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Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 22-Apr-2019 | Report No: PIDA26212

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Pakistan	P165982	Pakistan Revenue Mobilization Project	
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
SOUTH ASIA	11-Apr-2019	30-May-2019	Governance
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Economic Affairs Division	Federal Board of Revenue	

Proposed Development Objective(s)

Contribute to a sustainable increase in domestic revenue by broadening the tax base and facilitating compliance

Components

Results-based component: This component includes four areas of objectives: 1. Simple & coherent tax system, 2. Control of taxpayer obligations, 3. Compliance facilitation, 4. Institutional development
Traditional IPF component: Upgrade of FBR's ICT systems

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	1,500.00
Total Financing	1,500.00
of which IBRD/IDA	400.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	400.00
IDA Credit	400.00

Non-World Bank Group Financing

Counterpart Funding	1,100.00
Borrower/Recipient	1,100.00

Environmental and Social Risk Classification

Moderate

Decision

The review did authorize the team to appraise and negotiate

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **Pakistan, the sixth most populous country in the world, is at a crossroads. The economy accelerated with GDP growth of 5.8 percent in FY18 but is projected to slow to 3.4 percent in FY19 as fiscal and external imbalances are addressed**. **Poverty declined from 64.3 percent in 2001 to 24.3 percent in 2015, but inequality persists.** The country ranks low on the 2018 Human Capital Index, at 134 out of 157 countries. Gender disparities continue, and female labor force participation was only 20.1 percent in 2018. Natural disasters and unreliable water and power supply constrain progress. Growth is expected to recover as structural reforms take effect and macroeconomic conditions improve. Pakistan will need to protect gains made for the vulnerable during the projected deceleration in growth. Over the near to medium term, with increased and better targeted investment in physical and human capital and improved tax administration and business environment, Pakistan can achieve its poverty reduction and shared prosperity goals.

2. **Pakistan is a federation with responsibilities divided between the federal and four provincial governments.** The 18th amendment to the constitution of Pakistan (2010) expanded powers and devolved delivery of key services to the provinces. The federal government retains core or shared responsibility for functions including tertiary education, tax and trade policy regulation, and transmission and distribution of power. The World Bank's commitments are evenly divided between federal and provincial initiatives. In the near term, the World Bank is supporting Pakistan in raising revenue through tax administration reform, addressing Pakistan's energy needs, updating trade policy, and improving tertiary education.

Sectoral and Institutional Context

3. **Pakistan needs to increase its tax revenues to ensure fiscal sustainability and generate fiscal space to finance much needed investments in human capital and infrastructure.** Pakistan's revenue performance has improved significantly in recent years, rising from 9.5 percent of GDP in FY2011/13 to 13 percent in FY2017/18. This remarkable increase in

tax revenues has resulted from tax policy measures[1], notably reduction in tax exemptions for specific industries, and improvements in tax administration at the federal and provincial levels. The share of tax revenue collected by the provinces remains small at 9 percent of total receipts but has been growing rapidly, from 0.4 percent of GDP in FY2010/11 to 1.2 percent in FY2017/18 (**Figure 1**). Despite this progress, tax receipts still fall short of 15 percent of GDP, which is the minimum that international experts consider adequate to cover the basic expenditure needs of developing countries.[2] It also falls below the tax take of middle-income and low-income countries[3], and – more importantly -- the level needed to reduce the country's budget deficits and enable increased public spending on infrastructure, education, and health. At the same time, Pakistan has sparse room to cut public expenditure due to the rigidity of recurrent expenditures, which account for 80 percent of consolidated government expenditure.

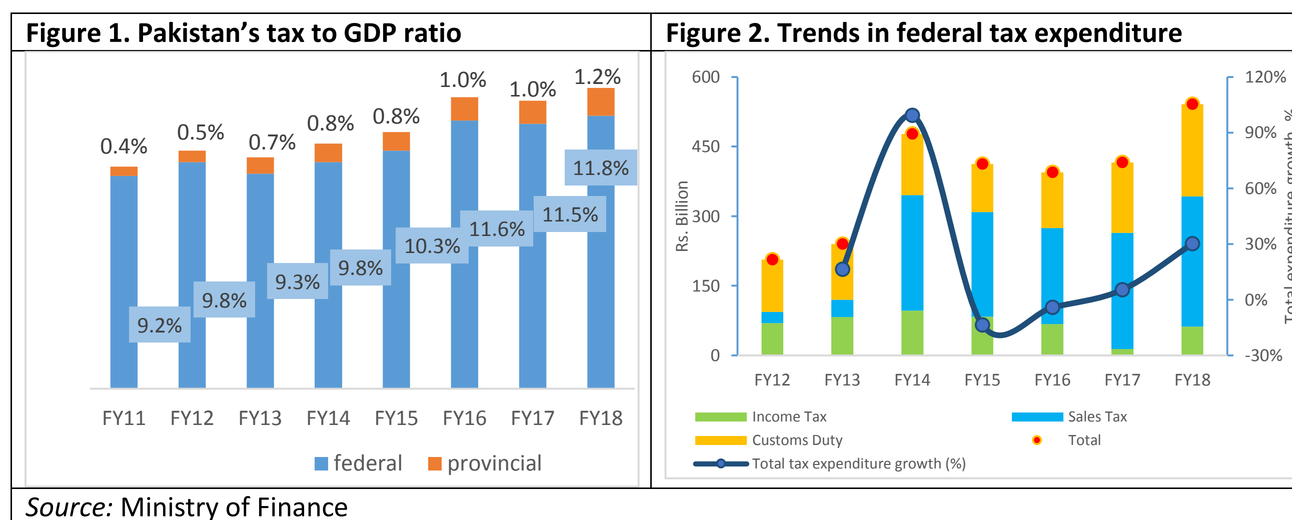

Figure 1. Pakistan's tax to GDP ratio | **Figure 2. Trends in federal tax expenditure**

Source: Ministry of Finance

4. **Pakistan has substantial potential to increase tax receipts without imposing new taxes or raising tax rates, which recommends a Broad Base-Low Rate approach.** A detailed gap analysis that has been recently completed by the World Bank indicates that Pakistan's tax revenue potential would reach 26 percent of GDP, if tax compliance were to be raised to 75 percent, which is a realistic level of compliance for LMICs.[4] This means that the country's tax authorities are currently capturing only half of this revenue potential, i.e. the gap between actual and potential receipts is 50 percent. The size of the tax gap varies by tax instrument and by sector. The tax gap in the services sector is larger than in the manufacturing sector (67 percent vs. 46 percent respectively) and it is larger for the GST/GSTS than for income tax (65 percent vs. 57 percent respectively). The size of the tax gap reflects primarily the relative levels of informality

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[1] The World Bank estimates that a reduction in exemptions accounted for an increase of 0.9 percent of GDP in tax revenues between FY2014/15 and FY2016/17. Prior to the elections of July 2018 however new exemptions were granted, only some of which were rescinded with the revised budget of September 2018.

[2] UN Committee of International Experts on International Cooperation in Tax Matters, *The Role of Taxation and Domestic Resource Mobilization in the Implementation of the Sustainable Development Goals*, October 2018, p. 3; V. Gaspar, L. Jaramillo and P. Wingender, *Tax Capacity and Growth: Is there a Tipping Point?*, IMF Working Paper 16/234, 2016, p. 30.

[3] The tax revenue averages for middle-income countries and low-income countries were 17.9 percent and 13.3 percent of GDP respectively.

[4] The World Bank analysis uses an input-output model based on GDP by sector, taxable portion of output, applicable tax rates, and actual tax revenue. An earlier study by the IMF based on data for FY2010/11 estimated Pakistan's tax potential at 22.3 percent of GDP. The study uses a 'stochastic tax frontier' model with comparative data (GDP per capita, trade as share of GDP, education levels, Gini coefficient) from 113 economies but does not include estimated compliance rates. R. Fenochietto and C. Pessino, *Understanding Countries' Tax Effort*, IMF Working Paper 13/244, 2003. This study is cited by Serhan Cevik, *Unlocking Pakistan's Revenue Potential*, IMF Working Paper 16/182, 2016.

and tax compliance in each sector. Other issues relate to the methodology that the FBR uses to assess the tax liabilities for some sectors (e.g. based on the electricity consumption bills for the steel sector).

5. **Broadening the tax base will involve scaling back the extensive tax expenditure from exemptions.** Multiple exemptions and discounted rates to select industries, economic actors, and economic activities (e.g. sugar, textiles, and fertilizer industries; 'associations' in the real estate sector; imports for infrastructure projects under the China-Pakistan Economic Corridor) are granted in each year's budget law, which distort competition and economic actors' incentives. In FY2017/18, Pakistan's tax expenditure (i.e., tax revenue foregone due to exemptions and concessional rates) was estimated at 2 percent of GDP, primarily due to exemptions from General Sales Tax (GST) and customs duties (Figure 2). Substantial exemptions also apply to property taxes, whereby properties below a certain size are exempted regardless of location, while revenue is also lost due to unrealistically low valuations used for taxation purposes. The Capital Gains Tax (CGT) returns negligible receipts due to the zero rate applied to capital gains from the sale of immovable property after more than four years of ownership, and rates of 5-10 percent for properties sold after one to four years of ownership.

6. **A broader tax base also requires an expansion of the tax net.** Income tax receipts come from a small number of taxpayers due to generous thresholds for individuals and widespread tax evasion. The budget law adopted in 2018 reduced the maximum income tax rates from 35 to 25 percent and for firms and from 25 to 15 percent for individuals. It also raised the threshold for Personal Income Tax to PKR 400,000 (around US$2,860 – approximately double the per capita GDP), with a nominal tax up to PKR 2,000 applied to incomes up to PKR 1.2 million (around US$8,580 – more than 5.5 times the per capita GDP).[5] Only incomes above PKR 10 million (around US$71,500) are subject to the maximum rate of 15 percent. In addition, legal loopholes combined with weaknesses in compliance enforcement enable large-scale tax evasion, which also erodes the tax base. While people and firms unregistered as taxpayers pay GST and income tax withheld on their transactions (e.g., by banks, telecom, and utility companies), the number of taxpayers who file tax returns (for GST and/or income tax) remains very small at 1.52 million, while those who declared incomes above the taxable threshold amounted to only 1.12 million FY2017/18 (Table 1).

Table 1: Taxpayers registered with FBR in FY2017/18

	Registered	Filed tax returns	Filed and paid tax
Income tax	4,786,743	1,522,627	1,116,066
GST	220,042	141,106	43,355

7. **Tax evasion is pervasive due to low tax morale and legal loopholes that enable high-value individuals to conceal their incomes.** Few Pakistani citizens think of themselves as taxpayers, even though they pay indirect taxes on their consumption. Therefore, taxation is not widely considered as a civic duty and essential to finance public services. In turn, better-off households generally do not rely on public education or health services and have little stake in paying taxes to finance better public service provision. At the same time, tax evasion is facilitated by legal loopholes. The Law on *Benami* Transactions of 2016, which prohibits anonymous transactions, could have closed one of the major loopholes. It has not however been implemented because secondary regulations have not been approved. Prize bonds, a large source of domestic borrowing for the government, have hitherto been both anonymous and tax exempt, making them an instrument of choice for investing funds of unexplained origin.[6] Likewise, foreign remittances are tax exempt and widely used to repatriate illegally exported capital. Low taxes on immovable property also offer opportunities for tax evasion and money laundering.

[5] These exemptions apply to individuals who draw more than half of their total taxable income from salaries.
[6] Since 2018, registration is mandatory for new purchases of high-denomination prize bonds.

8. **The tax system is complex due to overlapping jurisdictions with different laws, exemptions, and frequent policy changes.** The Constitution assigns income taxes (except for income derived from agriculture), the General Sales Tax (GST) on goods, customs duties, federal excises, and the Capital Gains Tax (CGT) to the federal level. These taxes are collected by the Federal Board of Revenue (FBR). The Constitutions assigns the following taxes to the provinces: GST on services (GSTS), tax on professions, Agricultural Income Tax (AIT), Motor Vehicle Tax (MVT), Urban Immovable Property Tax (UIPT), and other taxes related to real estate (e.g. stamp duty, Capital Value Tax). This tax assignment essentially fragments Pakistan into five markets in the services sector, with important consequences for tax authorities and taxpayers alike. These consequences include the following:

   a. **Double taxation.** Several taxes are often levied on the same transaction (e.g. stamp duty, registration fee, Capital Value Tax, and Capital Gains Tax on property transactions) and/or affect the same taxpayer segments (e.g. professionals are liable to income tax, professions tax, and GSTS). Double taxation is particularly serious problem for firms that provide services across the country. These firms are liable to Corporate Income Tax paid to the FBR and GSTS paid to each of the provinces where they operate and to the FBR for operations in the Islamabad Capital Territory. The five jurisdictions have different rates for GSTS and apply different principles in levying this tax (e.g. some levy the tax based on the firm's registered address, others based on the customer's location). Disagreements on the definition of goods and services also affect the restaurant and catering sector, which the federal level subjects to GST on goods (food and beverages), while the provinces also levy GST on services.

   b. **High compliance burden.** Service providers operating across Pakistan are obliged to file GSTS returns with all five jurisdictions every month, resulting in a total of 62 tax returns based on five different sets of rules and formats for GSTS alone. The requirement to file monthly GST returns is one of the main issues for Pakistan's low score and ranking in the *Paying Taxes* indicator, which is the country's worst ranking in the 2019 *Doing Business* report. Pakistan is ranked 173nd among 190 economies for this indicator with 47 payments and an estimated time to comply with tax obligations of 293.5 hours per year, down from 311.5 in the previous year.[7]

9. **Pakistan's tax system is also regressive due to its reliance on indirect taxes[8] and the collection of most income taxes through withholding agents.** This is a primarily due to the limited capacity of the tax administration to identify unregistered firms and individuals with incomes above the taxable threshold. This capacity constraint has driven the FBR to rely on withholding agents to collect the bulk of income tax. In FY2017/18, 60 percent of income tax receipts were collected by withholding agents such as banks, telecom and utility companies, and car dealerships. Withholding agents are required to levy income tax on transactions at the same time as GST.[9] Income tax collected in this manner essentially becomes an indirect tax. Individuals with incomes below the income tax threshold have income tax withheld on their transactions (e.g. payment of utility bills, banking transactions) would need to file income tax returns to have the withheld tax refunded, but in practice this is very onerous. The same applies to income tax filers who may claim a deduction of the withheld tax from their total income tax liability at the end of the fiscal year. For higher-income non-filers, paying the withholding tax might well be advantageous compared to filing income tax with FBR.

10. **The withholding regime is also problematic due to the administrative burden it places on businesses obliged to withhold taxes, as well as due to distortions on economic actors' incentives.** The requirement on retailers, wholesalers, and service providers to withhold GST and income taxes is a large part of the compliance burden on

[8] In FY2017/18, income taxes accounted for 14 percent of total tax revenues.
[9] Income tax filers have been exempted from some of these withholding requirements, notably on banking transactions.

these taxpayers. The withholding regime for income tax also contradicts other policy objectives, notably expanding the formal economy and strengthening the financial system. The introduction of withholding tax on banking transactions in FY2015/16 led to a decline in deposits, bringing the commercial banks' currency to deposit ratio from 29 percent at the start of FY2015/16 to 40 percent at the end of January 2019.

Institutional context

11. **The FBR is the only federal tax authority, which comprises the Inland Revenue and Customs services.** The FBR collects the bulk of total tax receipts (86 percent in FY2017/18), primarily from GST, Income Tax, and customs duties. The FBR is a statutory body established by the FBR Act of 2007 (amended in 2012) to replace the Central Board of Revenue. The FBR Act does not subordinate the FBR to any ministry but states that the Chairman and the members of the FBR Board are appointed by the *federal government*, and that the *federal government* may issue instructions to the FBR. An amendment to the FBR Act in 2011 established a Policy Board to provide oversight and guidance to the FBR.[10] The Chairman also holds the position of Secretary of the Revenue Division in the Ministry of Finance and thereby reports to the Minister of Finance, Revenue, and Economic Affairs. At the same time, the dual role of the FBR Chairman as Secretary of the Revenue Division gives the FBR a strong role in tax policy, especially as the Revenue Division has few staff and limited capacity. In December 2018 the federal government announced plans to separate tax policy from tax administration, assigning the former to the Ministry of Finance and leaving the latter to the FBR. Despite its somewhat diffuse accountability arrangements, the FBR lacks the main attributes of a semi-autonomous revenue authority, that is fixed tenure for its leadership, a formula-based budget allocation, and the authority to hire its own staff.

12. **Unlike most revenue authorities in the world, the FBR is not organized along functional lines, nor does it have a clear hierarchical structure.** The FBR is a large organization with a nationwide presence and more than 21,000 staff, of whom about two thirds work for Inland Revenue Service (IRS) and one third for Pakistan Customs.[11] The two services have separate career structures and human resource practices with limited shared services (e.g. accounting). Their audit functions, ICT systems, and territorial formations (Regional Tax Offices/Large Taxpayer Units for the IRS, Customs stations and control points) are also separate. The IRS is organized along tax instruments, territorial jurisdictions, and taxpayer segments (e.g. Large Taxpayer Units) rather than functions (e.g. taxpayer registration, assessment, tax audit). A mixed function-based and segment-based structure is considered more efficient, as it enables technical specialization of staff, automation of business processes by function, fewer offices, and complete taxpayer profiles – rather than separate records for each tax instrument as is the case in the FBR. In terms of management structure, the FBR Act assigns the decision-making functions to the Board with limited powers for the Chairman. In turn, Board Members are responsible for different functions but do not oversee FBR territorial formations, where most FBR staff are deployed. Moreover, IRS Directors-General report directly to the FBR Chairman rather than Board members.

13. **At the provincial level, the structure of the tax administration is more complex.** Each province has three revenue authorities: (i) the Excise and Taxation Departments, which collect the UIPT, the tax on professions, the MVT, and provincial excises; (ii) the Boards of Revenue, which collect the AIT, land taxes, stamp duty and other taxes on property transactions); and (iii) the revenue authorities that collect the GSTS (Sindh Revenue Board, Punjab Revenue Authority,

[10] The Policy Board however met for the first time only in February 2019. It is chaired by the Minister of Finance and includes other federal Ministers (Industries, Commerce), parliamentarians, and other members nominated by the Prime Minister.
[11] Despite a government target for women to reach 10 percent of public employees, the FBR has only 962 women staff (4.6 percent). Women are better represented among professional-grade staff (grades 17+), accounting for 17.6 percent of total staff in grades 17-22.

KP Revenue Authority, and Balochistan Revenue Authority). On the other hand, tax policy is clearly the domain of the provincial Finance Departments.

14. **Lack of coordination between the federal and provincial governments has a negative impact on total tax receipts, as well as complicating taxpayer compliance.** The different rules applied by the federation and the provinces generate frequent disputes, especially over input adjustments for GST and GSTS taxpayers. These disputes have entrenched a zero-sum mentality and eroded trust between the FBR and provincial tax authorities, resulting in a reluctance to share information. In turn, not sharing taxpayer data reduces all tax authorities' effectiveness in controlling compliance. This is particularly important for GST where lack of data sharing enables fraudulent refund claims (for inputs from different provinces), while complicating legitimate claims for firms that operate across Pakistan. Provincial authorities' information on GSTS taxpayers and owners of immovable property could assist the FBR's efforts to expand net for income tax. Likewise, the FBR could assist the provinces in collecting the AIT. The FBR receives returns claiming exemption from federal income tax on the grounds that the declared income is derived from agriculture. The FBR does not however demand proof of payment of AIT to the province where the income is generated, nor does it share these returns with the province concerned. The FBR and the provinces also use different property valuations for calculating CGT and UIPT/CVT/stamp duty respectively, which creates uncertainty for taxpayers, encourages under-declaration of property prices, and reduces the effectiveness of property taxation.

15. **Institutional arrangements for coordination of tax policies and tax administration regulations among the federal government and the provinces need to be strengthened.** Coordination of fiscal affairs including tax matters is part of the mandate of the Council of Common Interest (CCI), which brings together the Prime Minister and the Chief Ministers of the provinces. The CCI however meets infrequently and discusses a wide range of issues, leaving little room for resolving complex disputes such as the principles for levying the GSTS. The CCI has recently established a Fiscal Coordination Committee (FCC), which brings together the federal and provincial Ministers of Finance. The FCC may be a more promising forum for resolving long-standing issues related to taxation. The simplification of tax procedures and payment systems for business facilitation has also recently been discussed by the newly constituted 9th National Finance Commission, but contentious issues such as diverging definitions of goods and services remain to be addressed.

Government reform program

16. **The Government of Pakistan has placed a strong emphasis on improving revenue mobilization.** The main party in the federal government that emerged from the elections of July 2018 made increasing tax revenues and improving the performance of the FBR a prominent element of its campaign program to reduce Pakistan's reliance on borrowing and to finance social safety nets and improvements in public services. This an unusual campaign platform, given that politicians typically have not linked taxation to the state's capacity to provide public goods and services. Once in office, the government's first challenge has been to manage a difficult fiscal and balance-of-payments situation, which has made collecting more taxes a critical priority.

17. **In response to the government's priorities, the FBR has developed a Transformation Roadmap.** The purpose of the Roadmap is to guide the institution's transformation into a world-class, technology-savvy, and taxpayer-centred revenue authority. The Roadmap envisions that the FBR would become a semi-autonomous revenue authority with financial, managerial, and operational autonomy. This would involve a degree of financial and managerial autonomy from the regular controls and procedures of the federal government. Key changes would include security of tenure for the FBR Chairman for a fixed mandate; a financing formula whereby the FBR's budget would be fixed as a share of

the previous year's receipts (e.g. 1 percent); and flexibility to use its budget across budget lines (e.g. to hire consulting services or purchase equipment) as needed.

18. The Transformation Roadmap consists of three parts: (i) **a 10-year vision for the FBR's institutional transformation**; (ii) a **three-year dynamic implementation plan (FY20-FY22)** to be updated annually; and (iii) a **short-term action plan for accelerating revenue collection in FY2019**. The FBR has already launched several of initiatives under the Roadmap, including the following:

    a. **New payment options for taxpayers** launched (online, mobile, and ATM payments).
    b. **MoUs on exchange of taxpayer information** signed with NADRA and the provincial tax authorities of Punjab and Khyber Pakhtunkhwa.
    c. Ongoing work on **a unified tax portal with standardized forms** that will enable taxpayers to file and pay federal and provincial taxes.
    d. Ongoing **review of tax policy** to formulate a medium-term tax policy framework and propose measures to reduce tax expenditure for the next budget (FY2019/20).
    e. Ongoing **review of tax laws and regulations** to simplify and make them more accessible to taxpayers (e.g. by incorporating subsequent amendments in the main text) and enable improvements in tax administration (e.g. by providing a clear legal basis for risk-based audit).
    f. Establishment of **tax analysis unit** with externally hired, highly qualified economists.
    g. **Customs Strategic Plan** and ongoing work on risk-based customs clearance systems and implementation of the National Single Window (NSW), a government initiative for trade facilitation.
    h. **ICT Strategy** developed and approved.
    i. **Data on foreign bank accounts** of Pakistani citizens received and analysed to detect tax evasion.
    j. **Performance management scorecard** launched in field formations.
    k. **Integrity Management Unit** established.

19. **The Roadmap emphasizes investments in ICT and streamlined business processes to facilitate and control compliance.** Voluntary compliance rests on two main pillars: facilitation measures; and a credible risk of detection and enforcement. The FBR is currently not well equipped to detect tax evasion. Effective compliance enforcement in modern revenue administrations relies on collection and analysis of taxpayer/trader data from various sources. Relevant data are available from provincial tax authorities, other government entities, foreign jurisdictions, and withholding agents. The FBR however lacks not only access to many of these data sources but also the capacity to analyze these data to detect tax evasion by non-filers and under-declaration by filers. The FBR has two main IT systems, the Inland Revenue Information System (IRIS) and the WEBOC system for Customs, which have automated some business processes, including filing of tax returns and Goods Declarations (GDs). These two systems however do not share data and lack important functionalities such as tracking of tax payment arrears (IRIS) and transit module (WeBOC). The FBR therefore needs the ICT infrastructure and technical skills to integrate and analyze big data with adequate security protection. ICT investments will also generate efficiency gains through simplified and automated business processes enabling transition to paperless administration, real-time communications with FBR field offices, and the expansion of e-services for taxpayers. New business processes will also entrench a function-based re-organization, which will in turn support an integrated view of taxpayers and technical specialization in the FBR.

20. **The Roadmap also highlights measures to strengthen the technical expertise and improve the performance of the FBR's human resources.** Technical expertise will be strengthened by establishing technical streams for core tax administration functions for career FBR officials (e.g. auditors, lawyers, business intelligence analysts) and by externally hiring specialized staff for horizontal functions such as procurement, human resources, and

communications. In the latter functions, lack of expertise results in operational constraints such as inability to procure ICT equipment and the FBR's minimal engagement in taxpayer awareness. In core functions, the FBR is hampered by a dearth of up-to-date skills in audit techniques, economic research, and data analysis. This results from Pakistan's rigid career-based civil service system, whereby the federal Establishment Division recruits professional-grade staff through generic entry-level examinations and assigns recruits to different agencies regardless of academic background. These generalists are subject to frequent rotations across functions, which limit opportunities to build technical expertise. Moreover, civil service regulations do not require relevant knowledge for appointment to specific posts, nor do they recognize job performance as a criterion for promotion. In this system, lateral entry at mid-career or senior level is generally not possible, though few specialized positions may be filled by externally contracted employees. By contrast, the FBR's Transformation Roadmap envisages a robust evidence-based performance management system based on strategic organizational-level Key Performance Indicators (KPIs), with operational KPIs for FBR functions and units, and specific KPIs for FBR staff according to their roles. It is therefore critical for the FBR to obtain a degree of autonomy in HR matters on the model of the State Bank.

21. **The proposed project will support key initiatives and targeted results under the FBR's Transformation Roadmap.** The solutions offered by the project are based on the 'Low Rate – Broad Base' principle, whereby a sustainable increase in revenues is achieved by expanding the tax base and increasing compliance as opposed to introducing new taxes or raising tax rates. The project's interventions therefore focus on equipping the FBR with the needed ICT tools and technical skills to make effective use of taxpayer information using big data techniques and modern risk-based tools for more efficient, targeted compliance control and enforcement. The project also supports the FBR's efforts to promote voluntary compliance with taxpayer and trader facilitation measures.

C. Proposed Development Objectives

Development Objective(s) (From PAD)

Contribute to a sustainable increase in domestic revenue by broadening the tax base and facilitating compliance

Key Results

22. **PDO indicators:** The PDO will be measured based on the following indicators:

a. **PDO indicator #1:** Higher tax to GDP ratio – from 13 percent in FY2017/18 to 16 percent in FY2023/24
b. **PDO indicator #2:** Broader tax base, measured through an increase in the number of active taxpayers from 1.2 million in FY2017/18 to 4 million in FY2023/24
c. **PDO indicator #3:** Reduced compliance burden, measured by the hours required to file and pay taxes based on the Paying Taxes indicator of Doing Business – from 253.5 hours in 2018 to 157 hours in 2023
d. **PDO indicator #4:** Improved efficiency of customs controls measured by number hours spent for customs clearance at the border per the 'trading across borders' Doing Business indicator (average for imports and exports) – from 97.5 hours in 2018 to 58.5 hours in 2023.

D. Project Description

The proposed project will support the implementation of the FBR's Transformation Roadmap over the next five years.
The project is a five-year IPF with DLIs and comprises two main components:
(i) a results-based component with four areas of objectives; and (ii) an IPF component that will finance investments in ICT.
Component 1 (results-based). This component of US$320 million comprises the following four areas of objectives with eight
DLIs (Table 3).

Table 3: Areas of objectives and DLIs

DLI #	DLI name and rationale	(US$ million)
Objectives area 1: Simple and transparent tax system		**96**
1	**Scope of withholding regime reduced:** This DLI requires a reduction in the types of transactions subject to income tax withholding. It contributes directly to transparency of the tax system, given that the withholding regime transforms income taxes into indirect taxes, which are less visible to taxpayers. It will also greatly reduce compliance costs for firms that have to act as withholding agents.	30
2	**Transparent tax system:** This DLI requires detailed reporting of tax expenditure in the annual budget documentation with disaggregated information about the cost and beneficiaries of each exemption and concession. It is important to broadening the tax base because it exposes the revenue foregone due to each exemption/concession, and the industries that benefit.	32
3	**Coordination with provinces:** This DLI requires the FBR to reach agreements with the provinces on automated sharing taxpayer information, the methodology for calculating GST input adjustments, and common updated property valuation tables. This coordination will enable the FBR and the provinces to broaden their respective tax nets. Coordination can be facilitated through the newly established Fiscal Coordination Committee, comprising the federal and provincial governments.	34
Objectives area 2: Effective control of taxpayer obligations		**96**
4	**Track & trace and electronic monitoring of production in key sectors (# of sectors):** This DLI requires the FBR to implement—through licensed agents—electronic production monitoring for high-risk sectors (e.g., sugar, cement, fertilizer) and electronic tracking of production, distribution, and sale of final products (tobacco, beverages). It will increase compliance by reducing the risk of under-declaration of output, sales, and corporate profits.	30
5	**New taxpayers with taxable incomes/sales identified through automated data sharing and ICT-based BI (number):** This DLI ensures that the FBR will use the new ICT equipment and software that enables the BI and data mining tools acquired under Component 2 to identify unregistered or noncompliant taxpayers. It directly contributes to PDO indicator #2 (increase in the number of active taxpayers). It also disincentivizes the registration of individuals and firms without taxable income or sales, thereby avoiding inefficient use of FBR resources and negative impacts on micro firms and economically weaker households.	34
6	**Risk-based audit:** This DLI requires the FBR to conduct tax audits on cases selected through an automated risk-based tool, informed by analysis of integrated data from multiple sources. It sets targets for detailed field audits of large taxpayers, thereby making an efficient use of resources for the highest impact. Risk-based audit is essential to deterring tax evasion and increasing compliance, especially for large taxpayers	32

	who use complex tax evasion techniques. It also benefits compliant taxpayers, as it spares them the hassle and cost of ineffective mass audits and reduces the discretion of FBR officials to pick cases for audit.	
Objectives area 3: Facilitation of compliance		**65**
7	**GST filing simplification:** This DLI requires standardized tax returns for the FBR and provincial tax authorities, and a single portal for filing and paying GST/GSTS with automated processing of refunds. It therefore makes a direct contribution to PDO indicator #3 on reducing the time it takes for firms to file and pay GST, the most time-consuming tax for firms.	32
8	**Goods declarations subjected to customs inspections at the border:** This DLI requires Customs to progressively reduce the share of GDs inspected at the border (i.e., GDs going through the red and yellow channels), as its risk management systems become more robust. This DLI is supported by the procurement of contactless scanning equipment and weighing stations under Component 2. The DLI directly contributes to PDO indicator #4 on reducing the time it takes for cargo to clear customs at the border. The final target reduces the share of GDs inspected at the border by more than half (from 65% to 30%).	33
Objectives area 4: Institutional development for efficiency and accountability		**63**
9	**FBR core business processes simplified and automated:** This DLI requires the FBR to simplify, redesign, and automate its core business processes. The sequence of targets ensures that automation follows business process mapping and re-engineering. It also requires the FBR to put in place essential elements for successful automation: regulations to give electronic documentation legal validity and eliminate the previous paper-based processes, and adequate training of staff. In addition, given that processes will be defined in functional terms (e.g., taxpayer registration, audit, arrears management), business process automation will help entrench the FBR's transition to a function-based organization, which is the organizational model used by modern revenue administrations.	33
10	**Performance management:** This DLI requires the FBR to publish regular reports on its performance based on KPIs that capture the main areas of the FBR's performance (revenue receipts by tax instrument, taxpayer segment, geographical area; share of receipts from direct taxes collecting through withholding agents; number of tax audits completed; number of active taxpayers by tax instrument; timeliness in resolving claims for tax refunds; number of consignments processed by Customs through the red, yellow, and green channels; dwell time of cargo at the border until customs clearance). The indicator therefore supports the FBR's transparency and accountability to the Government and the citizens, which is needed to justify more financial and managerial autonomy for the FBR and to increase public trust in the tax system.	30
Total amount		**320**

23. The objectives areas comprise the following targeted results and interventions (beyond those reflected in the DLIs):

a. Objectives area 1: Simple and transparent tax system. In addition to the outcomes targeted by DLIs 1 and 2, this area of objectives targets the following outcomes (Intermediate Results Indicators):

i. Tax laws[12] simplified by incorporating amendments introduced through other legislation (e.g. annual appropriations acts) in the main text and harmonizing provisions on tax administration, appeals, enforcement, and penalties across tax instruments; and Customs Act updated to enable risk-based inspections and audit, new import valuation methods, and trade facilitation measures per the Revised Kyoto Convention (2006) of the World Customs Organization; and comply with the TIR Convention on

[12] Income Tax Ordinance, Sales Tax Act, Customs Act, and Federal Excise Act.

the transit of goods.

ii. Coordination with the provinces to resolve legal obstacles to the automated sharing of taxpayer information, harmonize definitions of taxable items subject to GSTS, agree on collection principles and method for calculating GST input adjustments, and update valuations of immovable property.

b. Objectives area 2: Effective control of taxpayer obligations. In addition to the outcomes targeted by DLIs 3 and 4, this area of objectives targets the following results related to compliance control and enforcement:

i. Implementation of risk-based audit selection framework managed centrally by the FBR headquarters
ii. Implementation of risk-based inspections and Post-Clearance Audit (PCA) in Customs, resulting in higher effectiveness of inspections and audits in identifying material violations.
iii. Systematic monitoring and analysis of payment arrears to increase collection rates.

c. Objectives area 3: Facilitation of compliance. In addition to the outcomes targeted by DLIs 5 and 6, this area of objectives targets outcomes for the following facilitation initiatives:

i. Expansion of e-services for taxpayers and traders with additional e-filing and e-payment options, including through mobile phones; online consolidated data profiles accessible to each taxpayer.
ii. Accelerated resolution of refunds and taxpayer appeals.
iii. Implementations of ‘trusted trader’ program to facilitate customs clearance for compliant firms.

d. Objectives area 4: Institutional development for efficiency and accountability. In addition to the outcomes targeted by DLIs 7 and 8, this area of objectives targets the following results:

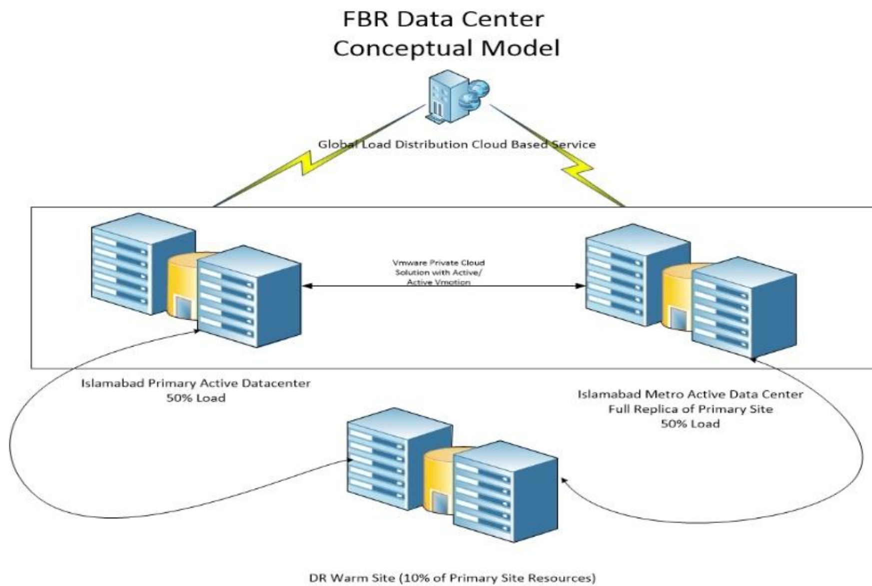
i. Career management based on technical streams and reduced rotation across functions.
ii. Horizontal functions (e.g. procurement, communications) staffed by externally hired specialists.
iii. Enabling environment and performance incentives for staff based on robust appraisal system
iv. Daily transfer of revenue receipts to the Treasury Single Account.
v. Measures to promote workforce diversity by improving attraction and retention of women staff in the FBR.

2. Component 2 (IPF): Investment in the FBR’s ICT systems. This component of US$80 million will finance the purchase of ICT equipment and software (goods); supply and installation of equipment for of automated customs control points; and consulting services for software development and technical assistance for complex initiatives (e.g. business process improvement and change management). It will comprise the following activities:

a. Replacement of end-of-life equipment, active-active private cloud, and update of legacy branded software. The ICT hardware currently used by the FBR has already reached its end-of-life, including all but two of the 207 servers of the FBR’s datacenters, resulting in a high risk of critical system failure and disruption of operations. The old equipment needs to be replaced by more sophisticated hardware to support an active-active virtual could solution for the FBR’s data centers (Figure 3). This activity will therefore reduce the risk of system failure, ensure business continuity, strengthen security from cyberattacks, and support new functionalities. The installation of the equipment will ensure adequate protection from failure risks, including climate and disaster-related risks (high heat and humidity,

earthquakes). Other equipment to be replaced includes electrical and network equipment for the datacenters; and computers, printers, and scanners for IRS offices and Customs control points. This activity will also finance the purchase of up-to-date versions of licensed software currently used by the FBR.

Figure 3: Illustration of the proposed active-active virtual cloud solution

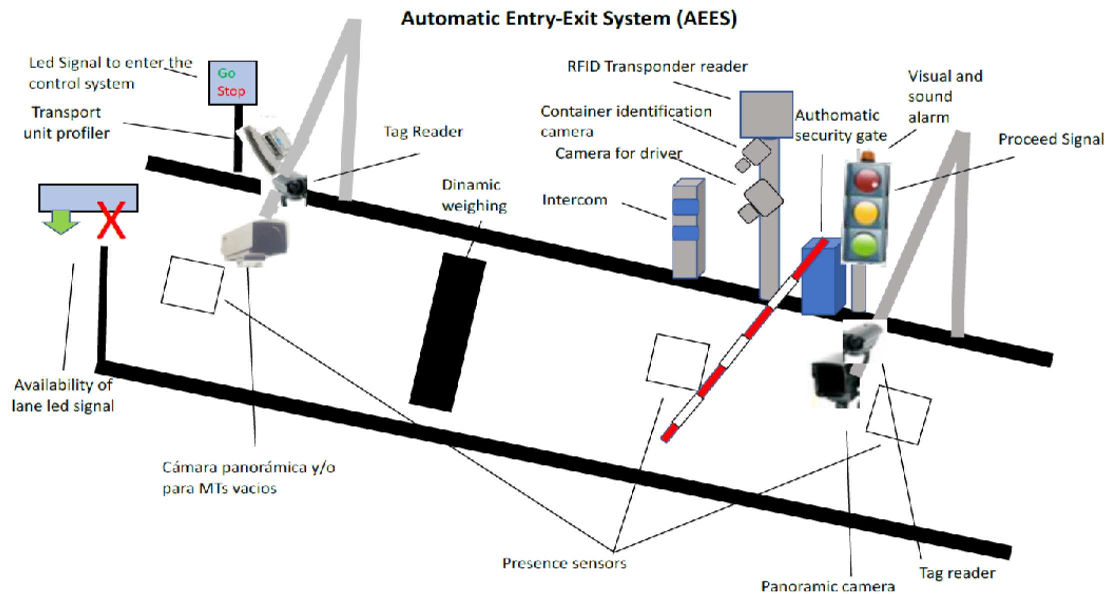


3. Data Warehouse and Business Intelligence tools. The FBR is currently using three main ICT systems with separate databases: IRIS for income tax, STRIVE for GST, and WeBOC for Customs. Provincial tax authorities also use STRIVE for the collection of the GSTS and have their own databases. All these systems are maintained by PRAL but automated data exchange even among the FBR's own systems is currently very limited. This activity will finance the purchase of a state-of-the art Data Warehouse solution with the capacity to handle big data. The volume of data will increase exponentially, as the range of data sources grows beyond the FBR's own databases to include those of provincial tax authorities; other government entities such as the State Bank of Pakistan (SBP), the Securities and Exchange Commission (SECP), and the National Database and Registration Authority (NADRA); foreign jurisdictions that have agreements on Automated Exchange of Information with Pakistan; and withholding agents that are required by law to share data with the FBR such as commercial banks, utilities, and telecom companies. This activity will also finance the acquisition and customization of state-of-the-art BI tools needed to analyze this information and detect inconsistencies and irregular patterns indicative of tax evasion or other suspicious activity. BI findings will be critical to improving the FBR's risk management systems, which in turn inform a range of compliance control functions such as risk-based selection of cases for audit and risk-based inspections of cargo by Customs.

4. Customs Automated Entry-Exit System (AEES). The activity will finance the supply and installation of ICT, cargo weighing, scanning and laboratory equipment for non-intrusive inspection of cargo for imports and exports at four locations: Karachi East, Karachi West, Port Qasim, and Lahore. The AEES will transmit the scanned data to the WeBOC system that will cross-check the information with the pre-arrival Goods Declaration (GD), run the Risk Management System (RMS), and direct the truck to the green, yellow, or red channel accordingly (Figure 4). In

addition to Customs, the data gathered by the AEES will be available to 43 other agencies involved in the implementation of the NSW. In combination with an RMS-enabled Post-Clearance Audit (PCA), the AEES is expected to deliver the following results: (i) reduced frequency of physical inspections; (ii) accelerated customs clearance at the border; and (iii) higher detection rate of fraudulent declarations ('hit rate' of inspections and audit).

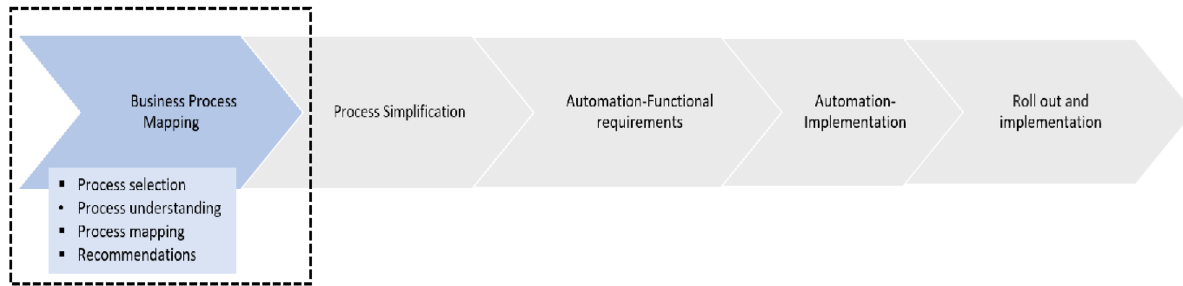
Figure 4: Illustration of the AEES



5. Upgrade of connectivity to FBR offices. This activity will finance the supply and installation of ICT equipment to upgrade the network connectivity of all FBR offices and customs control posts to support real-time data sharing and communications. This is essential for timely access to information (e.g. taxpayer records, BI data about unregistered potential taxpayers, WeBOC modules) to guide actions in the field and to obtain timely feedback from the field (e.g. findings of customs inspections).

6. Business process improvement, automation, and change management. This activity will finance TA for the mapping and re-engineering of FBR business processes, and software development to automate these processes. It will also finance TA for the change management process, notably internal communications, new Standard Operating Procedures, manuals, and staff training. The revised and automated business processes will replace the old paper-based process, thereby increasing efficiency, staff productivity, and reliability of adherence to rules and regulations through control points built into the systems. Business process automation will also enable the transition of the FBR to paperless administration. Finally, the new processes will support taxpayer facilitation with better client-facing applications such as taxpayer registration, e-filing, automated helpdesk, and taxpayers' online access to their records and profiles.

Figure 5: Phases of Business Process Improvement



7. Customs Central Risk Management and Post-Clearance Audit (PCA) frameworks. This activity will finance TA for the design of the Customs Risk Management framework and its application for the selection of GDs to be subjected to documentary review (yellow channel) or physical inspection (red channel) at the border, and to inform the selection of consignments for PCA. Robust risk-management systems are essential to improve the performance of Customs, which has fallen behind comparator countries since 2012 – with some recent improvement in the past two years, as measured by the 'trading across borders' *Doing Business* indicator.[13] Weak risk management has perpetuated Customs' reliance on documentary and physical inspections at the border, which delays clearance of cargo resulting in high costs for traders without much success in detecting fraudulent or other illegal behavior.

Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Assessment of Environmental and Social Risks and Impacts

The project involves automation of tax processes and FBR offices includes IRS and custom offices across the country in the selected regions, whereby IT equipment will be procured, and older IT equipment will be disposed of. This will generate substantial amount of Electronic Waste (E-Waste) for which there is no policy at the national and provincial levels. On the social aspect the project poses a risk of excluding taxpayers with low ICT literacy, which also holds true for small and medium enterprises/traders which can cause social unrest and can lead to decreased compliance. Also, persons with disabilities may also get further disadvantaged if the automation is not disability sensitive

Note: To view the Environmental and Social Risks and Impacts, please refer to the Appraisal Stage ESRS Document.

[13] Pakistan's second-worst ranking is for the *Trading across Borders* indicator, where it is ranked 142nd, an improvement by 29 places from **the previous year. The FBR however is one of multiple agencies regulating imports and exports, thereby affecting this indicator.**

E. Implementation

Institutional and Implementation Arrangements

8. **The Federal Board of Revenue will be the implementing entity for the project.** The FBR has established a Program Office (PO) that reports to the Chairman with the mandate to coordinate the implementation of the Transformation Roadmap and the proposed World Bank-financed project. The PO is led by a senior FBR official and includes specialized staff hired externally for project management, notably procurement and financial management specialists, environmental and social specialists, a communications specialist, an organizational performance and Monitoring and Evaluation (M&E) specialist, and a human resource management specialist.

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