

# Taxation Post 18th Amendment

Dr. Ikram ul Haq

(2022)

**About the Author**

**Dr. Ikram ul Haq** is an Advocate Supreme Court and Adjunct Faculty at Lahore University of Management Sciences (LUMS).

Edited by **Dr. Aneel Salman**, Chair Economic Security-IPRI.

**About IPRI**

The Islamabad Policy Research Institute (IPRI) is one of the oldest non-partisan think tanks on all facets of National Security, including international relations & law fare, strategic studies, governance & public policy and economic security in Pakistan.

## Executive Summary

This article deals with the fiscal management in the wake of the Constitution (Eighteenth Amendment) Act, 2010 [commonly called “the 18th Amendment”] that has made over 100 changes in the Constitution of Islamic Republic of Pakistan [“the Constitution”] a major one being deletion of the Concurrent Legislative List. Resultantly, in relation to taxes the provinces are empowered to legislate on all the subjects, other than those contained in the Federal Legislative List, Part IV, and Fourth Schedule to the Constitution. In terms of Article 142 of the Constitution, Majlis-e-Shoora [Parliament] since April 2010 enjoys exclusive powers to make tax laws with respect to matters mentioned in the Federal Legislative List, but have no authority to enact such laws regarding matters not enumerated therein, except that it shares with Provincial Assemblies the right to enact laws relating to criminal laws, procedures and evidence. However, Parliament [National Assembly] has exclusive authority to enact tax laws for areas not included in any province. Certain recommendation like NTA’s role as simple tax agency and NEC’s mandate after 18<sup>th</sup> amendment have also been covered in the paper especially the planning disconnect after federalization of NEC. The responsibility for income tax including agriculture tax to center and sales tax on goods to provinces are suggested for fiscal stabilization in Pakistan.

## Taxation Post 18<sup>th</sup> Amendment

The Constitution (Eighteenth Amendment) Act, 2010 [18th Amendment] made many changes in the Constitution of Republic of Pakistan [the Constitution] that included omission of entire Concurrent Legislative List and certain amendments in the Federal Legislative List contained in the Fourth Schedule—we are confined here to examine the impact on taxes alone. Before analyzing various changes relating to taxes, it is important to mention that in terms of Article 142 of the Constitution, Majlis-e-Shoora [Parliament] enjoys exclusive powers to make laws with respect to matters mentioned in the Federal Legislative List, but have no authority to enact laws with respect to matters not enumerated therein, except that it shares with Provincial Assemblies the right to enact laws relating to criminal laws, procedures and evidence. However, Parliament has exclusive authority to enact laws for areas not included in any province.

In the wake of 18th Amendment, the main entries related to imposition of taxes in Part I of the Federal Legislative List are:

- Duties of customs, including export duties (Entry 43)
- Duties of excise, including duties on salt, but not including duties on alcoholic liquors, opium and other narcotics (Entry 44)
- Taxes on income other than agricultural income (Entry 47)
- Taxes on corporations (Entry 48)
- Taxes on sales and purchase of goods imported, exported, produced, manufactured and consumed, except sales tax on services (Entry 49)
- Taxes on the capital value of assets, not including taxes on immovable property (Entry 50)
- Taxes on mineral oil, natural gas and minerals used in generation of nuclear energy (Entry 51)
- Taxes on the capital value of assets, not including taxes on immovable property (Entry 50);
- Taxes on the production capacity of any plant, machinery, undertaking or installation in lieu of one or more taxes (Entry 52); and
- Terminal taxes on goods or passengers carried by railway, sea or air, taxes on the fare and freights (Entry 53).

The 18th Amendment omitted two very important entries from the Federal Legislative List entitled ‘Duties in respect of succession to property’ [Entry 45] and ‘Estate duty in respect of property’ [Entry 46] meaning by that the provinces alone can levy these taxes. It also amended Entry 50 replacing the phrase ‘not including taxes on capital gains on immovable property’ with “not including taxes on immovable property”. The omission of Entries No. 45 and 46 was of no practical importance because long ago the federal government withdrew progressive taxes like Estate Duty and Gift Tax.

The major change was in Entry 50 as Capital Value Tax (CVT) on immovable property in the wake of 18th Amendment became provincial subject. The Federal Board of Revenue (FBR) thought otherwise. It sent a proposal of imposition of Capital Gains Tax (CGT) on the sale of immovable property to Ministry of Law. The Law Division also opined that after amendment in Entry No 50 of Federal Legislative List through the 18th Amendment Act, 2010, the levy of tax on capital gain on the disposal of immovable property would fall within the domain of the Federal Legislative List.

The FBR after securing favourable opinion from Law Division recommended in the Finance Bill insertion of a new section 236C in the Income Tax Ordinance, 2001 for collection of tax from the seller at the time of transfer of property. The aspect that escaped the attention of FBR and Law Division was that amendment in Entry 50 of the Federal Legislative List, in fact, debars the federation to levy any kind of tax on immovable property. The Capital value Tax (CVT) after 18th Amendment stands transferred to provinces. If federation cannot levy any tax on immovable property, how can it tax “capital gain” arising out of immovable property?

It is not comprehensible how FBR and Law & Justice Division by mere omission of the words “capital gains” in Entry 50 of the Federal Legislative List by 18th Amendment concluded that right to taxation on gain of immovable property has been shifted to federation from federating units? They have certainly misread the law. The second part of Entry 50 is couched in negative phrase—the phrase “not including taxes on immovable property” in Entry 50 cannot be read to “include taxes on capital gains on immovable property”.

The undeniable fact is that the rich and mighty dominating the Parliament, through the 18th Amendment managed to escape estate duty, gift tax and wealth tax. They do not pay any progressive taxes under any provincial tax law (agricultural income tax is just a farce under provincial laws and there is also no political will to secure its collection). They have ensured through 18th Amendment that on their colossal immovable assets no wealth tax, estate duty or gift tax can ever be levied by the FBR.

The fiscal management in the wake of 18th Amendment has been posing serious challenges for all. The problems diagnosed by experts are ambiguity over taxation rights between federation and its units, weak administrative structures, lack of political will and apparatuses to enforce devolved subjects/laws, issues of capacity, efficiency, rent-seeking and competitiveness, violation of the rule of law, non-acceptance of the norms of fair play in economic matters coupled with ‘reckless’ borrowing and ‘ruthless’ spending amidst dismal tax-to-GDP ratio.

Presently, all broad-based and buoyant sources of revenue are with the federal government and contribution of provinces in total tax revenues [Rs. 5273 billion] for fiscal year 2020-21 [11.1 % of GDP] was merely 9.6% and in overall national revenue base (tax and non-tax revenue) of Rs. 6903 billion [14.5% GDP] it was 9.5% against the total national expenditure of Rs. 10307 billion [21.6% of GDP].

All provinces together generated taxes of Rs. 508 billion [1.1 % of GDP] and non-tax revenues of only Rs. 150 billion.

The federal government spent Rs. 1316 billion on defence and Rs. 2750 billion on debt servicing and after transfer to provinces of Rs. 2742 billion under the 7th National Finance Commission Award (NFC), these two alone were Rs. 2067 billion higher than net revenue collection of the federal government. This is our main perpetual fiscal dilemma. While the federal government is accumulating debts, the provinces are heavily dependent on transfer from NFC Award. What makes the situation more disturbing is the fact that right of provinces to levy sales tax on services is encroached by federal government through levy of presumptive/minimum taxes on services under the Income Tax Ordinance, 2001, sales tax on gas, electricity and telephone services and excise duty on a number of services.

Before independence, the provinces had the exclusive right to levy sales tax on goods and services within their respective physical boundaries. The subject of sales tax was on the Provincial Legislative List at Serial No.48 in the Government of India Act, 1935 and was described as “Taxes on sale of goods and on advertising”. In the Constitution, 1956, “tax on sales and purchases” was mentioned at serial No.26 of the Federal Legislative List, and therefore, for the first time it became a federal subject. The position was maintained in 1962 Constitution, which mentioned “tax on sales and purchases” in the Federal Legislative List as clause (j) at serial No.43 in the Third-Schedule. In 1973 Constitution as originally adopted ‘tax on sales and purchases’ was kept on Federal Legislative List at serial No.49 of Part I of the Federal Legislative List given in the Fourth Schedule. The item was, however, completely substituted by Constitutional 5<sup>th</sup> Amendment Act, 1976 with effect from September 13, 1976 that read “Taxes on sales and purchases of goods imported, exported, produced, manufactured or consumed”. The second half of the amended entry appears to have been taken from the amendment made in Sales Tax Act, 1951 by Finance Ordinance, 1960. Through that amendment the words “consumption of goods” in the preamble were substituted by “importation, exportation, production, manufacture or consumption” [see details in *WAPDA v. Collector of Central Excise and Sales Tax* (2002 PTD 2077 and also in *Pakistan through Chairman FBR and others v Hazrat Hussain and others* (2018) 118 Tax 260 (S.C. Pak)].

The solution is to move towards harmonized sales tax on goods and services. The total collection by imposing unified sales tax on goods and services can reach around Rs. 6500 billion as against collection of Rs. 1990 billion by FBR in 2020-21 through sales tax on goods and provinces cumulatively of Rs. 294 billion through sales tax on services. The additional revenue collection of nearly Rs. 4200 billion will not only give fiscal space to the federal government to narrow down fiscal deficit but would also enhance distribution amount to the provinces. Distribution would be strictly as per Constitution of the Islamic Republic of Pakistan [“the Constitution”].

The retail sector alone has potential of nearly US\$ 5 billion, if not more. In Retail sector: has a US\$ 5 billion tax potential, TNS, [Political Economy] *The News*, September 6, 2020, it is shown how low-rate retail sales tax on retailers with fool-proof point-of-sale (POS) connectivity can bring prices down, yield higher revenues and accelerated growth provided

that fundamental structural reforms are made and taxation rights between the federation and its units are reconsidered to make Pakistan a self-reliant entity.

The potential of retail sector is yet not fully tapped by FBR through POS connectivity as target to register all the outlets is still a far cry as highlighted in *FBR falls short of POS target* [*The Express Tribune*, April 17, 2022]. Retail sector: a US\$ 5 billion tax potential, as a pilot project, is elaborated in detail along with other tax policy and administrative reforms in *Towards Flat, Low-rate, Broad and Predictable Taxes* (PRIME Institute, Islamabad, December 2020) but none paid heed. Thus revenue generation at federal level remains short of annual current expenditure what to speak of meeting development outlays. Provinces are also not meeting their constitutional obligations towards the citizens even after getting larger shares under the NFC Award—courtesy improvement in the collection of FBR.

On the basis of collection of first six months of the current fiscal year, share under the NFC Award of the four provinces was Rs. 1941 billion as compared to Rs. 1280 billion in the corresponding period of the last fiscal year. It squeezed the fiscal space for the federal government to meet the ever-increasing cost of debt servicing at Rs. 1453 billion.

Pakistan has been facing grim challenges on the fiscal front as Summary of Consolidated Federal and Provincial Fiscal Operations, 2021-22 (Provisional), available on the website of Ministry of Finance (MoF), for July 2021 to December 2021, shows that even part of defence spending is now funded by borrowing. It is more than a fiscal fiasco—a serious cause for concern threatening economic viability and national security of the country. The negative impact of mindless and costly borrowing, both external and internal, resulted in debt servicing of Rs.1453 billion with fiscal deficit reaching Rs 1.37 trillion.

The facts for fiscal year 2021 were highlighted in Budget FY 22: Tarin faces Herculean task, *Business Recorder*, May 20, 2021, Shaukat Tarin’s challenge, TNS, [Political Economy] *The News*, April 25, 2021 and More on the fiscal fiasco, TNS, [Political Economy] *The News*, February 28, 2021.

Total tax revenue collection by FBR from July 2021 to December 2021 was Rs. 2920 billion and after transferring the shares to provinces under NFC Award (Rs. 1225 billion), the net available to federal Government from tax and non-tax revenue (Rs. 3635 billion) was Rs. 1940 billion that could not even meet the two major heads, debt servicing (Rs. 1453 billion: domestic Rs. 1312 billion and foreign Rs. 140 billion) and defence (Rs. 520 billion). It means that all other expenses, including development outlays, to be funded by borrowed money.

Structural reforms and concrete actions are needed for tapping the real tax potential of the country, which is not less than Rs. 16 trillion at national and provincial levels [‘Towards Flat, Low-rate, Broad and Predictable Taxes’, PRIME, 2016]. Unfortunately, the present tax collection by federal and provincial governments is highly unsatisfactory. The real potential at federal level is not less than Rs. 12 trillion, whereas FBR is collecting nearly half of it. The same is the position of provincial tax authorities that have failed to realise the tax potential of

Rs. 4 trillion. At present, all broad-based and buoyant sources of revenue are with the federal government while contribution of provinces in total tax revenues is only seven percent—in overall national revenue base (tax and non-tax revenue) it is around eight percent. This has made them totally dependent on the federal government for transfers from divisible pool and/or direct grants.

Pakistan, as mentioned in ‘PTI and tax reforms’, *Business Recorder*, August 17, 2018, needs to increase collection at all levels of governments to bridge monstrous fiscal deficit that reached the level of over 8% of GDP for the fiscal year 2021-21. It was stressed in ‘Overcoming fragmented tax system’, *Business Recorder*, October 19, 2018 that all the tax collection agencies in Pakistan should be dismantled and merged into single National Tax Authority (NTA), which should effectively enforce tax laws at federal, provincial and local levels, besides providing single window facility to taxpayers. Before establishing NTA, all the four provinces should be consulted and consensus must be reached for establishing an All Pakistan Unified Tax Service (APUTS) as suggested and elaborated in ‘Case for All-Pakistan Unified Tax Service: PTI & innovative tax reforms’, *Business Recorder*, August 31, 2018, and ‘Doing business under scattered taxation’, *Business Recorder*, September 7, 2018.

One major hindrance towards optimizing revenue collection is the scattered and haphazard tax collection through multiple authorities at the federal and provincial levels. The trend was further strengthened consequent to the 18th Amendment after which the provinces established their own tax collection agencies at the provincial level. However, these provincial tax authorities still lack skilled manpower, tax collection expertise and other necessary human capital and paraphernalia to collect taxes. To meet these objectives, the services of FBR officers were requisitioned by the provincial authorities for their posting at provincial tax collection agencies on deputation basis. Resultantly, many of the FBR officers were sent to provincial tax agencies such as Sindh Revenue Board (SRB) and Punjab Revenue Authority (PRA).

Although the 18th Amendment was widely appreciated by the provinces, it created fissures in the revenue collection authority of FBR resulting in further decline in tax collection because tax on services fell in the provincial domains. On one side, the move was hailed by the provinces but, on the other, the taxpayers immediately started raising their eyebrows because they had to now face both federal and provincial tax authorities. All major Chambers of Commerce expressed their concerns and showed reservations on the scattered tax collection in the aftermath of the 18th Amendment. It is important to mention that Excise and Taxation (E&T) departments are already working as a separate entity under the provincial governments. The E&T departments have no formal administration connection with SRB, PRA and other provincial tax collection agencies. Unless, all federal and provincial tax agencies are unified and harmonized, the dream of optimum tax collection cannot be materialized. Through consensus and democratic process, all the parliaments can enact laws for establishing an autonomous National Tax Agency that can facilitate people to deal with a single Revenue Authority rather than multiple agencies at national, provincial and local levels. The mode and working of NTA can be discussed and finalised under Council of Common Interest [Article 153] and its control can be placed under National Economic Council [Article 156].



It is strange that with the devolution of a large number of subjects to the provinces since the Eighteenth Constitutional Amendment in 2010, Planning Commission is still working as arm of Federal Government without taking into account the command of Article 156(2) of the Constitution which says:

“The National Economic Council shall review the overall economic condition of the country and shall, for advising the Federal Government and the Provincial Governments, formulate plans in respect of financial, commercial, social and economic policies; and in formulating such plans, it shall, amongst other factors, ensure balanced development and regional equity and shall also be guided by the Principles of Policy set-out in Chapter 2 of Part II”.

The deletion of the subject of national planning from the exclusive domain of the Federal Government, and the placing of the National Economic Council (NEC) in the list of subjects mandated to be the joint responsibility of the Federal Government and the Provincial Governments remains unnoticed by our parliamentarians and independent experts. Strangely, the provinces have not raised this issue till today.

Centralized planning was an important factor in the dismemberment of the country in 1971. The planning, in the post-Eighteenth Amendment period should have to be federalized rather than centralized. But nobody has raised this issue. The Eighteenth Constitutional Amendment has redefined NEC on the pattern of Council of Economic Interests (CCI). The NEC forms part of the Chapter 3 of the Constitution entitled ‘**Special Provisions**’. Before the Eighteenth Amendment, Article 156 related to the NEC had two clauses. Clause (1) described the composition and clause (2) its functions. These clauses have undergone important changes after the Eighteenth Amendment. The pre-amendment clause (1) read as follows:

“The President shall constitute a National Economic Council consisting of the Prime Minister, who shall be its Chairman, and such other members as the President may determine:

*Provided that the President shall nominate one member from each Province on the recommendation of the Government of that Province.”*

While the apex planning body, the NEC, has been federalized, Planning Commission continues to be centralized. The spirit of the Constitution can be satisfied by (1) making Planning Commission, in place of the Cabinet Division, the Secretariat of the NEC and (2) by reducing the number of its members to five, one each from the Provinces and the Federal Government. Prime Minister chairs the NEC and there is no need for him to Chair the Planning Commission. The Chairman should be appointed by the CCI to represent the Federation.

There is an urgent need for restructuring the planning mechanisms in the provinces. At present, the provincial planning and development boards/departments are not working in harmony with NEC. An important reason why the centralized role of planning and the Planning Commission continues is the weak capacity of the provincial planning mechanisms. After the Eighteenth

Amendment, the Planning Commission could no more be a centralized body. Federal Legislative List, Part I, contains subjects which lie in the exclusive jurisdiction of the Federal Government. Before the Eighteenth Amendment, its item 32 related to planning—“National planning and national economic coordination including planning and coordination of scientific and technological research.” After the Amendment, the subject was included in the Federal Legislative List, Part II. The last-mentioned list of subjects is neither exclusively federal nor provincial; it is an area of joint responsibility. In the Constitution, a special institution, the Council of Common Interests (CCI), has been created to supervise the affairs of the Federation listed in Part II of the Federal Legislative List.

The taxation rights under the prevalent constitutional scheme needs reconsideration allowing provinces to raise adequate resources that will also help in overcoming overall fiscal deficit faced by the Centre. For example, Balochistan should get “net proceeds” on natural gas and Khyber Pakhtunkhwa on electricity, as envisaged in Article 161(1)(a) & (b) of the Constitution. Their present share in sales tax from divisible pool is as low as 9% and 14% respectively. They have rich natural resources and wealth of oil, gas and electricity but due to low population get a small share for goods they produce. The same is the case for Sindh. Punjab is the only beneficiary of the existing distribution of taxes under Article 160—it gets a lion’s share of 53%.

It is worth mentioning that planning, in the period following Constitution (Eighteenth Amendment) Act, 2010, received assent of President on April 20, 2010, should have been federalized rather than centralized. But even after a lapse of 12 years, nobody has raised this issue, what to speak of implementing it in letter and spirit. The Constitution (Eighteenth Amendment) Act, 2010 [commonly called the 18th Amendment] has redefined National Economic Council (NEC) on the pattern of Council of Economic Interests (CCI). NEC forms part of Chapter 3 of the Constitution entitled ‘Special Provisions’. In view of Article 167(4), the role of NEC has become very important though it has yet not been realized by the center and provinces. Debts needed by provinces and their servicing plus repayment should be borne by provinces to relieve the federal government of the enormous amount that takes away of tax revenues and non-tax revenues. Article 167 of the Constitution after addition of clause (4) by the 18th Amendment reads as under:

### **Borrowing by Provincial Government**

**167.** (1) Subject to the provisions of this Article, the executive authority of a Province extends to borrowing upon the security of the Provincial Consolidated Fund within such limits, if any, as may from time to time be fixed by Act of the Provincial Assembly, and to the giving of guarantees within such limits, if any, as may be so fixed.

(2) The Federal Government may, subject to such conditions, if any, as it may think fit to impose, make loans to, or so long as any limits fixed under Article 166 are not exceeded give guarantees in respect of loans raised by, any Province, and any sums required for the purpose of making loans to a Province shall be charged upon the Federal Consolidated Fund.

(3) A Province may not, without the consent of the Federal Government, raise any loan if there is still outstanding any part of a loan made to the Province by the Federal Government, or in respect of which guarantee has been given by the Federal Government; and consent under this clause may be granted subject to such conditions, if any, as the Federal Government may think fit to impose.

(4) A Province may raise domestic or international loan, or give guarantees on the security of the Provincial Consolidated Fund within such limits and subject to such conditions as may be specified by the National Economic Council.

The 18th Amendment gives provinces equal rights over their natural resources. Article 172(3) confers 50% ownership of hydrocarbon petroleum resources to the provinces. The subject was earlier held by the federal government. There still exist legal and administrative bottlenecks for implementing this provision.

Presently, many economists and politicians are arguing that 7th NFC Award and 18th Amendment are harming fiscal stability of federation. Their argument needs consideration. The issue of NFC Award vis-à-vis provisions of 18th Amendment must be examined holistically. The performance of provinces in collecting tax from the rich and mighty e.g. agricultural income tax is extremely appalling. This is a common issue both at federal and provincial levels arising from absence of political will to collect income tax from the rich—the meagre collection of agricultural income tax—less than Rs. 3 billion by all provinces and federal government in fiscal year 2020-21 is lamentable.

It is imperative that right to collect tax on income, including agricultural income, should be given to the Centre through dialogue and in a democratic way under Article 144 of the Constitution which says:

**Power of Majlis-e-Shoora (Parliament) to legislate for one or more Provinces by consent**

**144.** (1) If one or more Provincial Assemblies pass resolutions to the effect that Majlis-e-Shoora (Parliament) may by law regulate any matter not enumerated in the Federal Legislative List in the Fourth Schedule, it shall be lawful for Majlis-e-Shoora (Parliament) to pass an Act for regulating that matter accordingly, but any act so passed may, as respects any Province to which it applies, be amended or repealed by Act of the Assembly of that Province”.

In the same manner, the Centre and provinces should levy harmonized sales tax on goods and services. The division should be strictly according to formula agreed under Article 160 of the Constitution so collection will be efficient and citizens/taxpayers will have a one window facility. This will help the State to collect taxes of Rs. 12 trillion as per actual potential—details are available in ‘Towards Flat, Low-rate, Broad and Predictable Taxes’. This is the only way to meet the emergent economic challenges faced by the State and achieve fiscal stabilization in Pakistan without disturbing the 18th Constitutional Amendment and achieve the cherished goal of self-sustainability.

It is imperative that right to levy tax on income, including agricultural income, should be given to the Centre. In return, the Centre should hand over sales tax on goods to the provinces. This will help FBR to collect income tax as per actual potential and the provinces by levying sales tax on goods in addition to services will generate sufficient funds for their needs. It will also reduce fiscal deficit of the Centre. This is the only way to achieve fiscal stabilization in Pakistan without disturbing the 18<sup>th</sup> Amendment.