INTEGRATED SAFEGUARDS DATA SHEET
CONCEPT STAGE

Date ISDS Prepared/Updated: 26-Oct-2012

I. BASIC INFORMATION

A. Basic Project Data

<table>
<thead>
<tr>
<th>Country:</th>
<th>Pakistan</th>
<th>Project ID:</th>
<th>P128182</th>
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<tbody>
<tr>
<td>Project Name:</td>
<td>PK: Revenue Mobilization DLI (P128182)</td>
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<td></td>
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<tr>
<td>Task Team Leader:</td>
<td>Jose R. Lopez Calix</td>
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<tr>
<td>Estimated Appraisal Date:</td>
<td>18-Nov-2013</td>
<td>Estimated Board Date:</td>
<td>21-Mar-2014</td>
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<td>Managing Unit:</td>
<td>SASEP</td>
<td>Lending Instrument:</td>
<td>Specific Investment Loan</td>
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<td>Sector:</td>
<td>General public administration sector (90%), Other domestic and international trade (10%)</td>
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<tr>
<td>Theme:</td>
<td>Tax policy and administration (70%), Public expenditure, financial management and procurement (20%), Export development and competitiveness (10%)</td>
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<table>
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<tr>
<th>Financing Source</th>
<th>Amount</th>
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<tbody>
<tr>
<td>BORROWER/RECIPIENT</td>
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<td>International Development Association (IDA)</td>
<td>300.00</td>
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<td>Total</td>
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Environmental Category: C - Not Required
Is this a Repeater project? No

B. Project Objectives

The Project aims to facilitate improvement of tax compliance with tax laws. The project favors a results-based management (RBM) approach, both for the Federal Board of Revenue (FBR) and the Federal Tax Ombudsman (FTO) Office, and is supported by disbursement-linked indicators (DLIs). The project is expected to increase tax compliance and help raise tax revenues through (a) improvement of tax policy formulation and forecasting; (b) the institutional strengthening of FBR and FTO; (c) the enhancement of FBR’s services to taxpayers; (d) the improved effectiveness of FBR in tackling tax evasion, detection and control; and (e) the integration, upgrading and strengthening of FBR automation and IT systems.

C. Project Description
A. Concept

1. Description

The Government of Pakistan (GoP) has adopted a two-pronged strategy: tax policy change, to make the tax system more responsive to growth and easier to administer; and, tax administration improvements to enhance collection efficiency. Based on the recommendations of a Task Force, supported by the Bank, the FBR has developed a broad strategy for reforms focusing on: (i) restructuring of FBR along functional lines and integration of income, sales and excise taxes; (ii) reengineering and automating business processes and work flows; (iii) establishing databases for reporting and audit purposes; (iv) introducing a self-assessment system for filing tax returns; (v) improving services for taxpayers; and, (vi) strengthening the human resource base. GoP also adopted several tax measures including broadening the base of the General Sales Tax (GST), lowering the income tax rate, and gradual withdrawal of Central Excise Duties. Such efforts, however, have proven unsuccessful into raising the tax ratio above 10 percent, and until only last year, the tax ratio was on a declining trend.

In line with the Government strategy, and the urgent need for achieving concrete results, the lending instrument proposed is a Sector Investment Loan (SIL) that also includes Disbursement-Linked Indicators (DLI). Both a traditional SIL and a technical assistance loan (TAL) were considered, but rejected because one of the lessons from the previous Tax Administration Reform Program (TARP) loan points to the importance of including tax policy measures for achieving the desired collection objectives (see below). The performance orientation of the DLI, its flexibility and focus on results, and its integrated approach between investments/technical assistance activities and monitoring and evaluation systems makes it the most suitable instrument of the Bank portfolio for the proposed type of objectives and activities.

Figure 1: Project Conceptual Approach

In addition in view of the need to build institutional capacity for a results-oriented management approach, a US$3 million PPF was approved on April 4, 2012 (effective June 25, 2012) to support preparation activities at FBR and FTO, while ensuring steady consolidation of ongoing key tax administration reforms supported by the recently concluded Tax Administration Reform Project (TARP).

Lessons learned from the Pakistan TARP were carefully extracted and every effort was made to incorporate and apply the most salient into the current PPF and any future DLI operation. Particularly relevant were the following ones:

- Revenue collection targets may not be the most suitable outcome indicator for gauging the success of tax administration reform projects.
- FBR institutional capacity--both managerial and technical--has been eroded over time and needs to be carefully assessed before ramping up reform amplitude and intensity. Specifically, any reorganization plans need to be carefully phased with adequate safeguards and internal ownership.
- Hence institutional development, including strategic planning and change management controls, needs to be move in parallel and concomitantly with revenue mobilization efforts.
- A monitoring and evaluation system should be in place from the beginning.
- Policy and legal reforms perceived as necessary ingredients to carry out any intended reform need to be addressed up-front.
IT systems must be accompanied by requisite business operating procedures, with continuous training. Current delays in the full roll out of a functional organization in FBR are attributed to the persistent and parallel use of manual operating procedures in field formations that generate considerable inefficiency and compromise obtaining timely and accurate data on FBR revenue flows.

Overall, a capstone lesson taken into account by the PPF team is that Bank support to revenue mobilization reform need to address institution-building, tax policy analysis, political economy/governance considerations, and emerging operational issues in an integrated way. The PPF team has completed steps to achieve the necessary government commitment required along with a realistic action plan and timetable.

The specific DLIs and final components of the project will be formulated with the support of the PPF. In the meantime, preliminary components of the reform program already included in the PPF and their justification are as follows:

(a) Improving tax policy formulation and revenue forecasting (US$55,000). This component aims to strengthen the Government's capacity for institutionalized revenue forecasting and tax policy formulation. Specific performance indicators will be geared to measure this capacity. Moreover, it aims to prepare a study on tax expenditure to be published, preferably as an Annex in the budget. In addition, it will also strengthen FBR tax forecasting and fiscal research capacity. Forecasting of (FBR) tax revenue has suffered major and increasing deviations from the prescribed targets (partly due to exogenous factors, like growth slowdown and the floods), thus contributing to higher fiscal deficits than budgeted. Low buoyancy, continuous changes in the tax regime, and the persistence of a significant number of remaining tax exemptions and zero-rated taxes mainly explain this outcome. Lessons from tax reforms worldwide also suggest that the impact of tax administration on tax collection requires several years of sustained reform efforts to materialize, while tax policy can bring immediate tangible results. Thus, if a significant effort is expected in raising revenue, it should not rely on tax administration measures alone, but rather on a comprehensive effort combining changes in tax rates and thorough elimination of tax exemptions. And this has to be done in close coordination with the Ministry of Finance (MG). Hence, a dedicated tax policy component is required.

(b) Consolidating FBR tax administration reform by strengthening core functions supporting results-oriented management (US$240,000). FBR requires a performance-oriented Tax Administration Strategy Reform program. The last FBR Comprehensive Medium and Long Term Strategy program was prepared in 2001. The PPF will support its redesign. The revamped FBR Strategy should contain the new vision for the institution, integrate all key functional areas and lead departments in change management, redefine key enforcement and auditing procedures, define Key Performance Indicators (KPIs) for monitoring and control purposes, enjoy full internal ownership, and be publicly known. The PPF activities will also support specific actions in areas where FBR has achieved important progress, like registration, refunds, and e-filing; areas where important steps are being undertaken and progress is promising, like enforcement, auditing, and appeals; or activities that are self-contained but critical to the reform program in Inland Revenue and Customs. In addition, the PPF has identified activities aimed to consolidate the invoice management system, improve the withholding tax regime and review FBR’s remaining physical infrastructure needs.

(c) Enhancing accountability and transparency of tax administration (US$110,000). A Revenue DLI project supporting an RBM approach cannot move ahead unless there is a solid Monitoring and Evaluation (M&E) system in place and credible 3-5 year results are set. FBR currently lacks an adequate M&E system. It already has a broad set of key performance indicators, but it suffers from many deficiencies: they are too numerous; targets (often unrealistic) are set vertically and without
consultation with Large Taxpayers Units (LTUs) and Regional Tax Offices (RTOs); their tracking is done manually through interaction of several Information Technology (IT) systems that are not interconnected, and have very little reliability and internal utility. There is also no dedicated unit servicing the FBR Board by regularly reporting on compliance levels. In sum, KPIs are not user-friendly and FBR does not have the institutional capacity to track them effectively as a management tool. This component aims at supporting a review and subsequent design of a proper M&E system, and associated training for middle-to senior-level management. Moreover, to improve transparency, it aims to finance an FBR communication strategy for both internal and external stakeholders about its ongoing achievements. And to improve external accountability, it also aims to support a series of FTO-related activities, including workshops and study tours in country identified as role-models for FTO-related activities, especially in correcting mal-administration practices, the area where FTO has played a very positive “check- and-balance” role.

(d) Strengthening FBR automation for a modern and performance-based administration (US $1,300,000). There can be no effective M&E system of performance without a supporting IT platform. Perhaps one of the most important pending actions under TARP was to complete the design and roll-out of a unifying Integrated Tax Management Systems (ITMS), and the IT common platform supporting it. FBR authorities are fully aware of this. A recent FBR users’ survey on Pakistan Revenue Automation Limited (PRAL) systems found that despite the significant investment in hardware and software, the present PRAL systems are often not used, and staff passively resist them. Senior and middle managers at LTUs/RTOs also claim that dedicated managerial reports are absent and focused training provided by PRAL is insufficient. As a result, no less than 20 non-interactive and disconnected software applications persist in FBR. The PPF aims at supporting the technical and security audit of PRAL systems, the strategic redefinition of the ITMS, as well as the expansion of dedicated reporting modules and training focused on senior and middle FBR management, both at HQ and field formations.

(e) Project management (US$1,024,000). This includes supporting a change management team that FBR intends to use for revamping its strategy, defining a roadmap for change with a new vision, setting its performance management benchmarks and their monitoring tools, and re-formulating its internal procedures accordingly.

(f) FTO (US$271,000). This small component will support key FTO activities in the area of improving its work on tax maladministration and developing the human skills of FTO staff.

D. Project location and salient physical characteristics relevant to the safeguard analysis (if known)

E. Borrowers Institutional Capacity for Safeguard Policies

F. Environmental and Social Safeguards Specialists on the Team

II. SAFEGUARD POLICIES THAT MIGHT APPLY

<table>
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<th>Safeguard Policies</th>
<th>Triggered?</th>
<th>Explanation (Optional)</th>
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<td>Environmental Assessment OP/ BP 4.01</td>
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### III. SAFEGUARD PREPARATION PLAN

**A. Tentative target date for preparing the PAD Stage ISDS:** 30-Aug-2013

**B. Time frame for launching and completing the safeguard-related studies that may be needed.**

The specific studies and their timing\(^1\) should be specified in the PAD-stage ISDS:

Before August 30, 2013

### IV. APPROVALS

**Task Team Leader:**

Name: Jose R. Lopez Calix

**Approved By:**

<table>
<thead>
<tr>
<th>Regional Safeguards Coordinator:</th>
<th>Name: Sanjay Srivastava (RSA)</th>
<th>Date: 22-Dec-2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sector Manager:</td>
<td>Name: Vinaya Swaroop (SM)</td>
<td>Date: 05-Dec-2012</td>
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1 Reminder: The Bank's Disclosure Policy requires that safeguard-related documents be disclosed before appraisal (i) at the InfoShop and (ii) in country, at publicly accessible locations and in a form and language that are accessible to potentially affected persons.