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CBR PAKISTAN

DOT Gazette

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INTERVIEW

Yassie Hodges, CBR CONSULTANT

Ms Yassie Hodges was interviewed by the Director General, DOT, Mr. Muneer Qureshi, When she was visiting Lahore in connection with the Special Audit Course

DG(DOT): Yassie Hodges, can you tell us something about your professional background?

YASSIE HODGES: My overall background is that I have approximately 27 years of experience in tax administration.

I started my career with the Internal Revenue Service in the US as an auditor. I spent eight years as an auditor before I became resident lead instructor in training,training auditors that were coming into the service.

I initially worked as Chief of Audit and later became the Director of Compliance responsible for collection, compliance, criminal investigation and research.

Approx two years ago I left govt and started working with a private consulting firm.

Part of my work with the consulting firm had to do with helping tax administrators in developing countries deal with problems such as those obtaining in Pakistan.

I spent time in the Philippines specifically focusing in on their audit program looking at audit techniques.

Before I came here I was actually in Kenya doing very much the same type of work.

So I was selected here to actually take a look at the full audit program in Pakistan- not just make recommendations but rather reach an agreement with the CBR and implement a full fledged audit program and then follow up and monitor the program to see whether the changes envisaged are actually being properly implemented.

DG(DOT): You have been in Pakistan for some time now and have had an opportunity to get to know CBR personnel at all levels. What is your opinion of their overall competence and skill ?

YASSIE HODGES: Generally I must admit that I am very impressed with the overall skill set within CBR. I think you have a highly educated workforce which is a plus for the organization as a whole.

One of the things that I thought was a shortcoming however is whether you have the right people in the right job and that is something that needs to be taken into consideration.

I was impressed also by the fact that the organization puts in so much effort in it's overall training program but then again are we giving the right type of training to people for the jobs that they are assigned?

In particular I think that it applies to the MBA program. I think that's an excellent program but I was also wondering whether that was the most effective way to do the program at this point in time.

The new Income Tax Group & Sales Tax & Federal Excise officers have already spent 16 years in a learning environment and then to put them through a two to three year program before they even get any experience may be a little bit challenging in not being able to capitalize as much from

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PATRON
M. Muneer Qureshi (Director General)
STAFF ADVISOR
Dr. Hamid Ateeq (Additional Director)
EDITOR-IN-CHIEF
Amna Faiz BhattY (Deputy Director)
EDESIGN & LAYOUT
Zafar Iqbal

Directorate General of Income Tax Training & Research, Sutluj Block, Allama Iqbal Town, Lahore.
Ph: +92-42-7842710
PABX: +92-42- 7830211
Fax: +92-42- 7842702
Web: www.dgtrdt.gov.pk
e-mail: dg@dgtrdt.gov.pk

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The newsletter as well as its earlier issues are also available at our website www.dgtrdt.gov.pk

DOT Peacock
Photographed by: M. Muneer Qureshi

Kenwood Green re-inaugurated



The eye catching wood structure known as "Kenwood Green" is a DOT landmark and was built in 1998-99 entirely through funding contributed by Mr Khalid Hameed, then DOT instructor in Bookkeeping & Accountancy. Not only did he provide the funding for the project, he also supervised the erection of the structure right from the cuttting and shaping of the wood planks to the painting of the finished structure, the installation of the large clock on the face of the structure and also the electrical lights and fixtures. The beautiful lawn where the structure stands was then uneven, undeveloped, rough ground, strewn with stones and pitted with potholes. This too was prepared painstakingly under the supervision of Mr Khalid Hameed with tons of earth trucked in from outside and the ground levelled and planted with grass and flower beds laid out. All this was done by Mr Khalid Hameed out of his love and affection for DOT and the finished structure was inaugurated by him on15th March 1999 and a commemorative plaque was put up. Mysteriously, this plaque subsequently 'disappeared' sometime in 2000 and no one seemed to be much concerned - notwithstanding the attention drawn to the disappearance of the plaque by Mr Khalid Hameed who by then had left his teaching assignment at DOT. This 'wrong' has now been addressed and on 18th Jan 2007 "Kenwood Green" was re-inaugurated by Mr Khalid Hameed and a fresh plaque, that is a carbon copy of the original, was unveiled by him in the presence of DOT faculty and selected guests including Mr Haji Ahmad, RCIT, Eastern Region, Mr A.A. Zuberi, former Director, DOT / Member ITAT, Mr Mohsin Akhtar, former Director General, DOT / Member, ITAT, Mr Nazir Chaudhry, Accountant Member, ITAT, Lahore Bench, Mr Saadat Saeed, former Director







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EDITORIAL

The January issue of the DOT Gazette wishes its readers a very Happy New Year. May this year bring the best to all the readers. For DOT, this year is turning out to be as challenging and demanding as the previous we parted ways with.

In December we bid farewell to. the probationary officers of the 33rd STP who left for Karachi to pursue their MBA (Taxation) from IBA, Karachi. Since May 2004 till December 2006 The DOT administration was over stretched in organizing back to back five training programs of Income Tax Officers (ITO) and Assistant Commissioners . Come January 2007 ., and the Directorate is again geared up to shift its energies and resources to the Capacity Building Programs of Officers and Officials alike.

DOT also hosted the first ever joint training program of around 40 Audit officers of both Income Tax and Sales Tax Group from 15th to 27th January 2007

Recognizing the selfless services of Mr. Khalid Hameed, a visiting faculty member, who enriched not only the minds of his students but also the DOT landscape with a legendary Kenwood Green , the Director General Mr. M. Munir Quershi arranged a special inaugural of the site . It is hoped that this gesture shall set future traditions of giving the rightful credits where deserved.



the program than if they had they had some practical experience that they could relate to in the classroom.

DG(DOT): So the MBA program is a good thing?

Oh excellent!

DG(DOT): But the overall training timeframe is perhaps too protracted?

YASSIE HODGES: No, I was thinking of the timing for it.

To give you an example, when I went for my MBA program one had to be a manager for 5 years before they even considered you for the program. …….. The only thing that I was saying was that with this particular program where you bring in new Income Tax Group & Sales Tax & Federal Excise officers and put them in that type of situation for a whole year without any type of work experience…….. is that really the best way to do it.

Maybe giving them some practical experience first dealing with actual real life situations in the field and then bringing them back into the MBA program later will be a little bit more beneficial.

So I don't have any problem with the length of the MBA program but just the timing.

DG(DOT): Do you think it would be possible to achieve all the tax reform objectives by 2009 - the so called, 'year of arrival?'

YASSIE HODGES: I think it's very, very do-able -if you can stay focused.

Sometimes one of the problems I have faced is that there is so much going on that it is easy to get distracted and get side tracked and everytime you get side tracked it takes you away from the ultimate goal that you are trying to get to. That is something you will have to look at very closely.

Once the path is laid out then you should be able to put all available resources behind it so that you are able to fulfill the commitments instead of being directed to another area.

If you do that then I think it's do-able.

But it is going to be a hard job- I don't want anyone to think that this is going to be an easy job because it's not.

I personally think that there are a lot of skills and abilities throughout the organization but they may not be utilized in quite the right fashion and that's what needs to be focused in on.

DG(DOT): Many knowledgeable people see the present tax system as inherently complex and a strain on tax administration and see a system based on a standard 'flat tax' to be more easily manageable and more effective in terms of results. The debate in the U.S has been quite contentious and many people appear frankly fed up with the almost mind bending complexity of the present system and would like to see a change and a shift to the 'flat tax.' What is your opinion on the matter?

YASSIE HODGES: Yes, but that debate has been going on for some time.

Whether or not it is ever going to be a reality, I don't know.

But it's not only in the US that the debate has been going on. It is going on throughout the world because no matter what tax system you look at, everyone is saying the same thing whether or not an actual effort has in fact been made to simplify the system.

From a theoretical standpoint I think it's an excellent idea if you could have a flat rate system. However I don't know what the overall consequences would be if a flat rate system were actually implemented. I am not really familiar with any research in this area.

DG(DOT): So a shift to a 'flat tax' system is not imminent in the U.S?

YASSIE HODGES: Imminent? No I don't think so!

DG(DOT): There are skeptics in the Pakistan Tax Administration who are still uncomfortable with the Universal Self Assessment Scheme and see it as too far reaching and fear that given the weaknesses in tax administration,

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taxpayers are bound , sooner or later, to exploit these to the detriment of revenue. What do you think?

YASSIE HODGES: This topic I've often discussed with the Member Audit quite a bit.

Universal Self Assessment does'nt mean that taxpayers can file a Return in any manner and in any fashion that they feel like.

That's not what it means.

Rather, taxpayers are required to maintain proper books and file proper returns and in order to have a strong program you also have to couple that with an effective enforcement program. With a proper audit program in place the USAS will in my opinion yield very good results - for revenue and for taxpayers.

I do think that Universal Self Assessment is a very good idea. Taxpayers have already responded positively and frankly I don'nt see any reversal of the same.

DG(DOT): Based on your experience so far, what new training initiatives would you recommend?

YASSIE HODGES: One of the things that I think I would have most is instilling skills that would better enable tax personnel to solve practical problems that they come across.

I have found everybody is talking a lot about the many problems in the organization.

I would like to see people act a little differently- using skills to diagnose problems and then get to the root cause of those problems and finally resolve the problems. This is the way to move forward. When an organization focuses too much on the problems themselves and too little on ways and means for their resolution, it really starts getting everyone down. People lose their self esteem and morale. Any time you are in an environment where everything is so negative, you have a problem and you lose productivity.

The focus should always be on problem solving and if you can get people to start looking at the problem with a view to seeking it's resolution you will see dramatic improvement.

However this is not going to be easy and it is imperative that all available resources are brought to bear to ensure that the requisite problem solving skills are instilled in the work force through appropriate training.

DG(DOT): There is a lot of talk about the need to change the 'mindset' of the CBR workforce. This ofcourse is easier said than done. How do you think we should go about it?



Through lectures? Workshops ?

YASSIE HODGES: Not really. I think it's more how you interact with people and treat everyone.

I have a concern that there is still a 'class system' throughout the organization (CBR).

It depends on what position you hold.

People don't associate with certain types of people who they may perceive to be inferior to them in (official) status.

We need to change this negative attitude in the organization as a whole.

If that happens I think it would go a long way in changing the mindset on positive lines.

You will see a change in the way people go about doing their day to day job and they will interact better with taxpayers.

They will also take more interest in the organization as a whole.

DG(DOT): What are your specific recommendations to increase the effectiveness of the audit workforce?

YASSIE HODGES: One of the key things we can start with is the qualification of the audit personnel.

We may usefully refer to Malaysia in this context. Malaysia is often cited as a role model in the ATAIC group.

The manner in which Malaysia selects it's audit personnel has changed significantly since 2001. Auditor's are now required to have either an accounting or law background and without such a background one cannot even be considered for appointment as an auditor.

What that does is that it speeds up the learning process.

They are able to bring people in and put them through a shorter period of training - may be three to four months in a class room setting. Then they are given on-the -job training where they actually apply what they have learned in the classroom and then the process is rotated back and forth.

A more or less similar situation obtains in the U.S.

In time you will be able to assess what their overall skill level is and to determine whether they are fit for their particular job.

This way you can get much more productivity out of tax personnel than when you induct 'generalists' and put them in a class room setting for a protracted length of time.

DG(DOT): Strong Executive support is essential to the success of any program of tax reform. You have worked in the CBR for some time now and have met the senior officer's, including the Members and the Chairman. What is your candid opinion of their commitment to tax reform?

YASSIE HODGES: Frankly I really have been very impressed - especially with the Chairman himself because he really takes keen interest in any and every problem facing the organization and is ever willing to move forward. So do other members of his team.

When you have that kind of commitment in which the key players are willing to commit all available resources to get the job done, that is when things change for the better.

I think that's a critical aspect when you are going through a reform process.

DG(DOT): But the Chairman did not start his career in government as a taxman. Infact initially he worked in the private sector as a professional accounts man - he is a Chartered

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Accountant. Is that a problem?

YASSIE HODGES: I think that's a plus point.

Any Organization can do with fresh outside perspective to better understand problems confronting the organization and to be able to devise new approaches for their early resolution.

DG(DOT): Pakistan has a very narrow tax base. You have seen the statistics. Can anything be done in a hurry to enlarge the tax base?

YASSIE HODGES: In a hurry? I don't know.

Is it possible to expand the tax base within a 'reasonable' timeframe? Yes it is.

One of the things I looked at when I came here was there is so much business activity that is going on and to have only 1.5 million tax returns.....I just could'nt even imagine that especially when you consider that a large number of filers are salaried and wage employees.

What about all those businesses that are not filing Returns?

I think that if we, selectively yet systematically, focus in on a particular segment of the business population instead of doing a 'shotgun approach' trying to rope in all non- filers in one go, we will have much better results.

May be doing a pilot study with the Rawalpindi MTU - because they don't deal with the corporate taxpayers- to look at what kind of data is currently out there and see if we can get data more effectively from the provincial governments.

This way we can start using our own creative energy on a small part of the population and this narrow focus may actually help unearth many more non-filers than any other method. Once we have achieved success with this relatively small group, we can then replicate the methodology on a larger group until we have covered most of the 'potential' taxpayer population.

These are the type of things that I think are very, very doable.

DG(DOT): Finally, technology has been cited as a 'force multiplier' to dramatically enhance the effectiveness of tax personnel . What specific recommendations do you have in this area?

YASSIE HODGES: I think that's a critical aspect.

If collectively you really want to move forward quickly, technology provides many of the answers.

Trying individually to do things with pencil and paper, you can go only so far.

The rather limited taxpayer population in Pakistan actually makes it easier to concentrate resources and deploy technology effectively.

You already have underway the Integrated Data Management system and Data

Warehouseing.

In order to efficiently digitize and put to use the mass of available hard copy data, proprietory Optical Character Recognition software in conjunction with Optical Scanning hardware may offer a viable solution. Even if OCR is not always practical, Imaging technology can still help in making it possible to 'store' and then 'pull out' and use tax relevant information.

Technology is able not only to facilitate Tax Deptt personnel but also taxpayers. Electronic filing of Returns and data input and access across telephone lines are realistic possibilities using appropriate technology.

The imaginative use of technology creates a 'win-win' situation for everyone.

However whenever technology is put to use in this manner to store, retrieve and collate sensitive data, it is essential that robust control and data encryption systems be devised simultaneously to ensure that the new systems are not misused in any manner by 'unauthorized' persons.

Video of the Interview can be seen at www.dgtrdt.gov.pk

RESEARCH

Tax Incidence

Very few reliable studies of tax incidence in developing countries. Broad indication of mildly progressive impact. "Chile case shows that this is not due to direct taxation; with VAT strongly regressive. "World Bank study (Ferranti et al, 2004) stresses importance of topic but comes up with no new evidence.

Sources of Tax Revenue for various country groups, 2001

	Taxes on income profit and capital gains	Social Security contribution and taxes on payroll Property Tax	Property Tax	Sub-total: taxes on income and property	Taxes on goods and services	Other Taxes	Total
Percent of GDP							
OECDa	12.4	9.7	2.4	24.5	7.7	0.3	32.5
LACb	4.7	3.8	0.3	8.8	8.8	3.4	21.1
Othersc	6.5	0.8	0.2	7.5	8.3	3.4	19.2
Percent of total tax revenues							
OECDa	38.2	29.8	29.8	75.3	23.8	0.9	100
LACb	22.1	18.1	18.1	41.5	42.1	16.2	100
Othersc	33.9	4.2	4.2	39.1	43.2	17.8	100

a. Excludes Mexico

b. LAC include Argentina, Brazil, Chile, Guetamala, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela

c. Others include India, Indonesia, Malaysia, Russia, Singapore, Thailand and Ukraine

Sources: Artana, Lopez Murphy and Navajas, 2003

OBCD Revenue Statistics 2001: IMF Government Finance Statistics and IMF country reports to complete on subnational government

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Country	Decade	Before Tax Gini Coeff	After-Tax Gini Coeff	Difference
Brazil	1970s	56.2	55.3	-0.9
China	1970s	27.3	31.7	4.5
	1980s	31.7	33.3	1.6
	1990s	36.2	43.0	6.8
Czech Republic	1990s	28.3	22.1	-6.1
Ecuador	1990s	51.5	43.0	8.5
Hungary	1980s	26.9	22.4	-4.5
	1990s	28.1	26.3	-1.9
India	1970s	40.5	30.9	-9.6
Indonesia	1970s	42.7	36.6	-6.1
Mauritius	1980s	45.7	39.6	-6.1
Mexico	1970s	52.5	51.0	-1.5
	1980s	50.6	55.0	4.4
Nigeria	1980s	35.7	37.0	1.4
Pakistan	1970s	33.5	31.2	-2.3
	1980s	33.4	32.0	-1.4
Peru	1980s	49.3	42.8	-6.6
Singapore	1970s	38.7	34.0	-4.7
	1980s	41.3	35.5	-5.9
	1990s	37.8	37.9	0
Taiwan	1970s	29.3	28.9	-0.3

Source: Chu, et al. (2000)

Before and After-Tax Income distribution for Chile (1996)

Decile	Income share pre-tax	Income share after_tax	Change in total share -	Progressivity (tax as % of income Income tax	VAT	Other taxes	Tax System
1	1.45	1.4	0.05	0	11	3.42	14.4
2	2.74	2.63	-0.11	0	11.8	4.2	16
3	3.77	3.61	-0.16	0	11.4	4.33	15.8
4	4.73	4.59	-0.14	0	10.9	4.25	15.2
5	5.57	5.47	-0.1	0.01	10.7	4021	15
6	6.76	6.64	-0.12	0.04	10.2	4.07	14.3
7	8.22	8.2	-0.02	0.11	9.7	4	13.8
8	10.6	10.61	-0.01	0.23	9	3.85	13.1
9	15.42	15.75	-0.33	0.62	8	3.54	12.2
10	40.75	41.09	-0.34	2.54	6.3	2.96	11.8
GINI	0.4883	0.4961					
RATIO	13.41	14.12					

Incidence of tax and spend

- Now widely argued that a single rate of tax on income/consumption combined with equal per capita income would be strongly redistributive (IABD, 1998)
- But this would only work if large cash transfers to the poor were involved (not a feature of EMs) as in UK; and above all depends on strong assumptions about distributive effect of public goods.
- The imputation of the benefits of public goods by income class is difficult, and can only be done rigorously for health and education (a third or so of public expenditure).

Evidence on direct tax and growth

- Macroeconomic instability, debt overhang, social conflict much more an enemy of private investment that tax (Serven and Solimano)
- Empirical literature for OECD countries indicates little or no effect of direct tax rates on growth.
- Strong intuition in endogenous growth theory that human capital is not a credit collateral, so inequality hurts growth (Aghion and Howitt, 1998)

Growth and direct taxation

- Our preliminary estimates for OECD countries indicate a marginal positive relationship; and direction of causality remains to be established.
- Our estimates for Latin America indicate a barely significant (Rsq=1.7%) negative relationship. Growth is thus largely independent of tax rates.
- But even accepting this and assuming that causality runs tax=> growth, implies that doubling direct tax burden from 5 to 10% of GDP would only reduce growth by 0.4% - surely an acceptable price for the welfare gain?

Arguments against direct taxation

- Disincentives to saving and entrepreneurial or professional effort; corporation tax passed on to consumers.
- Difficulty and cost of collection, particularly in open economics (asset mobility) with large unregulated sectors (informal firms) and no cadasters etc.
- What matters is net incidence, so flat rate income tax (or better consumption tax, i.e. VAT) combined with targeted expenditure is the solution.

Arguments for direct taxation

- Savings effect ambiguous (Ricardian Equivalence) and effort disincentives exaggerated: inequality may lower growth.
- Collection problem one of political pressure rather than administrative incapacity.
- Direct taxation (progressive) central to the social contract with wealth-holders in a democratic society (Rawls).

Political issues

- Lack of administrative reach created by political process as well as crime, corruption etc. Wealthy avoid paying tax 'legally'.
- Tax evasion justified in elite discourse by corruption and waste in the public sector.
- Underlying lack of a sound social contract: not only between state and society, but between the wealthy and society.

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Integrated Audit Training

The first such training program was launched at DOT's main campus at Lahore by CBR Audit Wing on 15th Jan 2007. This was a twelve day session and in a significant move, personnel from both the direct and indirect tax jurisdictions participated to make this a truly 'Integrated Training" program.

Audit is a core component of the of the Tax Reform measures currently underway in CBR. are Without effective audit the Universal Self Assessment Scheme - an integral part of the Income Tax Ord 2001- cannot realistically be expected to yield the results expected by the framers of the new statute.

Regular Audit of Income Tax Returns has been held in abeyance by CBR for sometime now pending formulation of a clear policy for selection of Returns for Audit. Personnel deputed for Audit are also being trained on professional lines for the first time ever. The first such training program was launched at DOT's main campus at Lahore by CBR Audit Wing on 15th Jan 2007. This was a twelve day session and in a significant move, personnel from both the direct and indirect tax jurisdictions participated to make this a truly 'Integrated Training" program. The training itself had been 'outsourced' to M/s Professional's Academy of Commerce, a leading private sector institution manned by Chartered Accountants that was carefully chosen through a competetive, fully transparent selection process. The actual instruction in the class was less through the traditional 'lecture' and more through an interactive highly participative process, that included 'hands on' computer work.





DOT participated fully in the preparatory phase of the program including design of the training curricula and training methodology and it also made it's excellent facilities available for the training sessions. DOT also independently monitored the actual conduct of the training sessions. The training program ended on 27 - 01 - 2007.







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Capacity Building & Staff Training Programme durring Janurary 2007

In this context the Directorate regularly organizes Capacity Building Programs for officers and Refresher Courses for officials of the Income Tax Group. In the month of January 2007, two Refresher Co In the month of January 2007, two Refresher Co



CBR is presently undergoing massive reforms whereby functional as well as infrastructural reforms are underway. In this scenario there is an increased emphasis on the need to develop workforce capabilities at all levels by equipping them with appropriate knowledge, skills and abilities .

In this context the Directorate regularly organizes Capacity Building Programs for officers and Refresher Courses for officials of the Income Tax Group. In the month of January 2007, two Refresher Course were organized for officials such as UDC's and LDC's. The duration of each course was 12 days and were so organized that Computer skills , Income Tax Laws and Civil Service Rules were taught for 12 hours each . Spot tests /quizzes and strict class attendance ensure the level seriousness attached to these trainings. Each batch comprised of not less than 22 participants







The Directorate also held one Capacity Building Programs for officers of grade17-18 and one for officers of grade 19 in the month of January . The focus of these Programs was sensitization of participants to major economic issues facing the country in addition to issues related to Income tax. Lectures on topics such as WTO and Its implications for Pakistan, Water issue and its Economic Repercussions etc. were arranged from subject specialists. Multi dimensional training techniques were utilized to elicit maximum response from participants. To highlight the importance of Freedom Movement and the role of Jinnah , the movie "Jinnah" was shown to the participants and their views requested in writing.

