Domestic Resource Mobilisation

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State of revenue & task

- **Revenue has grown at a healthy 14% which is higher than nominal rate of growth – yet overall revenue-GDP ratio remains stuck at 11% and NBR-Tax-GDP at 9% only**
- **Two major tax reforms in 1980s and early 1990s followed studies by Government along with WB and IMF and scrutiny by committees headed by former secretaries / chairman of Tariff Commission and NBR, indicating <u>government ownership</u>**
- **Resource mobilization by tax shouls look at economic impact also.**

Customs Duty & para-tariff

- The reforms in early 1990s reduced nominal protection (25%) which has remained unaffected.
- The mid-range rates have been split and calibrated to help primarily import of industrial raw materials and intermediates
- VAT and SD rates have been varied and applied contrary to trade neutrality,
- para-tariff measures have been imposed
- together these have raised actual level of protection, besides increasing revenue

Value Added Tax (VAT)

- **The character of VAT as a consumption tax at 15% to be applied uniformly and in trade neutral fashion diluted by adopting truncated base, generous exemptions, imposition at import or production stage but not at retail stage (cases are too few still), variable rates and imposition contrary to trade neutrality for protection of domestic industry**
- **Other weaknesses are poor record keeping by business – many businesses cannot afford – deficient audit capability of VAT administration, and absence or weak credit mechanisms. VAT has become virtually excise duty at variable rates and been used freely for protection**
- **Reforms of VAT warrant retrieving its integrity as consumption tax, strengthening record keeping and audit capability, revisiting the rate coupled with wider extension and elimination or drastic reduction of exemptions. In addition, turn-over tax for small business needs to be revisited**

Supplementary Duty (SD)

- **SD was introduced to protect slippage of revenue to be applied (initially) to products which were subject to high rates of CD, Excise Duty or Sales Tax, and eventually to be applied in trade neutral fashion.**
- **SD has been applied to raise revenue, including protection of putative high level of revenue, as well as discriminatorily for protection contrary to trade neutrality**
- **Reform of SD involves retrieving the principle as in case of VAT but may be difficult because of significant revenue loss**

Regulatory Duty

- **RD has been applied indiscriminately to enhance revenue as well as protection; its rationale and legal character are the least understood.**

Implications of para-tariff, variable VAT & SD

- **Deviations from the principles and use of VAT for revenue as well as protection represent the dilemma:**
- **Of the imperative to raise more revenue while keeping CD low and VAT at uniform rate**
- **Also a pattern of policy response to demand for protection by entrepreneurs**
- **And low and calibration of mid-range rates, which facilitates import of industrial raw materials and intermediates, indicates <u>policy favouring industrialization through import substitution.</u>**

Income Tax

- **The structure of personal income tax is transparent and stable with four slabs and a minimum summary tax, taxable threshold remaining unchanged for long period, and no or few exemptions. The relief to the old and disabled by way of slightly higher threshold have little revenue implication.**

- **Corporate income tax structure is more complex and opaque with rates differentiated for joint stock companies (27.50), proprietorship or private limited companies (37.50), bank and non-bank financial institutions (42.50), and mobile phone operators (45.0), minimum summary tax, coupled with generous exemptions, deductibility and concessional rates to a large variety of corporate entities (reportedly too many to keep track).**

- **Reforms of corporate income tax may streamline and consolidate tax rates, eliminate or at least reduce drastically exemptions and concessional low rates, introduce method for tax assessment on standard rates and computation of the cost on account of deduction, exemption or concessional rates (i.e. tax-expenditure), also consider a dual-track policy for collection of tax on standard rates and refund or lump-sum subsidy explicitly to support industry, significant improvement of quality of tax administration (motivation & efficiency).**

- **Tax-expenditure or tax-refund/ subsidy scheme may lead to unrealistic high estimates to show <u>significantly large computed revenue but insignificant realized revenue.</u>**

Agricultural income tax

- **Tax on agricultural income is unlikely to have significant revenue impact because of the small proportion of large land and medium size owners (less than 5%)**
- **Besides, computation of income net of cost of cultivation including input and wage costs is too complex to be reliable.**

Tax Awareness & Education Programme

- **Improvement of the efficiency, quality and equity of public finance, supplemented by a tax awareness and education programme, may remove the prejudicial view that that government is exploitive, self-serving, and insincere, follow from long experience of colonial & long unrepresentative government, exacerbated by civil society neo-liberal rhetoric, may contribute to improved sense of government's legitimacy and compliance.**

Development partners' engagement

- **In order to encourage tax reforms by developing low income countries, development partners and public multilateral financial institutions need to have deep and long term engagement**
- **To provide resources to meet shortfall of revenues from tax reforms, assist investment in restructuring and facilitate investment in growth of new industries consistent with reduced protection.**
- **The present method of assistance, tranching or linking supply or its suspension of resources with specified acts by government, is not conducive to sustained tax reform.**

International Taxation - MNCs:

- International taxation refers to tax on multinational corporations (MNC) and Public International Bodies such as UNO, UN Specialized Bodies, Inter-Governmental Bodies, etc.
- Multinational obtain waiver of duties on all imports, including those for industry as well as personal consumption, and income tax as a condition for investment in developing host countries.
- Such waiver might have been justified when import was subject to ban or high tariff, but not after commodity tax and income tax have been reduced and meet WCO / WTO criteria.
- MNCs pay tax on global income in their own countries, and there are tax-sparing treaties between capital exporting and capital importing countries
- MNCs use infrastructures, utilities, policing, etc. in host countries, so should pay tax to host countries.
- EU may take lead – and DAC / OECD may follow – to establish international tax regime requiring MNCs to pay tax to the host country – if home country tax is higher, they pay the extra to the home jurisdiction (unless the latter foregoes it).

International Taxation – UN & International / Intergovernmental Bodies

- UN, IMF, WB, DAC members advise that developing countries raise tax revenue and eliminate exemptions or concessional rates to their own citizens or cooperate entities
- Paradoxically, all of them have institutionalized exemptions for their organizations, corporate entities, and employees
- The employees of UN bodies and other International / Inter-governmental bodies should pay taxes to the jurisdiction where they work and use the infrastructures, policing, etc.
- The organizations may also pay to the extent the infrastructures, policing, clean air, etc. provide the work environment
- That the UN and International / Inter-governmental bodies are not subject to municipal jurisdiction seems a flimsy ground for avoiding tax – subjection to sovereign jurisdiction and tax jurisdiction should be separated
- For a teaser consider the following argument: the people are the sovereign, so they would not pay tax to any authority
- Is that sound reason or sound laughter?

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Small savings & NSC

- **Postal savings and NSC, primarily to to encourage small savings, also a source of government borrowing to finance deficit in a non-inflationary and perhaps non-crowding out manner. Return on small savings which balances the intensity of sacrifice –- small earners need big efforts for small savings – is likely to encourage domestic savings and investment.**
- **When bank's deposit and lending rates are lowered by government's authoritative talk or central bank's moral suasion, postal deposits and NSC sales swell, enhancing burden of interest on the budget, but to a far lesser extent and smaller magnitude than the asset bubble in speculative trade on the stock market and the rise of price of urban land, including that of the expanding periphery, which mimics price of fast depleting non-renewable resource.**
- **Lower interest rate did not bring forth strong demand for investment, which was constrained by inadequate infrastructure and expectations of low demand.**
- **The above shows link between financial, credit and capital market, and between return on small savings and mini-bubbles in postal savings and NSC schemes. The relationship and causal interaction are not clear.**
- **An enquiry to understand the relationships and the behavioral motivations of small savers and those of the big players on the stock exchange and urban land transfer will be useful for appropriate policies to encourage small savings containing speculative bubbles.**

Remittance

- **Instruments for investment of remittance need to satisfy multiple needs of the recipient households – i.e. predictable stream of income indexed to inflation and exchange rate fluctuation, preferably paid as annuity, security, and social status. <u>In all these respects, land purchase has a much stronger appeal – especially status and appreciation of value.</u>**

- **Wage Earners Bond sales more than dollar investment and dollar premium bonds, showing that interest rate and insurance benefits differentials are good incentives. The interest on all three instruments (10.5%, 7.5%, 6.5%) are significantly higher than the interest rates in the countries where the income originates.**

- **Use of remittance for improving official foreign exchange reserve may not be the right direction for policy. The call on the official reserve for financing import lies far away in time depending on a strong spurt in domestic private investment.**

Conclusion

- **Efficiency and equity of government fiscal policy and administration can enhance legitimacy of the tax system and secure better compliance.**
- **Ethics and efficiency are joined in fiscal governance – they cannot be divorced and still expected to deliver.**
- **Let us recall a remark by one who was associated with LSE at the inception – 'That law is best enforced which is obeyed willingly and with least coercion'. He is ---------.**