

ESSAY TOPIC:

TAX REFORMS IN PAKISTAN: A NEED OF HOUR

OUTLINE:

1. Introduction

- Thesis Statement: Taxes is the major source of revenue generation, therefore holds significance in terms of regulating country's economic cycle. However, Pakistan is facing multiple critical challenges in this domain, thus effective policy reforms are needed to utilize tax potential of country in its progress and development.

2. Taxation Reforms in Pakistan as critical need of time

3. Major issues of Taxation Sector in Pakistan

a) High Tax net with Low Tax Base

b) Tax Evasion by Public-Private Enterprises

c) Excessive indirect taxation

d) Weak Institutional Capacity

4. Economic problems emerge due to Taxation shortfall

- a) Expansion of Budget Deficit
- b) Low budget allocation for Public Sector Development
- c) Increase dependency on Loans
- d) Insufficient budget allocation for Human Development

5. Pragmatic solution as Tax Reforms needed by Pakistan

- a) Increase Tax Base
- b) Policy Focus on Direct Taxation
- c) Mode of E-governance to regulate Informal Economy
- d) Effective reforms for Institutional capacity building
- e) Incentivise Tax payers
- f) Strengthen Transparency and Accountability mechanism against Tax Evaders

6. Conclusion

ESSAY:

What is the rationale behind taxation? Why public has to pay various taxes for example income tax, sales tax, property tax etc.? Why government needs public taxes? Where the government utilizes the money of tax payers? These are some frequently asked questions regarding taxation. Taxes attain foremost importance in the regulation of economic cycle of any country, therefore if taxation system of any country collapses, it halts progress and development of country as well. Pakistan needs critical taxation reforms to tackle major issues of revenue generation. Some significant issues include high tax net with low tax base, tax evasion, indirect taxation, weak institutional capacity and many others. Moreover, shortfalls of tax sector lead to further economic challenges for instance, budget deficit, excessive dependency on loans and weak performance in public sector and human development. Thus, Pakistan needs pragmatic solutions

in terms of tax reforms which include increase in tax base, direct taxation, mode of e-governance to regulate informal economy, institutional capacity building, and robust accountability mechanism against tax evaders. However, taxes is the major source of revenue generation and holds significance in terms of regulating country's economic cycle. In this domain, Pakistan is facing multiple critical challenges, thus effective policy reforms are needed to utilize tax potential of a country in order to make progress and development.

According to the economic survey of the World Bank, Pakistan's tax collection can be increased upto 70% of its present revenue generation by taxes. Thus, the survey finding clearly highlights shortfalls of taxation sector of Pakistan. Economy of any state predominantly stands on two basic elements; one is expenditure and second is revenue. Both the

elements are interconnected and interdependent on each other in multiple ways. Revenue is needed to run expenditures, whereas if expenditures are more than ^{the} revenue collection then it leads the country towards deficits for example, budget deficit, current account deficit etc. Therefore, to attain balance and stability, revenue generation is critically important and taxes hold foremost position in generating revenue. Weak taxation system of Pakistan is one major reason of ongoing economic crisis, thus Pakistan needs comprehensive reform policy and framework in this regard.

Taxation sector in Pakistan has multiple critical issues. One of the key issues is low tax base with high tax net. Low tax base implies that major percentage of public does not pay taxes either or they pay insufficient or false taxes. Low tax base shows low public morale in terms of

tax compliance as well as it automatically raises burden on existing tax payers. According to State Bank of Pakistan Report (2018), around 1.21 million citizens which constitute less than 1% of total population pay taxes in correct manner. In this way, tax net is high whereas tax base is low in Pakistan.

Furthermore, in this regard is tax evasion by public holders and private enterprises. Elite section of Pakistani society consists of politicians, civil-military bureaucrats, industrialists private businessmen etc. Thus, this elite section of Pakistani society evades significant amount of taxes by using their political authority or by hiding their actual taxable income and assets. Statistical Data by Federal Board of Revenue recorded tax evasion of Rs. 170 billion in the year 2018. Tax evasion in Pakistan occurs in such vast amount, thus it creates

magnificent tax gap in revenue collection. Therefore, it is critical challenge of taxation sector in Pakistan.

Besides low tax base and tax evasion by public, another serious issue with the taxation sector of Pakistan is excessive indirect taxation. Due to low tax base and vast amount of tax evasion, government increases indirect taxes to fill tax gap in revenue production. However, it increases burden on general public which further encourages people to avoid or curtail their direct taxes. Revenue collection in Pakistan is dependent on indirect taxes of about 60% and direct taxes of about 40%. (A Review of Pakistan Tax System by Adnan Z. Mirza, ISSRA Journal, 2018) Thus, indirect taxation is directly challenging to Pakistan's economy.

In addition to flawed policies of governance in terms of excessive indirect taxation, another

key issue in this respect is weak institutional capacity. Institutional capacity holds tremendous importance because revenue collection through taxation is only possible when there is strong and effective institution. Unfortunately, Pakistan is lacking in effective institution regarding tax collection as there is only one federal institution in this regard which fulfills multiple economic duties for instance, tax collection, subsidies allocation, handling of international financial emergencies etc. Dr. Ishrat Hussain in his book 'Governing the Ungovernable (2016)' mentions that Federal Board of Revenue (FBR) is overburdened with economic duties whereas its resources are limited and same as they were in 1960's. Thus, weak institutional capacity drastically affects whole taxation process.

Lackings of taxation system produce serious economic problems

and the one which is highly significant in this regard is expansion of budget deficit. Low revenue collection through taxation expands budget deficit as the expenditure exceeds revenue collection. Fiscal budget of any country consists of revenue and expenditures, thus low revenue generation through taxation creates fiscal gap which eventually affects economic performance of state. (Pakistan's Agenda of Economic Reforms, Vagau Ahmed, 2017) In this way, taxation reforms are highly important to deal budget deficit as major economic challenge.

In addition to budget deficit, weak performance in revenue sector critically affects budget allocations. It has direct and serious implications on public welfare and development as public sector development (PSDP) highly depends on country's revenue. In this case, low revenue production curtails budget allocation for Public Sector Development Programmes

(PSDP) of country. According to many studies, governments of Pakistan have cut PSDP budget upto significant percentage due to increasing budget deficit and low revenue generation. (Governing the Ungovernable, Dr. Ishrat Hussain, 2018) Thus, taxation is very important for public welfare and development.

Furthermore, budget deficit due to expanding gap between revenue and expenditure leads the country towards external financial resources. Low revenue generation minimizes financial options for government, thus increases dependency on internal or external financial resources. According to Pakistan Economic Survey Report of Fiscal year 2021 to 2022, fiscal deficit of a country stands at PKR 2.56 trillion whereas internal debt stands at 28 trillion Rupees and external debt is 162 billion USD. However tax to GDP ratio is significantly low

at 8.5%. Therefore, taxation is highly important in broader economic perspective.

Moreover, low tax collection leads budget imbalance which further affects human development. Human development requires extensive economic resources, thus it faces serious hurdles due to low revenue collection through taxes. According to the World Bank statistical data and National Institute of Population Studies (NIPS), Pakistan has around 225 million total population. To accommodate such large number of population in order to generate economic benefits, government needs vast budget. However, low revenue generation eventually affects budget allocations for human development. Human Development Index (2020) ranked Pakistan at 154th among 189 countries, which shows low profile of country in human sector development. Thus, in this way, taxation holds critical importance in country's progress.

Aforementioned issues and economic challenges determine importance of tax reforms, therefore Pakistan needs comprehensive framework of tax reforms in order to tackle broader economic challenges through pragmatic solutions. Key important aspect in this regard is enhancing tax base. Pakistan needs to increase its tax base to increase revenue collection. By increasing tax base, it implies inclusion of more tax payers in record. It is important to curb tax evasion as well as to lower tax burden on existing tax payers. According to annual report of State Bank of Pakistan (2018), around 57.5 million people are employed and earning some income but they are not included in taxpayers list. Therefore, expansion of tax base is significant in order to achieve efficient tax collection.

In addition to tax base, another policy reform is needed in order to

Increase revenue collection and that is increase in direct taxation. Government of Pakistan needs to focus on direct taxation rather indirect taxation. Direct taxation is an efficient way of revenue generation that follows principle of equity whereas indirect taxation in the form of general sales tax (GST) on daily based commodities increases burden on masses. (Pakistan's Agenda of Economic Reforms, Nigar Ahmed 2017.) Thus, economic policies of government need diversification in terms of determining their focus and priorities.

Furthermore, tax evasion is one major problem regarding taxation system of Pakistan. Tax evasion also follows direct or indirect methods. Public holders avoid taxes through political patronage or while using the authority of their respected offices whereas major section of corporate enterprises evades taxes

indirect techniques. These methods include ^{hiding of} income, false tax reports generation through bribery to tax officers and most important is non-registration of corporate businesses. According to State Bank of Pakistan, 30 to 50% of Pakistan's economy is un-registered which is termed as informal economy or shadow economy. Therefore, modes of e-governance is prerequisite to increase tax base while maintaining record of informal economy.

Additionally to governance reforms regarding taxation, effective enhancement in institutional capacity building attains high regards. It is highly important because strong and robust institutions can generate revenue in efficient manner. In this regard, complete overhauling of government institutions is needed to meet the targets of revenue collection. Federal Board of Revenue is the only effective institution which

performs multiple economic tasks for instance, tax collection, subsidies generation, economic regulations regarding financial issues e.g. fulfilment of FATF requirements etc. Thus, institution of FBR needs restructuring in terms of its duties and resource management so that it can generate tax collection in an efficient way. (Governing the Ungovernable, Dr. Ishrat Hussain, 2018)

Besides restructuring of revenue departments, another important aspect in this regard is incentive policy for tax payers. Various studies conclude that 'tax evasion' in Pakistan is a social problem rather economic problem. It implies that large number of population holds this social attitude and they consider no wrong in tax evasion. Furthermore, corruption of public holders also encourages people on tax evasion. To address this social culture of tax evasion, government needs to reform

its tax policy. Policy of incentives and reward is needed to encourage more people to pay their taxes.

(Pakistan Beyond the crisis state, Malecha Lodhi, 2011) Tax evasion is social culture in Pakistan, thus it requires social mechanism in order to achieve desired results.

Furthermore, weak transparency and accountability mechanism encourages people especially public holders to avoid taxes. In order to increase tax-base, transparency and accountability mechanism against tax evaders of country needs to be robust and efficient. Moreover, tracking system should be introduced. Federal Board of Revenue (FBR) has already introduced "Track and Trace System" to register informal economy including industries, retailers goldsmiths etc. Further, it needs tracking system against tax evaders that hold public-private offices.

Thus, strong accountability mechanism with effective transparency is required to prevent tax evasion.

In order to conclude one may say that taxation is critical factor in country's economic development and public welfare. Taxation system needs comprehensive and robust mechanism from effective tax policy to implementing structure. Pakistan is facing complex level challenges in order to meet its tax revenue targets. These challenges are also expanding broader economic crisis. Therefore, in order to meet its target and to increase revenue collection, Pakistan needs comprehensive reform measures which address issues of tax base, indirect taxation, registration of informal economy, weak institutional capacity and accountability mechanism etc. Pakistan is facing multiple level challenges regarding taxation but suggested tax reforms can help in improving overall situation of taxation in the country.