in determination of values for duties and application of exemption notifications.
- At present there is no negative profiling system for maintaining record of high-risk clients for targeted enforcement measures. However, a positive system of profiling for various categories of exporters and for sanctioning duty drawback claims has been introduced.
- The dispute resolution system is slow and cumbersome. Stakeholders are generally dissatisfied with the existing system to redress genuine grievances arising out of the arbitrary exercise of authority and delays in decision-making, which adds to their financial costs.
- Customs administration handles an ever-increasing volume of international trade with a tall hierarchy. Superimposed on the operational level is a top-heavy supervisory tier. The documents have to pass through several layers of officials before a single transaction is finalised.
- There is a preponderance of inappropriately qualified non-functional support staff vis-à-vis operational level officers.

Presence of such a large number of non-operational staff adds negative value to business processes.

- Quality of clearing agents, responsible for making important professional input to the business processes, is generally poor due to weak system of issuance and renewal of licenses to the clearing agents.
- Officials of the rank of sepoy perform critical functions of escorting bonded warehouse goods and similar other functions. Likewise, the office support staff (Lower Division Clerks and Upper Division Clerks) is involved in the custody of documents/files involving large amounts of revenues in the shape of bank guarantees. This may lead to manipulation of documents/records with substantial financial risks.
- There is no uniformity in business processes on countrywide basis. Most of the inland Customs stations follow business procedures specific to their local settings.

Corruption

Corruption in the tax administration is a two-way street. For each corrupt CBR employee, there is a corrupt private sector person who is indulging in corruption either willingly or under duress. The findings of the task force in 2001 suggest that a large majority of the private sector justifies non-payment of taxes because of the dismal or simple non-performance of the government in its duties. Many respondents to the task force survey mentioned other countries where the state ensures provision of decent quality infrastructure such as, health, education, social security, roads and, above all, security of life and property. Most felt that the GOP has failed miserably to provide for any of these facilities and hence does not have any moral basis to ask for taxes. While causes beyond

CBR may not be considered part of the scope of this study, we feel that overlooking them will make any attempt at corruption reduction in the tax administration futile. Hence, even if we cannot change anything in this area, we feel it is our duty to alert the decision makers about the very important role that they play in encouraging and sustaining corruption in the tax administration.

I strongly believe that the antiquated state structure, systems & culture are the underlying causes of corruption in the GOP, which manifest themselves in other causes in the tax administration (or in any other GOP institution). First, the colonial mindset of the GOP treats citizens as serfs as opposed to worthy clients who deserve the very best in service. This in turn, leads to allocation of State resources that are woefully inadequate to meet citizens' fundamental needs of security of life and property and basic infrastructure of health, education, sanitation, basic utilities, etc. Unless the citizens are guaranteed these basic rights they will remain reluctant to discharge their obligations towards the State. The current, apparent tax revolt is reflecting this basic sense of an unjust relationship between the citizens and the State. Following responses from public suffice to indicate their perception:

- Whatever money is collected is looted by rulers or spent on unnecessary luxuries of the powerful classes of Pakistan.
- "Government wastes our money. If people believed their money will be used for health, education, infrastructure, etc., 90% will pay."
- "I do not see good use of money in any case. The state is not fulfilling its contract of protecting life, property, and health. So why should we fulfil our contract?"

- “You waste my money in Umras with an entourage of 150 ‘Jiyalas’.”

Lack of tax culture or tax education is the next most important cause of corruption in the private sector. Respondents felt that this is because of unnecessarily complex systems of taxation and poor quality of management in the private sector. This results in easy manipulation of private business by unscrupulous tax functionaries. Some in the tax administration also echo this:

- “Outsiders cannot understand our systems. Even after one year of training I have great difficulty understanding the sales tax system.”
- Because of the complexity, many respondents feel they are forced and/or tempted by tax administrators themselves into not paying the correct amount of tax.

The next important reason cited for corruption in the private sector is high tax rates. People gave the example of reduction in customs duties (because of WTO), which has resulted in less corruption in the Customs department as the motivation to evade duties is reduced. Many examples were given where the collection went up once the rates were reduced.

- “The department for registry of property in Sialkot was extremely corrupt. When the stamp duty was reduced from 20% to 5% the revenues increased significantly.”
- “Our tax rates are too high. They once used to be around 70%. Tax evasion became more pronounced in the late sixties. There was a time when a flood surcharge was added to the taxes taking them to over 80%. This led to massive tax evasion.”

Finally, many respondents cited greed and lack of accountability as a major reason of corruption by the private sector. They see many leading businessmen and rulers getting away without paying any taxes. Hence they feel they should try the same.

- “Top professional, i.e., famous doctors and lawyers do not have time for you. They give you appointments after two to three months. Top lawyers who charge Rs five to ten lakhs per case do not have time for your case. And yet their tax returns show minimal earnings.”
- “It is cheaper to evade taxes than to pay them.”
- “If bigger sharks do not pay taxes and get away with it then why should the middle-class pay?”
- “They can get away with it with collusion. So there is a lot of incentive to evade. On the one hand you have high tax rates, and on the other, the facility to collude. Businessmen who do not pay taxes can out compete those who do. Nobody has ever been caught in any case.”

Human Resource Management

At the outset I would like to state that the current tax administration in Pakistan does not have a professional HRM function to design and implement various policies and practices affecting over 30,000 employees of the organisation. Although this weakness is noticeable in all government institutions, the absence of an HRM function creates more difficulties for tax administration in managing its employees. Enhancing tax administration capacity necessitates the overhaul of its present working environment, recruitment, training, career management, performance evaluation, and compensation practices. Without this

overhaul, the tax administration can not become effective tax collection machinery nor can the two key requirements of integrity and staff morale be assured. analyses in the area of HRM practices has identified a number of factors, leading to dissatisfaction, inefficiency, and corruption in the staff of tax administration. Some of these factors are listed below:

- The system of recruitment through which non-officers are inducted into the organisation is highly politicised.
- Current training and development practices do not expose the staff to best practices in tax administration.
- Career progression is slow for both officers as well as non-officers.
- Hardworking and honest employees are not adequately rewarded.
- The performance appraisal practice suffers from instrument and process flaws.
- Inadequate compensation system fails to attract and retain highly qualified professionals. It also compels a large number of people to engage in unfair practices to supplement their income.
- The working environment is not conducive for sustained high quality work.
- Staff is expected to spend money from their own pockets to furnish their offices, to get stationery for office work and to meet other operational expenses to keep their offices functional.
- Revenue targets fixed without adequate consultation with managers and staff lead to anxiety in the staff, who in turn, indulge in intimidation and harassment of the taxpayers.

Recommendations

Income Tax

- Improve effectiveness of existing processes through the work reorganisation which reduces tax payer/tax collector interface, provides pre-audit anonymity of auditors, assigns and distributes functions and responsibilities in a manner that reduces discretion of assessing officers, promotes one window operation, assigns functional responsibilities to specialised divisions, relieves assessing officers from non-assessment functions, and moves to a systematic basis for selection of cases for tax audit.
- Develop a system with key features of universal self assessment with selective audit, centralised information system, survey and research capability, functional specialisation, taxpayer education and customer service.
- Initiate education of taxpayers and withholding agents through a well-integrated programme of media campaign, booklets and brochures.
- Simplify and standardise the process of issuance of exemption certificates.

Sales Tax

- Create taxpayer assistance units as a point of contact between the department and the taxpayers. Its functions should include: receipt of registration, de-registration and refund applications, issuance of registration certificates, notices and orders of the Sales Tax Act and any other acknowledgement for the tax payers, administer the voluntary disclosure process, provide tax payer education and training, and register tax payer complaints.

- Create an exception – based process of refunds using information on an exporter's compliance history to ensure the access of compliant exporter to a fast track contingent on future compliance performance backed by a strong audit. As a medium term measure, introduce input tax verification scheme.
- Develop support systems for audit, standardise audit work, develop well-defined work programmes and check lists for different types of audits. A risk-assessment instrument may be developed to systemise the steps to be taken during an audit in each risk area.
- For large corporate taxpayers, develop system audits of their record keeping and accounting systems to evaluate its comprehensiveness, control procedures and transaction flow systems.
- Revenue targets should be based on gross receipts.
- Upgrade the auditors by recruitment in Executive Group 1 and enact reward rules for auditors.
- Train auditors, both in-house and outsourcing with professional firms on regular bases.
- Discontinue the multiplicity of audit. A taxpayer should not be audited more than once a year.
- Retain outsourcing of audit keeping in view the revamping and transition cost of adopting a modernised audit system. Establish rigorous pre-qualification criteria as a key improvement in the system.
- As a part of the adjudication process reform, induce greater independence in adjudication, develop a sustained specialisation

in the adjudication function, and improve the human capital and physical infrastructure for adjudication.

- To reduce pressure on adjudication, short filing, late filing, and non filing should send directly to recovery.
- Introduce the concept of advance rulings by the CBR.
- Institute voluntary disclosure to encourage voluntary settlements by the taxpayer.
- Reform the recovery process to streamline the multifarious enforcement functions, efficient mechanism of charging of additional taxes, and provide a 30 days grace period prior to which recovery will not be initiated.
- Avoid introducing tax amnesty schemes.
- Re-design the return form to capture vital information on arrears and adjudication.
- Create a networked database on adjudication, arrears and recoveries to provide essential information for control purposes.
- Develop a procedure for return rectification in the event unwarranted errors are committed.
- Develop a semi-automated pilot programme for filing of returns and tax payments initially for large tax payers, which may be extended to other tax payers at a later stage.
- Implement NTN as a common tax number on a priority basis to harmonise documentary requirements and lower the manpower usage in registration across taxes.
- Reduce the existing exemption thresholds for registration.
- To facilitate the taxpayer stay of recovery should be allowed on submission of bank guarantee.

- Make a provision in the law, which allows for a transfer of jurisdiction in the event a taxpayer shifts location.
- Make the compulsory registration process more systematic. Create a centralised national database, which captures information from sales tax, income tax and customs, utility bills, PTCL, SECP, industrial associations, and state enterprises. The selection of cases to be registered should be automated to reduce discretion. A separate register should be maintained for the same.
- Undertake measures to lower the extent of non-filing. Remove the contaminated portion of the register, and maintain a separate register for effective monitoring.
- Remove the physical infrastructure constraints with great urgency. These include building space, basic amenities and record rooms.
- Improve the task of taxpayer education by publishing booklets and brochures explaining VAT principles, procedures and practices, and methods of record keeping. The information sharing with taxpayers regarding the audit work programme would help. Arrange regular seminars with traders and industry associations. Keep CBR web site up to date with user friendly material. Reinforce business advisory committees at the Collectorate's level.

Customs

Business Process Reforms

- Make a paradigm shift from the manual system of operations and business processes to a fully automated and information based system.
- Delete redundant steps in business processes, automate elements of processes and reduce document flows therein, reduce official discretion by providing information base for the processes, and relocate steps to cut the numbers of officials involved in the processes.
- Improve business processes concerning imports. Constitute appraisement groups. Revise examination (KPT and KICT), accounting systems (cash section and personal deposit accounts) delivery (KPT), bonded warehouse (receipt and delivery system), safe transportation, transshipment permit procedures, indemnity bond (deposit and release), bank guarantee (deposit and release), and import refund procedures.
- Improve export processes concerning temporary import (SRO 818), manufacturing bond (Custom House and bonded warehouse), bank guarantee (deposit and release) temporary export, processing of bill of export, examination, rebate claims.
- Improve airport processes concerning unaccompanied baggage, immediate clearance groups, import airfreight unit, export processing and examination.

Replace the exiting system of filing of declarations on hard copies with electronic data processing system (EDPS) to effectively address the problem areas peculiar to the existing operational environment based on a manual system.

- Bonded warehouses i.e. central control, online availability of inventory of goods, sanctioning the renewal of bonded warehouses/issuance of notices/enhancement of bond value/closure of bonds/recovery of duties and taxes, access of the appraisal groups to data base of bonded warehouses, complete profile of licensees of bonded warehouses, record of entry/removal of goods from bond with time/date stamping ,
- Exports i.e. submission of electronic declarations, validation of bills of exports,
- Processing section i.e. automated allocation of bills of export to appraising officers, on-line linkage to export policy order/duty draw-back notifications, automated communication of examination instructions to the examining staff,
- Examination i.e. allocation of bills of exports to sheds/examination areas/appraising officers, automated random selection or package numbers for examination, recording of examination report, preparation of export general manifest,
- Duty draw back i.e. avoiding separate submission of duty draw back claims, automated calculation of amount of duty draw back, pre-audit of duty draw back claims, and automated remittance of duty draw back amount to exporter's bank account, etc.
- Introduce a comprehensive system of profiling and risk management based on past experience and records in respect of customs' clients and stakeholders. Develop risk management techniques to identify high risk commodities, importers/exporters, various combinations of traders and clearing agents, countries of supply and ports of transshipment, travel patterns and nationalities of smugglers, etc.

Replace the present system of positive profiling of reliable importers by a system of negative profiling.

- Simplify the duty draw back sanctioning process. It should be considered as a routine activity and end at the deputy collector level. The time frame fixed by CBR for sanctioning the duty draw back claims should be closely monitored.
- Improve the quality of adjudication and address the genuine concerns of trade and industry. Provide extensive training to the adjudicating officers and evaluate their performance based on the quality of their decisions and efficiency in disposing of their work. Enhance number of benches of customs appellate tribunal. Suitably enhance the monetary limit of Rs. 100,000 of duty/taxes for the single-member bench. Prescribe time limit for disposal of cases where goods are lying in the port area pending completion of adjudicating process.

Corruption

- Create a healthy relationship amongst the three stakeholders in the taxation system viz: GOP, CBR and taxpayers.
- As confidence building measures and to address tax payers concerns, Government must demonstrate genuine austerity at the top levels, arrange public disclosure of tax returns of ruling elite, earmark some percentage of incremental revenues for specific social sectors, and create a demonstrable linkage between revenue generation and development expenditures of an area.
- GOP should create an enabling environment through legal changes autonomy and effective supervision so as to improve its efficiency and integrity.

- Improve CBR's credibility with taxpayers through improved organisation design and human resource management along with re-engineering of income tax, sales tax and customs processes.
- Improvements in organisational and human resource management should entail:
 - maximum autonomy to the tax administration,
 - separate tax assessment and adjudication,
- Improve recruitment, training, compensation, evaluation of promotion systems, and a permanent and independent watchdog body comprising representatives from tax administration, tax payers and professionals.
- Business process reengineering should entail minimum tax payers/tax collectors interaction, simplified systems and rules, reduced discretionary powers, strengthened monitoring and accountability, and increased transparency.

Human Resource Management

- Improve the present system of recruitment, training, compensation, performance evaluation, promotion, separation and accountability.
- Reorganise the present system of pay scales of officers and staff. There should be two categories of tax administration staff: the executive group (EG) and support group (SG). The executive group will correspond to BS-17 to 22 and divided into five grades, EG-I through EG-V. The support group will correspond to BS-1 to 16 and divided into six grades, SG-I through SG-VI.
- Recruit officers in EG from among persons with demonstrated competency in areas relevant to tax administration through an

Independent Recruitment System in tax administration rather than through the FPSC.

- Recruitment examination should comprise general aptitude tests in quantitative skills (mathematics and statistics), verbal skills (English comprehension and communication), and analytical skills (understanding and reasoning). It should be compulsory to appear in two subject tests out of principles of accounting, principles of finance, micro and macro economic, business administration, public administration and fundamentals statistics, patterned on the GRE Subject Test.
- Establish a Tax Administration Academy under a Board of Management consisting of seven Members as an overall policy making body on the training programmes. The Directorates of Training for Income Tax and Customs may be merged into the Academy. The Academy would also conduct refresher courses for the serving officers.
- The major programmes and activities of the Academy would include: foundation training programme, specialised training programme, executive training programme, short courses and support group training.
- The foundation training programme for newly recruited executive group trainee officers would consist of on-campus course work, attachment with private sector organisations and synthesis, and evaluation over a period of six months.
- Specialised training programme as presently being conducted would be strengthened, particularly in the managerial and information technology areas. The training quality and resources need to be upgraded.

- Executive training programme for EG-II officers with 5-8 years of service would provide training in specialised disciplines relevant to their work.
- Advanced training programme would impart general management skills and knowledge to prepare senior managers to strategically manage their responsibilities. This would replace the present training at NIPA and PASC.
- Introduce systematic, effective and quality training for the support group of tax administration. While on-the-job training would be sufficient for SG-I – II, the SG-III to IV should be training in basic office procedures, administrative, communication and computer skills. SG-V – VI, being the front-line staff, should undergo systematic and effective training that equips them to adequately perform their duties.
- On the basis of continuous needs assessment, train selected number of employees at different national and international institutions for training in general management and leadership courses. A three year training plan is given in Table-I and II of the chapter on Human Resource Management.
- Upgrade the quality of faculty for the proposed Training Academy. Posting of officers to the Academy be given extra weight at the time of promotion. Give better monetary incentives to attract the external faculty resources.
- Encourage use of interactive methods, case situations, extensive use of information technology and audio-visual material for enhancing effectiveness of all training programmes.
- Develop objective criteria to screen out the incompetent from amongst the existing staff in BPS-1 to 16. After the

rationalisation exercise, the employees in BS-1 to 16 should be adjusted into the proposed Support Groups. Appointments to EG-III to V should be opened to competition from outside. Twenty five percent appointments in these groups should be made through an open competition to improve the in-house capacity, particularly in audit, information technology and human resource management. These appointments should be made through an Independent Recruitment System based on eligibility criteria to be determined by the restructured tax administration.

- Provide fast track promotion opportunities to good performers. At least twenty five percent posts in SG-VI and EG-III should be open for fast track promotion to internal candidates only. The independent recruitment system should assess suitability for promotion against this stream to ensure objectivity and transparency in promotion.
- Introduce a process-based system of performance management, which ties individual's performance with overall departmental and organisational objectives.
- Introduce a new Instrument for Performance in tax administration, which should replace the present ACR Performa. Major components of the proposed Performance Management Instrument include: planning performance objectives, appraisal against objectives, behavioural & trait performance dimensions, comparative performance rating, potential assessment, and identification of training & development needs. The standards for performance measurement, assessment and deadlines should

be established at the beginning of the performance year. Each section of the appraisal instrument would carry different weights.

- After the adopting of the new performance evaluation system for the first two years, the bottom ten percent employees should be put on six month probation. If the desired performance is not visible at the end of this period, their services may be terminated. Where there is an integrity issue, services should be right away terminated.
- Performance appraisal process should include its documentation, quarterly performance evaluation with regular feed back, proper job description, realistic target settings through a consultative process, and training of ratters.

Information Management

- The proposed information management systems should address matters concerning automation of business processes, creation of data bases in carrying out tax-related functions, and generation of information for control and decision making (MIS) and supporting decision making processes (DSS).
- Replace separate tax payer registration processes presently in place in CBR with a single registration process which should involve entry of a certain minimum amount of information for a registered tax payer irrespective of the types of taxes which he is liable to pay; recording of an indication of taxes which are applicable; and additional information required for each type of tax that is applicable.

- Separate processing of tax documents from audit. The former should be carried out by the data processing facilities in each tax department.
- Introduce concept of Customers Service Centres (CSC's) in all taxes to provide full range of services. Also, allow designated professional firms to provide certain functions like submission of tax returns and pass on the transaction to the CSCs.
- Introduce electronic declaration and processing system (customs) concerning import and export consignments. Necessary steps for this purpose would include simplification of document formats (single administration document). Standardise the electronic format on which documents are to be submitted, prepare software to be used by the agents/trading partners for document preparation and submission, allow agents/trading partners to submit the electronic documents either on-line or to a CSCs.
- Establish Customer Service Centres at all locations where there are significant numbers of taxpayers. These should service a minimum number of taxpayers below which division of work on functional lines would not be possible. The CSCs should be functionally responsible to the information management function within the CBR. In the initial stages of development, CSCs could continue to function within individual departments. In the longer term, CSCs at smaller locations for different taxes should be merged into single entities providing a range of services for all taxes. Each CSC should be given access to the central data base of the CBR to the required extent to perform the functions assigned to them.

- To encourage the electronic submission of data, license certain professional firms and large tax payers for submission of electronic data. They should be linked with a particular CSC both for income tax and sales tax. Service firms should be allowed data entry and validation of manual returns/submission of the electronic forms to CSCs over communication link, and facilitation of tax payment through generation of challans related to automated payments as well as payment through transfer entries.
- Strengthen technical capacity of CBR in development and implementation of standard procedures with respect to systems design and development, change management, documentation, systems deployment, quality assurance and audit, network and data security, planning and project management. Also strengthen technical manpower resources with experience of working in large information systems organisations that follow formal procedures.
- Build specific expertise to manage properly the outsourcing process and relationship, particularly for evaluating the functions to be outsourced, drawing up terms of reference for outsourcing and setting performance benchmarks, identifying suitable vendors and inviting/evaluation bids, negotiating contracts, and monitoring/reviewing outsourced contracts.

End Notes:

¹ The growth in income tax revenue is compared with the growth in non-agriculture GDP because agriculture incomes are exempt from federal income tax.

² Of the total of Rs 110 billion collected in income tax revenue in 1999-2000, current expenditure on salaries and related expenditures of the department amounted to Rs 0.95 billion. These expenditures do not include 'headquarter expenditures' i.e. expenditures at the CBR level. These amounted to Rs 0.25 billion and need to be prorated over customs, excise, sales and income tax departments.

³ In 1999-2000 the number of salaried taxpayers were 440,000 and those who filed under the self-assessment scheme were 275,000.

⁴ Examples of such countries include Turkey, South Africa, Chile, Uruguay etc.