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The Hike in Petroleum Taxes

About IPR

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Petroleum products are subject to relatively high rates of taxation in Pakistan. Three types of taxes are levied on these products, namely, import duty, general sales tax (GST) and the petroleum levy. The combined revenue generated from these taxes on petroleum products was Rs 520 billion in 2013-14, equivalent to 35% of the total revenue from indirect taxes at the Federal level. The contribution of the GST on these products was Rs 400 billion, followed by Rs 103 billion from the petroleum levy and Rs 17 billion from the import duty.

The precipitous decline in international oil prices and its transmission to domestic prices of petroleum products was likely to lead to a significant loss of revenues of almost Rs 70 billion on an annualized basis. Consequently, the Government has moved recently through promulgation of SRO 1152(1)/2014 to raise the GST on petroleum products (excluding furnace oil) from 17% to 22% initially and then to 27%. In proportionate terms the increase in the tax rate is almost 60%.This is the largest SRO in the history of Pakistan in terms of its revenue impact.

The first issue relates to the legality of the enhancement in the tax rate through an SRO by FBR. Ideally, this should have been done by an extension to the Money Bill of 2014-15 and subjected to approval by the National Assembly. It also conflicts with the commitment made earlier by the Government not to bring about changes in the taxation system through the promulgation of SROs.

The second issue relates to the magnitude of enhancement in the GST rate and its impact on the economy. **IPR estimates that the Government has gone for an 'overkill' and has over compensated for the impact of falling prices on GST revenue from petroleum products.**

The largest GST share in collection within petroleum products is from High Speed Diesel (HSD) of over 40%. The prescribed price for this product has been reduced by 32% and the retail price by almost 27% between June 2014 and February 2015. In the absence of a tax rate enhancement revenues would have fallen by over 30%. However, with the increase in the tax rate to 27%, the GST per liter of HSD has risen from Rs 15.58 in June 2014 to Rs 17.06 in February 2015. Therefore, the adjustment in the tax rate will lead to a net gain in revenues of Rs 12billion over the level of revenue that would have been generated if the price of HSD had remained unchanged at the June 2014 level of Rs 109.34 per liter and an unchanged tax rate of 17%.

Similar calculations for other petrol products reveal that there is only a minor decline in GST per liter, ranging from Rs 0.75 in the case of motor spirit to Rs 1.36 in the case of Light Diesel Oil. However, additional revenues will accrue due to two other factors.

The first factor is that the fall in retail prices will stimulate demand. This is already visible and is one of the reasons for the recent petrol crisis in Punjab. Consequently, the tax base will be larger and this will contribute to more GST revenues. Second, although the rates of petroleum levy remain fixed there will be larger revenues from this source also because of increased consumption of petroleum products.

Overall, IPR estimates are that revenues are significantly larger in relation to the revenues that would have been generated if the prices and the GST tax rate had remained unchanged at the June 2014 level. Under conservative assumptions, the increase in revenues is 15% in the case of HSD, 7% in motor sprit, 6% in kerosene oil and 5% in LDO. **In effect, the Government has raised the GST rate not only to compensate for the fall in revenues due to the decline in prices, but also to generate additional revenues of almost Rs 36 billion on an annualized basis.**

Unfortunately, the Government has adopted the policy of raising the GST rate on petroleum products in a non-transparent manner. The impression conveyed is that this step will only partially compensate for the loss of revenues, whereas it is actually likely to lead to a net increase in revenues. **A revenue-neutral transition could have been, more or less, achieved by a lower enhancement in the tax rate of up to 5 percentage points.**

The important point is that in an effort to generate higher revenues from petroleum products, the Government has deprived the people of Pakistan from a welfare gain of almost Rs 80 billion. The higher taxation of petroleum products has also made the tax system more regressive and pre-empted a bigger decline in prices of essential items.

IPR's view is that the enhancement in the GST rate on petroleum products must be subjected to very careful scrutiny by the Parliament. **Efforts must be made to transfer an even larger part of the lower international oil prices in order to provide more relief to the people who have suffered through high inflation over the last seven years. Furthermore, lower prices of petroleum products will stimulate growth in the economy and create more employment opportunities.**

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4- Shami Road,
Lahore Cantt,
Pakistan