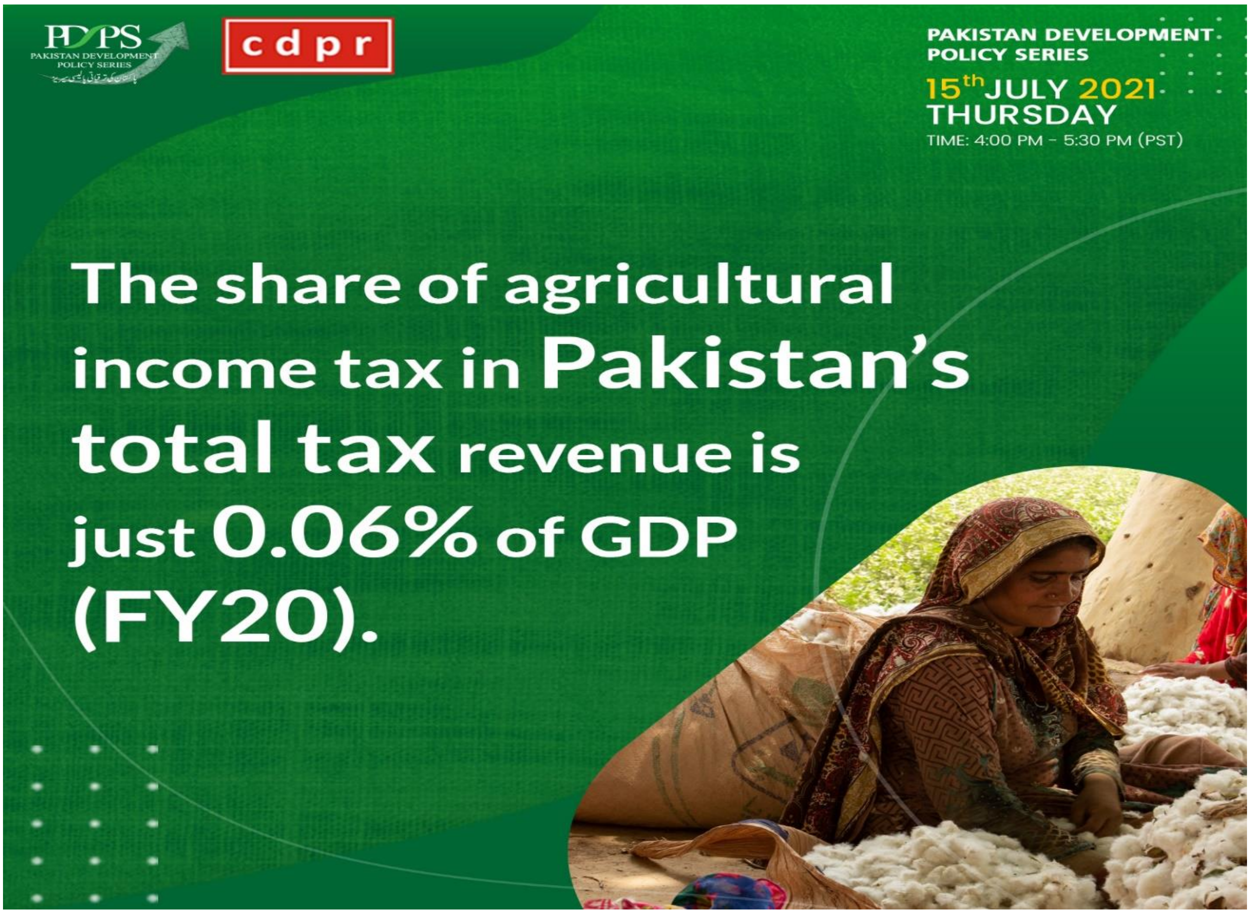
Event Brief: Closing the Agriculture Tax Gap

The Consortium for Development Policy Research (CDPR), in collaboration with the World Bank, hosted a webinar "Closing the Agriculture Tax Gap" on Thursday, 15th July 2021. The webinar was a part of the ongoing Pakistan Development Policy Series (PDPS) 2021 which aims to invite discussion and debate on key development policy issues relating to Pakistan's economic and social by engaging with multiple stakeholders including policymakers, policy experts and representatives from the private sector and civil society.

Context

Agriculture income tax is an important source of revenue for the government, even more so in the case of Pakistan where the economy is predominantly agrarian. Agricultural income includes crop farming and rental income from land and/or income from livestock and animal husbandry. While the agriculture sector contributes to almost 19% of the national GDP, the share of agricultural income tax (AIT) in the country's total tax revenue is abysmally low, at just 0.06% of GDP (FY20). Pakistan is failing to tap into its large agrarian base and this is largely because it violates two basic principles of taxation: horizontal equity (taxing equal incomes equally) and vertical equity (taxing all earners). This further leads to two issues:

1. Revenue raised from such taxes is low.
2. Tax evasion remains high.



Additionally, there are structural issues that have contributed to this tax gap. Agricultural income tax in Pakistan is constitutionally a provincial tax that gives provinces the mandate to levy tax on agricultural incomes. Currently, the provincial governments levy tax on cultivated land (not cropped land) and on area under orchards. However, provincial governments can change this law and tax cropped acreage instead of cultivated acreage. Federal government collects tax on all sources of income except agricultural income. Due to this exemption, Pakistan forgoes almost Rs 69.5 billion worth of revenue each year.

Secondly, agriculture tax is effectively a tax on land and not income. Provincial governments do not revise tax rates to reflect changes in the income potential from land. Therefore, tax as a share of income continues to fall as agricultural income increases, compromising its progressivity. Currently, taxpayers can divide land amongst family members or associates thereby evading the tax. However, if an agriculture income tax is imposed, it would allow for heavier taxation on those with sufficient ability to pay and would also provide exemptions to the poor.

It is in this context that the webinar was held, with the discussion aiming to provide answers to the following questions:

● How to strengthen provincial tax administration to improve enforcement?
● What reforms can bring agricultural income taxation at par with taxation of business incomes (including an accurate estimation of the potential income from land and equitable redistribution of the burden of tax)?
● What data-sharing mechanisms between the federal and provincial tax authorities can be implemented to close existing loopholes on tax evasion that occur by misdeclaration of business income as agricultural income?
● What alternative options can be explored in the short-term to implement AIT: PIU-based tax, withholding tax?

<u>Event Proceedings</u>

The webinar was headed by Dr. Ijaz Nabi (Chairperson CDPR) and Mr. Najy Benhassine (Country Head of the World Bank) and hosted a panel of prominent experts from the government and private sector. Ms. Arifa Noor (journalist and lead anchor at Dawn News) moderated the discussion which also included Mr. Taimur Jhagra (Minister for Finance & Health, Government of Khyber Pakhtunkhwa) as the keynote speaker. Keeping in line with the broader aim of the PDPS, to ensure engagement between all relevant stakeholder, the panel was carefully curated to ensure that it included taxation experts, government representatives and equally importantly, perspectives of the farmers. As such, the panel also hosted Dr. Hanid Mukhtar (former Lead Economist at the World Bank and fellow at CDPR), Mr. Tuan Minh Lee (Lead Economist at the World Bank), Mr. Tariq Bajwa (Former-Chairman Federal Board of Revenue), Mr. Syed Zafar Ali Shah (Senior Member, Board of Revenue Khyber Pakhtunkhwa), and Mr. Aamer Hayat Bhandara (Farmer and Co-founder Agriculture Republic).

The discussion was initiated by Dr. Ijaz Nabi, who stated that much of the issues regarding revenue generation from agriculture stem from the conceptualization of taxation in the agriculture sector which at presently is more in the form of a land tax rather than an income tax. Compounding this issue, is the fact that this tax collection is not carried out by provinces and who also lack the capacity to collect it. Dr. Nabi then raised the question as to how to empower and equip the provinces with the technical knowhow to collect agriculture income tax to bolster their revenues?

The floor was presented to Mr. Taimur Jhagra, the keynote speaker for the event, who highlighted some of the policy actions undertaken by him as Minister for Finance in Khyber Pakhtunkhwa. During his tenure, the GoKP has been able to increase revenue collection provincial taxes by 75% over the past three years, which had been previously been lagging under 5% per year. Such success in revenue growth, he pointed out, was a result of two reforms initiated by his ministry. Firstly, the government abolished the land tax which earlier had only been providing a nominal contribution to the national exchequer earlier. Secondly, he highlighted that government increased the tax limit for farmers, brining it in line with other income tax regulations set by the Federal Board of Revenue (FBR). In line with these he explained that farmers would then have to declare agriculture related income to the authorities thereby, reviving the culture and spirit of an income tax. The KP Board of Revenue to that end has played a crucial role digitizing land records to make it easier to determine agricultural income and impose an agricultural income tax. Mr. Jhagra also stated that there was a long way to go realizing the true potential of tax collection from the agriculture sector and that the KP Board of Revenue was exploring innovative ways to modernize the “Patwari” system for tax collection and welcomed input from the rest of the panel to explore various solutions such as the possibility of the Federal Board of Revenue (FBR) sharing tax filers’ data with provincial governments, to minimize tax evasion by declaring other sources of income as agricultural income.

Mr. Tuan Minh Le then proceeded to provide a comparative analysis on the nature of agriculture in both developed and developing countries and put agriculture tax collection in that context then. He pointed out that in developing countries, agriculture is largely done at a subsistence level therefore tax collection should be reflective of such variations and also provide protection to small scale farmers.

Ms. Arifa Noor, steered the discussion towards the role of the FBR and raised the question towards Mr. Tariq Bajwa as to how it could work more closely with the provinces to assist in greater tax collection? Joining in the discussion, Mr. Bajwa pointed out that the provinces at present are collecting only about 2% to 3% of the true tax potential and he stated that a major stumbling block to reforms is the agriculturalists who possess a very strong lobby in both the provincial and national assemblies. He pointed out that loopholes at the provincial level have allowed relaxations to individuals who voluntarily declare their agriculture income. According to Mr. Bajwa, the provincial laws call for 10% taxation on such individuals while the FBR calls for a 25% taxation. Since provincial laws are not in line with the FBR regulations tax collection is low. Mr. Bajwa called for an amendment to this law which would abolish this loophole and also curtail tax evasion.

Dr. Hanid Mukhtar who had previously carried out a study on agricultural taxation in Punjab opined that the problem lies in the structure and enforcement. As far as the structure is concerned, Dr. Mukhtar explained that no other source of income generated in Pakistan has an option to be taxed under two separate laws and which directly affects enforcement and collection. Secondly, he was also of the view that provincial boards of revenue are there to collect land tax and not income tax, and moving forward if land tax is to be abolished in place of income tax then provincial boards are not the correct vehicle for tax collection moving forward.

Ms. Arifa then brought into the discussion, Mr. Syed Zafar Ali Shah who brought in his experience from the provincial board of revenue of KP. Mr. Shah has been at the forefront, spearheading the reforms in KP which have transformed tax collection in the province. He emphasized the importance of data sharing between FBR and the provincial boards and the efforts undertaken by the GoKP in this regard. He further highlighted that in KP, the board of revenue has initiated the digitization of land records which its completing at a rapid pace. In pointing all of this out, Mr. Shah highlighted the operational capacities of the provincial boards of revenue and how it can be a functional cog in the tax collection regime of Pakistan.

The floor was handed over to Mr. Aamer Hayat Bhandara then, to provide his unique perspective as a practicing farmer. Mr. Bhandara firstly, corrected a misperception that tax evasion is rampant amongst farmers. He stated that all farmers, both small and large land holders, pay tax in some form or the other especially on seeds and fertilizers. He also pointed out that in the rural farmlands, the system is largely informal. The lack of formal documentation in the agriculture marketing system is the main hurdle in tax collection. Lack of awareness and literacy amongst farmers in filing their tax returns is where the problem lies. He continued that agriculture value chain must be made more accountable, such as limiting the power and role of the middleman sitting in the markets.

The webinar concluded with a question and answer session with the audience, followed by closing remarks by Dr. Ijaz Nabi. He stressed on the need for greater tax revenue from agriculture, owing to agriculture’s sizable contribution to the GDP and as an importance source of provincial revenue. It was agreed by all panelists that there is a need to bring agriculture income tax at par with the country’s broader income tax regime.