



INTERNATIONAL MONETARY FUND

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***Funding Program Assessment
Pakistan - Tax Policy Project***

Final Report

COUNTRY (S): Pakistan

DATES: 7/1/2020 - 4/30/2023

PROGRAM ID: FAD_PAK_2021_01

LEAD DEPARTMENT: FAD

REGION (S): MCD

FUNDING SOURCE: RMTF01

PROJECT MANAGER: Verhoeven, Marijn

ASSESSMENT TYPE: Final

ASSESSMENT PERIOD: 5/1/2022 - 4/30/2023

BUDGET: \$11,271

I. PROGRAM PURPOSE

II. PROGRAM IMPLEMENTATION AND ACHIEVEMENTS

Results Overview and Key Achievements

A mission to Islamabad in February of 2023, in conjunction with a visiting MCD mission to conduct the 6th Review under the Extended Fund Facility (EFF) arrangements, resulted in two key achievements:

Commitment of the authorities to move the tax policy analysis function from the Federal Board of Revenues (FBR) to the Ministry of Finance as a key step toward strengthening this critical function for improved decision making on tax policy—the current caretaker Government has indicated that it will move forward with this in early 2024 and has requested follow-up FAD support.

Agreement with the authorities to update the medium-term plan for reform of tax policy based on a FAD tax policy diagnostic. A mission to conduct such a diagnostic and provide advice on establishing a Tax Policy Unit in the Ministry of Finance is planned for November-December 2023.

Continuous engagement with the authorities and the MCD country team has ensured agreement during EFF reviews and the negotiation of the successor Standby Arrangements on cohesive revenue measures building on previous FAD advice. Shifting the burden of taxation to higher-income households and strengthening the Sales Tax were key measures undertaken during the assessment period.

Challenges Encountered and Lessons Learned

Authorities' tax policy priorities are subject to frequent change. Over the last six months, capacity development support on the area of tax policy has focused on identifying the appropriate policy measures in response to recent floods. Widespread floods during June-October 2023, with estimated damage of US\$32 billion (9 percent of GDP), have contributed to deteriorating fiscal and BOP balances and worsening inflation. The priority of the Government and the IMF-supported EFF program has shifted to identifying measures to raise revenues in the immediate term.

CD support needs to effectively balance more volatile short-term priorities and longer-term objectives under the CD program. Integrating CD support with on-going policy discussions under the EFF ensures that the support is relevant and timely for the authorities and ensures support from the area department for CD priorities. Prioritizing support for tax analysis capacity in the Federal

Board of Revenue (including through the upcoming mission) promotes larger policy cohesion and improved time consistency.

Partner Outreach and Coordination

Donors and providers of CD support meet at least on a quarterly basis to coordinate their activities and prevent overlap. The ADB, OECD, UK's HMRC and FCDO, as well as the World Bank and WHO participate in these coordination meetings. FAD's Revenue Management I Division also provides support, with a focus on compliance risk management.

Next Steps

Support strengthening of the Tax Policy Unit as it is moved to the Ministry of Finance.

Recommend short- and medium-term reform with a view to improving revenue performance as well as efficiency, neutrality, simplicity, and equity of the tax system.

III. LOGICAL FRAMEWORK

Pakistan (PAK)				
OBJECTIVE:				
Outcome	Rating	Verifiable Indicators	Baselines	Results
Increased/decreased revenue quantity due to amended tax rates or base	Not Achieved	Tax as a percent of GDP	15 percent of GDP in FY23	10 percent of GDP in FY23
Milestones	Rating	Milestone Achievements		
First step of Sales Tax harmonization proposal has been discussed with FBR and provincial authorities	Fully Achieved	Target completion date December 30, 2020 was met: Agreement reached between FBR and Provinces on common definitions of goods and services for Sales Tax purposes IT infrastructure developed for administration of the Sales Tax across jurisdictions		
Reforms to further increase revenue have been presented and discussed with the authorities	Fully Achieved	Target completion date September 01, 2021 was met: Key reforms introduced with the FY22 budget included: rationalization of tax expenditures under the Corporate Income Tax; raising tobacco excises; and higher taxes on fuel (which was later rescinded)		
Other proposals to further improve ST, PIT, excises, and CIT are submitted to the Parliament	Fully achieved	Completion was delayed from the target date of May 01, 2021 to June 30, 2021, see previous item for achievements		

Other proposals to further improve ST, PIT, excises, and CIT are submitted to the Parliament	Fully achieved	Completion was delayed from the target date of May 01, 2022 to June 30, 2022: Reforms with the FY23 budget included: rationalization of tax expenditures under the Personal Income Tax; higher taxes on fuel; increased income taxation of high earners; introduction of an excise on sugary drinks; increased rates for the Capital Gains Tax Additional reforms were undertaken with the FY23 and FY24 budgets, including: rationalization of tax expenditures under the Sales Tax; introducing a super Profit Tax on high earnings in selected sectors (sugar, automobiles, banking, cement, cigarettes, fertilizers, oil and gas, and aerated beverages); introducing and increasing various taxes on property; and introducing a fixed tax on retailers (legislated but yet to be implemented)		
Models are ready and staff have been trained	Partially achieved	Target completion date March 01, 2022 was partially met The Tax Policy Wing of FBR has developed a VAT model for the Tax Expenditure Review Microsimulation of income taxes remains undeveloped		
Second step of Sales Tax harmonization proposal has been discussed with FBR and provincial authorities	Partially Achieved	Target completion data of September 01, 2021 was partially met FBR and Provinces have continued discussion but implementation of the new IT infrastructure by Provinces remains partial		
Outcome	Rating	Verifiable Indicators	Baselines	Results
Improved distributional fairness across taxpayers due to amended tax rates or base	Partially Achieved	Tax preferences (exemptions, low rates, etc.) benefiting mainly high-income households are reduced	0	1
Milestones	Rating	Milestone Achievements		
Additional corrective measures are proposed in relation to the ST and PIT reforms	Fully Achieved	Completion was delayed from the target date of March 30, 2021 to July 1, 2022: As of July 2022, increased taxation under the Personal Income Tax for high earners by increasing tax rates and rationalizing credits and exemptions		

Several tax exemptions and tax incentives have been eliminated	Fully Achieved	Completion was delayed from the target date of September 30, 2021 to July 1, 2023: - As of July 2023, tax expenditures under the Sales Tax were rationalized including items mostly consumed by high-earning households such as high-end phones and cars - See also previous point on rationalizing PIT credits and exemptions as of July 2022		
Several tax exemptions and tax incentives have been eliminated	Fully Achieved	Target completion data of September 01, 2021 was met, see previous item		
Outcome	Rating	Verifiable Indicators	Baselines	Results
Maximized transparency (including in the policy process) and potential for enforcement and minimized administration and compliance costs	Fully Achieved	Tax expenditures are published households are reduced	0	1
Milestones	Rating	Milestone Achievements		
Tax expenditures are published	Fully Achieved	Target completion date of May 31, 2022 was met: In July 2020, Pakistan started with the publication of an annual tax expenditure report		
Several tax exemptions and tax incentives have been eliminated	Fully Achieved	Target completion data September 01, 2021 was met, see previous item		

IV. RISK ASSESSMENT AND MITIGATION

Risks are assessed based on probability and impact. Risk ratings are low, medium, high and very high.

Risk Description	Risk Rating	Mitigation Measures	Risk Update
Political Support			
There may be pressure for the Government to focus on quick-win revenue collection, rather than on critical reform. Authorities may delay or tend to modify the reforms in the face of the political cost implementing changes to CIT / PIT / ST/ incentives.	Medium	Helping build consensus in government to back the reforms and identifying a subset of measures that can be politically acceptable	While political support remained fragmented, the Government over largely followed the priorities of the capacity development project, with some

Risk Description	Risk Rating	Mitigation Measures	Risk Update
			delays and occasional backtracking
Management Support and Technical Staff Commitment			
Tax Department management focuses mainly on tax administration measures and uses tax policy to address compliance and enforcement problems.	Medium	Develop a prioritized and resourced reform plan. Maintain strong engagement and mentoring of supervisory and managerial staff.	The risk and mitigation strategy played out during the implementation of the capacity development function. The decision to move the tax policy analysis function from the tax administration (FBR) to the Ministry of Finance planned for early 2024 is an important follow-up step to mitigate this risk for future reforms
Resource Adequacy			
Inadequate systems, operational equipment (computers, software, etc.) and infrastructure.	Medium	Adopt a multi-donor support approach to improve resource availability.	Other donors, and specifically the World Bank, have provided substantial support
External Climate/Conditions			
Weak economic performance may affect revenue mobilization.	Medium	Adopt a coordinated approach with the IMF Area Department	Weak economic performance became key issue under the capacity development program. Close coordination with the IMF Area Department transformed this issue into an opportunity as CD support under the project was closely integrated with policy discussions.
Other Risks			
None			