

Final report

Pilot study on effect of political influence on tax payment compliance

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Pilot Study on Effect of Political Influence on Tax Payment Compliance

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Table of Contents

Glossary.....	2
Abstract	3
Summary.....	3
Main Results.....	3
Policy Implications.....	4
Project Design.....	4
Data	4
Introduction.....	6
Relationship between Distortionary Tax Measures and Economic Growth.....	7
Motivation	7
Project Description.....	9
Data Streams Examined for Pilot Project.....	10
Statutory Regulatory Orders (SROs).....	10
Data collection	11
Challenges Faced in Assessing SROs	14
Property-Level Survey Analysis	15
Definition of Key Variables	16
Summary Statistics	16
Preliminary Results	17
Nomination Papers of Candidates for Political Office.....	17
FBR Income Tax Directory & “Representation without Taxation” Study	19
Conclusions and Next Steps	20
Bibliography.....	22
Annexure.....	23
Appendix A1: Definitions of Key Variables (Property Tax).....	23
Appendix A2: Simple Calculation of GARV	25
Appendix A3: Exemptions	26
Appendix B: Example of Income Tax Section in Nomination Papers	30

Glossary

AOP	Association of Persons
ARV	Annual Rental Value
CERP	Center for Economic Research in Pakistan
CIRP	Center for Investigative Reporting in Pakistan
CNIC	Computerized National Identity Card
E&T	Excise and Taxation
ECP	Election Commission of Pakistan
FBR	Federal Bureau of Revenue
GARV	Gross Annual Rental Value
IGC	International Growth Centre
IMF	International Monetary Fund
MNA	Member of National Assembly
MPA	Member of Provincial Assembly
NIC	National Identity Card
NTN	National Tax Number
SRO	Statutory Regulatory Order
SDPI	Sustainable Development Policy Institute
VAT	Value-Added Tax

Abstract

Summary

Pakistan's economic growth largely depends on the provision of high-quality infrastructure and public goods that facilitate economic players in a highly competitive global economy. For this to happen, it is critical that the state's revenue-generation strategies are optimized. Constraints on these strategies have included high levels of protection, both centrally planned as well as ad hoc, instituted through Statutory Regulatory Orders (SROs) issued through the bureaucracy; and – as unofficial conversations suggest – through arbitrary tax cuts and benefits provided to citizens connected with the political and bureaucratic apparatus. It is important to unpack these distortions, the magnitude of their impact on the state's ability to collect revenue, their effects on tax morale as well as welfare effects. However, beyond larger commercial players, it is not easy to identify the universal set of direct and indirect beneficiaries of these distortions. Further, which distortions are most viable to study, or demand urgency for investigation, is not obvious at the outset. To identify opportunities in researching the issue of political connectivity and taxpayer compliance, the project team executed a pilot which was used to conduct scoping exercises on a number of different data sources, in consultation with the government.

Main Results

The key results of the pilot are:

- **The use of SROs by the government of Pakistan is waning**, under pressure by international financial institutions. While SROs have been a key distortionary instrument, the opacity of major SROs can create challenges in the identification of their direct and indirect beneficiaries.
- The universal set of **income tax** data is available in government-issued tax directories. However, it is vital for researchers to be able to identify citizens' connections to influentials. Other aspects of taxation such as **property tax collection in the Punjab province** provides fertile grounds for such exercises, with burgeoning state-compiled datasets and private research on household networks.

Policy Implications

- Political connectivity of taxpayers adversely affects the state's revenue-generation efforts through direct impacts, via tax evasion and tax avoidance, and through indirect channels such as reducing voluntary tax compliance due to erosion of tax morale of other citizens.
- The government of Pakistan is taking measures to weed out distortionary policy measures that benefit connected individuals and influential economic lobbies disproportionately, such as through the gradual rollback of existing SROs which are said to benefit specific individuals and firms, and through for example, improvements in the customs auditing and monitoring regime. However, there is significant room for improvements via other channels such as income and property taxes.
- Given the theorized impact of connections to influentials on taxpaying behavior in Pakistan and across other developing countries, it is important for governments to identify these effects and to quantify them, so as to be able to prepare appropriate policy measures to respond to them. This study sets out to explore ways in which this can be achieved.

Project Design

The pilot was conducted as a collection of multiple, parallel scoping exercises that explored the viability of utilizing different data streams to answer the question of whether (and by how much) do connections with influentials (political, military or bureaucratic) impact tax payment compliance. To this end, the project team also consulted a number of government officers, both at the Federal Bureau of Revenue (FBR) and otherwise, in official as well as off-the-record settings. These meetings also informed our scoping exercises, which focused on the following key indicators:

- Availability of and accessibility to data within a given data stream.
- Sample size and potential variation in the data.
- Transparency of data, such as the ability of researchers to identify direct and indirect beneficiaries of tax orders and policies, as well as their enforcement (or the lack thereof).
- Identification of information in data that could be used to link beneficiaries with influentials.

Data

The project exploited a number of data sources. These included: (i) publicly available Statutory Regulatory Orders (SROs) issued by the Federal Board of Revenue (FBR), Pakistan; (ii) Income Tax Directories published by the Government of Pakistan for both legislators and other citizens; (iii)

property tax data compiled by the Center for Economic Research in Pakistan (CERP) in collaboration with the Excise & Taxation (E&T) Department, Government of Punjab; (iv) property tax data maintained by the Punjab government's Urban Unit; and (v) nomination papers submitted by nominees to public offices to the Election Commission of Pakistan (ECP).

Introduction

Limits to fiscal capacity are a major constraint on growth in developing economies: the lack of ability to raise revenue hinders investment in public goods and can result in a reliance on distortionary tax instruments (Gordon and Li 2009, Best et al. 2014). This study sought to examine a potential limiting factor on the development of state fiscal capacity: the distortionary impacts of political connections on tax compliance.

Tax compliance is multidimensional: taxpayers may evade and often seek to avoid taxes, taking advantage of special waivers, exemptions, and deductions. Political connections could facilitate non-compliance on all of these margins. Tax officials may be reluctant to enforce taxes on politically connected taxpayers and may grant special tax provisions that are favourable to the taxpayers. Interviews with tax officials in a number of developing countries indicate that both mechanisms are widely prevalent. Such behaviour undermines good tax policy and administration and generates economic distortions.

Developing countries provide a natural context in which to study these issues. Evasion, including pure non-payment of owed taxes, is common: a recent study found that over 60% of members of Parliament and the Provincial Assemblies did not pay any taxes (CIRP, 2011), and survey evidence from Khan et al. (2014) indicates that connections to politicians is one factor that explains failure to pay taxes owed in the property tax context. In addition, the passage of specific tax exemptions or waivers (Statutory Regulatory Orders – SROs) was quite common until recently. These SROs are widely perceived to be driven by elite lobbying. Such measures directly impact the state's fiscal capacity, which in turn contributes to slower growth of the economy.

There is wide consensus that the political economy constitutes the structural issue behind low fiscal capacity. Studies like this are important to estimate the magnitude of tax non-compliance due to political connections. This can provide powerful evidence to policymakers to make a case for tax reforms. Tax officials privately confirm the importance of political pressures as a major constraint to taxation and thus reveal a high, implicit demand for such a study. This study is also complementary with other research projects that are currently looking into 'technical' reforms in the taxation sector by focusing on the take-up of reforms given political economy considerations.

Relationship between Distortionary Tax Measures and Economic Growth

Politically driven tax breaks (official or unofficial) present a number of challenges to economic growth. First, such policies directly reduce the tax base and resulting revenue collection. In addition, a culture in which elites receive special tax treatment could weaken tax morale and compliance more generally through perceptions of unfairness and the recognition that political elites and citizens connected to these elites are able to avoid taxes, while taxpayers that are not politically connected are expected to contribute a disproportionate share of tax revenues. Therefore, if tax policy and the enforcement of taxes are widely perceived to be subject to political pressures, the independence and general credibility of the tax authority is eroded. So while tax avoidance and evasion directly reduces revenue-generation, the subsequent erosion of the state's credibility amongst other taxpayers can cause their non-compliance, further damaging tax collection efforts by the state.

Second, preferential tax treatment to politically connected firms results in economic distortions in the economy. For example, SROs are generally believed to be highly inefficient as tax policy, resulting in both efficiency loss and administrative complexity while promoting evasion as a social norm. Passage of preferential tax provisions and selective enforcement of taxes also provides a competitive advantage to connected firms.

Third, such policies can affect economic development more broadly. For example, a World Bank (2002) report discussing development strategies in Pakistan states that: "A large share of Pakistan's private sector was content with operating behind high protective barriers and special tax privileges – rent-seeking behavior often referred to as the Statutory Rule Order (SRO) culture – or 'tailor-made privileges' – which have prevented it from reaping the benefits of integrating into world markets. This situation created an increasingly unfavorable investment climate which has constrained Pakistan's growth potential by discriminating against exports, SMEs and productivity growth in the industrial sector." While we plan to examine these issues in the context of Pakistan, similar concerns are relevant in many developing countries.

Motivation

The problem of favorable tax treatment of political elites is widely acknowledged within Pakistan. Independent watchdog reports and popular press regularly criticize the prevalence of

SROs and other special tax provisions as well as “unofficial” tax breaks received by elites through selective enforcement of the tax code. In informal interviews, tax officials almost universally confirm that they are subject to political pressure and that they would be subject to retaliation (via possible transfers to other positions/locations or removal from office) for failure to act in accordance with these political pressures.

However, while policymakers privately acknowledge the importance of such a study focusing on the politics of taxation, it is unlikely and infeasible to expect any tax official to declare explicit demand for such a project, given the politically sensitive nature of the issue. Nevertheless, domestic revenue mobilization is a salient issue in Pakistan and the Federal Board of Revenue (FBR) has taken a number of initiatives to both increase revenue collection and to reduce the distortionary impact of political connections on taxes, e.g. by committing to end SROs, by publishing an online a directory of all taxpayers, and by compiling a directory of tax payments for all legislators. Therefore, this broader project is closely aligned with stakeholder needs and its results will provide the FBR and others the evidence that they need to further curtail distortionary practices in taxation.

Moreover, there is broad consensus that political economy constitutes the structural issue behind the low fiscal capacity in Pakistan. Studies like this are important because these can estimate the magnitude of tax evasion due to political connections. This can provide powerful evidence to policymakers to make a case for tax reforms. As noted above, tax officials almost universally confirm the importance of political pressures as a major constraint to taxation and thus, reveal a high implicit demand for such a study.

This project contributes to the existing literature along several dimensions. First, although it is widely acknowledged that political considerations are central to the functioning of tax systems and tax collection in developing economies, research on this topic is scarce. On a conceptual level, standard models of optimal taxation and tax enforcement generally abstract from the incentives of those implementing tax policy. More recent work has focused on the agency problem at the tax inspector level, focusing on how elected officials (as principals) can put in place appropriate incentives for honesty and effort by tax inspectors (as agents) (Khan et al. 2014). This project explores a different type of agency problem, one in which elected officials themselves may be acting in self-interest rather than societal interest and may be engaging in rent-seeking behavior through control over the tax authority. On the empirical front, there have been few studies that have attempted to establish the causal effect of political connections on tax compliance.

Second, this project contributes to our understanding of the welfare impacts of political connections and corruption on the economy (Mauro 1995, Fisman 2001, Khwaja & Mian 2005). As discussed, politically driven tax policy often moves countries away from best practices in both tax policy and administration, potentially resulting in large economic distortions. For example, countries may start with a simple, single rate VAT that quickly becomes differentiated through myriad special rates and exemptions. Such behavior can also result in market inefficiency by providing a competitive advantage to connected – but potentially less productive – firms. Tax preferences to elites will also have distributional consequences, likely shifting both the de jure and de facto tax burden toward poorer firms and households.

Finally, the context of taxation provides a window on to broader political economy questions. A number of studies have now documented positive effects of political connections on firm performance (e.g., Fisman 2001, Jayachandran 2006, Knight 2006, Acemoglu et al. 2014), but direct evidence on underlying channels is much more limited (see Akey 2013 and Faccio et al. 2006). While there are papers that examine political interference and favorable treatment of (politically) connected firms during the financial crises (Mian et. al. 2010, Igan et. al, 2011, 2014), to the best of our knowledge, no previous study has demonstrated that political connections can result in the passage of tax laws that are favorable to the connected firm or individual. The pilot has been used to ascertain the feasibility of answering such questions, in the context of a developing country such as Pakistan.

Project Description

Specifically, we attempt to examine the effects of political connections on taxpayer compliance. Given the complex channels through which these distortions impact tax compliance, and the expected difficulty of developing data sources to examine these distortions, this study was utilized as a pilot. The pilot had a less ambitious agenda of exploring multiple data sources and ascertaining their feasibility for further examination.

An analysis of the impact of political connections on taxpaying behavior is dependent on tax and identity data, both of which can be highly sensitive and confidential. This is one of the most significant constraining factors faced by the study and the reason why we opted to begin with a pilot to assess the viability of using different data sources. However, before analyzing different data sources, we set out to construct frames for multiple tax instruments, their legal bases and

corresponding rules that are used to compute tax liability of the citizens. Some of the specific indicators that we looking at in the context of different data sources were public availability, transparency in terms of identifying beneficiaries, and verifiability. We found urban property taxes in the Punjab to be a high-potential data source, with certain constraints which will be discussed later in the report. Feasibility of other key instruments that we assessed were Statutory Regulatory Orders (SROs), income tax and nomination papers with the Election Commission of Pakistan (ECP). Using these instruments, we want to be able to analyze the causal impact of political connectedness on a variety of tax outcomes, including (1) overall tax payment; (2) use of “grey area” tax exemptions and deductions; and (3) benefit from special tax provisions and waivers.

The next section highlights the progress that we made in examining other data sources, together with constraints faced. This will be followed by our conclusions drawn from the study, as well as a discussion of next steps.

Data Streams Examined for Pilot Project

The project team assessed the viability of working with the following major data sources:

- 1) Statutory Regulatory Orders (SROs)
- 2) Property tax data from Punjab province
- 3) Nomination papers submitted to the Election Commission of Pakistan (ECP)
- 4) FBR Income Tax Directory and CIRP’s “Representation without Taxation” study

Statutory Regulatory Orders (SROs)

Statutory Regulatory Orders are an instrument of taxation that allow the Federal Bureau of Revenue (FBR), Pakistan to bypass the Parliament in issuing taxation orders related to sales tax, income tax, federal and excise duty as well as customs duty. While allowing FBR the flexibility to respond to economic issues more quickly, the circumventing of the parliament significantly reduces transparency of the tax and tariff regime in Pakistan. Under the advice of the World Bank and the IMF, the Government of Pakistan has been in the process of rolling back historical SROs, and reducing the issuance of new orders.

More specifically, SROs can be initiated by the FBR for Customs as well as Inland Revenue. Inland Revenue consists of Income Tax, Sales Tax and Federal Excise. Notifications related to

active SROs are available online on the FBR website. During the pilot, the project team collected all publicly available SROs. We were guided during this process by officials at the FBR. While access to the publicly available SROs is not a constraint, their relation to different industrial, commercial and political lobbies as well as interest groups is not straightforward. The difficulty of doing so is a function of opacity of the language of some SROs, as well as the need for institutional knowledge to understand the relation of SROs to specific interests, especially when beneficiaries are broadly defined in the SRO.

To guide our preliminary research, the project team set out to do the following:

1. Collecting all SROs available online.
2. Collecting SROs available with publishers.
3. Conducting a gaps assessment for the universal set of SROs.
4. Identifying “smoking guns” in SROs, where there was potential to match beneficiaries of SROs with lobbying efforts.

Data collection

The aim of the SRO data collection exercise was to undertake an exhaustive search of the FBR database which is publicly available online at <http://www.fbr.gov.pk/SROs.aspx>. There are two broad classes of levies for which SROs can be issued:

1. Customs
2. Inland Revenue

Further, Inland Revenue is divided into (i) Income Tax, (ii) Sales Tax and (iii) Federal excise. For each of these categories and subcategories, we wanted to see how many SROs were available online, and whether the number of SROs that have been issued and are publicly available, has increased, decreased or generally remained constant across time. We expected the number to show a downward trend since the government has been under intense pressure in more recent years from donors such as the World Bank to rationalize the SRO regime. This exercise is important to see if we even have a critical mass of SROs to work with, in terms of sample size for identifying the impact of having political connections on being granted tax benefits through these SROs.

We find that after peaking in 2006, the number of SROs has shown a sharp downward trend, driven by a drop in the number of sales tax-related SROs issued. The levy which produced the most SROs overall is sales tax. Since 2010, almost an equal number of SROs have been issued for sales tax and income tax. The trend in SRO issuance and the actual number of SROs per year per category is provided below. What is clear is that while the issuance of SROs has declined, it has not halted by any means.

Figure 1

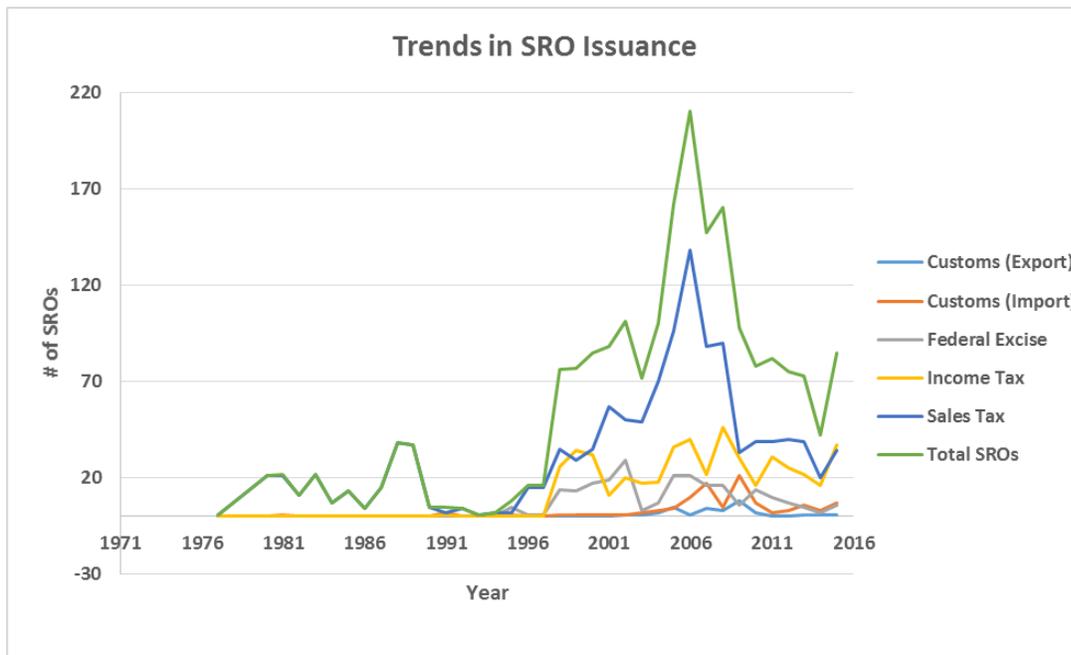


Table 1

Year	Customs (Export)	Customs (Import)	Federal Excise	Income Tax	Sales Tax	Total SROs
1977	0	0	0	0	1	1
1980	0	0	0	0	21	21
1981	0	1	0	0	21	22
1982	0	0	0	0	11	11
1983	0	0	0	0	22	22
1984	0	0	0	0	7	7
1985	0	0	0	0	13	13
1986	0	0	0	0	4	4
1987	0	0	0	0	15	15
1988	0	0	0	0	38	38
1989	0	0	0	0	37	37

Year	Customs (Export)	Customs (Import)	Federal Excise	Income Tax	Sales Tax	Total SROs
1990	0	0	0	0	5	5
1991	0	2	0	1	2	5
1992	0	0	0	0	4	4
1993	0	0	0	0	1	1
1994	0	0	0	0	2	2
1995	0	1	5	0	2	8
1996	0	0	1	0	15	16
1997	0	0	1	0	15	16
1998	0	1	14	26	35	76
1999	0	1	13	34	29	77
2000	0	1	17	32	35	85
2001	0	1	19	11	57	88
2002	1	1	29	20	50	101
2003	1	2	3	17	49	72
2004	2	3	7	18	70	100
2005	5	4	21	36	96	162
2006	1	10	21	40	138	210
2007	4	17	16	22	88	147
2008	3	5	16	46	90	160
2009	8	21	6	30	33	98
2010	2	7	14	16	39	78
2011	0	2	10	31	39	82
2012	0	3	7	25	40	75
2013	1	6	5	22	39	73
2014	1	3	2	16	20	42
2015	1	7	6	37	34	85
Total	30	99	233	480	1,217	2,059

During the scoping exercise, the project team found multiple amendments for a large number of customs (imports)-related SROs. We decided to study these amendments to figure out if proposed changes were minor, or worth counting as additional SROs. We found that on average, these changes were minor, and supplementary to previously issued SROs. Therefore, we excluded such amendments from the data provided above. For amendments which served as significant policy measures, we captured them and added them to our compiled list of SROs. For a better understanding of these SROs, we have provided multiple examples of different kinds of amendments within Customs (imports). We observed that:

- For exemptions-related SROs, the amendments usually specify certain words to be added, omitted or substituted in specific clauses. These mostly relate to the technical aspect of a good such as in the SRO 678(I)/2004 regarding exemption of duty and taxes on machinery and vehicles for exploration and production companies, a subsequent amendment specifies the type of the vehicle exempt from duty.
- Some of the amendments relate to changes in the HS (Harmonized System) codes of the goods which suggest that there is not much change in the main gist of the original SRO.
- A few of the amendments only specify a new amount or rate of exemption, not affecting the class of goods covered by the SRO. For instance, exemption SRO577(I)/2005 regarding duties imposed on second hand vehicles from Asian markets has a number of subsequent amendments and most of these specify a new amount above which duty is exempt while the others make only minor changes in the clauses.
- In amendments to SROs regarding imposition of duties and taxes on certain goods, the changes involve addition or omission of a few goods or minor changes in the duty or tax rate. However, in some amendments a large number of goods are added which can make the amendment markedly different from the original SRO. For example, SRO 568(I)/2014 contained 313 goods while the amended SRO 1177(I)/2015 contained 400 goods on which duties were imposed.
- For some SROs, the tables containing goods on which duties are levied are updated in subsequent amendments, however, the original SRO on the FBR website mentions the amendments and does not have the original table of goods. In such a scenario it will be difficult to ascertain how the amended table is different from the original.

Challenges Faced in Assessing SROs

While a large number of SROs issued through the late 1990s up until now are available online, the FBR has not uploaded all SROs generated before that time. In order to acquire these SROs, the project team, in consultation with the FBR, reached out to multiple publishers. These included Huzaima & Ikram, SA Islam, Mohammad Arshad and Tariq Najib. However, none of these publishers has a complete compilation of all SROs within all categories. Most hold compilations of one of two categories, and mostly for 1990 and later. For example, Tariq Najeeb has the ability to provide books containing most SROs for Customs, Sales and Excise from 1990 onwards, but not for Income tax. They also have some SROs for a few prior years, but these do not form the universal set of all SROs issued during that time.

Even for SROs that were available, the binding constraint was the difficulty of seeing through an SRO to unpack how interest group pressure might have caused the creation or amendment of the SRO. This challenge cannot be emphasized enough, since it is a major impediment in building a database which can be used to examine the link between assignment of an individual or firm as a beneficiary of the SRO, with that individual or firm having political connections which caused – or at least encouraged – the creation of that SRO. The project team is currently making further efforts to ascertain if such institutional knowledge can be developed and deployed for an informed analysis of existing SROs, which provides useful insights into their background.

Property-Level Survey Analysis

We focused on property taxes as an outcome measure, comparing payment and liability rates across groups with and without connections with influentials such as politicians, bureaucrats or army/police officers. The aim was to see if having these connections changed taxpaying behavior.

The target area is the Punjab in Pakistan, a province which is home to an estimated 100-million people. We use property-level data collected during a survey conducted by the Center for Economic Research in Pakistan (CERP) in 2013, in collaboration with the Excise and Taxation (E&T) Department of the Government of Punjab, as well as data collection partners RCons. Representative data was collected for 480 circles across all 11 divisions of Punjab, with 25-35 properties in every circle being randomly sampled and surveyed during the exercise. In total, we have data on 16,354 properties.

For this sub-analysis, we wanted to answer two broad questions:

1. For a constant level of officially registered tax liability, do property owners with political connections pay less than property owners with no political connections?
2. For a constant level of actual, computed demand, do property owners with political connections succeed in reducing the level of registered tax liability?

The first question deals with issues related to tax evasion, whereby, property owners might bargain with the inspector to reduce what they have to pay on the amount that is due to the state. This partial or complete evasion of property taxes will increase arrears on taxes. Individuals who do

not pay property taxes are known in the department as “chronic defaulters”. We try to assess if property owners with political connections are more likely to evade taxes.

The second question deals with the issue of how property owners might bargain with inspectors to reduce and misrepresent the tax liability on the property in the official tax registers. This is a more subtle process of tax avoidance, whereby, property owners might bargain with tax inspectors during the assessment phase to suppress the baseline tax liability to begin with, using incorrect categorization of property class, size or exemption status. This is a significant issue within the department and is commonly referred to as “suppression”. We tentatively measure if property owners with political connections are more likely to indulge in this behavior.

Definition of Key Variables

Key indicators used in this analysis include gross annual rental value (GARV) of the property; tax liability on the property; tax payment against different liability measures; property class of the property; residential/non-residential status of the property; and connections of property owners with politicians, bureaucrats and/or police/military officers. A detailed explanation of these variables, their definition and use is provided in Annex A1. Further, Annexes A2 and A3 provide a detailed explanation of the rules surrounding the computation of GARV and enforcement of exemptions, respectively.

Summary Statistics

After data cleaning and dropping of identifiable outliers, summary statistics for the final dataset were generated. These are provided in the table below:

Table 2: Summary Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Property Category	14738	3.75	1.54	1	7
GARV (Computed)	14738	27743.22	44795.10	0	396522
GARV (PT-8)	13978	24520.79	38108.69	0	351840
Liability (Computed)	14738	4839.35	9450.93	0	84831.55
Liability (PT-1)	13949	4959.13	8351.76	0	74993
SR_payment	15215	3496.41	6348.65	0	51400
Last Payment (PT-8)	9112	3351.12	6468.60	0	58420
% Suppression (Liability)	12898	-10.15	61.06	-100	100
% Suppression (GARV)	13827	6.24	40.89	-100	100
connect_any	15216	0.35	0.48	0	1

No. of connections	15216	0.51	0.79	0	3
At least one connection	15216	0.35	0.48	0	1
Connection (Politician)	15216	0.05	0.21	0	1
Connection (Bureaucrat)	15216	0.22	0.41	0	1
Connection (Police/Army)	15216	0.24	0.43	0	1

Preliminary Results

Our preliminary results are sensitive to robustness checks. For basic specifications where we regress outcome variables such as tax payment and suppression (difference between what taxpayers' liability should be as computed by the government, compared to what it actually is), we find that payments and suppression actually increase when property owners are connected with influential. However, once we control for characteristics such as property class type (the value class of the property), property type in terms of residential versus non-residential and districts, the estimated impact of having connections on taxpaying behavior fluctuates.

Given that the aim of the pilot was to examine different data sources that could be used for a full-scale assessment of the impacts of political connections on taxpaying behavior, this data source has emerged as the most promising. The principal investigators are currently going beyond the scope of the project to conduct in-depth analysis, comparing results obtained from different intervals of the data to see if heterogeneity of estimated impact across different socioeconomic groups can be teased out. A key aim of this exercise is to ensure that the data is stable and provides consistent, robust estimates across a range of appropriate specifications.

Nomination Papers of Candidates for Political Office

Nomination papers are available publicly on the Election Commission of Pakistan (ECP) website. These nomination papers have been scanned and uploaded on the website, so they have to be digitized first before they can be analyzed. Also, scans of some nomination papers might not be legible, leading to the need to send formal requests to the ECP for these nomination papers. Nomination papers provide basic information about candidates, as well as self-reported information on total income, source of income, income tax paid, landholding, agricultural income and tax paid against this income. This information is supposed to be available for the 3 years preceding the year of the election cycle. The nomination papers also contain the nominee's statement of assets and

liabilities. These nomination papers are submitted by candidates for elections at all levels: local, provincial and federal. The data includes information on identifiers such as NIC and NTN numbers, names, father's name; sources of income; land holdings and financial statements. While self-reported, the types of data found in these nomination papers would have been valuable to set up benchmarks for taxpaying behavior with additional controls. Two examples of income tax information in these nomination papers are provided in Annex B.

However, the scoping exercise for ECP data was not without its challenges. Scanned nomination papers are only available for 2013. The following table provides an election cycle-wise, summary break-up of the availability of nomination papers which can be acquired without requests for information being made to the ECP:

Table 2

Election Cycle	Information Available	Nomination Papers Status
General Elections 1970	List of returning candidates for national assembly available for East and West Pakistan.	Nomination forms are not available
General Elections 1977	List of returning candidates for national assembly available.	Nomination forms are not available
Results 1988-1997	Contains list of successful candidates to the national and provincial assemblies.	Nomination forms are not available
Members of National Assembly 1972-1997	List of the names of the MNA's from 1972-1997	Nomination forms are not available
General Elections 2002	Lists of contesting candidates are available for national and provincial assemblies along with the result details.	Nomination forms are not available
General Elections 2008	Lists of contesting candidates, results and party position are available. Lists of seats reserved for women and minorities are available separately.	Nomination forms are not available
General Elections 2013	Detailed lists about results, reserved seats notification, nomination forms and other statistics are available.	<i>Nomination forms are available.</i>
Senate Elections	Data for 2009 and 2012 is available only. Information about contesting candidates and senate party position	Nomination forms are not available.

is available.

In order to acquire this missing data, a “Request Under Freedom of Information Law” can be submitted to the ECP. This takes approximately 21 days to be processed, but the ECP does not usually hand over neatly packaged documents. Even after receiving approval for the request, the team will need to go through the ECP’s archives to collect the relevant data. Given these constraints and our simultaneous assessment of a number of other data streams, we decided to park this data source temporarily, given the difficulty of acquiring data through it.

FBR Income Tax Directory & “Representation without Taxation” Study

The Federal Bureau of Revenue publishes an annual Income Tax Directory for all elected members of the senate, national assembly and each of the provincial assemblies. The project team reviewed the directories published in 2014 and 2015. The directory is compiled by the FBR using information from tax returns filed both manually and electronically.

Variables on which data is provided include:

1. Constituency
2. Name
3. CNIC
4. Tax Paid
5. Tax Paid by AOPs in which taxpayer is a member

Further, the Center for Investigative Reporting in Pakistan’s (CIRP) “Representation without Taxation” study collected information on elected individuals’ income tax returns using the following sources:

- 1) Information collected directly from Members of the National Assembly (MNA)
- 2) Nomination papers acquired from ECP
- 3) FBR website
- 4) Information request submitted to FBR for residual MNAs

The study’s data covers income tax returns for all members of national and provincial assemblies who won the election in 2013. Data is available on names; the status of the office holder (MNA or senator); constituency; political party name that office holder is affiliated to; amount of tax paid; NTN and CNIC.

The report's examination of nomination papers submitted in 2010 found that 61% of parliamentarians and members of provincial assemblies did not pay any income tax. Further, 51% of all sitting senators were also found to have not paid any income tax. These poor numbers are highly discouraging, and point to an even more urgent need to assess the impact of being politically connected on revenue generation, or the lack thereof. Both of these data and analytical sources were used to inform our understanding of taxpaying behavior across political elites in Pakistan, which in turn allowed us to think about how direct and indirect connections with these elites could also cause tax suppression across the citizenry.

Conclusions and Next Steps

This exercise was critical in gaining insights into the viability of using a number of different data streams for teasing out the impact of having political connections on taxpaying behavior. Major data sources that were explored included FBR records of income tax payment by citizens and their representatives, information on SROs in circulation, and property tax data from Punjab province.

None of these information streams come without their challenges. Linking individuals across different panels is a constraint, due to a number of reasons. On the one hand, it is difficult to delineate cleanly the beneficiaries of SROs. On the other, individuals for whom specific data on tax payments together with identifiers in the form of CNIC numbers is available – as is the case in the government tax directories – it can be difficult to ascertain their connections to politicians, both at the extensive as well as the intensive margins.

However, the exercise provided important lessons on how some of these challenges could be circumvented. At a time when the government is rationalizing its use of SROs as a discretionary taxation instrument, as well as rolling back past SROs, the urgency of looking at these distortionary policy measures is decreasing. In the meantime, property tax reform in large regions such as the Punjab have increased even further, the significance of property taxes as instruments of revenue-generation. In 2015, the Punjab government began rationalizing property tax rates that had been stagnating for more than two decades. Concomitant to this, the Punjab government digitized its urban property tax systems, creating tremendous opportunities for the government to work with researchers to fine-tune policymaking.

Such burgeoning data sources, together with active research in the area being conducted by organizations such as the CERP allows for a fertile environment to explore more subtle relationships between taxpayer connectivity to influential and tax payment compliance. Even beyond the completion of the pilot, this area is currently being unpacked to set up an analytical framework that can exploit these research opportunities.

The next steps would involve utilizing data streams such as the Punjab property tax database, together with existing data from the 2013 survey on property owners' connections to influentials as well as new data collected on household networks to assess how the rationalization of property tax rates by the Punjab government has interacted with political connectivity to affect the taxpaying behavior of the citizenry. Further, we will be exploring avenues to unpack the connections of SROs in our data with specific beneficiaries and exploring potential lobbying activities that preceded the issuance of these SROs.

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Annexure

Appendix A1: Definitions of Key Variables (Property Tax)

GARV (PT-1): The urban property tax in Punjab is levied on the Gross Annual Rental Value (GARV) of the property, which is computed by formula. Specifically, the GARV is determined by measuring the square footage of the land and buildings on the property, and then multiplying by standardized values from a valuation table that depend only on the property location, use, and occupancy type. These valuation tables divide the province into seven categories (A to G) according to the extent of facilities and infrastructure in the area, with a different rate for each category. Rates further vary by residential, commercial or industrial status, whether the property is owner-occupied or rented, and location (i.e. on or off a main road). The tax is calculated by applying the appropriate multiplier to the size of the land and buildings on the property. A simple example of calculation of GARV is provided in appendix A. For each surveyed property, the GARV was noted from the PT-1 – a register or book maintained by E&T inspectors and their staffers, in which these calculations are done and the value of the GARV officially noted. GARV (PT-1) is in PKR amounts.

GARV (Computed): The difference between this variable and GARV (PT-1) is that while the latter was recorded from official tax registers, we constructed the former by computing the GARV in-house, using data collected on all the characteristics and the multipliers that were being used by the Punjab government as of 2013-14. As a side note, these multipliers were dramatically rationalized in 2015. However, this change does not impact our analysis. GARV (computed) is in PKR amounts.

Tax Liability (PT-8): This is the actual amount that citizens have to pay. Data for this variable was recorded using information in the PT-8 register (another register used by tax inspectors and their staff to record final tax liability and payment data). It is calculated using the GARV. This includes 2 steps. Firstly, an adjustment for depreciation of the property is made. GARV scaled down and converted into Annual Rental Value (ARV) by multiplying GARV by a factor of either 0.9 (if

the property is less than 10 years old - *check years*) or 0.85 if the property is older. Secondly, if ARV < PKR 20,000, then tax liability is calculated as tax liability = ARV*0.20. If ARV > PKR 20,000, then tax liability = ARV*0.25. Also note that exemptions are a distortion which place constraints on the amount of tax that the government can collect. Exemptions reduce or eliminate tax liability for property owners. They are granted to widows, the disabled, owners of plots below 5 marlas (about 125 square meters), retired federal and provincial government employees and religious charitable institutions. A detailed explanation of exemptions is provided in appendix A. Tax liability (PT-8) is in PKR amounts.

Tax Liability (Computed): This is the same as above, except that the values for each observation were calculated by us, using data on property characteristics and ownership that was collected during the survey. Tax liability (computed) is in PKR amounts.

Last Tax Payment (PT-8): This variable gives information on the amount of the most recent tax payment during 2012-13, as recorded by the E&T staff in the PT-8 register. Recall that tax payment is made against the tax liability, not GARV. Last Tax Payment (PT-8) is in PKR amounts.

Last Tax Payment (Survey): This is self-reported data on the amount of the tax payment in 2012-13. Simply, this is the amount that property-owners cited when asked by enumerators as their most recent tax payment. Last Tax Payment (survey) is in PKR amounts.

Pct Suppression in GARV = $100 * (\text{GARV_computed} - \text{GARV_PT1}) / (\text{GARV_computed} + \text{GARV_PT1})$. So in this case, a value of 100 means we had full suppression – owner paid 0 when he/she was supposed to have paid something +ve) & -100 means owner is seriously overpaying.

Pct Suppression in Liability = $100 * (\text{liability_computed} - \text{liability_PT8}) / (\text{liability_computed} + \text{liability_PT8})$. So in this case, a value of 100 means we had full suppression – owner paid 0 when he/she was supposed to have paid something +ve) & -100 means owner is seriously overpaying.

Suppression in GARV (Categorical): This is a categorical variable, taking a value = 1 when pct suppression in GARV > 20%, value = -1 when GARV < -20% and 0, otherwise. The 20% is arbitrary, but informed by an earlier exercise that we conducted for the department when we tested the impact of the rationalization of the tax rate – we suggested that errors within 20% be ignored by the department.

Suppression in Liability (Categorical): This is a categorical variable, taking a value = 1 when pct suppression in Liability > 20%, value = -1 when Liability < -20% and 0, otherwise. The 20% is arbitrary, but informed by an earlier exercise that we conducted for the department when we tested

the impact of the rationalization of the tax rate – we suggested that errors within 20% be ignored by the department.

Connections: This is a vector of variables indicating different types, and *magnitudes* of connections with power holders. These include (1) politicians, (2) bureaucrats and (3) police and army officers.

- Number of Connections: Out of these three, how many are property-owners connected to.
- Any Connections: Dummy = 1 if respondent is connected to *at least one* type of power holders.
- Connection-Politician: Dummy = 1 if respondent is connected to a politician.
- Connection-Bureaucrat (connect_officer): Dummy = 1 if respondent is connected to a bureaucrat.
- Connection-Police or Army Officer: Dummy = 1 if respondent is connected to a police/army officer.

Other Controls

- *Class of property:* Properties are divided into 5 classes (A, B, C, D & E) with A being the most valuable and E being the least valuable, so to speak. These are official classes used by the Punjab government to ascertain the tax multiplier to be used in the calculation of the property.
- *Class*Connection:* Interaction term between property class and the respective connection variable.
- *Residential dummy:* This is a dummy = 1 when a property is in residential use. 0 otherwise.
- *Residential*Connection:* Interaction term between residential dummy and connection variable.
- *District Dummy:* These are dummies for each of the districts. For most regressions, these are omitted because of perfect multicollinearity. This is because they're fixed within each of our clusters.
- *District*Connection:* Interaction term between district dummy and connection variable.
- *Tercile dummies:* These are dummies for whether a property, by virtue of its GARV, is in the top, bottom or middle 33%.
- *Tercile*Connection:* Interaction term between tercile dummy and connection dummy.

Appendix A2: Simple Calculation of GARV

Property description:

- Main Road
- Category A
- Residential Self Occupied
- Land Area = 500 Sq. Yards

- Covered Area = 2250 Sq. Feet
- Single Story

Step 1 (Valuation Table):

Land Area	= 500*0.4 =	200
Covered area	= 2250*0.4=	900
Total	=	1100

Step 2 (GARV):

$$\begin{aligned} \text{GARV} &= \text{Total} * 12 \\ &= 1100 * 12 \\ &= 13200 \end{aligned}$$

Step 3 (ARV)

$$\begin{aligned} \text{ARV} &= \text{GARV} * 0.9 \\ &= 13200 * 0.9 \\ &= 11880 \end{aligned}$$

Step 4 (Tax Liability):

Important Note:

- ***When ARV is Less than Rs. 20,000 (ARV < 20,000), Tax liability = ARV*0.20***
- ***When ARV is Greater than Rs. 20,000 (20,000 < ARV), Tax Liability = ARV*0.25***

$$\begin{aligned} \text{Tax Liability} &= 11880 * 0.20 \\ &= 2376 \end{aligned}$$

Appendix A3: Exemptions

The exemptions are broadly divided into two different categories, exemptions that are based on the ‘owner of the property’ and exemptions that are based on the ‘type of property’. There is also an exemption for the age of the property and the time of the year in which tax is paid, this is explained at the end.

Owner Exemptions¹:

¹ Punjab Urban Immovable Property Tax Act, 1958

- These exemptions are allowed under Section 4 of the 1958 Act. The most common being under Section 4 (G) which allows exemptions for Widows, Minors and Orphans. Exemptions under Section 4 (G) and (GG) require an order that allows the exemption and states the amount exempted. The exemption is recorded in the PT-8 by a stamp which states the section it falls under.
- The total Tax liability (Annual Value Assessed on the PT-8) is first calculated and then a revised value (Tax Demand) is written after the exemption. The pictures in the folder show this.
- I'll go over these one by one:
 1. (a) Owned by the federal Government. Completely Exempt. (These are usually not included in Gross Demand)
 2. (b) Owned by Government of Punjab or Local Government. Completely Exempt (These are not usually included in Gross Demand)
 3. (c) Any Property who's ARV doesn't exceed Rs. 1,080 for commercial properties and Rs. 1,620 for residential properties. Completely Exempt
 4. (d) Any school owned by the Government. Completely Exempt
 5. (e) Public Parks, Play grounds and Libraries. Completely Exempt
 6. (f) Religious institutions, Graveyards, etc. Completely Exempt
 7. (g) Widows, Minor's and Orphans. This is tricky. **These people are exempt up to a liability of Rs. 12,150 or ARV Rs. 48,600. If the liability is higher than this amount they are only taxed for the amount over and above this.**
 8. (gg) Retired Government Official up to land area 500 Sq. Yards. **Important point here is that in case the property is 600 Sq. Yards for example, they will be taxed for the entire 600 Sq. Yards, in that case there is effectively no exemption. This makes it different from (g) above. It's also important to mention that not all inspectors apply it this way but this is what the law says.**
 9. (h) Self Occupied Residential under 5 Marla in Katchi Abadi. Completely Exempt (these are usually not included in gross demand)
 10. (i) Residential under 5 Marla. Completely exempt (these are usually not included in gross demand)

Type of Property Exemptions:

- These exemptions are more complex and are explained here
 1. Plazas or multi storied buildings. There is a 10% exemption for each floor, above and below the Ground Floor and up to a maximum of 50%. The deduction is made after the tax liable. **It is important to remember that for each floor the land area is calculated separately not just for the ground floor. Hence the Land Area should be included for each floor. This effects GARV**

Property Description:

Main Road

Category A

Land Area = 250 Sq. Yards

Covered Area per floor = 2250 Sq. Feet

Commercial

Rented

4 Floors

Floor 1:

Land Area Ground Floor	= 250*12	= 3000
Covered Area Ground floor	= 1500*12 + 750*10	= 18000 + 7500 = 25500
GARV	= 25500*12	= 306000
ARV	= 306000*0.9	= 275400
Tax Liabile	= 275400*0.25	= 68850

Floor 2:

Land Area Ground Floor	= 250*12	= 3000
Covered Area Ground floor	= 1500*12 + 750*10	= 18000 + 7500 = 25500
GARV	= 25500*12	= 306000
ARV	= 306000*0.9	= 275400
Tax Liabile	= 275400*0.25	= 68850
Exemption	= 68850*0.9	= 61965

Floor 3:

Land Area Ground Floor	= 250*12	= 3000
Covered Area Ground floor	= 1500*12 + 750*10	= 18000 + 7500 = 25500
GARV	= 25500*12	= 306000
ARV	= 306000*0.9	= 275400
Tax Liabile	= 275400*0.25	= 68850

$$\begin{aligned} \text{Exemption} &= 68850 * 0.8 \\ &= \mathbf{55080} \end{aligned}$$

Floor 4:

$$\begin{aligned} \text{Land Area Ground Floor} &= 250 * 12 &= 3000 \\ \text{Covered Area Ground floor} &= 1500 * 12 + 750 * 10 &= 18000 + 7500 \\ & &= 25500 \end{aligned}$$

$$\begin{aligned} \text{GARV} &= 25500 * 12 \\ &= 306000 \end{aligned}$$

$$\begin{aligned} \text{ARV} &= 306000 * 0.9 \\ &= 275400 \end{aligned}$$

$$\begin{aligned} \text{Tax Liable} &= 275400 * 0.25 \\ &= 68850 \end{aligned}$$

$$\begin{aligned} \text{Exemption} &= 68850 * 0.7 \\ &= \mathbf{48195} \end{aligned}$$

Total Tax Liable

$$\begin{aligned} \text{Floor 1} &= 68850 \\ \text{Floor 2} &= 61965 \\ \text{Floor 3} &= 55080 \\ \text{Floor 4} &= 48195 \\ \mathbf{\text{Total}} &= \mathbf{234090} \end{aligned}$$

2. Seasonal Use properties. This is simple; there is a 50% reduction in the tax liable. This is mostly for industrial properties and should be careful that industrial rates are applied when such properties come about. This is Annex 3 in the World Bank report. **It is also important to mention that all inspectors do not apply this! They just charge for the entire year**
3. Buildings and lands used for office and private educational institutions are taxed a residential rate + 50% on **GARV**. This one is slightly tricky. If a person has opened an office in his house then this rate applies. **However if his office is in a commercial plaza or market then a full commercial rate is applied.** Commercials markets or plazas are usually identified by the presence of a Steel Shutter in front of the property. **This information should also be included in the next round of the survey.**
4. Hotels. This one is also confusing and there have been some recent court cases on this as well. I'll elaborate on this one later
5. Private Hospitals, Marriage halls, cinemas, petrol pumps etc. There isn't really an exemption here, just a clarification that every part of these properties will be included

6. Industrial Units: These are taxed the same rate as residential properties maintaining the differentiation of self vs. rented and main road vs. off main road. The category is the same as what is assigned to the area. The valuation table for industrial properties **has not** been put into practise.
7. Agricultural lands: don't come directly under property tax
8. Godowns / Warehouse. They are applied a commercial rate and then given a reduction of 50% on the final tax liable.

Age of Property Exemption:

- This is a simple exemption that is actually used to calculate the ARV from the GARV. Para 29 of the World Bank paper explains it pretty well. It comes under section 5 of the 1958 Act.

Time of Payment:

- There is an exemption of 5% if tax is paid in the first quarter.
- Every month after that there is a penalty of 1%.
- Since this is a new rule there is no agreed upon way of recording this in the register. Ideally there should be a new tax liable for each month.

Appendix B: Example of Income Tax Section in Nomination Papers

Example 1: Sardar Ayaz Sadiq, MNA from NA-122

12. The income tax paid by me during the last three years mentioned above.

Total Income Rs.	Source of Income	Tax Year	Total Income Tax Paid
2482263	SALARY & PROFIT	2010	129515
3032169	"	2011	184500
2944280	"	2012	177098

Note 1: Attach copies of income tax returns of the years mentioned above.

**If more than one sources of income, attach detail. ATTACHED

13. How many times traveled abroad during last three years and cost incurred thereon. (Attach copy of the passport and detail of expenditure).

14. The agricultural income tax paid by me during the last three years is given below:

Tax Year	Land Holding	Agricultural Income	Total Agricultural Income Tax Paid
		NIL	

... of the last three years mentioned above.

Example 1: Muhammad Hamza Shabbaz Sharif, MNA from NA-119

12. The income tax paid by me during the last three years is given hereunder:-

Total Income	**Source of Income	Tax Year	Total Income Tax Paid
22,662,582	AS PER ANNEX-E	2012	3,526,195
11,148,639	AS PER ANNEX-E	2011	2,316,356
10,082,933	AS PER ANNEX-E	2010	2,016,257

Note 1: Attach copies of income tax returns of the years mentioned above. (Annex F & G)
 **If more than one sources of income, attach detail.

13. How many times traveled abroad during last three years and cost incurred thereon. (Attach the passport and detail of expenditure) (Annex F & H)

14. The agricultural income tax paid by me during the last three years is given below: (Annex I)

Tax Year	Land Holding	Agricultural Income	Total Agricultural Income Tax Paid

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