

The Inspection Panel
Report and Recommendation

On

Request for Inspection

Re: ISLAMIC REPUBLIC OF PAKISTAN: Tax Administration Reforms Project (IBRD Loan No. 72640-PAK; IDA Credit No. 4007-PAK)

A. BACKGROUND

1. On December 22, 2009, the Inspection Panel (the “Panel”) received a Request for Inspection (the “Request”) related to the Pakistan: Tax Administration Reform Project (the “Project” or TARP) financed by the International Development Association (IDA) and the International Bank for Reconstruction and Development (IBRD).¹ The Request was submitted by members of the Officers of Customs and Excise Group Association (OCEGA). The Requesters state that they have suffered, and are likely to suffer, harm from the Project. The Requesters have asked that their identities be kept confidential.
2. The Panel registered the Request on January 19, 2009 and Management submitted its response (the “Management Response”) on February 19, 2010.
3. As provided in paragraph 19 of the 1993 Resolution establishing the Inspection Panel (the “1993 Resolution”),² the purpose of this report is to determine the eligibility of the Request and make a recommendation to the Executive Directors as to whether the matters alleged in the Request should be investigated.

B. THE PROJECT

4. According to the Credit Agreement, the Project objectives are “(a) to improve the effectiveness, responsiveness, efficiency, integrity and fairness of tax administration; (b) to promote compliance with tax laws and broaden the tax base; and (c) to promote trade facilitation.”³
5. In this regard, the Project has seven components⁴, namely:

¹ For the purpose of this Report, IDA and IBRD are referred to as “the Bank”.

² International Development Association, Resolution No. IDA 93-6, and International Bank for Reconstruction and Development (IBRD), Resolution No. IBRD 93-10, dated September 22, 1993 (the “1993 Resolution”).

³ Development Credit Agreement (Tax Administration Reform Project) between Islamic Republic of Pakistan and International Development Association, Dated March 9, 2005, Schedule 2.

⁴ Project Appraisal Document (PAD), Report No: 30374-PK, November 5, 2004, p. 47.

- **Component 1: Management and Institutional Development (US\$9.29 million).** This component includes carrying out a re-organization of the Central Board of Revenue (CBR)⁵, development and implementation of a human resource management strategy, a staff training program, development and implementation of a code of conduct and ethics, establishment of an internal audit function, an internal affairs and vigilance function, and development of a change management strategy. This component supports the broader tax reform strategy by addressing institutional, organizational, and legal constraints of tax and customs administration.
- **Component 2: Improving Revenue Operations (US\$93.7 million).** This component supports strategies to transform the administrations of the CBR's three revenue streams: Direct Tax, Sales Tax and Central Excise, and Customs. To accomplish the transformation, an extensive re-engineering of the core business processes and operating procedures of these three administrations will be undertaken to enable the accomplishment, in the long term, of functionally integrated, automated and decentralized revenue streams.
- **Component 3: Strengthening Revenue Services (US\$6.62 million).** This component supports establishing separate functions at the national level for tax audit, collection and enforcement, appeals and dispute resolution, intelligence gathering and risk management, and tax and customs fraud investigation and prosecution;
- **Component 4: Creating a Tax Compliant Culture (US\$6.27 million).** This component supports the development and implementation of information technology systems to create greater efficiencies in tax administration. This will be done by designing software, establishing a Call Center, improving communication between CBR and taxpayers through a Communication Program, establishing a Taxpayer Identification and Registration system, and putting in place a Quality Assurance and Monitoring program.
- **Component 5: Adopting Responsive IT Systems (US\$3.65 million).** This component supports the transition of the CBR from a highly manual organization to an automated one by upgrading its information technology systems;
- **Component 6: Infrastructure Up-gradation and Development (US\$24 million).** This component supports a program of up-grading, developing and/or acquiring new infrastructure and facilities for the CBR.
- **Component 7: Project Management and Implementation (US\$3.06 million).** This component finances the implementation of the Project, including the setting up of a Project Management Unit (PMU).

6. The total Project cost is US\$149 million consisting of an IDA credit of 53.5 million Special Drawing Rights (SDR) which at the time of Project approval was equivalent to US\$ 78.5 million, an IBRD loan of US\$ 24.4 million, and a United Kingdom Department for International

⁵ The CBR was renamed Federal Bureau of Revenue (FBR) in July 2007.

Development (DFID) grant of US\$23 million, with the Government of Pakistan providing US\$23 million.⁶

7. The IDA Credit and IBRD Loan were approved by the IDA and IBRD Boards of Executive Directors on December 12, 2004 and became effective in April 2005. The original Closing Date of December 31, 2009 has been extended to March 31, 2010 and the Bank is currently considering a two-year extension and Project restructuring.⁷
8. The Project is implemented by the Federal Board of Revenue (FBR). A Project Management Unit (PMU) has been constituted within FBR to assist in the implementation of the Project.

C. THE REQUEST

9. What follows is a summary of the Request for Inspection. The Request is attached to this Report as Annex I.
10. According to the Request, the Project was launched in 2004 to *"fundamentally reform the Central Board of Revenue (CBR), which is now known as the Federal Board of Revenue (FBR), and to create a more efficient and effective revenue administration system "*. The Request states that the Project has led to the creation of the Inland Revenue Service (IRS) as a new occupational service group under the Central Superior Services (CSS) of Pakistan with the objective of collecting and administering all federal taxes in order to bring about the *"functional integration"* of all domestic taxes.
11. The Request explains that the Customs and Excise Group (CEG) and the Income Tax Group are amongst the twelve occupational groups under the federal civil service system known as the Central Superior Services, and the only two that fall under the administrative authority of the Federal Board of Revenue. The CEG is *"responsible for collecting and administering three out of four federal levies, namely customs duties, federal excise duties and the general sales tax which are all indirect taxes, whereas the Income Tax Group collects and administers direct taxes"*. Each service group *"maintains a separate seniority of its officers which is based on the merit determined at the time of entry in any given occupational group"* and the *"CEG has remained amongst the top three choices/options of the candidates qualifying the Central Superior Services exam, while Income Tax Group is usually 5th or 6th choice "*.
12. The Requesters state that *"under immense pressure from the World Bank staff, Federal Board of Revenue through its Office Order No. 9(3)/2009-MI dated 12.09.2009 and Government of Pakistan through the Establishment Division's Office Memorandum No.F 6/2/2009-CP.II dated 12.09.2009 have created Inland Revenue Service and have asked, inter alia, the officers of the existing Customs and Excise Group (CEG) and Income Tax Group (ITG) to submit irrevocable options for inclusion or otherwise in the IRS [...]. Those officers of the existing Customs and Excise Group who would not join IRS would become part of a truncated Pakistan Customs Service which will be responsible to collect and administer customs duties only"*.

⁶ Management Response – Request for Inspection of the Islamic Republic of Pakistan: Tax Administration Reform Project (IBRD Loan No. 72640-PAK; IDA Credit No. 4007-PAK), February 19, 2010, p. 5.

⁷ Management Response, p. vii.

13. The Requesters maintain that while the Project sought the *"functional integration of domestic taxes"* from the very beginning, it did not envisage the *"administrative merger of the Customs and Excise Group and the Income Tax Group into one cadre and creation of a brand new service group in total disregard of the Constitution of Pakistan and all laws and statutes that deal with service matters"*. They note that the *"creation of the IRS at the behest of the World Bank has unduly penalized"* them as a group and that they are being disproportionately disadvantaged as the proposed new service structure will cause the Officers of the CEG to *"lose their operational latitude, promotion, and career prospects and it will jeopardize the terms and conditions of their service which are otherwise safeguarded by the Constitution, as well as the rules governing the services of the Federation of Pakistan"*. They believe they are *"aggrieved by certain aspects of this Project"* which in their view will also cause harm to the economy of Pakistan.
14. The Requesters maintain that they *"are not against tax reforms as long as they stay focused on achieving their stated and original objectives of making the tax system more transparent, vibrant, and taxpayer friendly"*. They state they are *"ready"* for the *"original plan"* of merging all domestic tax functions under one *"hierarchy"* but are concerned about the changes brought about in the Project which are a *"deviation from the original action plan of TARP"*.
15. The Requesters also assert that the Project has been *"mishandled in the recent past"* and that the *"advice given to Government of Pakistan by people working for the World Bank has caused violation of the law of the land"*. Furthermore, the Requesters state that the *"misguided policies of the World Bank staff have resulted in a situation where an entire workforce is highly disgruntled, demoralized and uncertain"* and that this *"does not augur well for the continuity and sustainability of the reforms once TARP is over"*.
16. The Request notes that the *"voices and concerns of the Customs and Excise Group"*, an important stakeholder in the reforms process, were not taken into account which is a *"violation of para 10 of World bank's Operational Manual-BP 13.05-Project Supervision"*.
17. The Requesters note that they sent several emails to communicate their *"legitimate concerns"* to World Bank staff but did not receive any response and that *"several attempts made by the Association to arrange a meeting with the visiting World Bank Task Team to apprise them of our concerns"* were also not responded to. The Request includes correspondence to demonstrate efforts made to contact World Bank staff and several other relevant attachments.
18. The Requesters also point out that a lawsuit filed by the *"Officers of the Customs and Excise Group"* before the Lahore High Court has resulted in an *"order of restraint"* which prevents further implementation of the Project until the legality of the creation of the Inland Revenue Service is decided. The legality of the new institutional structure of the FBR is a main issue in the Requesters claim and is the subject of ongoing legal proceedings in domestic courts.
19. Based on the foregoing, the Requesters ask that the Inspection Panel conduct an investigation of the matters described in the Request for Inspection.
20. The above claims may constitute, *inter alia*, non-compliance by the Bank with various provisions of the following Operational Policies and Procedures:

D. MANAGEMENT RESPONSE

21. What follows is a brief summary of the Management Response⁸, a complete copy of which is attached to this Report as Annex II (a).
22. **Context.** According to the Management Response, weak revenue mobilization due to an “*inefficient and ineffective tax administration, a narrow tax base, a skewed tax structure, a complex and non-transparent tax system, and corruption and tax evasion*”⁹ has been a key development challenge for Pakistan. Furthermore, despite several years of strong economic growth, the tax-to-GDP (Gross Domestic Product) ratio has declined in the last decade from 9.1 percent to 8.8 percent; in addition, the system is inequitable in that only 3 percent of income earners pay taxes and only 80,000 businesses file sales tax returns.¹⁰ Management also states that compared to other fast growing developing countries, Pakistan’s economic growth did not translate into a corresponding increase in tax collection. Management believes Pakistan’s weak revenue mobilization is due to deficiencies in both tax policy and administration and that this results in a fiscal gap which renders the country unable to cover its core development expenditure in education, health care, and infrastructure. Moreover, the country remains dependent on external aid and vulnerable to economic shocks.¹¹
23. **Government Strategy.** Management explains that tax reforms pursued by the Government of Pakistan in the 1990s had limited impact due to a variety of factors and that “*it has long been recognized that far-reaching reforms are necessary in both tax policy and tax administration*”. In June 2000, an 11-member Task Force financed by the World Bank and appointed by the Government, proposed “*radical reform of recruitment, training, compensation, and performance management*” and recommended major changes in tax policy and administration. Management states that this Task Force Report, and additional inputs from international tax administration consultants, led to a 2001 strategy on tax reform which was further developed into the FBR’s *Comprehensive Medium and Long Term Strategy* in May 2003. This Strategy, according to Management, articulated a clear objective of moving from a “*type-of-tax*”¹² organizational structure to a “*functionally integrated tax administration*”¹³ over the long term so as to increase efficiency, transparency, customer service, revenue collection and curtail corruption.
24. Management notes that the World Bank has been supporting the Government’s tax administration reforms since 2004 through different instruments, of which the Project has been a main vehicle. The Project, according to Management, was prepared at the request of the FBR in 2003/04 “*to*

⁸Management Response – Request for Inspection of the Islamic Republic of Pakistan: Tax Administration Reform Project (IBRD Loan No. 72640-PAK; IDA Credit No. 4007-PAK), February 19, 2010.

⁹ Management Response, p. 2.

¹⁰ Ibid.

¹¹ Management Response, p. 4.

¹² Management explains a type-of-tax structure as one in which each tax, such as sales tax, income tax, excise tax, and customs duties, has its own rules, procedures and administration. Management Response, p. 5.

¹³ Management explains that a functionally integrated tax system is one where unified business processes, such as audit, enforcement, collection, and registration apply to all types of taxes. Management Response, p. 5.

*assist the Government and the FBR in implementing its comprehensive tax administration reform strategy” and the Project objective is to “fundamentally reform the Federal Board of Revenue for a more efficient and effective revenue administration system”.*¹⁴

25. **Project Performance.** Management states that though the Project has achieved a number of outputs, *“these were not being translated into effective outcomes in terms of the initial development objectives”* mainly, in its view, due to *“inconsistent commitment”* to the reforms and weaknesses in Project management.¹⁵ Moreover, Management explains that there is a sequence to the reforms envisaged by the Project and that *“any break in the chain of reforms had consequences for the investments envisioned by the project”*.¹⁶ Management notes that the reform process had also slowed down when the country experienced high growth rates which led to a temporary increase in tax revenue and a reduced sense of urgency about dealing with the more difficult items in the reform agenda. Management states that as a result of these *“problems”* and *“weak performance”*, the Bank considered closing the Project before its completion date but decided against this after the 2008 economic crisis led the Government to re-focus its energies on the reforms process *“leading the World Bank to consider a restructuring and possible extension of the project”*.¹⁷
26. Management also mentions that the Government’s decision to introduce a Value Added Tax (VAT) by July 2010 made the *“reform of the FBR along functional lines particularly urgent”*. The Bank was requested by the Government in September 2008 to provide a separate technical assistance to constitute an international team of tax reform experts who were to work directly with FBR on tax administration reforms. According to Management, the *“TA team recommended the ‘full merger’ of sales and income tax consistent with what had originally been envisioned in the 2003 FBR strategy document”*¹⁸ and that the *“recommendations of the TA team were consistent with the earlier observations of the TARP team”*.¹⁹
27. **Merger of Occupational Groups.** Management underlines that *“the FBR designed and implemented its own plan for the merger of occupational groups”* and that the *“World Bank has supported the implementation of that plan”*.²⁰ Management further states that the World Bank’s engagement with the Government of Pakistan on tax reform is based on the FBR’s 2003 *Comprehensive Medium and Long Term Strategy* which calls for the *“merger of all domestic taxes”* and the *“integration of tax administration along functional lines”*. Management notes that the specific reorganization plan to merge existing occupational groups and create the IRS was *“designed and initiated by the FBR in consultation with the Establishment Division and the Law Division”*²¹ within the context of Pakistan’s laws and civil service guidelines.²² Management also notes that the Requesters are concerned about the merger of occupational groups and not the integration of the collection of domestic taxes. This, in Management’s view, refers to the

¹⁴ Management Response, p. 5.

¹⁵ Management Response, p. 7.

¹⁶ Ibid.

¹⁷ Management Response, p. 8.

¹⁸ Management Response, p. 18.

¹⁹ Ibid.

²⁰ Management Response, p. 14.

²¹ The Establishment Division is the administrative arm at the federal level of the Government of Pakistan and regulates all matters of general applicability to various Occupational Groups in public service. The Law Division provides advice to the Government of Pakistan on legal and constitutional questions. See: www.Pakistan.gov.pk

²² Management Response, p. 14.

*“administrative means to reach the end of a tax administration organized along functional lines and not the end itself.”*²³ Management also explains that the occupational merger of the Income Tax Group and the Customs and Excise Group was partial because *“in addition to creating the IRS, the Government retained the Customs and Income Tax Groups in order to accommodate staff concerns and give them choice and flexibility. Each officer was given a choice to join the IRS and stay in the existing group; that is, joining the IRS was voluntary.”*²⁴

28. Management states that *“while the World Bank continually stressed the importance of the merger of all domestic taxes, the TARP did not initially envision a merger of existing occupational groups”* and instead supported the FBR’s 2003 strategy’s *“gradual approach to the reorganization of tax administration, which envisioned a 5-7 year time frame for the eventual merger of all domestic taxes”*.²⁵ Management further clarifies that the *“TARP did not make any recommendation on whether or how to reorganize the civil service groups according to which the existing officers were organized, nor did it propose the creation of the new IRS”*.²⁶ This is because, in Management’s opinion, the *“establishment of cross-cutting functions for all of these taxes did not necessarily require a merging of the existing occupational groups”*²⁷ and several options were possible. Management notes that *“handling the configuration of occupational groups under a new, functionally integrated tax administration was a civil service issue rather than a tax administration issue”*²⁸ and as such, this decision rested with the Government in the purview of Pakistan’s civil service guidelines and procedures.
29. However, Management writes that several years into Project implementation and in view of the pressures of domestic economic and global financial crisis, neither the World Bank nor the Government was satisfied with Project results. This was when, in the midst of the economic crisis, the Ministry of Finance *“requested the services of a team of internationally recognized tax administration experts to work [...] on the implementation of the necessary reforms”*. The World Bank financed this TA²⁹ and in September 2008, the TA team recommended the full merger of sales and income tax in keeping with the original vision of the 2003 FBR strategy. Management writes that the Ministry of Finance adopted the advice of this TA team and pursued a more *“robust plan of organizational reform to fully integrate income, sales, and excise taxes through the establishment of the IRS and the voluntary merging of existing occupational groups”*. Moreover, the World Bank supported this *“new plan”* as it believed it had the potential to meet the TARP’s development objectives. Management further states that the World Bank *“explicitly linked the further restructuring and extension of the TARP beyond its initial closing date of December 31, 2009 to the plan’s successful implementation”*.³⁰

²³ Management Response, p. 13.

²⁴ Management Response, Footnote 12, p. 13.

²⁵ Management Response, p. 14.

²⁶ Management Response, p. 16.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Technical Assistance – Pakistan: A Tax Administration Review, September 2008, World Bank. The Terms of Reference of this TA states that *“a major objective of the tax administration reform is to create an organizational structure for FBR based on functions rather than tax-type lines. This ultimately involves the full merger of the sales tax and income tax organizations into a single organization”* and that the TA will support implementing the *“elimination of Direct Tax and Indirect Tax Wings”*, *“functional organization and integration of the administration of different taxes, with clear lines of reporting for LTUs and RTOs”*, and *“full integration of the administration of different taxes in LTUs and RTOs”*. An LTU is a Large Taxpayer Unit and an RTO is a Regional Tax Office.

³⁰ Management Response, p. 14.

30. Management notes that it was aware of the concerns raised about this integration of the domestic tax administration, and specifically that some staff of the revenue streams which were to be merged would be concerned about their career development. This is why, according to Management, the Bank called for *“effective human resource planning and outlining a career path [...] so that staff concerns could be effectively addressed”*.³¹
31. Management states that in June 2009, the FBR presented the World Bank with a *“new reorganization plan centered around the creation of an IRS and the provision of voluntary options for all officers of the Customs and Excise Group and Income Tax Group to join the IRS or remain in their existing groups”*. Furthermore, though Management had begun preparations for the closure of the Project, the *“reinvigorated commitment to the reform agenda”* and the *“clear reorganization plans”* convinced Management that critical institutional reforms, on which Project success was contingent, were now possible. In view of these developments, Management informed the FBR that it had linked the possible restructuring and extension of the TARP to the implementation of the FBR’s reorganization plan as outlined in the July 10, 2009 agreement which called for the establishment by the Government of *“one or two new occupational groups”*.³²
32. Management concludes by stating that though the establishment of the IRS was not part of the original TARP Implementation Plan nor was it directly financed by TARP, *“it was consistent with the overall development objectives of the project”* and that *“the decision to merge all direct taxes in a new IRS was not a ‘deviation from the original action plan of TARP’ as claimed by the Requesters”*.³³
33. **Impact on National Economy.** Though Management regrets the *“internal divisions sparked by the administrative merger of the two services and the numerous legal challenges”*,³⁴ it does not believe there is empirical evidence to suggest these have harmed the economy of Pakistan. Management believes the slow growth in tax revenue in the past 18 months *“can be attributed to the sharp overall slowdown in economic activity and trade as a result of Pakistan’s economic crisis and the global financial crisis”*.³⁵ Moreover, Management believes the economy has been negatively impacted by the contraction of the manufacturing sector, which is not something that can be attributed to the administrative merger of the occupational groups.
34. **Consultations and Communication.** Management *“underscores that the preparation and implementation of the TARP have involved extensive consultations according to the requirements of the World Bank’s operational policies”*.³⁶ Management points to a \$2.9 million Project preparation facility which ensured that the TARP was *“built upon a series of strategic inputs, several of which including extensive consultation with stakeholders”*³⁷ as evidence that the World Bank did take into account the concerns and opinions of the Customs and Excise officers in preparing and designing the TARP. Moreover, Management states that the World Bank *“advised*

³¹ Management Response, p. 19.

³² Management Response, Annex 3, p. 2.

³³ Management Response, p. 19.

³⁴ Management Response p. 23.

³⁵ Management Response, p. 24.

³⁶ Management Response, p. 25.

³⁷ Ibid.

the FBR to engage in effective change management leadership”³⁸ as a result of which an HR consultant and a Management Development Consultant were hired to conduct change management workshops. Moreover, Management points to a July 2009 recommendation to FBR Management that it execute a communication plan so as to inform staff about the administrative merger and “*clarify misconceptions*”³⁹ and also to develop an HR management strategy and creation of a new position of Director General Human Resources to implement the actions required to put in place the new administrative structure.

35. Management recognizes that “*World Bank staff made an error in not acknowledging receipt of emails*”⁴⁰ sent to it about the Project, some of which were unsigned and others which claimed to represent “*All Officers of Customs and Excise Group of Pakistan*”.⁴¹ Though Management has been informed of the reasons why staff did not reply to these emails, Management regrets the error and states “*the responses could have been handled in an appropriate manner*” and that it has “*provided appropriate instruction to the relevant teams on proper guidelines for responding to such external requests*”.⁴²
36. **Supervision.** Management believes the World Bank supervised the Project in accordance with the requirements of OP/BP 13.05. In addition to having the Task Team Leaders based in Islamabad until very recently, Management conducted five formal supervision missions and ten Implementation Supervision Missions during which it states it met with all the relevant stakeholders. Management also explains that as it was the FBR that took the decision to establish the IRS, it was the FBR which took the lead in consulting with stakeholders on the implications of the administrative merger. According to Management, the FBR held discussions with the representatives of the Association of Customs Officers about the “*preparations to establish the IRS*” and a full day consultation in June 2009 with both the Associations of Customs and Excise and Income Tax Officers before the creation of the IRS in September 2009. World Bank staff attended this latter consultation.
37. Management recognizes a “*failure of oversight by the World Bank*”⁴³ to allow a mission report of October 19, 2009 to contain a “*regrettable reference to the legislative process in Pakistan*”⁴⁴ and “*Management unequivocally recognized the error and communicated this to the Government of Pakistan*”.⁴⁵
38. **Management Response.** Management acknowledges that though staff and consultants made some “*misjudgments in communication*”, it believes that the “*World Bank has properly applied its policies and procedures and pursued concretely its mission statement in the context of the project*”. Consequently, “*Management believes that the Requesters rights or interests have not been, nor will they be, directly and adversely affected by a failure of the World Bank to implement its policies and procedures*”.⁴⁶

³⁸ Management Response, p. 24.

³⁹ Management Response, p. 25.

⁴⁰ Management Response, p. 28.

⁴¹ Management Response, p. 27.

⁴² Management Response, p. 28.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Management Response, p. 29.

39. **Supplement to Management Response.** On March 19, 2010 the Panel received Management’s “*Supplement to the Bank Management Response*”⁴⁷ in which Management proposed to emphasize and expand the Project component on human resource management and development under the purview of the on-going Project restructuring. Management reiterated that the FBR reorganization is “*premised on the principles of voluntariness, respect to inter se seniority, horizontal mobility, and stability in the career path*”. Management also states in this document that “*project activities would be focused on supporting FBR management to facilitate an effective integration of the FBR staff into the new functionally integrated administration and to ensure appropriate support for the career development of all FBR officers. Such activities would include: (i) support for new HR policies consistent with the new organizational structure on job classification, compensation, appraisal, integrity, and mobility; (ii) support for the development of career paths and the updating of position descriptions based on the new organizational structure; (iii) support for retraining of the FBR staff in line with new career development opportunities and performance criteria; and (iv) support for the internal and external communications campaign to enhance awareness of the rationale for and the objectives of tax administration reforms*”.⁴⁸
40. Management stated its commitment in the “*Supplement to the Bank Management Response*” to “*work with the FBR to include the FPSC as a key stakeholder to consult in the design of the human resource strategy to be developed for all FBR staff under the proposed restructuring of the TARP*” and confirmed that FBR will continue to formally involve the FPSC in the upcoming recruitment of new FBR officers.⁴⁹

E. ELIGIBILITY

41. The Panel must determine whether the Request satisfies the eligibility criteria set forth in the 1993 Resolution establishing the Panel and the 1999 Clarifications,⁵⁰ and recommend whether the matters alleged in the Requests should be investigated.
42. As part of this process, the Panel has carefully reviewed the Request and the Management Response. Moreover, Panel Member Alf Jerve and Operations Officer Mishka Zaman visited Pakistan from February 22, 2010 through February 24, 2010. During its visit, the Panel team met with the Federal Board of Revenue, the Ministry of Finance, the Economic Affairs Division, the Establishment Division, Bank staff, the Requesters, and Office Bearers of the Association of Customs and Excise Group. The Panel wishes to express its appreciation to everyone mentioned above for sharing their views and exchanging information and insights with the Panel.
43. The Panel also wishes to thank the World Bank Country Office in Islamabad for providing relevant information and assisting with logistical arrangements, and the World Bank Project team for briefing the Panel team on relevant aspects of the Project.

⁴⁷ *Supplement to the Bank Management Response to Request for Inspection Panel Review of the Pakistan Tax Administration Reform Project (TARP)*, dated March 19, 2010. Attached to this Report as Annex II (b).

⁴⁸ *Supplement to the Bank Management Response to Request for Inspection Panel Review of the Pakistan Tax Administration Reform Project (TARP)*, March 19, 2010.

⁴⁹ *Ibid.*

⁵⁰ *Conclusions of the Board’s Second Review of the Inspection Panel (the “1999 Clarifications”)*, April 1999.

44. The Panel is satisfied that the Request meets the technical eligibility criteria set forth in the 1993 Resolution and Paragraph 9 of the 1999 Clarifications, as described below.
45. During the visit, the Panel confirmed that the Requesters are legitimate parties under the Resolution to submit a Request for Inspection to the Inspection Panel. The Requesters are affected parties who have common interests and common concerns, and reside in the Borrower's territory. The Request therefore satisfies item (a) of the said Paragraph 9.
46. The Request "*assert[s] in substance that a serious violation by the Bank of its operational policies and procedures has or is likely to have material adverse effect upon the requesters,*" as per the requirement of Paragraph 9(b). The Requesters allege that the administrative merger of the Income Tax Group and Customs and Excise Group will negatively impact their individual rights as civil servants and career prospects because their promotions, and eventual inter-service lateral mobility, will be delayed and fewer officers of the Customs and Excise Group will likely get promoted as the two Groups will be competing for a reduced number of senior positions in the new Inland Revenue Service. In the Requesters view, this impact of the restructuring of the FBR and the creation of the IRS constitutes a "*material adverse effect*" and they allege a violation of the World Bank Operational Policy 13.05 on Project Supervision. The Panel's consideration of these issues is addressed further in the section on "Observations", below.
47. The Panel confirms that the World Bank was aware of the concerns of the Requesters for a considerable time period prior to the submission of the Request for Inspection. The Requesters have provided the Panel with evidence of their correspondence with the Bank and have stated that they did not receive a satisfactory response from the Bank. The Panel is therefore satisfied that the Request "*does assert that the subject matter has been brought to Management's attention and that, in the Requesters' view, Management has failed to respond adequately demonstrating that it has followed or is taking steps to follow the Bank's policies and procedures.*" Hence, the Request meets the requirement of Paragraph 9(c).
48. The Panel notes that the subject matter of the Request is not related to procurement, as required by Paragraph 9(d).
49. The revised Credit closing date is March 31, 2010. The Project is currently undergoing restructuring which, if approved, will allow it to be extended by two years.⁵¹ As of the date the Request was filed, about 0.5% of the IBRD Loan was disbursed and 32 % of the IDA Credit had been disbursed. The Request therefore satisfies the requirement in Paragraph 9(e) that the related Loan has not been closed or substantially disbursed.
50. Furthermore, the Panel has not previously made a recommendation on the subject matter of the Request. Therefore, the Request satisfies Paragraph 9(f).

F. OBSERVATIONS

51. According to Management, the Government's reform strategy talks about "*restructuring of CBR along functional lines and integration of income, sales and excise taxes*"⁵² but it does not elaborate

⁵¹ Management Response, p. vii.

⁵² PAD, p. 8.

on an administrative model that could be adopted to achieve the functional integration. Moreover, Management states that the “TARP did not make any recommendations on whether or how to reorganize the civil service groups according to which the existing officers were organized, nor did it propose the creation of a new IRS” and that “several other options were feasible.”⁵³

52. The Panel observes that the Project Appraisal Document (PAD) does not contain details of an institutional model to administer the functional integration of the direct and indirect taxes. The PAD says that “the long term vision of CBR provides for a functionally integrated tax administration system; moving to such a structure will avoid the present duplication of functions such as audit, collection and enforcement across departments”⁵⁴ and that “recognizing the challenges of the change process during the transition period, CBR will maintain the separation of function by tax type in the initial reform period with the aim of gradually reducing this over time, while carefully considering the legal, political, geographical and revenue implications.”⁵⁵
53. Keeping this in mind, the Panel observes that though an administrative model in the specific form of the Inland Revenue Service is not mentioned or elaborated upon in the PAD, neither does the PAD propose another model. The Panel observes, and was informed by the Requesters, that there can be several models that could be employed to administer the functional integration of a tax system. In the case of Pakistan, the Government chose to adopt, after receiving advice from a 2008 technical assistance report financed by the World Bank, the administrative merger of two service groups which led to the creation of a single service that will manage all of the inland direct taxes.
54. The Management Response states, and the Panel heard during its eligibility visit, that Project performance had not been satisfactory due to a variety of reasons at the mid-term mark.⁵⁶ In fact, Management writes that the World Bank’s internal supervision reviews rated project implementation and achievement of development objectives as “moderately unsatisfactory”.⁵⁷ Owing to this weak performance, the World Bank considered closing the TARP prior to its scheduled completion date in December 2009 but was convinced otherwise when a change in Government leadership, the global financial crisis, and national revenue shortfall created a renewed impetus for tax reform which led to the 2008 technical assistance report which advised Government, among other issues, on how to achieve the functional integration.
55. The Panel is not in a position to comment on the allegation by the Requesters that the establishment of the IRS was done at the behest of the Bank. During its visit, the Panel team heard from relevant Government officials that the decision to create the Inland Revenue Service was taken by the Government in light of the best advice it received from the Bank and other sources. The Government also affirmed its commitment to the tax reform agenda and informed the Panel team that it would finance the tax reforms from its own resources if required. On the other hand, the Requesters were of the view that the Bank exerted pressure on the Government to create the IRS.

⁵³ Management Response, p. 16.

⁵⁴ PAD, p. 14.

⁵⁵ Ibid.

⁵⁶ Management Response, pg 7.

⁵⁷ Management Response, p. 8.

56. Interaction with the Requesters during the eligibility visit enabled the Panel team to identify three main allegations of harm which the Requesters believe are directly the result of the Project. In the Requesters view, the reorganization of the FBR and creation of the IRS will negatively affect the individual rights of the officers of the Customs and Excise Group as civil servants. This perceived harm relates mainly to the career prospects of the Requesters. The second alleged harm is that the reorganization will lead to, and already has created in some instances, an adverse working environment in the co-located offices because of the rivalry between the Income Tax Group and Customs and Excise Group, and that this rivalry will be exacerbated by the administrative merger which will compel the two service personnel to work together. The third alleged harm is that the reorganization of the FBR has already resulted in declining efficiency of the revenue administration due to the demoralization of staff, ongoing litigation in domestic courts which challenge the legality of the creation of the IRS, and various labor actions.
57. The Panel was informed via a March 9, 2010 Press Release issued by the Federal Public Service Commission (FPSC) that in its view the creation of the “*new occupational service namely Inland Revenue Service....should have been done as per rules, after taking the Federal Public Service Commission on board which was not done*”.⁵⁸

G. CONCLUSION

58. The Panel examined the claims of the Requesters in light of the Panel’s analysis of its eligibility criteria, as described above. The Panel also took into consideration actions proposed by Bank Management to address claims of non-compliance raised in the Request for Inspection, pursuant to paragraph 5 of the 1999 Clarification to the Panel Resolution.⁵⁹
59. The Panel notes the importance of the issues raised in this Request. The Panel further notes that administrative reforms may change, positively or negatively, prospects for promotion and professional development. In this regard, the Panel notes that Bank policy does not require that administrative reforms of the type in question in the present case must be pursued under a principle requirement that they be neutral to career prospects. The Panel further notes, however, that reforms may be implemented in ways that infringe on legal or negotiated rights of individual or groups of civil servants. In the case of Pakistan, established recourse mechanisms for civil service disputes are available either through appropriate courts or the Public Services Tribunal. The Panel notes that some Requesters have initiated court proceedings and are awaiting the outcome of court decisions. The Panel wishes to clarify that it is not addressing issues of legality under domestic law in this report.
60. The Panel welcomes the “*Supplement to the Bank Management Response*” of March 19, 2010 and the actions proposed therein to respond specifically to the Requesters concerns regarding human resource development and management.
61. With respect to allegations in the Request, the Panel notes that key stakeholders were engaged in discussions about the IRS proposal but wishes to highlight the Requesters’ concerns that the

⁵⁸ Federal Public Service Commission, Press Release, March 9, 2010.

⁵⁹ Paragraph 5 of the 1999 Clarification of the Board’s Second Review of the Inspection Panel states “*The Inspection Panel will satisfy itself as to whether the Bank’s compliance or evidence of intention to comply is adequate, and reflect this assessment in its reporting to the Board*”.

timeframe for consultation on, and enactment of, such a major administrative reform was too short. The Panel also wishes to highlight the importance of Management's statement that "*the key to minimizing the disruptions that could result from the ambitious institutional reform undertaken by the FBR is effective consultation and communication*"⁶⁰ and notes that the "*Supplement to the Bank Management Response*" contains actions that can potentially further effective communication and consultation. At the same time, the Panel agrees with Management's position that the proposal to create the IRS was not a departure from the original Project objectives.

62. In light of the above considerations, the Panel does not recommend an investigation of whether the Bank has complied with its operational policies and procedures with respect to the allegations contained in the Request for Inspection. If the Board of Executive Directors concurs with this recommendation the Panel will advise the Requesters and Management accordingly.

⁶⁰ Management Response, p. 24.