

Enhancing Tax Revenue in Pakistan: Issues and Challenges

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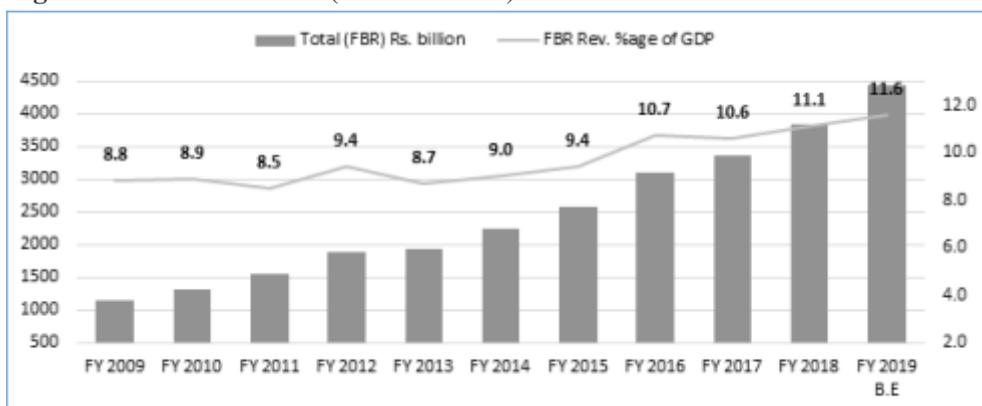
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Introduction

Economic stability is the major concern for all present-day modern states. Indeed, economic strength now overshadows political strength as well as military might on the global political stage. That makes economic security imperative for national security (Beckley, 2010). It is linked with the government's ability to generate wealth not only from indigenous resources but also through outside world to sustain its economy. Out of all such arrangements, what the governments gets in turn is tax in various forms. Financial administrative pyramid of the state is stemmed with its government's ability to maximize tax collection. As the governments need funds to invest in development to eradicate poverty and provide public services to the masses to materialize the very idea of a welfare state in which the public pays its due share in the form of taxes and the government rationalize its need-based spending. A good tax system provides these resources to the government to boost investment and growth to help spin the economic wheel through cash flows. Moreover, the fair and transparent tax system also helps in financial inclusiveness through technological advancement, encourages healthy competition in different sectors by patronizing weak sectors, ensures good governance, addresses income disparities, uneven wealth accumulation and promotes social justice to make an egalitarian society wherein potential at individual level differs but all are provided with equal opportunities. (World Bank, 2011).

Low revenue generation through taxation is amongst the major challenges being faced by the economy of Pakistan since long. The tax-to-GDP ratio of the country is hovering around 11 percent (Government of Pakistan, 2018-19) which is the lowest amongst emerging economies. The developed economies are collecting around 40% of their GDP in taxes whereas a typical developing economy collects 15% of its GDP in taxes (Akitoby, 2018). The abysmal performance of revenue collection machinery has resulted into abnormal increase in fiscal deficit and accumulation of huge unsustainable public debt. The tax revenue of the country seems unable to provide fiscal space to the government necessary for provision of healthcare, security and education to masses besides expenditure on infrastructure and social welfare of unprivileged stratum of the society.

Figure 1: Tax-to-GDP ratio (FY 2009-2019)



Source: Pakistan Economic Survey (2018-19)

Though, Federal Board of Revenue (FBR) has posted average growth of 14.6% per annum in revenue collection during last five years yet growth in revenue remained fail to finance developmental and non-developmental expenditures of the country throughout this period. The revenue collection has been increased from Rs. 2,254 billion in financial year (FY) 2013-14 to Rs. 3,844 billion in FY 2017-18. During these five years, average growth in Customs Duty was 21% while Income Tax, Sales Tax & Federal Excise Duty (FED) grew by 15.7%, 12.2% & 12.1%, respectively .

Table 1: Net Collection and Growth for Last 5 Years (Head-wise)

Year	Net Collection (Rs. billion)				
	Income Tax	Sales Tax	FED	Customs	Total
2013-14	877.3	996.4	138.1	242.8	2254.5
2014-15	1033.7	1087.8	162.2	306.2	2590
2015-16	1217.5	1302.4	188.1	404.6	3112.5
2016-17	1344.2	1329	197.9	496.8	3367.9
2017-18	1536.6	1485.3	213.5	608.4	3844

Source: Pakistan Revenue Automation Limited (PRAL) 2019

According to the World Bank (Pakistan Revenue Mobilization Project, 2019) tax compliance in Pakistan is considerably low which deciphers into huge tax gap of about 50% between actual revenue collected and potential tax revenue. Although, FBR puts utmost efforts to increase number of tax return filers during last three years and these efforts culminated into significant increase in tax filers. However, taxpayers who furnish income tax returns and actually pay tax has not kept up pace with the increase in number of National Tax Number (NTN) holders.

The database of Pakistan Revenue Automation Limited (PRAL) shows that total number of persons with the tax department was 4.79 million (approximately 2.3% of country's total population) during FY 2017-18. However, out of these total 4.79 million taxpayers only 1.85 million taxpayers filed tax returns in the FY 2017-18 while only 1.28 million people pay income tax as highlighted in Table below:

Table 2: Low Compliance – Income Tax

Financial Year	Number of Registered Persons	Number of Return Filers	Number of filers who paid Income Tax
2015 -16	3,977,984	1,511,178	981,955
2016 -17	4,245,886	1,805,536	1,151,512
2017 -18	4,786,939	1,852,101	1,284,383

Source: Pakistan Revenue Automation Limited (PRAL) 2019

Existence of huge undocumented and informal economy, narrow tax base, structural flaws in revenue system and tax exemptions etc. actually twists the knife to slash economic size by lowering tax collection. Such dismal situation may not help sustaining in the long run hence modernizing tax system of the country is no less than a challenge to generate more revenue for sustainable development without exacerbating income disparity and social inequalities.

Moreover, weak tax administrations exist in almost all developing countries and Pakistan is not an exception. While a well-functioning revenue administration is crucial to mobilizing internal resources. Like other developing countries, many sectors in Pakistan are hard-to-tax due to various social, economic and political reasons. These include agriculture, traders, small retailers and professionals. The incapability of the tax authorities to tax all sectors of the economy fairly and equitably leads to tax evasion, non-compliance with fiscal laws, narrow tax base and low tax-to-GDP ratio.

The government has introduced major changes in fiscal laws through the Finance Act, 2019-20 to broaden the tax base, documenting the economy and increase revenue collection. These changes include compulsory disclosure of complete details of unregistered persons in Sales Tax returns by the registered taxpayers, strict restrictions on cash transactions to purchase properties to document the economy and elimination of non-productive tax exemptions and concessions. In order to make the tax system

fair and just, the government is trying to provide level playing field to all taxpayers by treating them equally. Therefore, most of the businesses such as commercial importers and steel melters etc. which were falling under the Presumptive Tax Regime (PTR) or the Fixed Tax Regime (FTR) in the past have been brought into the Normal Tax Regime (NTR) this year.

Scope

Identification as well as eradication of the reasons responsible for sluggish revenue mobilization in Pakistan in order to formulate a policy to enhance revenue collection is the need of the hour for the economic betterment and the public good. Further, it is important to increase tax collection for reducing fiscal deficit and debt servicing to provide fiscal sustainability to the government to materialize its development agenda in socio-economic sphere that may also instrumental in attaining political objectives reflected in political manifesto as every subsequent regime promises to address such issues at first. The problem of low revenue collection severely affects all walks of life and it is one of the most important reasons of poverty and poverty related serious issues such as terrorism etc. (Maleckova, 2002)

Research objectives

The objectives of this research paper encompass contemporary challenges and issues in enhancement of revenue collection in Pakistan. Since the topic is too wide to cover all aspects comprehensively so it is limited to issues and challenges being faced for enhancement of revenue collection at the federal level but not at provincial level that is dealt through provincial revenue authorities. Keeping in view the aforementioned limitation of this vast topic, objective of this research study is to analyze existing tax system and to find out some pragmatic solutions to enhance tax collection of the country. Further, the study will answer following research questions:

1. How confidence building measures to promote voluntary compliance and rationalization of concessionary regime can help in enhancing revenue collection in Pakistan?
2. What measures should be taken by the Federal government to document the economy to plug the loopholes for expanding revenue collection?
3. How the government can broaden the tax base of the country to improve its tax-to-GDP ratio?

Literature Review

Several studies have been carried out internationally to find out the determinants of tax revenue for developing and developed economies, however, not a single comprehensive study is available to help determine issues responsible for low tax revenue in Pakistan (Waseem, 2018).

There are various factors which are responsible in low tax collection in Pakistan. Such as the share of agriculture sector is large in GDP of Pakistan, however, its meagre contribution in tax revenues is evident on account of political reasons. This makes the sector too difficult to get into the tax net at par with its size in the economy (Ahmed & Mohammad, 2010). The agriculture sector is exempted from federal Income Tax under the provisions of Constitution of Islamic Republic of Pakistan. The exemption of tax on income earned on account of agricultural activities creates distortion in tax system because tax evaders have been laundering their untaxed money by misdeclaration of its agriculture income. However, recent changes in the Income Tax Ordinance, 2001 and improvement of tax collection and monitoring by provincial revenue authorities. It has become difficult to understate tax liability in the guise of this constitutional tax exemption.

It should be primary concern of the revenue authorities of a good tax system to promote voluntary compliance with tax laws (OECD, 2013). Irrespective of the fact that tax morale is considered as individual thing, it is responsibility of the government to take various motivational actions to encourage tax compliance in the country. In order to formulate strategy to promote voluntary compliance it is important that tax authorities understand preferences of an individual taxpayer. Morale of a taxpayer could be assessed through several mechanisms which are mutually exclusive from each other. The mechanisms are: a) deep-down motivation, which is an extra term in the utility function that increases in the sum total of taxes that the individual is willing to pay; b) reciprocity, which means perception of a taxpayer about the fairness of the tax system and relationship of an individual to the state; c) social influences and peer effects, in which the additional utility term for paying taxes depends behaviors and views of peers and other individuals; d) long-run cultural norms and factors also affect the keenness to pay taxes; and e) probability of detection of evasion of taxes (for example, taxpayers may perceive that revenue authorities are unable to detect their tax evasion due to information imperfections) (Torgler, 2011). The study further

established that there is significant correlation among tax morale and tax compliance in both developed and developing economies. Therefore, tax morale is crucial determinant to promote voluntary tax compliance.

Tax concessions and incentives have played significant role in spurring economic growth and attracting Foreign Direct Investment (FDI). For instance, in Singapore and Korea, tax incentives and concessions- proposed as part of broader policy to attract FDI – seem to have promoted rapid industrialization (Vito & Zee , 2000). However, in most of the cases tax incentives attract little or no new investment. Some studies offer insight into factors responsible for effectiveness of different tax incentive schemes (UN, OECD, IMF, World Bank, 2015). For instance, resource seeking FDI (to exploit and utilize natural resources), strategic asset-seeking (to exploit technology or local know-how) or market-seeking (to penetrate in local niche markets) shows meager response to tax concessions. FDI that is efficiency seeking (to get benefit from cost advantages in production to achieve economies of scale necessary to capture world market) response positively towards tax exemptions(Gulbert, Harry, & Mutti, 2004).

During mid-1980s and mid-2000, China is an example of successful implementation of wide range tax incentive polices to promote industrialization in the country. The country offered tax concessions for special economic zones, significantly reduced rates of taxes for FDI and tax holidays for strategic industries. The economy of the country witnessed accelerated inflows of FDI during this period and many multinationals chose China as a preferred destination for their industries. For instance, Cheng & Kwan (2000) find that special economic zones in China boosted FDI inflows between 1985-1995. However, contrary to China, tax incentives are found less effective in Africa (Parys & Sebastian, 2010).

Moreover, the formal sector of the economy pays taxes while huge undocumented and informal sector of the country is out of tax net. The undocumented economy fuels on cash transactions making it impossible for a tax system to trace these transactions. Therefore, existence of underground economy in the country is an impediment in enhancing tax revenue in Pakistan (Ashraf & Kemal, 2019). He also suggested that economy can be documented by increasing in the number of legal documentation, strengthening the public institutions, improving governance, eliminating the unnecessary regulations and curbing smuggling through rationalization of tariff to reduce tax evasion.

The government has been striving hard to document the economy to enhance tax revenue. The Ministry of Finance & Revenue has launched a program to increase financial inclusion which will help in the documentation of economy.

The economy of Pakistan has been facing serious challenges for many years such as inadequate infrastructure, ineffective tax collection system and narrow tax base. Aamir (2011) studied comparison between Pakistan and India regarding collection of revenue through direct and indirect taxes. They established that tax system of Pakistan is more relying on indirect taxes than direct taxes while Indian tax authorities collect more direct taxes than indirect taxes. The indirect taxes are regressive in their nature; therefore, they promote inequality and hinder efforts of the government to mobilize resources. Furthermore, the indirect taxes such as the Sales Tax and Custom duty are inflationary, therefore, they increase cost of living of poor strata of the country. Failure of the government to collect Income Tax from rich and affluent class of the society weakens its writ. Ultimately, a society where the government collect tax from all its people at a single benchmark irrespective of their income level and tax contributing capacity becomes more prone to economic collapse due to financial disparities and social injustices. A sustainable economic system is designed by the individuals living into it who withstand all its odd as per one another's capacity to perform that's why in developed countries the rich are more responsible than the poor or the rich protects the system and the system protects the poor to stabilize the economy with no social divide between the classes.

The governments of developing countries remain incapacitated to provide their people with basic amenities and social securities that ultimately add to their miseries. Therefore, individuals of the country lose trust over the system and start doing things on their own by not paying tax that, according to them, only fills the government's pockets instead of addressing public grievances. Stashing money and tax evasion fulfil their social needs first ignites burgeoning informal economy that has no role in national economy despite its presence in the geographical and well as legal boundaries of the country. The governments of developing economies are responsible for this ignominy due to their inefficiency and lack of resolve to address the basic issues that add up to be indicated on national economic chart.

The objective of this literature review is to understand the concept and importance of tax structure and its collection at national level. This research study shed some light on

the corrective measures and workable suggestions for increasing tax revenue by promoting voluntary compliance and broadening the tax base in order to spin the economic wheel towards national development.

Research Methodology

Both quantitative and qualitative methods have been used in this study to comprehend a research problem necessary to answer stated research questions.

Pakistan Economic Surveys, numerical data given in different International Monetary Fund (IMF), World Bank, Organization of Economic Cooperation and Development (OECD) reports, Yearbooks of FBR, publications of Pakistan Bureau of Statistics (PBS) and the State Bank of Pakistan (SBP) will be analyzed during course of this research. Moreover, relevant provisions and schedules to the Income Tax Ordinance, 2001, The Sales Tax Act, 1990, The Federal Excise Act, 2005 and The Customs Act, 1969 will also be scrutinized. The qualitative research method will be used to formulate recommendations for enhancing tax revenue through confidence building measures necessary to promote voluntary compliance, analysis of tax exemptions and concessions to devise an actionable strategy to rationalize these exemptions to make the tax system fair and investment friendly. The data has also been analyzed to evaluate risk-based audit framework which is in place in FBR to minimize tax evasion and avoidance and to create deterrence of tax authorities vital to make the Universal Self-Assessment Scheme (USAS) effective and to provide recommendations for documentation of the economy and broadening of the tax base.

The qualitative analysis of different public documents such as IMF Executive Board's approval of US\$6 billion 39-months extended Fund Facility Arrangement for Pakistan, FBR strategy papers 2017-18 and 2018-19 has also been carried out as a part of qualitative research methodology. Therefore, both quantitative and qualitative data analysis is done to draw meaningful conclusion during course of this research study.

The subject research has been done by collecting and analyzing a sizeable data of secondary sources of primary and secondary data. Dearth of time, lack of physical and financial resources restrained to go for further collection of primary data or to conduct direct interviews in the concerned quarters. Moreover, latest data in all respects is normally not available as the major certified reports having high credentials related to the veracity of data are issued annually, bi-annually or quarterly. However, figures turn out monthly or even weekly in the media reports that may be conflicting or debatable.

Despite all this, efforts have been made to ensure maximum representation of facts and figures to reach a logical and justified conclusion.

Findings and Discussion

Confidence Building Measures

The business community of the country often complains about power abuse or misuse of authority by the revenue department is creating trust deficit among taxpayers. In response, FBR is putting utmost efforts to bridge the trust gap which exists between taxpayers and business community.

Tax amnesty schemes

The government introduced two consecutive tax amnesty schemes within a year with the objective to build trust of citizens on tax system of the country. The Foreign Assets (Declaration & Repatriation) Ordinance, 2018, the Voluntary Declaration of Domestic Assets Ordinance, 2018 and the Assets Declaration (Amendment) Ordinance, 2019 played a vital role in bringing potential taxpayers into tax net. A large number of resident and non-resident Pakistani individuals, Association of Persons (AOPs) and companies availed these tax amnesty schemes and declared their undisclosed incomes, un-declared and under declared expenditures, local and foreign asset such as cash, prize bonds, precious metals, vehicles and residential and commercial properties etc. to the tax revenue authorities. The philosophy behinds the amnesty schemes was to encourage business community to participate in the legal and documented sector of the economy. The persons who furnished declarations at nominal amount of tax have become tax filers and these schemes would help FBR in enhancing revenue in future.

Bar on conducting raids

Section 38 of the Sales Act, 1990 empowers the Inland Revenue department of FBR to conduct raids on business or manufacturing premises of a taxpayer to inspect and impound documents, records, statements and accounts, bank statements, utility bills, information regarding sources and nature of funds and business assets to ascertain the declared facts about business transactions and its volume. However, raid under section 38 of the Sales Tax Act can only be conducted after seeking prior approval from the Magistrate. The Sales Tax law also provides vast powers to the tax authorities to arrest and prosecute tax fraudsters involved in tax fraud which is cognizable offence under the law.

Moreover, section 175 of the Income Tax Ordinance allows tax department to enter and search premises of a taxpayer without obtaining search warrant from the Magistrate. The field formations of FBR exercise powers of section 38 of the Sales Tax Act, 1990 and section 175 of the Income Tax Ordinance, 2001 to plug revenue leakages. However, the business community agitates against raids and usually complains that FBR arbitrarily exercises this power which damages reputation of their businesses.

FBR has recently placed restrictions on conducting of raids to improve confidence of taxpayers on the tax system. These restrictions will boost morale of the honest taxpayers, however, at the same time cost of doing tax evasion has also been reduced which will be counterproductive for the optimal collection of revenue.

Change in procedure of attaching business banks accounts

The fiscal laws of the country facilitate tax department in recovering of outstanding tax arrears by empowering them with the authority to attach bank accounts of tax defaulters. Section 140 and Section 40 of the Income Tax Ordinance, 2001 and the Sales Tax Act, 1990, respectively allow FBR to recover tax from bank accounts of a person who remains fail to discharge his tax liability within specified period of time under the law.

However, the incumbent Chairman FBR has devised and circulated a lengthy procedure which is required to be followed by the department before taking stern actions against tax defaulters. Now, prior approval of the Chairman FBR followed by the intimation to the tax defaulter by the Commissioner is prerequisite to attach any bank account of the taxpayer. The philosophy behind this procedure is to build confidence of the taxpayer, however, this process has made recovery of tax arrears cumbersome for the Inland Revenue department of FBR.

FBR-NADRA database link

FBR has linked its database with the database of National Database and Registration Authority (NADRA) to promote and ensure taxpayer friendly environment. It has enabled taxpayers to check their personal information such as details of assets, transactions and records available with FBR from e-Sahulat centers of NADRA. This facility also exists on the official website of FBR.

Having access to this information will enable the taxpayers to preemptively prepare to explain their position before tax authorities, without waiting to receive the departmental notice. It would help build confidence of the taxpayers resulting into increase in tax revenue.

Ease of doing business

The significant changes have been made in the Sales Tax Act, 1990 through the Finance Act, 2019-20 to gear up efforts on “Ease of Doing Business”. For instance, simplified Sales Tax registration process has been reduced which would eliminate contact between the taxpayers and tax collectors. Similarly, restriction on purchase of vehicle and property by the non-filer has also been withdrawn which is another confidence's building measure.

FBR has also introduced a mobile app to facilitate taxpayers in filing of returns of income under the Income Tax Ordinance, 2001.

All the above-mentioned measures point towards the clear direction that FBR is taking, i.e. making the tax machinery more friendly and trustworthy for the individual taxpayer to enhance tax revenue to improve tax-to-GDP ratio of the country.

Tax exemptions and concessions

The purpose of tax exemptions and concessions is to support local industry by lowering the value of their inputs and machinery and incentivize export-oriented business through duty and tax remission. Therefore, The Federal Government has given different tax incentives to export oriented sectors to promote growth and to build up foreign reserves by attracting new investments in manufacturing sector. The government has also given tax holidays to Independent Power Producers (IPPs) to encounter a major issue of power crisis and to attract FDI in this sector.

Tax exemptions in Income Tax

In 2010, the government made a change in the Income Tax Ordinance, 2001 and announced a ten years tax break to all new investments. These concerns are allowed to claim 100 percent tax credit till end of year 2019. This tax break attracted huge investment in manufacturing, agriculture and mining sectors.

The government also announced hundred percent income tax exemption to power producers to combat a major issue of electricity crisis. Same incentive is also given to Information Technology sector to promote investment and to generate employment for qualified youth.

Tax expenditure in respect of direct taxes during FY 2018-19 has been reflected in Table 3 below:

Table 3: Tax Expenditure of Direct Taxes during FY 2018-19

#	Description	Cost (Rs billion)
1	Tax credit for charitable donations u/s 61	2.448
2	Tax credits u/s 64A	1.191
3	Tax credit u/s 64AB deductible allowance on education expenses	0.067
4	Tax credit for employment generation by manufacturers u/s 64B	0.0096
5	Tax credit for investment in balancing, modernization and replacement of plant & machinery u/s 65B	90.954
6	Tax credit for enlistment u/s 65C	0.356
7	Tax credit for newly established industrial undertakings u/s 65D	5.487
8	Tax credit for industrial undertakings established before the first day of July 2011 u/s 65E	6.458
9	Tax credit u/s 100C	13.977
10	Tax credit for investment in shares and insurance u/62	2.055
11	Tax loss due to exempt business income claimed by IPPs under clause (132) of Part I of the Second Schedule	18.034
12	Tax loss due to exemption to export of IT services under clause (133) of Part I of Second Schedule.	0.608
Grand Total		141.645

Source: Pakistan Economic Survey (2018-19)

The table 3 shows that the government sustained loss of tax revenue on account of tax exemptions of Rs. 141.645 billion in the year 2018-19. The tax exemptions provided to IPPs and newly established industrial undertakings caused loss of Rs. 18.034 billion and Rs. 5.487 billion, respectively to the national exchequer. Likewise, in the year 2018-19, the government forewent Rs. 13.977 billion revenue by giving 100% credit to NPOs and NOGs under section 100C of the Income Tax Ordinance, 2001.

Tax exemption in Customs Duty

The government of Pakistan slashed custom duties on import of raw materials to reduce cost of manufacturing to encourage investment in the country. The Prime Minister of Pakistan.

Table 4: Tax Expenditure of Customs duty during FY 2018-19

S.#	Description	Cost (Rs Million)
1	Concession of customs duty on goods imported from SAARC and ECO countries	348.8
2	Exemption from customs duty on import into Pakistan from China	2.5
3	Exemption from customs duty on import into Pakistan from Iran under Pak-Iran PTA.	0
4	Exemption from customs duty on imports into Pakistan from under SAFTA Agreement	1,614.80
5	Exemption from customs duty on import into Pakistan from China	31,620.70
6	Exemption from customs duty on goods imported from Mauritius	6
7	Exemption from customs duty on import into Pakistan from Malaysia	3,162.70
8	Exemption from customs duty on import into Pakistan from Indonesia under Pak-Indonesia PTA.	3,950
9	Exemption from customs duty on imports from Srilanka	2,401.60
10	Conditional exemption of customs duty on import of raw materials and components etc. for manufacture of certain goods (Survey based)	4,755.10
11	Exemption of customs duty and sales tax to Exploration and Production (E&P) companies on import of machinery equipment & vehicles etc.	5,725.70
12	Exemption from customs duty for vendors of Automotive Sector	26,604.40
13	Exemption from customs duty for OEMs of Automotive Sector	38,818.80
14	Exemption from Customs Duty on Cotton	2,275.90
15	Exemption from Customs Duty for CPEC	1,009.20
16	Exemption from Customs Duty for Lahore Orange Line Metro Train	749.1
17	Exemptions [Special Classification Provisions]	10,530.80
18	Exemptions/ concessions	99,558
Grand Total		233,134

Source: Pakistan Economic Survey (2018-19)

The table shows that the government has granted exemptions of customs duty of Rs. 233.134 billion on import of various goods during the year 2018-19.

Tax exemption in Sales Tax

Sales Tax exemptions and concessions under the Sales Tax Act, 1990 has caused loss of Rs. 597.7 billion during last financial year. However, the government has withdrawn exemption on local supplies of five zero rated sector through recent Finance Act.

Tax expenditure in respect of Sales Tax during FY 2018-19 has been reflected in Table 5 below:

Table 5: Tax Expenditure of Sales Tax during FY 2018-19

S#	Description	Rs. billion)
1	SRO 1125(1)/2011, dated 31.12.2011 (leather, textile, carpets, surgical)	86.7
2	Import under 5th Schedule	0.59
3	Local supply under 5th Schedule	53.5
4	Imports under 6th Schedule.	53.7
5	Local supply under 6th Schedule	247.3
6	Imports under 8th Schedule	62.7
7	Local supply under 8th Schedule	93.3
Grand Total		597.7

Source: Pakistan Economic Survey (2018-19)

The table 5 shows that the government sacrificed Rs. 597.7 billion last year on account of Sales Tax exemptions. Exemptions on the local supplies of 6th schedule items and five zero rated sectors caused loss to the national exchequer of Rs. 247.3 billion and Rs. 86.7 billion, respectively.

Negative impact of Tax exemptions on the tax system

Tax exemptions and concessions allowed certain positive economic activities under different concessionary regimes have resulted in loss of considerable revenue in the past. Exemptions and concessions allowed under different concessionary Statutory Regulatory Orders (SROs) of Customs, Sales Tax, Federal Excise Duty and Income Tax laws have caused distortions in the economy and ended up creating a complex tariff regime leading to widespread exercise of discretionary powers. Moreover, no mechanism in place to monitor efficiency of tax exemptions, therefore, tax fraudsters can easily misuse these concessions.

Broadening of the Tax Base

FBR has been focusing on broadening of the tax base for last many years because there are very low numbers of tax filers in the country and most of potential taxpayers are keeping themselves out of tax net. The tax system of the country could not attract people to file their tax returns in spite of the fact that the government introduced Universal Self-Assessment Scheme (USAS) in the Income Tax Ordinance, 2001.

According to the press statement of the chairman FBR, 2.51 million returns were filed for the year 2018 which are 67% more returns compared to the preceding year . However, huge room still exists to broaden the tax base to enhance collection of revenues and to improve tax-to-GDP ratio.

Establishment of dedicated BTB zones

During 2017, an extensive BTB initiative was propelled by FBR to address this core issue and respond to all challenges ahead. The Directorate General Broadening of Tax Base (BTB) headed by a BS 21 officer of Inland Revenue Service (IRS) was established under section 230D of Income Tax Ordinance, 2001. Subsequently, three dedicated BTB Zones were put into operation at Lahore, Karachi and Islamabad during the 1st phase of BTB restructuring plan . However, dedicated BTB zones don't exist in other major cities such as Peshawar, Faisalabad, Rawalpindi, Gujranwala, Multan, Hyderabad and Sialkot.

In 2015, the government introduced different tax rates for filers and non-filers of tax returns in the Income Tax Ordinance, 2001. FBR started generating Active Taxpayers' List (ATL) consists of taxpayers who had filed tax returns for last two consecutive years. According to the Income Tax Ordinance, rates of withholding tax of the active taxpayers were less than non-filers of tax returns. For example, adjustable tax under section 236K of the Income Tax Ordinance, 2001 on purchase of plot or constructed building was 2% of value of the property for active taxpayers while it was 4% for inactive taxpayers. This increase in the tax cost of non-filers resulted into broadening of the tax base.

The Finance Act 2018-19 placed restrictions on inactive taxpayers on purchase of vehicles and properties of worth Rs. 4 million or above. The change in law had impacted negatively on auto and real estate, however, it helped FBR to broaden the tax base of country. This restriction on purchase of vehicle and property has been withdrawn by the government through the Finance Act, 2019-20.

As discussed above, the law i.e. the Income Tax Ordinance, 2001 is supporting tax authorities in broadening of the tax base because it has raised tax cost of non-compliant persons. At the same time, it has reduced tax cost of compliant filers of tax returns. However, it is imperative that administrative steps should also be taken to increase number of tax filers to enhance revenue. The broad tax base will also reduce tax burden of compliant taxpayers and documented sector of the economy.

Salient Features of Recent BTB Initiatives

The salient features of recent BTB initiatives can be summarized as follows:

- BTB Zones at Islamabad, Lahore and Karachi have become operational and they are conducting field visits for identification of high net worth individuals who are unregistered, plazas' mapping, survey of commercial markets in recently developed areas, mapping of major commercial and residential projects and exhaustive surfing of real estate portals like zameen.com.
- BTB Zones have developed close liaison with National Database & Registration Authority (NADRA) for identification of unregistered potential taxpayers
- FBR has obtained data from Electricity Distribution Companies (DISCOs) for identification of those manufacturers who have industrial meters and liable to file tax returns under the Income Tax Ordinance, 2001 and the Sales Tax Act, 1990 but they are not registered with the tax department.

Challenges in broadening of the tax base

Commercial banks play central role in commercial activities. Therefore, the Income Tax Ordinance, 2001 obligates banks to share information of their account holders with the tax department. However, banks are reluctant to provide this information due to various reasons. Moreover, a robust tax culture is not being promoted and it is quite unfortunate that tax evasion and nonpayment of due taxes is quite acceptable in our society. The mindset to consider tax cheating as norm is a major challenge in the broadening of the tax base.

Conclusion

Economic situation of the country is mainly due to the issue of low tax-to-GDP ratio amongst other significant challenges responsible for economic meltdown. Sustainable economic growth can be achieved by enhancing tax revenue to finance socio-economic development across the country.

The tax system of Pakistan is facing multifarious issues and challenges which are impeding desired growth in tax revenue. Low number of income tax returns filer speaks volume about trust deficit of general public into tax system of the country. Therefore, this research study discussed ways to build confidence of the taxpayers to enhance tax revenue.

The government introduced tax amnesty schemes and simplified tax registration process to build trust of individuals, AOPs and companies. Similarly, FBR is toeing the line of taking a few confidence building measures such as restriction on conducting raids and searches, approval of the Chairman FBR prior to attaching bank accounts of tax defaulters to recover outstanding tax and developed link with the database of NADRA etc. Significant rise in number of tax filers in the year 2018-19 is self-evident of encouraging public response towards these confidence building measures. However, the government should go an extra mile to facilitate taxpayers to achieve intended objective of increase in tax revenue.

As discussed in this research study that unnecessary tax exemptions and concessions create distortions in the economic system as these exemptions are prone to be misused by different interest groups when no effective monitoring and evaluation mechanism is in place. For instance, the government has given tax holidays to newly established industrial concerns. However, this incentive is being widely misused by the manufacturing sector as they are availing themselves by splitting up their already established industrial units. Resultantly, country is sustaining huge revenue losses due to these tax incentives.

This study suggests transforming of the tax culture, both within the government bodies as well as the general public's attitude, by incorporating workable provisions into the existing tax laws and encouraging people to understand win-win approach to yield benefits. Although, the government has taken some drastic legal and administrative measures to bring businesses into tax net which include raising tax cost of non-filers and establishment of dedicated BTB zones, yet FBR should also develop linkages with commercial banks for real time exchange of information. To conclude, onus of running a successful and growing economic system does not lie on the government unilaterally to accomplish this cumbersome task of enhancing tax revenue but a collective responsibility of the society as well by promoting voluntary tax payment culture. So, understanding challenges and compulsions at both ends would be a welcome development to materialize the dream of socio-economic well-being of the society having a competitive global economy.

Policy Recommendations

This research study suggests following policy recommendations to enhance tax revenue in Pakistan:

- The complete ban on field formations of FBR on conducting raids and searches under the Sales Tax Act, 1990 and the Income Tax Ordinance, 2001 has been widely appreciated by the business community, however, it reduced cost of tax evasion. Likewise, this confidence building measure (CBM) may be misused by tax fraudsters in their own favor to cause loss to the national exchequer. So, instead of making enforcement provisions of fiscal laws redundant, Standard Operating Procedure (SOP) to regulate raids and searches should be developed to protect rights of honest taxpayers to boost their confidence but not at the cost of state exchequer to be plundered through such CBMs.
- Under the USAS regime, it is a responsibility of the taxpayers to discharge their tax liability truly and honestly. In order to enhance tax revenue, the database of FBR should be linked with third parties' IT systems such as database of commercial banks, Federal Investigation Agency to obtain information related to travel details of passengers, housing authorities, developers, builders, architects and departmental stores selling luxury goods to assess true tax and broadening of the tax base.
- Moreover, in the absence of monitoring and evaluation system, it is impossible to evaluate a tax exemption or concession to determine whether it is achieving its objectives or not. For instance, subject to few conditions, the government is allowing hundred percent tax credit to newly established manufacturing units to attract investment and to create employment opportunities in the economy. However, a comprehensive and well-defined monitoring and evaluation system should be developed to assess, whether this exemption is achieving its objectives by attracting investment or it is causing revenue loss by encouraging existing taxpayers to shift their profits from their taxable manufacturing units to exempt units to reduce their tax bill. Therefore, periodic reviews of tax incentives are necessary to determine whether these incentives are achieving intended goals or otherwise.
- The real estate sector is widely considered a parking ground of ill-gotten money in Pakistan. However, data available on online property portals such as zameen.com, graana.com and olx.com should be used for broadening of the tax base. The Director General, BTB should allocate dedicated human and physical resources to obtain, scrutinize and synthesize information exist on property portals to enhance tax revenue.

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