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Tax to GDP Ratio:
Measures for improvement

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Preface

We would like to thank Allah Almighty for giving us the courage and devotion to complete this project. We are highly grateful to our syndicate advisor Ms. Qaisara Fatima whose supervision and guidance in relation to selection of material for perusal and formatting of the research paper helped us to do the work on time and in a professional manner. We are highly grateful to the Director General DOT (DT), Mr. Shahid Naseem whose able guidance helped us to analyze the causes of low tax to GDP ratio in Pakistan.

Abstract

We are now quite used to hearing the rhetoric by the government and bureaucracy on how Pakistan has one of the world's lowest tax to GDP ratios since long (by their account it has stood between 9.50 and 10.40 percent in recent years), which also happens to be extremely low when compared to its neighboring countries and similar economies. So Government is unable to allocate reasonable funds for development projects. Although Pakistan has adopted best practices of the World through Income Tax Ordinance 2001 and formulation of Inland Revenue Services after harmonizing Inland Federal taxes. However it is suffering from structural weaknesses including narrow tax base, low compliance, widespread exemptions, low coverage and weak audit and enforcement which are responsible for such low tax to GDP ratio. This paper aims at analyzing the road to improving the low tax to GDP ratio in Pakistan. As a first step we analyze the history of low tax to GDP ratio and in the second step we compare our tax system with countries having almost similar circumstances like India, Srilanka, and Bangladesh and also compare with one of the developed state, Sweden. In third step, we analytically study different reasons for low tax to GDP ratio. Results of the whole analysis indicate the tough choices and difficult decision for the government in trying to improve the currently low tax to GDP ratio in Pakistan. Root cause of almost all reasons, is lack of political will. We thus recommend carrot and stick approach to enforce the existing tax laws and policies besides addressing major flaws in the system in order to widen the tax base.

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Section I:
Introduction

"Tax" includes any penalty, fee or other charge or any sum or amount leviable or Payable[1]. In ordinary sense, taxes are the "levies" by the Government in exchange for the services provided to the general public and are the lifeline of any country because of the fact that major chunk of the revenue to run a country comes from them. Taxes whether direct or indirect are linked with the economy of the country and that is generally represented with the term Gross Domestic Product (the total market value of all final goods and services produced in a country in a given year).

Tax-to-GDP ratio can be defined as total government tax collection divided by the country's GDP. The Countries with the best tax-to-GDP ratios are Denmark 50 percent , Sweden 49.7 percent, Zimbabwe 49.3 percent , Belgium 46.8 percent, France 46.1 percent, Cuba 44.8 percent, Finland 43.6 percent, Norway 43.6 percent, Lesotho 43.9 percent, and Italy 42.6 percent. If we analyze Tax-to-GDP ratio in Pakistan it is worse even than its neighboring South Asian countries. For example India's tax to GDP ratio is 17.7 percent, Maldives' 20.5 percent and Sri Lanka's 15.3percent. Now if we want to compare Pakistan's tax to GDP with any country of the region we can find only Bangladesh with 8.5%, Bhutan 10.7 percent and Nepal again 10.7 percent. So, indeed Pakistan's tax to GDP ratio is one of the lowest in the region[2].

Pakistan barely managed 8.9 percent Tax-to-GDP ratio in fiscal year 2009-10. Unfortunately the country is being run on the financial oxygen being provided by international donor's agencies. Government borrowing from State Bank of Pakistan has reached astronomical figures. The burden of circular debt has shot up to 63 percent from 58 percent of GDP. This financial inflexibility has ultimately squeezed public sector development programs with the result that government spending on education and health sector is equal to nothing.

It is unfortunate that the Government has failed to persuade the feudal class to give taxes but on the other hand the poor salaried individuals are the victim of withholding tax regime. Besides this inequality there are many loopholes in the prevailing tax system by which rich class manage to evade taxes but poor is forced to bear the brunt of taxes. Tax exemptions/subsidies are also by and large given to the class that has the ability to pay the taxes. Besides inequality the biggest problem remains social as people do not feel it as their duty to pay taxes yet they demand services.

Tax to GDP ratio can be enhanced only when all sectors of economy contribute proportionately toward tax revenue, but if we analyze different sectors, their contribution in overall economy does not match with their contribution to Tax-to-GDP ratio in Pakistan, for example whole sale and retail sector, transport, construction, hotels, restaurants and commission agents. According to FBR estimates the contribution of most of the sectors

1. *Income Tax Ordinance 2001*, 12th ed. (Lahore: Lahore Law Publications, 2010
2. OECD tax to GDP 2009-10

like banking, insurance and telecommunication is also below potential. Live stock is contributing 50 percent of the value addition to agriculture, but has virtually no share in taxes. Similarly, tax contribution of sprawling orchards and horticulture is almost missing. Within the manufacturing sector, contribution of textile sector compared to its contribution to GDP remains a mystery and so is the contribution of food processing industries.

Federal Board of Revenue is responsible for the collection of revenue in Pakistan. However many questions have been raised by both national and international forum regarding its transparency and integrity issues. According to 2010 reports of Transparency International, FBR has been ranked at 8th position in the list of the most corrupt institutions in the country. Besides corruption, Board is being criticized for its failure to maximize revenue potential because of its inefficient administration and staff.

Pakistan gravely lacks in tax culture, rather it comes as an alien concept. The real dilemma of country is that rich as well as poor both are not willing to pay the taxes on the ground of overall insecurity and lack of basic necessities. Government is of the view that in absence of revenue, demands of the public can not be fulfilled thoroughly. In this dismal scenario the only available option to the Government is to improve its internal revenue collection mechanism because how long the donors agencies will help us with their tax payers money when we are not trying to improve our own revenue system.

The way forward presented in the paper is through implementation of a comprehensive resource mobilization strategy which has three pillars.

1. Expansion of the current GST to cover services and exempted and zero-rated sectors.
2. Improvement of direct/income tax administration.
3. Bringing large underground economy to documentation.

In this paper our focus will be on:

- Analysis of the Historical perspectives of lower tax-to-GDP ratio in Pakistan.
- Comparative analysis of tax to GDP ratio with that of India, Bangladesh, Srilanka and one developed country Sweden.
- Highlighting various reasons leading towards low tax to GDP ratio in Pakistan.
- Finally, recommendations for improvement in tax to GDP ratio in Pakistan.

Section II:
Historical analysis of the low Tax- to- GDP ratio

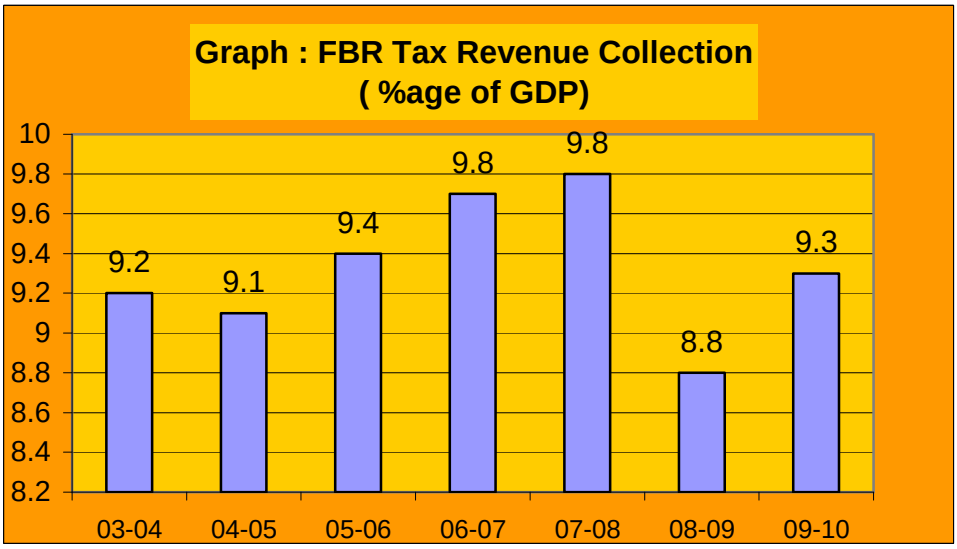
As per historical records taxation system was introduced in Sub- continent through Income Tax Act of 1922 and Central Board of Revenue was created on April 01, 1924 through enactment of the CBR Act, 1924. When Pakistan came into being, it continued with the pre-partition taxation system. Afterwards, taxation Research Committee was formed in 1958 consisting of Government officers and representatives of trade bodies, which after thorough deliberations recommended some changes in Income Tax Act of 1922. Income Tax 1922 Act gradually became complicated due to numerous amendments with the passage of time, which led the Government of Pakistan to introduce a new Income Tax Ordinance on 28th June 1979. Later on, Federal Government formed a National Commission on Tax Reforms in 1985 which was comprised of members of both houses of the Parliament, Government officials and renowned businessmen of the country. The main objective of that commission was to propose improvement in the working of Income tax laws of country. After 22 years of the enactment of the 1979 Income tax ordinance, the Government of Pakistan introduced Income Tax ordinance 2001 0n 13th September 2001. The basic purpose of the new ordinance was to harmonize the Pakistani taxation system with International best practices.

Sales Tax, which was administered by the provincial governments before partition, however was made a federal subject in 1948. Goods and Services Act was introduced in 1951 to collect GST in the country. Afterwards Government of Pakistan replaced the GST Act 1951 with GST Act 1990 with a purpose to collect this levy in VAT mode.

Pakistan is one of those countries which have the lowest tax to GDP ratio in the world (as shown in the table). Pakistan's taxation system suffers from structural weaknesses like narrow tax base, low compliance, widespread exemptions, low coverage, and lack of audit etc which are directly responsible for abysmally low tax-to GDP ratio. Aggregate tax-to-GDP ratio



has shown a declining trend, with a fall of over one percent of the GDP during the period. Revenue collection by FBR does not show any proportionate relationship with tax-to -GDP ratio as is shown in the following table; with 268.0 million collections in 1995-96, Tax-to GDP ratio is highest 13.7% while 1007.2 million collections in 2007-08 yields only 9.6 %age.



Source: www.fbr.gov.pk

At independence Pakistan had a low level of tax collection as a proportional of national income. The increase of collection from 9% in 1960-61 to 12.5% by 1970-71 was closely related to changing structure of economy, permitting higher collections from excise and particularly from custom duties. Collections have, however, stabilized at around 12%-13% of GDP over the last two decades. Striking features during the 1980's have been the declining contributions of income taxes (down from 21% of tax collections in 1981-82 to 14% in 1985-86) and of domestic taxation (excise declined from 31% of tax collections to 23% in the same period). The fact that tax collections have nevertheless remained constant as a proportion of GDP is largely because of greater reliance on custom duties, the contribution of this tax instrument increasing from 38% of tax collections to 42% over the same period.

During early 1990's there has been trade liberalization in Pakistan and the emphasis in development strategy shifted from import substitution to export promotion. Consequently, import tariffs have been gradually scaled down from initially very high levels to a maximum tariff of 25 percent. The implication of the tariff reforms was a major decline in the tax-to- GDP ratio of import duties from almost 5 percent to just over 1 percent of the GDP during the previous years. This was bound to exert a strong downward pressure on the overall tax-to-GDP ratio unless complementary reforms introduced to raise the tax-to-GDP ratio of other taxes.

During the early to mid 1990's, an elaborate withholding /presumptive tax regime was put in place. Beyond the typical deductions at source of wage /salary income, unearned capital income was brought into the tax net. Deductions at source were introduced on income from bank deposits, securities, national saving schemes, dividends, house rentals, etc. In addition, withholding taxes in the form of advance taxes were introduced on proxies of income like electricity, telephone and gas bills, cash withdrawals from banks, car sales, etc.

The other area of reform was in the sales tax. The Sales Tax Act of 1990 contains elements of a value added tax. The tax base was broadened initially to cover more goods like petroleum products, electricity and gas. Subsequently, a number of large and rapidly growing services like telecommunications were brought into the tax net. The standard tax rate has also been enhanced from 12.5 to 15 percent and then to 17 percent. Consequently over the last two decades, the sales tax-to-GDP ratio has increased by two percentage points. Overall, it is clear from the above description that the loss of revenue from the reductions in import tariffs has only been partly compensated for by reforms in direct and Indirect taxes.

Introduction of these reforms in the IMF standby facility of 2000-01, also involved efforts at extending the general sales tax to retailers (above the threshold level of Rs 5 million). Effective broadening of base was also rendered difficult by the absence of adequate documentation in the economy. In another effort under the Poverty Reduction and Growth facility (PRGF) for 2001-02 to 2003-04, the tax-to-GDP ratio was to be raised from 10.5% in 2000-01 to 14.3% by 2003-04. The actual ratio in 2003-04, in fact, remained somewhat lower than 10.3%.

Implementation of reforms was highly dependent on political will and governance capacity, for example, in early years of the last decade of the last millennium, the government achieved notable success in extending the network of withholding and presumptive taxes within the income tax system because a number of favorable factors came in concert .These included the projection of the particular reform as an integral part of the government's vision of change, building of a strong and diversified coalition of support, strong leadership from the top.

From 2001-02 to 2007-08, more fiscal space was created by larger aid inflows and debt rescheduling, there appears to have been a visible slackening of the fiscal effort and resorting to the 'supply-side economics' of stimulating growth by tax cuts. The first step was the abolition of the wealth tax. This was followed by sharp reductions in tax rates. The corporate income tax rate was brought down for private limited companies from 40 percent to 35 percent and for banks from 58 percent to 35 percent.

The maximum personal income tax rate for salaried earners was reduced from 35 to 20 percent and for the self-employed to 25 percent. Some withholding tax rates, for example, on importers were also scaled down.

Table-1: Tax-to-GDP Ratio, total and of Individual Taxes 1990-91 to 2009-10

(%)

	Direct Taxes	Customs Duty	Sales Tax	Central Excise Duty	In-direct Taxes	Total FBR Taxes	Sur-charges	Total Federal Taxes	Total Provincial Taxes	Total Taxes
1990-91*	1.49	4.89	1.50	2.07	8.46	9.99	1.01	10.96	0.51	11.47
1994-95*	2.74	3.45	1.94	1.94	7.33	10.07	0.92	10.99	0.50	11.49
1999-2000	2.95	1.61	3.05	1.46	6.12	9.07	1.02	10.09	0.47	10.56
2004-05	2.82	1.78	3.67	0.82	6.26	9.08	0.41	9.49	0.45	9.94
2006-07	3.85	1.52	3.57	0.82	5.91	9.76	0.74	10.50	0.42	10.92
2007-08	3.77	1.47	3.76	0.82	6.05	9.82	0.34	10.16	0.40	10.56
2008-09	3.47	1.16	3.55	0.91	5.62	9.09	0.99	10.08	0.36	10.44
2009-10	3.60	1.10	3.50	0.80	5.40	9.00	0.80	9.80	0.40	10.20

Source: www.fbr.gov.pk

* The GDP has been increased by 20.6% following the rebasing of national income accounts

Overall, during the last decade a historic opportunity for achieving a significant jump in tax revenues in a period of fast economic growth was lost. The above analysis shows that if somehow the negative 'rate' effects could have been avoided, Pakistan's tax-to-GDP ratio could have been almost 2.5 percentage points higher, at close to 13 percent of the GDP. In the same period, with fast economic growth, India's tax-to-GDP ratio increased by over 3 percentage points, with income and corporation taxes contributing 71 percent of this increase.

1. Aisha Ghaus Pasha, "Can Pakistan Get Out of the Low Tax-to-GDP Trap?" *The Lahore Journal of Economics 15, (September 2010): 171-185*

Section III:
Comparative analysis of Pakistan with different countries

Most developing countries are increasingly focusing on domestic resource mobilization toward economic development. In this context, tax performance is of crucial importance, especially for a developing country, since it is the prime source for domestic resource mobilization. Many developing countries often face difficulty in augmenting tax revenue to the desired level and considerable attention is being devoted to formulating fiscal policy best suited for increasing revenue.

In this section we will analyze the tax performance of neighboring countries like India, Bangladesh, and Sri Lanka, since ground realities in all three countries are almost alike. More interestingly India, Bangladesh and Pakistan have come a long way since British left them. Of the three nations India has seen by far most dramatic growth. Pakistan and India are clustered together at numbers 138 and 139 respectively in the UNDP's 174-country ranking of human development, which takes into account such components of well-being as life expectancy, education and gender equality. In both countries tax revenues are below 15% of GDP and come largely from Indirect taxes like sales tax and customs, which discourages imports. India had a far slower growth rate than Pakistan's from about 1947 to the 1980, has not only improved its performance fundamentally over the last twenty years, but has also grown consistently for the past two decades leaving Pakistan far behind. Even Bangladesh, once considered as a "basket case "by some Pakistani economists and planners, has recently had several years of stable growth despite political uncertainty. With almost similar circumstances, India, Srilanka and Bangladesh have achieved reasonable tax–to GDP ratio which in case of Pakistan is non-existent. So a comparative analysis of these countries will be helpful in coming up with analysis which contribute to broadening of our tax-to-GDP ratio.

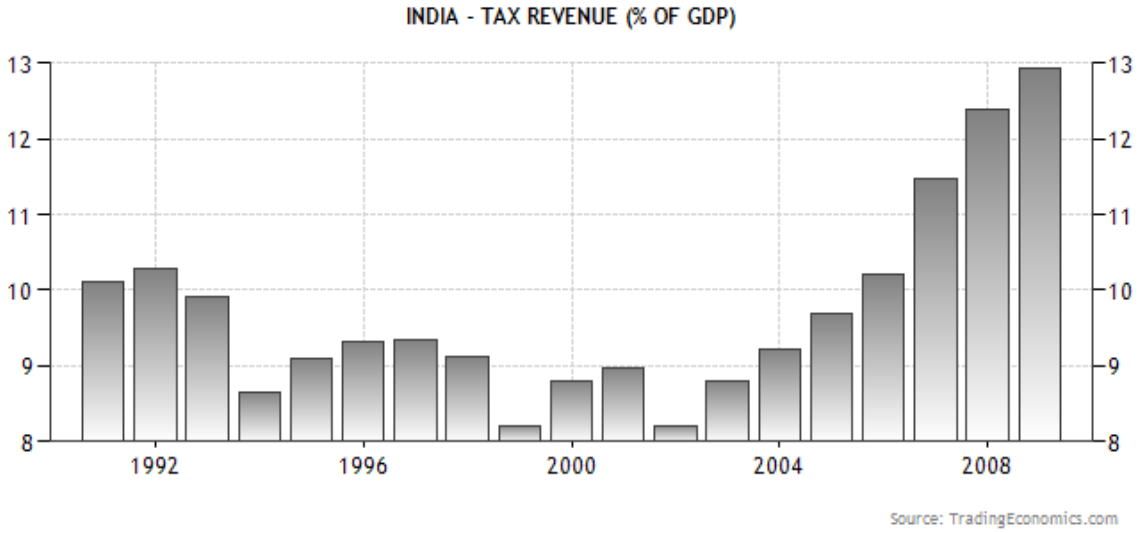
3.1 Pakistan Viz-a-Viz India

The Indian economy is the 12th largest in USD exchange rate terms and second fastest growing economy in the world. In terms of purchasing power parity, the Indian economy ranks the fourth largest in the world. India's GDP has touched US$1.25 trillion. The crossing of Indian GDP over a trillion dollar mark in 2007 puts India in the elite group of 12 countries with trillion dollar economy[1]. The Central Board of Direct Taxes (CBDT) is a part of the Department of Revenue in the Ministry of Finance, Government of India. The CBDT provides essential inputs for policy and planning of Direct taxes in India and is also responsible for administration of the direct tax laws through Income Tax Department. The CBDT is a statutory authority functioning under the Central Board of Revenue Act, 1963.

The growth of revenue in India is not quite impressive, rising from a meager of 6.7%of GDP in 1950-51 to 10.2% in late 1990s and peak of 12.9% in 2008-09.Important point to note is that tax-to-GDP ratio has started increasing constantly from 2004 and has reached at 12.9% in 2009.while tax-to-GDP ratio in Pakistan has started declining from peak 13.2% in the last decade of millennium and has constantly declined since 2000 to 2009 reaching at 8.9 in 2009. By international standards the average level of taxation in India is below the

1. www.economywatch.com/indian

average of high income developed countries and much lowers than the industrial nations but can be compared well with the tax share exhibited by the low income developing countries like Pakistan. In case of India constant increase from 2004 onward reflects partly the increase in the role of the government and increasing revenue potential of the states.



In India, like many developing countries bulk of revenue is being collected from domestic indirect taxes mainly from excise and sales tax. Constitutional arrangements assign exclusive power to states to levy sales tax while the central government has to rely on excises, as consequence excise become major central tax instrument with more extensive tax coverage than other countries including Pakistan. Taken together sales tax &excise account for more than half of the total tax revenue in India. India has seen a rising dependence on foreign trade taxes in short. It is indeed administrative difficulties with direct taxes that lead to the major role for indirect taxes and corporate taxation in developing countries including Pakistan. Aside from the increased governmental efforts, the increase in non agriculture sector has contributed to rise in tax collection as this sector is easier to tax. Secondly growing share of imports facilitated overall tax ratio as imports provide a significant base for imports duties as well as excise and sales tax.

RS in crore

Tax revenue of centre and states in INDIA									
Year	Total tax revenue All India			Central taxes (Gross)(A)			States shares in central taxes (B)		
	Direct	Indirect	Total	Direct	Indirect	Total	Direct	Indirect	Total
1991-92	16657	86541	103198	15353	52008	67361	5104	12093	17197
1992-93	19367	94779	114166	18140	56496	74636	6057	14465	20522
1993-94	21713	100248	121951	20299	55443	75742	7767	14473	22240
1994-95	28878	118971	147849	26973	65324	92297	8560	16283	24843
1995-96	35777	139482	175259	33564	77660	111224	11274	18011	29285
1996-97	41061	159995	201056	36698	90864	129762	13516	21545	35061
1997-98	50538	170121	220659	48282	90938	139220	21102	22446	43548
1998-99	49119	183898	233017	46601	97196	143797	14480	24665	39145
1999-2000	60864	213719	274583	57960	113792	171752	16523	26958	43481
2000-01	71762	233558	305322	68305	120293	188605	18655	33290	51945
2001-02	73109	241426	314535	69195	117862	187060	21492	31906	53398
2002-03	87365	268912	356277	83363	132542	215905	21473	34369	56122
2003-04	109545	304538	414084	105091	149257	254348	28492	38874	67366
2004-05	137093	357277	494370	132183	172774	304957	36828	43331	80159
2005-06	167635	420053	587688	162337	203814	388151	44511	51376	95887
2006-07	231376	605331	736708	225045	248467	473513	60454	61876	122331
2007-08	318839	551490	870329	312220	280927	593147	80650	72950	153600
2008-09	346390	601270	947660	338906	289043	627949	Na	Na	161979
2009-10	372051	624823	996885	363956	277123	641080	98888	67974	166862

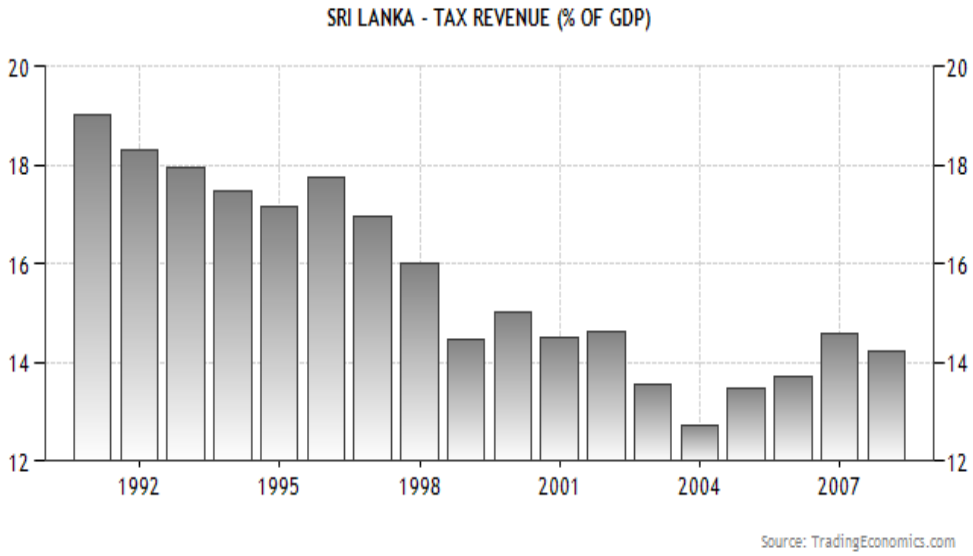
Source: Public finance statistics of India

There has been a steady decline in the share of direct taxes from 21 per cent in 1970-71 to about 14 per cent in 1990-91.But after the introduction of tax reforms in 1992, as part of the shift in country's tax structure direct taxes paid by individuals and companies continued to account for the majority of tax receipts and revenue from direct taxes has grown faster than revenue from other taxes. So the distinguishing feature of Indian Tax system is that share of direct tax revenues has increased to 56% in 2008-09 because of strong enforcement mechanism.

The second most important feature of the Indian tax system is the contribution of the states in the country's overall ratio. In the Indian federal polity, both central and state governments exercise revenue powers and the latter raise about 37 per cent of total revenues. Tax assignment between different levels of government follows the principle of separation, as these separate taxes levied by the centre (excise duties, income tax, corporate tax), states (sales taxes, state excise duties, taxes on motor vehicles, goods and passengers), and local governments (octroi) fall on the same tax base. It is baffling that provincial tax receipt in Pakistan is totals to an abysmal 0.7 percent of GDP.

3.2 Pakistan viz-a-viz Srilanka

Sri Lanka since early 80's, has been facing a deteriorated law and order situation when ethnic conflict gained momentum there and Sri Lanka's economy showed a low GDP growth. The revenue to GDP ratio of Sri Lanka declined from 18.5 % in 1991 to 14.8 % in 2007 and further down to 14.3 % in 2008 and 12.80% in 2009 but soon it overcame this impediment by focusing on its main strong hold of economy like its Tea exports, Tourism sector and on the other hand government tried to improve the revenue collection. But the tax to GDP ratio is still high at 14.3% as compare to that of Pakistan



There exists high revenue collection in Sri Lanka, despite facing deteriorating law and order situation, and it has been successful in improving revenue collection, by offering incentive to the taxpayers, levies relaxation in time limit for payment of tax, and there are some relatively high tax rates, which also contributed to the revenue collection. Sri Lanka has adopted two pronged strategy, taking pro taxpayer and pro revenue measures at the same time. Sri Lanka 's taxation laws are quite similar to that of Pakistan's though, like taxation threshold for income is same as well as exemption culture.

In Sri Lanka, for taxpayer's facilitation, tax is collected in 5 installments. While in Pakistan under the law, taxpayer has to pay the tax in lump sum and extension in time or installment based payment is allowed under some special circumstances only if the Commissioner is satisfied. Another noticeable measure is provision of incentive to the taxpayers in the form of discounts if they show compliance e.g. any individual who makes

any quarterly self assessment income tax payment, one month before the due date is entitled to a 10% discount there on. Privileged cards are issued to compliant taxpayers.

Personal income tax is applicable on salaries, rent, small businesses and earnings from self employment. An annual income of LKR 300,000 is exempted from this tax .The income exceeding this limit is taxable at rates ranging from 10% to 35% under different slabs. Tax liability in Sri Lanka starts from 300000 with tax rate of 10%and rate of 35% will be applicable on income exceeding 1600, 000.While in Pakistan income tax rates are quite low ranging from 0.75% for PKR 300,000-350,000 to 20 % for income above PKR 4,550,000 as compare to above given rates in Sri Lanka. These higher income tax rates contribute to high revenue collection.

Similarly Sri Lanka gradually moved from a Turn over tax to a GST in 1998, and subsequently to VAT introduced by Act, NO. 14 of 2002 replaced Goods and Services tax (GST). The sectoral composition of the economy has changed from that of agricultural to one dominated by services sector. The services sector has been the highest contributor to GDP at 60 % followed by Industrial sector at 28 % and agriculture 12 % in 2008. Trade liberalization, private sector participation and increased competition have contributed to the expansion of services sector with marvelous performance in transportation, communication, financial services, trade and tourism. The structure of exports has changed over the years from a few traditional plantation crops to several industrial exports. The share of agriculture exports has now declined to 20 % while that of industrial exports has grown to 78 %.

Like Pakistani economy Srilanka is also predominantly an economy of small and medium enterprise and over 50 % GDP is contributed by this sector. Sri Lanka government, however, attaches significant emphasis on the development of SME's realizing their as significant contributor to the GDP growth.

Pakistan and Sri Lanka, both economies have faced almost same social and economic problems but Sri Lanka succeeded in maintaining a high tax to GDP ratio by boosting its economy on one hand and by improving revenue collection on the other hand. In Sri Lanka too, there exists the same problems like poor law and order situation as it has witnessed the ethnicity based terrorism which affected its economy and its most strong economic sector of tourism. In spite of the fact that in Srilanka there too exist the problems of corruption, narrow tax based exemptions from taxation, insufficient infrastructure for domestic trade but there are more incentives to the tax payer and simple tax laws, with high taxation rates. There is also focus on higher direct tax rates and low indirect tax rates to facilitate the common man.

3.3 Pakistan viz-a-viz Bangladesh

Bangladesh, as an emerging developing country, is committed to augmenting revenue and achieving fiscal discipline with a view to increasing self-reliance. The external environment influencing the tax performance of Bangladesh has changed remarkably as the country became increasingly integrated with the global economy during the 1990s and

onward. Revenue receipt of a government consists of two parts, viz tax-revenue, and non-tax revenue.



Total taxes in Bangladesh are divided into direct and indirect taxes. Direct taxes in Bangladesh consist of taxes on income (income tax, corporation tax, agricultural income tax) and taxes on property (wealth tax, gift tax, estate duty, capital gains tax, urban property tax, house rent, land revenue, registration and non-judicial stamp). Like other developing countries, direct taxes contribute little to overall tax revenue in Bangladesh. Around 75% of the total tax revenue in Bangladesh is comprised of indirect taxes. The direct taxes in general accounted for less than a 25% of the total tax revenue of the country. Traditionally, the tax structure of Bangladesh is such that it has to rely on indirect tax for revenue generation, which is discriminatory in nature. Bangladesh has only 2.7 million NTN-holders out of a population of more than 150 million.

National Board of Revenue (NBR) is the central authority for tax administration in Bangladesh and collects almost 75.37 percent of total revenue for the country, non tax revenue 20.88%, revenue beyond NBR 3.76%. (NBR Annual Report, 2007).Tax revenue constitutes around 80 percent of total internal resources in the country. The NBR under the Internal Resources Division of the Ministry of Finance is the apex tax authority of Bangladesh and collects about 95 percent of the country's total tax revenue. The non-NBR portion of tax mainly includes narcotics duty, land revenue, non-judicial stamp, registration fee and motor vehicles tax.

Notwithstanding the various fiscal reforms of the recent past, Bangladesh fiscal system continues to suffer from a number of major weaknesses:

- Narrowly Based Tax Structure
- *Low Level of Revenue Mobilisation and*
- Low Revenue Productivity and High Administrative Costs
- *Regressive Nature of Taxation*
- *High Tax Incidence and tax evasion*
- *Cumbersome* Legal Procedures

In recent years, the Government of Bangladesh has initiated some administrative and policy reforms in the tax system. An improved tax administration in association with some pragmatic policy initiatives has resulted in a modest improvement in the tax-GDP ratio of late. However, the performance is still unsatisfactory as compared to other countries at a similar stage of economic development.

Similarities between the Pakistan and Bangladesh taxation system is low tax to GDP ratio and heavy reliance on indirect taxes besides both the countries are facing almost same problems in collection of tax viz, apprehensions and lack of confidence of general public, inefficient administrative staff, absence of proper audit system, element of corruption at lower level, tax evasion, tax avoidance, narrow tax base and cumbersome legal procedures etc. The main difference between the two is that there are certain additional taxes in direct taxation i.e. corporation tax, agricultural income tax (Agricultural tax is exempt in Pakistan) and taxes on property includes wealth tax, gift tax, estate duty, urban property tax, house rent, land revenue, registration and non-judicial stamp etc which are not the part of direct taxation in Pakistan.

Direct taxation contributes around 26% in overall tax receipt while in Pakistan it is around 20%. Tax payers are divided in to three main categories in Bangladesh's taxation system which are corporate, salaried and other tax payers while in Pakistan we usually have individual, AOP and company.

Pakistan is comparatively better with regards to Administrative Capacity, Resource freedom (Human and Logistics) and Centralised Taxation System which is lacking in Bangladesh taxation system.

Strengthening of inspection, survey, search and seizure, Tax holiday, help desk, citizen's charter, Freeze/take over of bank accounts of tax defaulters, Strengthen monitoring mechanism with a view to ensure deposit of withholding tax and outstanding income tax, Retrieve household asset holding number from municipality and trade-license related information of businesses and thus identify new tax payers, Identify forged TIN, Regular visit in order to coordinate the works of field level offices, Establish tax offices at district level, Establish a special tribunal to prioritize resolution of long-standing tax payment cases, Improve publicity and information to encourage individuals and firms to register and pay tax, improve on-the-job training and undertake other capacity building measures, Develop one-stop service centers to provide information and advice to taxpayers and create a more positive tax compliant environment, Further simplify tax forms and improve tax payment procedures such as payment through mobile phones are the measures which can be adopted to improve tax to GDP ratio of Pakistan.

3.4 Pakistan viz-a-viz Sweden

Sweden is considered one of the countries with the highest tax-to-GDP ratio in the world. The post-World War II boom propelled Sweden to greater economic prosperity, putting the country in third place in per capita GDP rankings by 1970. Although it faced a deep economic recession during 1990's and the welfare system that had been growing

rapidly since the 1970's got disturbed. The response of the government was to cut spending and introduced a number of reforms to improve Sweden's competitiveness. When the international economic outlook improved combined with a rapid growth in the IT sector, which Sweden was well positioned to capitalize on the country was able to emerge from the crisis. So Sweden managed to raise again and in 2006 it had the world's ninth highest GDP per capita and tax to GDP ratio at 49.1%. Sweden has achieved an enviable standard of living under a mixed system of high tech capitalism and extensive welfare benefits.

Sweden has a unique economic model characterized by close cooperation between the government, labor unions and corporations. The Swedish economy has extensive and universal social benefits funded by high taxes, close to 50% of GDP. Sweden is an export oriented mixed economy and the main sectors which contribute to its GDP are services sector 71.8%, industry 26.6 and agriculture 1.6%. In 2010 Sweden has revenue of $ 196.9 billion, its GDP is $333.9 billion and its GDP per capita is $ 37,775.

According to the 2010 edition of the publication of taxation trends in the European Union, issued by Euro stat. Sweden had the highest personal income tax rate, which was about 56.4 percent. For personal income, the tax rate is progressive. The higher the income, the higher the rate is. At the top level, it may even exceed 50 percent of the income. Interestingly, the corporate tax is set comparatively low. This encourages people in pursuing business activity. With such figures, it is not surprising that the individual tax contributes more than corporate taxes. People also tend to be self-employed rather than being employed. In addition, this tax structure brings income equality. In real life, the gap between the rich and the poor is difficult to see in Sweden. Surprisingly, the Swedish people live peacefully with such high individual taxes. Swedish loved being taxed! Swedes believe their money will be returned to them with a better value.

In Sweden, for instance, all education fees, from elementary to university level, are free. The country also provides abundant subsidies for public needs, such as subsidies for unemployed people, pensions for every taxpayer, and free medical services for those under 18 etc. An article in The Guardian (Nov. 16, 2008) entitled "Where tax goes up to 60 percent, and everybody's happy paying it". According to an interview in the article, most Swedes believe that the state will manage their taxes well. This public trust is supported by simple tax procedures and transparency on tax allocation. Tax invoices can be received even by cell phone.

The tax agency provides a detailed explanation of the allocation of the paid tax to the taxpayers. For instance, if you pay a 100 kronor (US$13.65) tax, then 43 kronor will be allocated by the state for social security, 14.5 kronor will be for education, 13.1 kronor for health and medical services, 12.4 kronor for public administration etc. Furthermore, the tax agency publicly reports their investigation of any tax gaps and law enforcement measures taken to discourage tax evaders and bring fairness to the taxpayers. The agency also intensifies the civil administration to make sure that everyone is officially registered. In Sweden, every newborn babies and new immigrants with residence status has a tax register number that is integrated with their personal identity (person number).

Section IV:
Causes of low tax to GDP ratio

After thorough understanding and analyzing the tax policies of three developing and one of the developed nations, through which these countries succeeded in achieving enviable tax to GDP ratio and analyzing the historical records of fiscal background of Pakistan, we will now analyze the share of various factors in low tax to GDP ratio in Pakistan:

4.1 Demography of Pakistan

Demographic trends of a country play important role in tax to GDP ratio. More the people are professionals and in employment zone, higher is tax to GDP ratio because this segment of society is involved in economic activity and becomes instrumental in increasing the revenue collection. However demographic trends in Pakistan are not favorable for revenue collection. Presently population of Pakistan is about 187 million[1] out of which male and female population is about 48% and 51% respectively. 36.7% of the population (male 33,037,943 / female 31,092,572) is 14 years old or below of it. 59.1% of the population (male 53,658,173/female 49,500,786) lies between range of 15 and 64 years. 4.2% of the population (male 3,495,350/female 3,793,734) is above 65 years. Pakistan's urban population has increased by sevenfold and total population has increased by fourth fold during last two decades. Its birth rate is about 1.6%.

If we improve demographic trends in Sweden its population is 9.1million out of which 15.4% of the population (males 722,558/female 680,933) is 14 years old or below of it. 64.8%of the population (male 2,982,268/female 2,910,135) lies between 15-64 years. 19.7% of the population (male 80,068/female 992,665) is 65 years or above of it. Whereas Sri Lanka population is about 21.9 million and Age structure is:

0-14	**years:**	24.9%	(male	2,705,953/female	2,599,717)
15-14	**years:**	67.2%	(male	6,993,668/female	7,313,440)

65 years and over: 7.9% (male 720,219/female 950,916)

According to 2009, Human Development Report of the United Nations Development Programme (UNDP), 60.3% of Pakistanis live on less than $2 a day[2]. In this situation when a big chunk of teenage population and half of the adult population i.e. women are playing no role in the economic activity, revenue generation possibilities are less. Consequently tax to GDP ratio is necessarily also low. Similarly people have meager buying capacity resulting in low collection of Sales Tax

[1] http://www.spdc.org.pk/pubs/rr/rr73.pdf

[2] CIA-The World Factbook: Population growth rate

4.2 Literacy

Without education and in the absence of technically and professionally skilled population, economic as well as social development can hardly be achieved. Consequently tax to GDP ratio is also low in this situation. Pakistan has not performed well overall in the field of education and particularly professional studies. The adult (i.e. population of ten years age and above) literacy rate of Pakistan as per national census 1998 was 45% which increased to 54% according to the findings of the Pakistan Social and Living Measurement (PSLM) survey 2007-08.

The projected literacy rate for the year 2009-10 was around 60%[3]. About 55% males and 45% female population out of this 60% literate people was projected[4].

Merely a literate person cannot contribute in its lot national exchequer, instead people with technical education and professional background play due role in increasing the revenue collection. The Literacy rate of different countries is given below:

Bangladesh	…….. 53.5%
Pakistan	…….. 54.2%
Sri Lanka	…….. 90.8%
Sweden	…….. …99%
Malaysia	…….. 91.9%
Nepal	…….. 56.5%
India	……... 66%
Japan	…….. 99%
China	…….. 93.3%
Singapore	…….. 94.4%

One should keep in mind that a major chunk of population of the above mentioned contraries comprises of literate as well as skilled people and professionals who are playing important role in economic activities. As far as Pakistan is concerned, about 60% of the total literate population can only read and write and are particularly not doing much in revenue generation for the country. Thus low literacy rate is also an important factor in low tax to GDP ratio in the country.

4.3 Socio Economic Factors and low Tax to GDP ratio in Pakistan

Socio economic problems facing Pakistan are glaring. Law and order situation, terrorism, poverty and unemployment are some of the social problems which are taking toll on the revenue collection of Pakistan. It is so because economic activity has declined and foreign investors are reluctant in investing in Pakistan. Besides, this economic situation in Pakistan is not satisfactory. Energy crises has destroyed the industrial base of Pakistan. Most of industries are bearing losses and are contributing nothing in Government exchequer.

[3] Country Paper prepared for the Eighth E-9 Ministerial Review Meeting

[4] http://finance .gov.pk/survey/chapter_10/10_Education.pdf

International increase in oil prices and Pakistan's internal unfavorable business conditions are two important factors responsible for high rates of inflation. Consumer Price Index (CPI) as well as Wholesale Price Index (WPI) is at all-time high. In contrast, purchasing power of masses is at an all-time low. In this situation it is difficult to increase the tax to GDP ratio, unless and until these menaces are not addressed directly.

4.4 Narrow Tax Base:

There is no figure of speech to explain it more appropriately that greatest threat posed to revenue collection in our country is our narrow tax base which has a direct correlation with low tax-to GDP ratio. Measurement of narrow tax base is important because the mobilization of tax revenue has a direct nexus with the number of taxpayers participating actively in the system set up to levy and collect taxes. In the case of Income Tax , the number of persons filing periodic 'Returns' viz a viz the total population of the country, is a key indicator of the 'Tax Base' for the direct taxation of income earned by individuals and other entities including corporate entities recognized as 'persons.'

Since many years Pakistan's (Income) Tax Base has been more or less stable at 1% or less of the total population. In the United States, 72 million Returns of Income are filed annually with the I.R.S which, given a population of 300 million, translates into a tax base of just over 24%. In Malaysia, the tax base is about 20%. In India, tax base is touching 4% and in Turkey it is 5%.

Out of Pakistan's 1.7 million taxpayers, around 1.6 million taxpayers pay about Rs. 21, 000 each as income tax every year. All of these people fall into the lowest tax bracket where their annual income tax is less than Rs. 500,000. Even more interesting is the fact that this particular tax bracket has not gained many new entrants over the past three years; to be exact, statistics show that 1.663 million taxpayers paid less than Rs. 500, 000 as income tax in 2008. This number went down to 1.478 million in 2009 and then back to 1.662 million in the tax year 2010. Clearly, over the past three years not many new taxpayers have been identified by the FBR. Less than 20,000 people in Pakistan earned enough to pay between Rs. 1 million and Rs. 5 million (10 lakhs to 50 lakhs) as their annual income tax in 2010, while 21, 077 taxpayers have paid annual income tax in the range of Rs. 0.5 million to Rs. 1 million (five to 10 lakhs) and earned the state exchequer a little over Rs. 13.5 billion. This means that each of these 21,077 people paid an annual income tax of around Rs. 650, 000. And this was the income tax bracket with the second highest number of taxpayers. Only 7,680 taxpayers earned enough to pay income tax in the range of Rs1 million to Rs1.5 million (10 to 15 lakhs). With a total collection of over Rs 8 billion, each of these taxpayers contributed a mere Rs1.52 million to the government exchequer in the year. Around 3,000 taxpayers paid income tax between Rs1.5 million and Rs2 million (15 to 20 lakhs) a year while 2,414 taxpayers paid tax in the range of Rs2 million to Rs2.5 million (20 t0 25 lakhs).

For the next tax bracket, the number of taxpayers dropped steeply. Only 1,526 people paid tax in the range of Rs2.5 million to Rs3 million (25 to 30 lakhs) followed by 838 taxpayers who paid Rs3.5 million to Rs4 million (35 to 40 lakhs) as annual tax in 2010.

The number reduces to a mere 602 when it comes to people who paid more than Rs. 4 million to Rs, 4.5 million (40 to 45 lakhs) as annual tax. And only 526 taxpayers paid up to Rs. 5 million (50 lakhs). Each of them contributed Rs. 4.5 million (45 lakhs) to the government; this is less than the amount that one would need to purchase a Prado Land Cruiser. Also, there are only 4,426 taxpayers across Pakistan who declared income tax to be more than Rs. 5 million. However, FBR officials point out that this bracket includes corporate and other businesses.

Although the number of these taxpayers was low, their contribution in the total income collection stood at Rs286.023 billion during 2010 out of the total collection of Rs373.685 billion from 1.706 taxpayers. In other words, income tax collection from Pakistan's 1.6 million taxpayers remained Rs. 87.662 billion[1].

FBR if so intends, can bring a lot in tax net as it has been noted that in Pakistan there are some 25 million bank account holders. This means that after accounting for the 1.7 million who do file Returns of Income annually, more than 23 million can be potential return filers.[1] Nonetheless the data base is there and is a veritable treasure trove of information that could have a direct bearing on the income earned by the account holders.

Record from PTA can also be utilized to broaden the tax net. According to the Pakistan Telecommunication Authority (PTA), the country now has 100.2 million mobile users – all of whom pay 10 per cent income tax on mobile use, irrespective of whether they earn taxable income or not, as well as the 19.5 per cent sales tax. Many of these users are paying income tax much below their ability.

4.5 Faulty Tax policy:

Tax policy is the government's approach to taxation, both from the practical and normative side of the question. Countries with high tax to GDP ratios follow a policy with focus on progressive taxes (taxation at rates which rise with income) so for as it corrects income inequality and precludes enduring differences in society. But in Pakistan whole emphasis is on Indirect taxes. Even direct taxes are being collected in shape of indirect taxes.

In Pakistan progressive taxes like wealth tax and capital value tax on transfer of expensive immovable property, has the potential of not less than 400 billion. But unfortunately Wealth tax was abolished in 2003 on extreme pressure of certain influential elements. The dilemma in this country is that the rich and mighty in this country, are not ready to pay wealth tax/income tax on their colossal wealth and income. In this situation, government is constrained to pounce upon the poor with regressive taxes – sales tax and presumptive taxes under the income tax code. When these taxes were imposed in 1990 and 1991, fiscal deficit in the country was just Rs80 billion. After 20 years, the deficit has soared

[1.] Mubarak Zaib Khan, "Low Tax Compliance" *Daily Dawn*, 17 March 2010.

to over Rs900 billion, proving beyond any doubt that, far from assisting fiscal management, irrational taxes has pushed the nation to total economic collapse. Irrational tax measures have always played a decisive role in destroying civic society and paving the way for anarchy and chaos.

Over the period of time, the incidence of regressive taxes shamelessly levied on the poor has been increasing, making the powerful sections society richer and richer. Progressive taxes, like wealth tax, estate duty, capital gain on immovable property and gift tax were abolished to benefit the rich. This has distorted the entire tax system, created income inequalities, widened the rich-poor divide and retarded economic growth. On average, developing countries obtain their bulk of revenue from:

Domestic taxes from goods & services.

i) Foreign trade taxes mainly imports.

ii) Income taxes (mainly on corporations) respectively.

In contrast three big sources of revenue in industrial states are:

i) Income taxes (more than 40 % of tax revenue mainly on individuals)

ii) Domestic taxes on goods and services

iii) Social security contributions (more than 10% of GDP) respectively.

4.6 Undocumented Economy of Pakistan:

The undocumented economy is undeclared income earned through some economic activity over a period of time. A large size of the undocumented economy includes cases of non-declaration of income due to ignorance, fear from harsh attitude of tax collector, and low literacy rate. It is estimated that we have an undocumented economy that is three times the size of regular economy. Even with various tax amnesties and opportunities to whiten money through different products, we have not been successful to bring enough people into the tax net. 2.75 million Pakistanis, or 1.6 percent of the country's estimated 160 million people, are registered taxpayers. Only approximately, two million people file their returns and the compliance ratio has always been low. The share of taxpayers to population is low when compared with a large developing and developed countries.

The undocumented economy has been the major cause of low tax to GDP ratio. FBR has tried its best to get this major chunk of the informal economy into registration but even then the informal sector has been successful in escaping the documentation, for example when VAT mode was introduced to collect tax at each stage of supply chain so that every person involved in transaction should be registered, they started practice of fake and flying invoices. Through the use of fake and flying invoices they get the benefit of VAT mode taxation but the real purpose of getting the economy documented is not being fulfilled.

Issuance of SRO509/2007 in which the whole supply chain of the major export industries have been made zero rated, was to avoid huge refunds on the bases of fake and flying invoices sacrificing documentation.

Efforts have also been made by amending the law for example through income tax ordinance 2001 different new categories of return filers have been introduced in addition to the existing return filers in Section 114 e.g. A person who is having above 1000cc engine vehicle, 250 Marla plot in municipal limits, cantt, or capital city area so in a way broadening the tax base for filing return. Wealth statement has been made mandatory to be furnished with the return U/s 116 of I.T.O 2001, for a salaried person having 5 Lac salaries per month is also an effort to trace the informal economy by focusing on assets and expenditures.

Section 111 is also there to deal with any unexplained income which in fact leads to the detection of undocumented source of income and introduction of tax on capital gains on shares of a public company has been u/s 37A to not only broaden the tax base but also enforce documentation of economy

World Bank report of September 2009, emphasized that the country‘s tax system under performed as it has a narrow base and major chunk of the economy is out of tax net. According to one view point, tax collectors instead of putting emphasis on the “Source of Funds” should rather accept undocumented wealth as it may help in generating additional revenue, create employment and result in additional payment of taxes, thereby enhancing the government’s revenue between 4.7 percent and 86.4 percent.”

Agriculture income is exempt from income tax since 1947. If income tax is imposed on agricultural income any time in future, how the agriculturalists would prove their “Source of Funds” for the wealth they have earned so far created. If confronted with the same question, Will they be asked to summarize their 63-year-old record to establish their entire wealth? We cannot declare their previous exempt wealth as dubious one and hence drive away the entire wealth from the economic activity or enlarge the size of the undocumented economy.

4.7 Weak Audit and Enforcement:

One of the major problems in Pakistan which also hinders the smooth audit and examination procedure is the lack of documentation particularly in the case of individuals and also pertains to the firms and small corporations. It implies that an incomplete and inaccurate data is provided by the taxpayer with poor record keeping.

Although detailed working and procedures have been identified in the National Audit Manual to reform the audit system of Federal Board of Revenue, but it requires implementation in its true spirit to yield the desired results. This year only 18,098 corporate entities filed their income tax returns as against total registered taxpayers i.e. 44,794 companies, so a deficit of more than 60 %. Even filing of corporate returns remained short by 13.8 % as more than 21,000 corporate entities filed tax returns during the same period last year, indicating a weak enforcement of law. In AOPs case, there are only 34,155 AOPs

which filed their return this year as against total registered 135,292 AOP taxpayers with the tax department, showing a shortfall of 74% in filing of returns.

The Tax Gap (the difference between the sum of tax owed and amount of tax paid voluntarily and on time) stands at 79% of actual tax receipts in Pakistan. A World Bank report in September 2009, pointed out that the total tax evaded in 2007-08 stood at Rs.796 billion against a collection of just Rs 1.1 Trillion.

Only 2.4 million people (out of a population of 180 million) file their tax returns. This is because of tax evasions, avoidance which thrive because of weak audit and enforcement. Only a fraction of taxes illegally evaded or legally avoided, can be recovered through initiation of legal proceedings against the tax evaders. This involves a cumbersome legal process and we are rarely able to recover the exact unpaid amount of taxes after delays of months and years because of weak enforcement, lacunas in laws, social and political pressures and widespread corruption. In Pakistan all returns are filed under Universal Self-Assessment Scheme. Taxpayers are selected and the audit proceedings are carried out. In Pakistan the primary objective of the audit has always been to create deterrence, improve and encourage compliance to the tax laws on voluntarily basis i.e. promoting self assessment system. Treating audit as source of revenue has been a secondary objective.

Another major cause of weak audit is that even at the selection of audit cases, there are no open or declared criteria and law also provides u/s 214C for selection of cases by random balloting through computers. Due to this most of the time ordinary cases are also selected instead of the potential cases. As every year the criteria for selection of cases is changed and also kept confidential so most of the selection ends in litigation. Due to this even Supreme Court ordered to suspend the audit for the time being and it remained so almost for eight years and there has been virtually no audit since then, which indeed speaks of a very sorry state of affairs. Due to lack of tax culture, mostly desk audit is preferred over field audit. The following table reveals data regarding audit in Pakistan:

Audit Cases u/s 177 of Corporate entities -2007-08:

Audit Cases for Disposal	**Amendment u/s 122(5)**	**%age of cases amended**	**Demand created (millions)**
6600	**688**	**10.4**	**10008**

Audit cases u/s 177 of non-corporate entities-2007-08:

Audit Cases for Disposal	**Amendment u/s 122(5)**	**%age of Cases Amended**	**Demand created (millions)**
15593	**1640**	**10.5**	**1813**

The above data reveals that not only the cases selected for audit are on lower side but also the disposal of these cases is quite discouraging and dismal. The audit and enforcement system of Pakistan is still in the nascent stage as the present system started with the change in the tax system to universal self assessment scheme in 2003. Though the

audit procedure has been clearly defined in the law, but has not been effective due to inadequate policy, as well as administrative and implementation issues.

The FBR has still not developed a required data base for analysis. There are many companies which do not file return while they are active on the record of SECP. So there are still some important institutions whose data is not available for cross matching with the figures provided by the taxpayers. The Intelligence and Investigation Department of FBR is a subordinate department of FBR working independently and mainly concerned with internal audit. It is a check on the officers with respect to malpractices and corruption. This department is also not contributing to overcome the problem of weak audit and enforcement by the officers. No appreciable performance has been recorded by this department.

There is no effective enforcement of adequate penalties in fraudulent cases and so the tax evaders are not adequately deterred. The professional capacity of the allied and support staff also need improvement and thorough training.

4.8 Corruption:

Corruption is considered to best the root cause of all social problems including lack of good governance and low tax to GDP ratio in Pakistan and in Pakistan it is a well established phenomenon. In the year 2010, **Transparency International Pakistan (TIP)** found the country to have slipped from 42nd most corrupt state in 2009 to 34th in 2010. It identified corruption cases worth Rs. 300 billion in Federal Government departments during the year. While focusing on petty corruption only, National Corruption Perception Survey 2010 indicated that corruption in 2010 had increased from Rs. 195 billion in 2009 to Rs. 223 billion. According to 2010 report taxation department is at no 8 in term of corruption. And out of different taxes, **income tax** is the most corrupt field. The areas where corruption has been pointed out are: reducing fictitious assessment, under assessment, reduction in tax, getting tax certificate, releasing goods, and refund of extra paid tax.

In corruption perception report 2010, **customs** stands at no 9. The areas where corruption is found are: inspection of goods, valuation of goods, reduction of customs duties, benefit for inspection, and for quick service. Actors involved were custom officer, duty officer, custom collector, custom constable and others, and biggest cause of corruption in both is given as lack of accountability.

Audit report 2009-10

In 2009-10, Auditor General Pakistan (AGP) office has detected Rs 116.564 billion irregularities in the accounts of the Federal Board of Revenue in direct taxes and indirect taxes, according to audit report for audit year 2009-10. The report incorporates audit observations involving Rs 72.209 billion indirect taxes out of which observations worth Rs 4.104 billion were raised through desk audit and Rs 68.105 billion observations through regularity audit.

From National corruption survey TI (Transparency International) Pakistan 2010 and The Reports of Auditor General of Pakistan, huge amounts of irregularities are found in the accounts of FBR. The TIP report gauges the perception of corruption rather than actual corruption but the AGP report is based on facts and figures which comprehensively exposes the corruption and maladministration in FBR.

4.9 Tax exemptions:

Section 53 of the Income Tax Ordinance 2001, section 13 of sales tax act 1990 and section 16 of Federal Excise Act 2005 etc. empowers the Federal Government to exempt from tax any income or classes of income, or person. Tax exemptions are granted under restrictive set of conditions but take many shapes with far reaching revenue implications. In certain cases these are granted to promote investment, exports and growth, in other cases privileged personalities are entitled to such exemption, or they are allowed to vulnerable groups to preserve equity in the tax system (essentially tax expenditure). Some of these exemptions are time-bound, i.e. they lapse after the due date unless renewed further or they have no expiry date and their termination (or continuation) depends on the design of tax policy being pursued.

With the passage of time the list of exemptions had grown bigger to include tax rebates, concessions and non-standard exemptions. Pakistan's economic instability stems in large part from low government revenue resulting from the elite's use of tax evasion, loopholes etc. Less than three million of Pakistan's 175 million citizens pay any income taxes, and the country's tax-to-GDP ratio is only 9 percent. Pakistan's tax evasion problem is caused by three things: poor legal frameworks and bureaucratic capabilities with regard to revenue collection; corruption in the form of a predatory class that privileges certain sectors and vested interests with unjustified tax "exemptions"; and elites who cut deals with the state to evade taxation, made possible by an anemic agriculture income tax (agriculture makes up 22 percent of Pakistan's GDP, but only 1 percent of its tax revenue). Research suggests that with a more extensive, transparent, progressive, and equitable tax structure, government revenue could easily double, thus closing the huge gap between defense and development expenditures.

4.10 Sectoral discrepancy in tax collection:

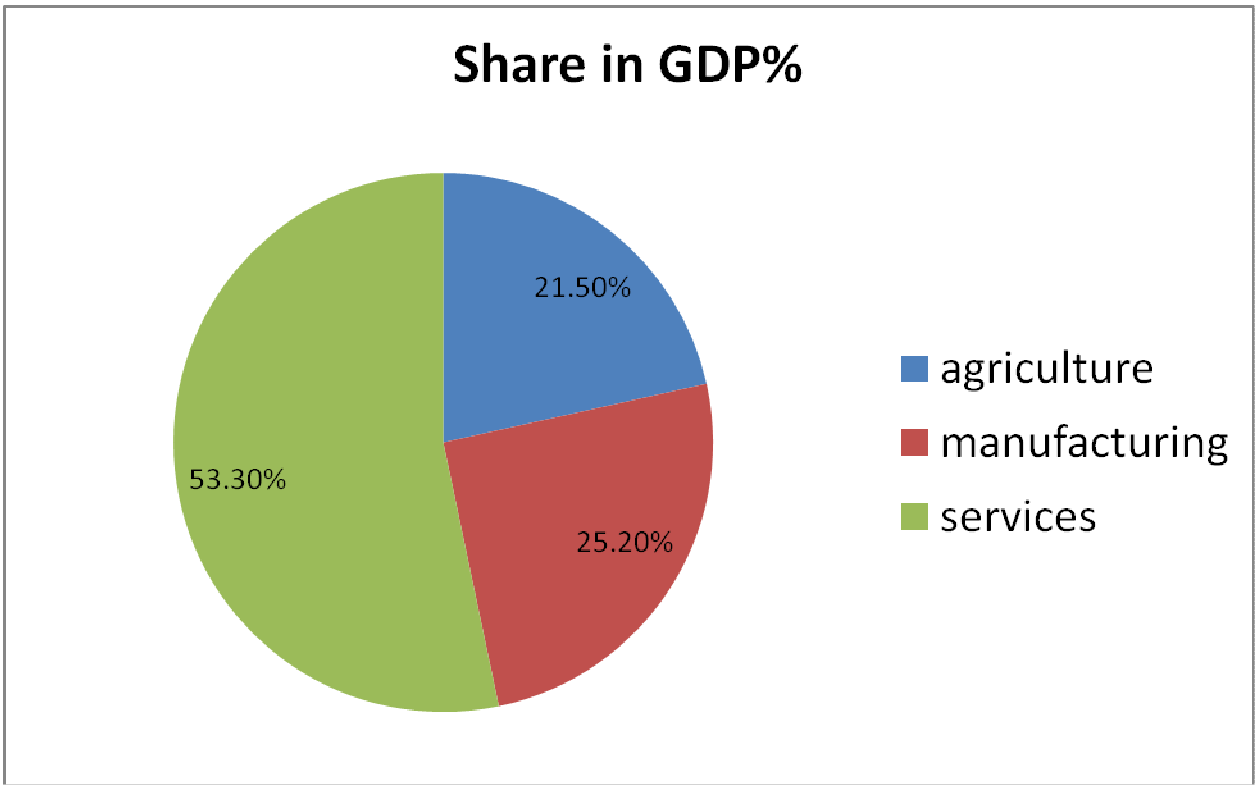
A sectoral analysis to determine the real factors responsible for creating the gap between tax to GDP ratio shows that services sector is the major tax non compliant sector. The number of sub-sectors whose tax contribution does not match with their contribution to GDP is far too many. These include wholesale and retail sector, transport, construction, hotels/restaurants and commission agents.

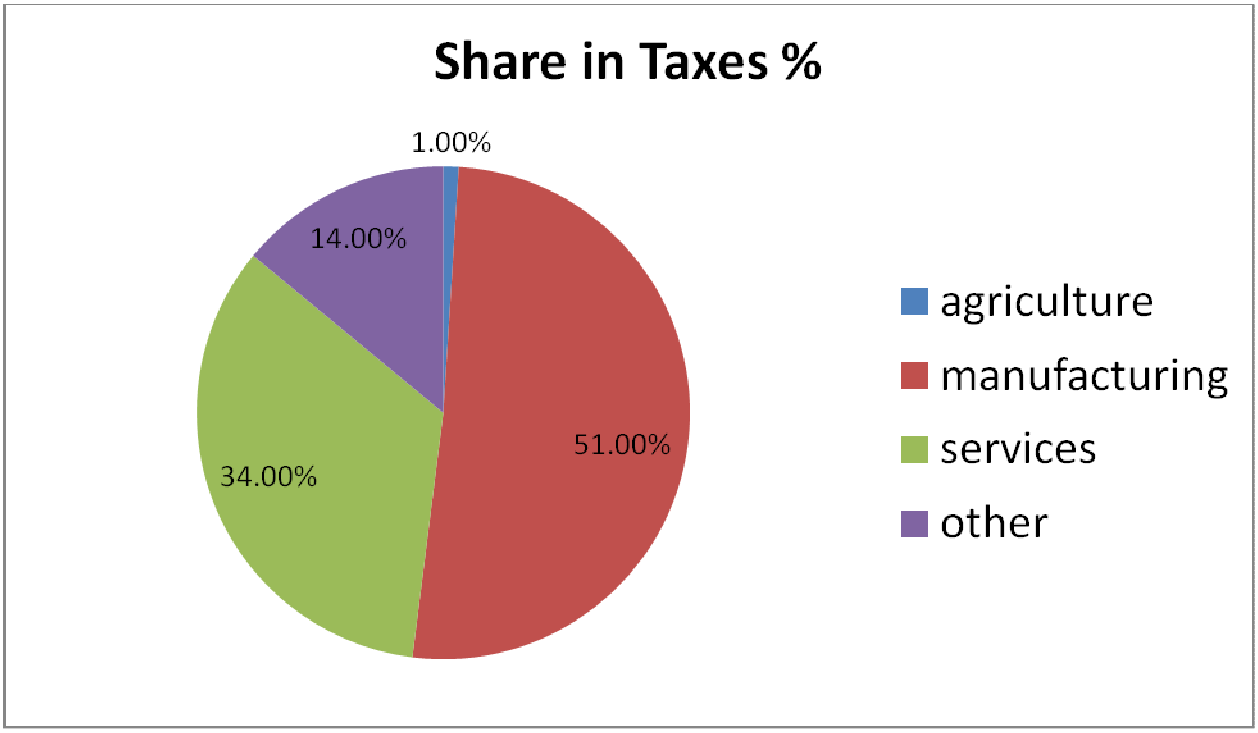
According to FBR estimates, the contribution of the most of the sectors like banking, insurance and telecommunication is also below potential. Dr. Ather Maqsood (member FBR) said that live stock (poultry industry i.e. chicken/eggs, animals farming, milk and meat) is contributing 50% of the value addition to agriculture, but has virtually no share in taxes. Similarly, Tax contribution of sprawling orchards and horticulture is almost missing.

Big business houses including Oil and Gas sector, Cement industry, banking sector, telecom industry, and sugar industry etc contribute about 30-35% in the total revenue collection of the country. In this way these business houses affect the tax to GDP ratio in a big way every year. For instance if any of these industries goes for expansion in a year, it claims depreciation and initial allowances which results in decrease in the revenue collection. Similarly, if any of these industries bear losses during a year, it also causes decrease in tax to GDP ratio.

Sectoral contribution in terms of net indirect taxes showed that 83% of all indirect (net) taxes originate from only 18 commodities and 73% by 10 commodities. 53% of indirect taxes are generated from 5 commodities, including petroleum products, automobile, telecom, machinery, and cigarettes. The POL, including LPG contributes 26.2% of the indirect taxes. Sugar industry pays 3% of the indirect taxes and contribution of textile sector is 1% in gross terms and minus 1.9% in net terms.

Sectoral Imbalance:





Source: Economic Survey of Pakistan 2009-10

Source: Economic Survey of Pakistan 2007-08 & FBR data

Section V:
Conclusion

Apparently the word tax comprises of only three letters but it has a wider spectrum in terms of applicability. Since the inception of Pakistan government is striving for the effective implementation of taxation system and collection of major bulk of revenue from it. Currently more than 80% of the source of government revenue is through tax collection levied under the scope of income tax, sales tax and federal excise tax etc. Our inability to collect enough direct taxes has forced successive governments to increase indirect taxation as well as the prices of basic utilities and petroleum products to increase revenue generation.

Increase in tax collection is hardly keeping pace with increased budgetary targets and GDP. Over the last ten years, indirect taxation has increased on the average by 22.02 percent (FBR Yearbook '09-'10) due to near static income tax collection. WB has been pushing forward some big measures in the form of tax readjustment policies like the VAT, however, the biggest problem remains that people do not feel their duty to pay taxes yet they demand services. Comparing tax to GDP ratio of Pakistan with other countries of the region has lifted the curtain from the weaknesses prevailing in the taxation system of Pakistan. Since Only Bangladesh has a slightly lower tax to GDP ratio than Pakistan while the other countries like Srilanka and India has better tax to GDP ratio than Pakistan. In India the tax culture is quite strong because there is less political interference in tax collection, no exemptions for agricultural income and better enforcement which has led to the progress of revenue collection through direct taxation. While in Srilanka the main factor which is responsible for their better tax to GDP ratio stems in the incentives to the compliant and regular tax payers.

In our research paper, we have also tried to learn about the taxation system of developed countries like Sweden. In Sweden personal income tax rate is progressive and the corporate tax is set comparatively low, which encourages people to do business and encourages self-employment rather than being employed. It can be inferred that the policies adopted by the developed countries are difficult but are not impossible and can be implemented in Pakistan. It merely needs awareness, strong political will and community participation with zeal and commitment. Pakistan has a greater potential for improvement, we have many untapped sectors which can contribute a lot in Pakistan's total revenue collection. Ours may be a low tax effort country but does have a high buoyancy ratio, implying that the policymakers of Pakistan should tap the potential to opt for greater revenue mobilization through internal resources in order to meet the budgetary deficit by overcoming unlimited tax exemptions, poor tax base, inequality of taxing, undocumented economy, repeated tax amnesty etc. Therefore, it is important to place greater emphasis on administrative reinvention and policy reform in order to identify and remove the loopholes in the revenue generation process.

In a nutshell with all prevailing loopholes and deficiencies we have a greater potential for advancement and betterment of taxation system of Pakistan. The need of the hour is to deal with the main causes responsible for low tax to GDP ratio i.e. uncalled for exemptions, sectoral discrepancy, low tax base and weak audit etc, with iron hand.

Section VI: Recommendations

There is an urgent need for the government to broaden the tax base on an emergent basis; given the fact that country is at present heavily relying on foreign injections to meet its annual expenditures. This paper gives following recommendations in this regard:

1. "Political will" is the sine qua non to increase the tax to GDP ratio in Pakistan. Unfortunately, In Pakistan political will has been a desire unfulfilled in relation to administrative matters and fiscal reforms regarding administrative changes have been proposed by the bureaucrats and the technocrats in the past but have suffered staled progress because of lack of political will.
2. Government must ensure that the taxation system is equitable by doing away with all kinds of exemptions allowed to certain powerful lobbies, pressure groups and cartels and help reduce the burden on common tax payers.
3. A vigorous campaign for documentation of economy be launched.
4. Data mobilization with an integrated database system linkage with NADRA.
5. In Pakistan the Universal Self Assessment scheme has not shown the desired results because of lack of tax culture and effective and comprehensive audit to create deterrence for the tax payers, so it must be backed by strong audit.
6. Income from agriculture escapes tax levy and must be brought into tax net.
7. Share of services sector, agriculture sector, livestock, textile, sports, etc. be made proportionate to their contribution to the GDP of the country.
8. Improvement in direct tax administration and collection be made commensurate with countries having high tax to GDP ratio.
9. Provincial tax to GDP ratio be enhanced, currently all four provinces collectively contributes less than half percent of the GDP.
10. Effective and transparent incentive and reward system for the officers of the department is introduced, and stringent action, be taken against those who deviate.
11. Public awareness campaigns be launched on regular basis in order to facilitate the public in understanding the complex tax laws besides emphasizing the positive effects of tax compliance and inculcation of tax culture.

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