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Q#1 How can Pakistan reform its tax system ... environment?

1. Introduction:

Pakistan's tax system has long been criticized for its low revenue collection. With the **tax-to-GDP ratio** of approximately **9.2%** in FY2023, the system fails to meet the country's fiscal needs. The tax system prominently relies on indirect taxation. According to **FBR report 2021-22**, **60%** of the annual tax collection comes from value added taxes (VAT) which in turn also suffers from inequity as exemptions are granted to some sectors. Similarly, tax evasion and avoidance remain the biggest challenge for Pakistan. However, with the help of technological advancements, implementation of electronic filing and payment system, shifting to direct taxes and tax simplification, Pakistan can increase revenue collection and reduce external borrowing.

2. Current Challenges in Pakistan's Tax System

a- Narrow tax base

Pakistan, despite being the 5th most populous country, has lowest tax-to-GDP ratio as it stands at 9.3% in contrast with the South Asian average of 19%. Similarly, according to Revenue Board of Punjab's report published in 2023, Punjab collected less than 3 billion in taxes while it has the capacity to collect Rs. 55-75 billion per year. The weak taxation system translate into the underperformance of the country's economy.

b- Reliance on Indirect Taxes:

The tax system prominently relies on indirect taxes. According to FBR, 60% of tax revenue comes from indirect taxes like GST and custom duties. In FY2023, GST was raised to 18%, that significantly increased the cost of essential

goods. This disproportionately burdens low-income groups.

c- Tax Exemptions and Concessions:

Tax exemptions and concessions significantly reduce the tax net. They remain the biggest challenge in revenue collection as they are supported by political elites for political gains. According to Finance Division, it has led to the estimated loss of 400 billion in 2022 alone. Weak enforcement by the Federal Board of Revenue exacerbate the problem.

d- Complex Tax Structure:

According to the World Bank's Ease of Doing Business Index Report 2020, Pakistan ranks 161 out of 190. Due to the complex tax structure, corrupt practices and the culture of red tape, investment rate lags behind and it also discourages compliance with the tax regime.

3. Proposed Reforms:

Reforms

Electronic Filing and Payment System

Shift to Direct Taxes

Integrated Digital System

Incorporate Agricultural Sector

a- Electronic Filing and Payment System

Technological advancements in the field can significantly enhance the tax collection of Pakistan that will lead to reduce reliance on external borrowing. According to World Bank Report 2020, improvements in the tax administration of over 100 countries were largely driven by technological advances specifically the implementation of electronic filing and payment system. By implementing electronic filing system, Pakistan

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can broaden its tax base and create a more equitable economic environment.

b- Integrated Digital Systems:
According to the studies, Pakistan can build an integrated digital system through which records of dividends payments made by financial institutions to companies and individuals would be linked to the tax system. This is widely followed internationally.

c- Broadening the Tax Base:
Pakistan needs to broaden the tax base and bring the informal sector into tax system. Pakistan's informal sector constitutes nearly **35% of GDP** but remain largely untaxed. It is the need of the hour to regulate the tax system and broaden its base to the informal sector.

d- Incorporate Agricultural Sector:

Agriculture contributes significantly to the GDP but is exempted from taxation. A progressive tax on the agricultural earnings can generate significant revenue.

e- Shift to Direct Taxes:

Pakistan needs to reduce the reliance on indirect taxes and initiate progressive taxation.

Taxes on luxury cars, assets and goods can yield substantial revenue.

4- Conclusion:

Tax reforms are essential for Pakistan's economic growth and reducing reliance on external debts. By modernizing taxation system, Pakistan can generate significant amount of revenue that will lead to more equitable economic environment.