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Beyond Tax Collection: Towards a Comprehensive Tax Policy for Pakistan

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Context

Pakistan lacks a standing, comprehensive tax policy document—a codified statement of principles, objectives and procedures that governs how, why and when new taxes are introduced or existing ones altered. In its absence, taxation has become an instrument of short-term fiscal management rather than long-term economic design. Nearly every Finance Bill introduces new levies, withdraws exemptions or raises rates and slabs, often mid-year through Statutory Regulatory Orders (SROs) issued under delegated authority. The consequence is a tax structure increasingly reliant on indirect taxes – sales tax, customs duties and petroleum levies—which fall disproportionately on lower-income groups, alongside a growing set of federal levies deliberately kept outside the divisible pool governed under the National Finance Commission (NFC) Award. This brief document traces the gap between the ideals of tax policymaking, the constitutional framework governing taxation in Pakistan and the reality of current practice, and proposes a policy pathway.

Canons of Taxation and the Rationale for Introducing a Tax

Classical and modern public finance theory provides a well-established framework for evaluating taxation before enactment. Adam Smith's four canons remain foundational, while modern theory emphasizes productivity (adequate and stable revenue), elasticity/buoyancy (revenue growth with the economy without repeated changes in tax rates), simplicity (ease of understanding and compliance), diversity (a balanced tax mix), neutrality (minimal distortion of economic decisions), equity (fair distribution according to ability to pay), certainty, convenience, and economy in collection.

These principles should inform a structured policy process: identify the fiscal or corrective objective; assess the tax base, elasticity, incidence and distributional effects; evaluate compliance, administrative, and economic costs; and undertake meaningful stakeholder and public consultation. Proposed taxes should then undergo critical parliamentary scrutiny rather than be imposed by executive fiat. Any delegated rule-making should remain narrowly bounded, time-limited and subject to subsequent ratification, ensuring that a tax's rationale, yield and distributional consequences are transparent and contestable before their imposition.

The Constitutional Framework for Taxation in Pakistan

The Constitution of Pakistan establishes taxation as a legislative rather than executive

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function. Article 77[3] provides that no federal tax may be levied except by or under the authority of an Act of Parliament, while the Federal Legislative List[4] specifies federal taxation powers, including income tax (excluding agricultural income), customs duties, federal excise duty and sales tax on goods, with sales tax on services devolved to provinces following the 18th Amendment. Article 160 establishes the National Finance Commission and the constitutionally mandated sharing of specified federal taxes with provinces through periodic NFC Awards, while Article 161 protects provincial claims to royalties and development surcharges from natural gas and hydroelectricity generated within their territories. Collectively, these provisions envisage taxation as a transparent, legislatively sanctioned and fiscally federal exercise, whereby revenue is raised through Parliament and shared according to predictable constitutional arrangements rather than structured to circumvent them.

Current Practice: Divergence from the Ideal

Actual practice diverges sharply from this design. Three interlinked problems stand out:

- **Taxation by administrative instrument rather than deliberation:** A significant share of rate changes, exemption withdrawals and new levies are introduced through SROs issued by the Federal Board of Revenue (FBR) or Ministry of Finance under delegated powers in tax statutes or bundled into the annual Finance Bill with minimal debate. Neither instrument is typically accompanied by a published rationale, an incidence analysis or an assessment of impact on the general public or vulnerable segments. Taxpayers and businesses are frequently confronted with changes announced with immediate effect, undermining the canon of certainty and raising compliance costs, contrary to the canon of economy.
- **Growing reliance on indirect and regressive levies:** Faced with narrow direct-tax bases and politically difficult reforms, successive governments have leaned on sales tax, customs duties and notably the petroleum levy, whose rate has been raised repeatedly with limited public justification. Because these are largely consumption-based, their burden falls disproportionately on lower and middle-income households who spend a larger share of income on taxed goods, directly violating the equity canon and entrenching a regressive overall structure.
- **Deliberate positioning of levies outside the divisible pool:** The petroleum levy, the Gas Infrastructure Development Cess (GIDC) and similar charges are structured as “levies” or “cesses” rather than as taxes captured by Article 160’s divisible pool. This is not incidental: because these revenues need not be shared with the provinces under the NFC Award, the federal government has a structural incentive to expand them rather than raise divisible-pool taxes such as income tax or standard sales tax, even where the latter would be more equitable or efficient. The effect is a widening gap between the constitutional intent of fiscal federalism and the federal government’s actual revenue-raising choices, along with an opaque justification for why particular revenue streams are excluded from provincial sharing.

Together, these practices produce a tax system that is unpredictable, places a skewed burden on the poor, is poorly explained, poorly explained to the public and increasingly detached from both the procedural ideal and the constitutional design it is meant to operate within.

Towards a Policy Framework: Recommendations

ABridging this gap requires institutionalizing rather than merely recommending the standards outlined above. The following framework is proposed:

[3] Tax to be levied by law only: No tax shall be levied for the purposes of the Federation except by or under the authority of Act of [Majlis-e-Shoora (Parliament)]
[4] Fourth Schedule: Federal Legislative list: Part I: section 43-54

- **Legislate a National Tax Policy / Medium-Term Revenue Strategy (MTRS):** Pakistan should adopt a statutorily mandated tax policy document, reviewed and updated on a rolling three to five-year cycle, setting out the guiding canons, target tax to GDP composition (*direct versus indirect*), sectoral priorities and the process by which any new tax or rate change must be justified. This mirrors practice already recommended by international financial institutions and adopted in several peer economies.

- **Institutionalize a mandatory rationale and impact statement for every tax measure:** No new tax, rate change or exemption withdrawal, whether in the Finance Bill or via an SRO should be tabled without an accompanying public statement covering: the policy objective, expected revenue yield, incidence and distributional impact (*with explicit attention to low-income and vulnerable groups*), compliance cost and consistency with the national tax policy document.

- **Curtail and sunset delegated legislative power:** The scope of SRO-based rule-making should be narrowed to technical or administrative matters, explicitly excluding substantive rate or base changes. Where delegation is unavoidable, SROs should carry automatic sunset clauses and require ratification by the relevant parliamentary committee within a fixed period, restoring the primacy of Article 77 of the Constitution of Pakistan.

- **Treatment of Levies:** Federal levies such as the petroleum levy, GIDC and similar cesses are highly regressive, disproportionately burdening poor and middle-class households by increasing fuel, energy, transportation and essential goods costs. The budget should therefore prioritize their phased removal or reduction to the lowest feasible level, retaining them only where demonstrably necessary and after assessing their inflationary and distributional consequences.

- **Rebalance the tax mix towards equity and elasticity:** Priority should shift from repeated rate increases on existing indirect taxes and compliant filers towards base broadening, bringing undertaxed sectors (*retail, real estate, agriculture income*) into the net and strengthening progressive direct taxation in line with the equity and productivity canons.

- **Build institutional separation between tax policy and tax administration:** A dedicated Tax Policy Unit distinct from FBR's collection function should lead rationale development, distributional modeling and stakeholder consultation, ensuring policy design is not subordinated to short-term collection targets.

- **Mandate periodic review and sunset clauses for major tax provisions:** Levies and exemptions should be time-bound and subject to renewal only after a published cost-benefit review, preventing indefinite continuation of measures introduced as "temporary" fiscal fixes.