

# Poor Tax Collection System and the Economic Growth of Pakistan

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*In this article, a link between poor tax collection systems in Pakistan and the decline in economic growth will be drawn, with suggested improvements to galvanize the system to achieve optimum growth and development. Moreover, an infrastructure will be mapped out for realizing the actual tax potential of Pakistan—what it is rightly and realistically capable of achieving. The conditions that will be discussed in this article are unique to Pakistan and call for tailor-made solutions for the country that has an abundance of resources and opportunities, which if effectively utilized, can easily render it self-sufficient. Beginning with economic development indicators, it will be shown how Pakistan's economic status leaves more to be desired in the form of growth and development; and its connection with the tax collection system.*

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## I. INTRODUCTION

Taxation in the modern global world is not a free-standing concept. It is the remarkable interplay of varied social, economic and financial considerations, and political agendas. A canvas depicting the unique artisanship and diverse draftsmanship of a gallery of artists: economic masterminds, legislative and financial experts; which has wide-ranging implications on the economy of a country. It is a vital organ of a progressive society and the open secret of a developed nation.

The fact that a well-thought out and all-embracing taxation policy and tax collection regime inevitably leads to economic growth and prosperity is not mere rhetoric. It is this phenomenon that ought to engage the attention of all stake holders in both developing and developed countries if they are to not just survive and exist but prosper with every passing day, month and year. However, what is surprising is that how policy makers, legislators and administrators manage to overlook such a cardinal feature of a nation-state as tax collection, which if properly designed and monitored, can act as a springboard for economic growth and work miracles for a developing economy such as that of Pakistan.

The term 'Tax collection systems' is of a wide import, and entails a plethora of elements and considerations, which encompass both, tax collection and utilization. The term 'poor tax collection systems' does not relate to collection alone, and also refers to other aspects such as taxation policy *viz. a viz.* failure to tap the right sources of revenue in accordance with the actual tax potential of Pakistan; the omission to bring in the tax-net potential taxpayers, and other discrepancies in the system.

Similarly, 'economic growth' can neither be gauged nor achieved by facts and figures alone. It stems from policy issues—from the ground realities of any economic model. Hence, achieving the revenue target at the cost of inhibiting production and rising inflation does not amount to economic growth. It is not a numbers game. It is

not just blind theory and practice. It is more than how the outside world sees it.

To evaluate the working of the current ‘tax collection system’ in Pakistan, the drawbacks of the tax machinery and their adverse effect on economic growth, we need to analyze many components of the taxation framework, such as taxation policy, legislation, administration and economic aspects of taxation.

In this article, the link between poor tax collection systems in Pakistan and the decline in economic growth will be drawn, with suggested improvements to galvanize the system to achieve optimum growth and development. More significantly, over the course of this exposition, an infrastructure will be mapped out for realizing the actual tax potential of Pakistan—what it is rightly and realistically capable of achieving. Placing its economy on the fast track. Towards the penultimate goal of economic expansion and enrichment.

## II.

### REVENUE AND FISCAL DEFICITS AND THEIR RAMIFICATIONS

Should a tax policy be target specific? When a government under-estimates or over-estimates the revenue capacity of a state in terms of a fixed threshold, and that calculation is ill-conceived, little is to be gained by way of revenue’s contribution towards economic development.

#### *A. Poor Tax Collection: Revenue Deficits*

For the past many years, the government has been downsizing the revenue potential of Pakistan. ‘According to the general perception, the revenue target fixed for fiscal year 2007-08 at Rs1.025 trillion is

ambitious. In reality, this is still on the lower side as potential of total tax collection in the country is not less than Rs. 2.5 trillion.<sup>1</sup> 'The potential of Pakistan is much more than what is presently fixed by worthless fiscal managers. We can easily generate tax revenue between Rs 3 to 4 trillion'.<sup>2</sup>

Yet, in spite of the downward revision, the government has failed many a times to achieve the revenue target. 'The 'Economic Survey (2007-08)' on Tuesday showed that the FBR was to face revenue shortfall of Rs 25 billion as collection would stand at around Rs 1 trillion, against the original target of Rs 1.025 trillion for 2007-08.'<sup>3</sup>

Therefore, revenue deficits have continued unabated.

### 1. Collection Figures

Given below are the statistics of revenue collection for the years 1990-91 to 2008-09:<sup>4</sup>

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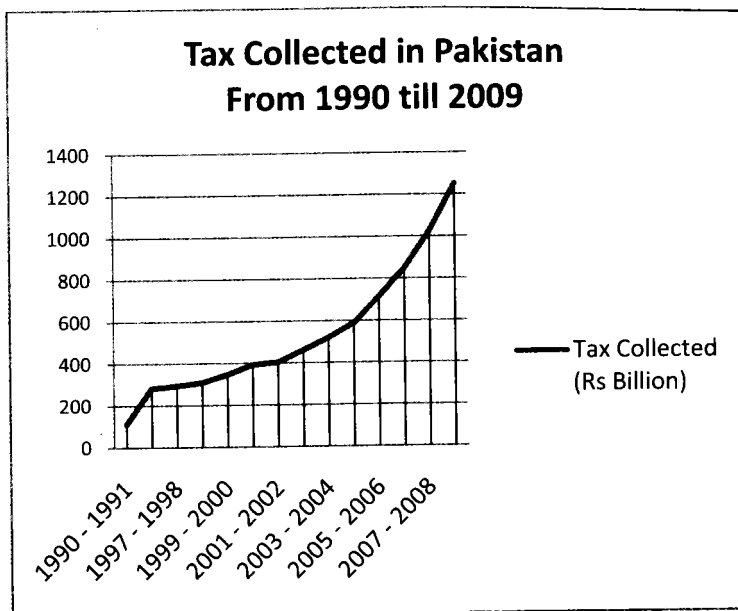
<sup>1</sup> Huzaima Bukhari and Dr. Ikramul Haq, *Tax Collection Target-2007-08: A Critical Appraisal*, TAX REVIEW (2007) 6:1 LLP 274.

<sup>2</sup> Huzaima Bukhari and Dr Ikramul Haq, *The Luxury of Being Rich*, MONTHLY TAX FORUM (May-June 2009).

<sup>3</sup> *Tax collection hit by political turmoil*, BUSINESS RECORDER, Islamabad 11 June 2008, available at <http://www.brecorder.com/index.php?id=762730&currPageNo=5&query=&search=&term=&supDate=> (lastly accessed on 2<sup>nd</sup> August, 2009).

<sup>4</sup> See Nazia Gul, *Fiscal Development* in PAKISTAN ECONOMIC SURVEY 2008-09 at Ch. 4, available at <http://www.finance.gov.pk/admin/images/survey/chapters/04-Fiscal%20Development09.pdf> (last visited on 16<sup>th</sup> August, 2009).

<b>Years</b>	<b>Tax Collected (Rs Billion)</b>
1990 – 1991	111
1996 – 1997	282
1997 – 1998	293.7
1998 – 1999	308.5
1999 – 2000	346.6
2000 – 2001	392.3
2001 – 2002	403.9
2002 – 2003	460.6
2003 – 2004	518.8
2004 – 2005	588.4
2005 – 2006	713.4
2006 – 2007	847.2
2007 – 2008	1025
2008 – 2009	1250



These revenue collections are noticeably meager when contrasted with the real tax potential of Pakistan. The consequence of this low tax collection is fiscal deficit. For the fiscal year 2007-08: 'The revenue deficit, despite record collection of Rs.841.4 billion, was monstrously high at Rs. 200.5 billion and fiscal deficit touched the alarming figure of Rs. 373.5 billion.'<sup>5</sup>

## 2. Poor Tax-to-GDP Ratio

Inefficiency of successive governments in Pakistan is apparent from the fact that for the past ten years, the tax to GDP ratio of Pakistan has remained at its lowest, between 9% to 10%. Despite claims of unprecedented growth by officials of the Federal Board of Revenue (FBR), for decades these revenue and fiscal deficits combined with fiscal imbalances have remained unaddressed.

Poor tax collection just shows the insufficient planning of the officials of the Federal Board of Revenue (FBR), which has negative repercussions on the economic growth of Pakistan, as reflected in the

<sup>5</sup> Bukhari, *supra* note 1 at p. 276.

poor tax-to-GDP ratio from the year 1990-2000 to 2007-08 illustrated in the following table:

**Table: Tax-to-GDP Ratio – 1990-00 to 2007-08<sup>6</sup>**

Year	Tax/GDP Ratio (%)		
	Total Direct Taxes	Total Indirect Taxes	Total Taxes
1990-00	2.98	6.17	9.15
2000-01	2.99	6.43	9.42
2001-02	3.24	5.94	9.18
2002-03	3.15	6.40	9.55
2003-04	3.02	6.52	9.54
2004-05	2.68	6.22	8.90
2005-06	2.90	6.30	9.20
2007-08	3.02	6.48	9.50

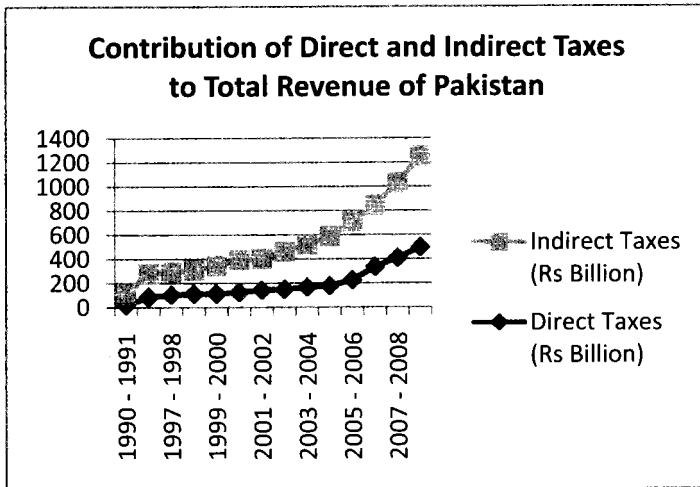
<sup>6</sup> CBR YEAR BOOKS & ECONOMIC SURVEY 2006-07; Bukhari, *supra* note at p. 275.



It is pertinent to mention that in 2008, the government of Sweden collected taxes at 50% of GDP, almost twice as high as the total tax revenue of America and Japan, with both collecting around 25% of GDP. In the Euro area, tax revenue, on average, reaches 40% of GDP.<sup>7</sup> Conversely, in Pakistan, taxes were collected 'at 9% of GDP in 2008-09',<sup>8</sup> which is really low as compared to the tax-to-GDP ratio of other countries.

### 3. Imbalance between Direct/Indirect taxes

The reason for poor tax-to-GDP ratio in Pakistan lies in the disproportionate balance of taxation, which is focused on deriving the maximum revenue from indirect taxes as demonstrated below:<sup>9</sup>



<sup>7</sup> Bukhari, *supra* note 2 at p.110.

<sup>8</sup> Ibid.

<sup>9</sup> Gul, *supra* note 4.

<b>Years</b>	<b>Direct Taxes (Rs Billion)</b>	<b>Indirect Taxes (Rs Billion)</b>
1990 – 1991	20	91
1996 – 1997	85	197
1997 – 1998	103.3	190.4
1998 – 1999	110.4	198.1
1999 – 2000	112.6	234
2000 – 2001	124.6	267.7
2001 – 2002	142.5	261.6
2002 – 2003	148.5	312.2
2003 – 2004	165.3	353.6
2004 – 2005	176.9	411.4
2005 – 2006	224.6	487.9
2006 – 2007	333.7	513.5
2007 – 2008	408.2	622.3
2008 – 2009	496	755.5

‘...direct taxation in Pakistan accounts for only 4 percent of GDP, whereas in other developing countries this ratio is as high as 7 percent.’<sup>10</sup>

Pakistan’s tax revenue-to-GDP ratio stood at only 10 percent of GDP during 2007-08, compared to an average of 18 percent for other

<sup>10</sup> Tax Collection in turmoil, *supra* note 3.

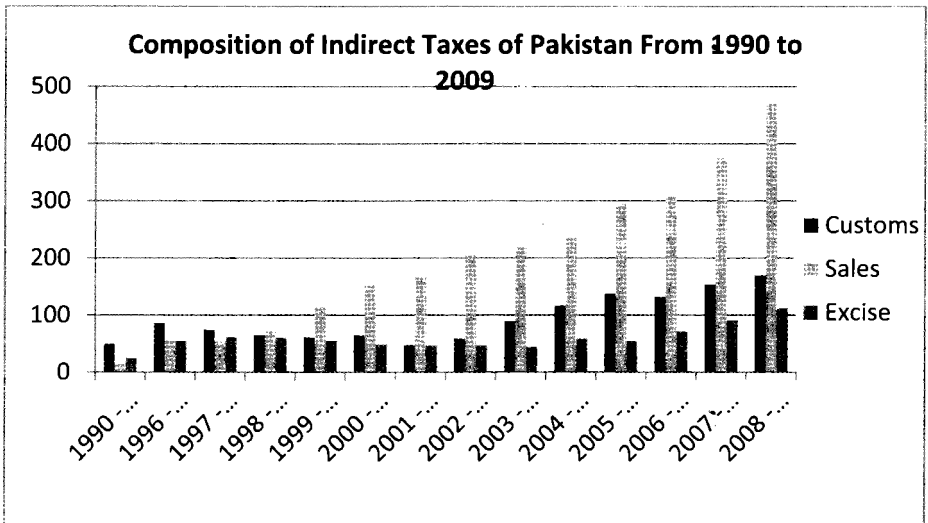
developing countries, indicating that substantial tax policy measures are still needed to broaden the tax base. The indirect tax-to-GDP ratio stood at around 6 percent, and direct tax-to-GDP ratio was calculated to be 4 percent and less than 2 percent, if withholding taxes are excluded. The overall services sector, including wholesale and retail trade and agriculture, are potential candidates for broadening the tax base.<sup>11</sup>

The following table shows the composition of these indirect taxes and their respective contribution towards tax collection:<sup>12</sup>

Years	Customs	Sales	Excise
1990 - 1991	50	16	25
1996 - 1997	86	56	55
1997 - 1998	74.5	53.9	62
1998 - 1999	65	72	60.8
1999 - 2000	61.6	116.7	55.6
2000 - 2001	65	153.6	49.1
2001 - 2002	47.8	166.6	47.2
2002 - 2003	59	205.7	47.5
2003 - 2004	89.9	219.1	44.6
2004 - 2005	117	235.5	58.7
2005 - 2006	138	294.6	55
2006 - 2007	132.3	309.4	71.8
2007 - 2008	154	375	91
2008 - 2009	170	472	112

<sup>11</sup> Ibid.

<sup>12</sup> Gul, *supra* note 4.

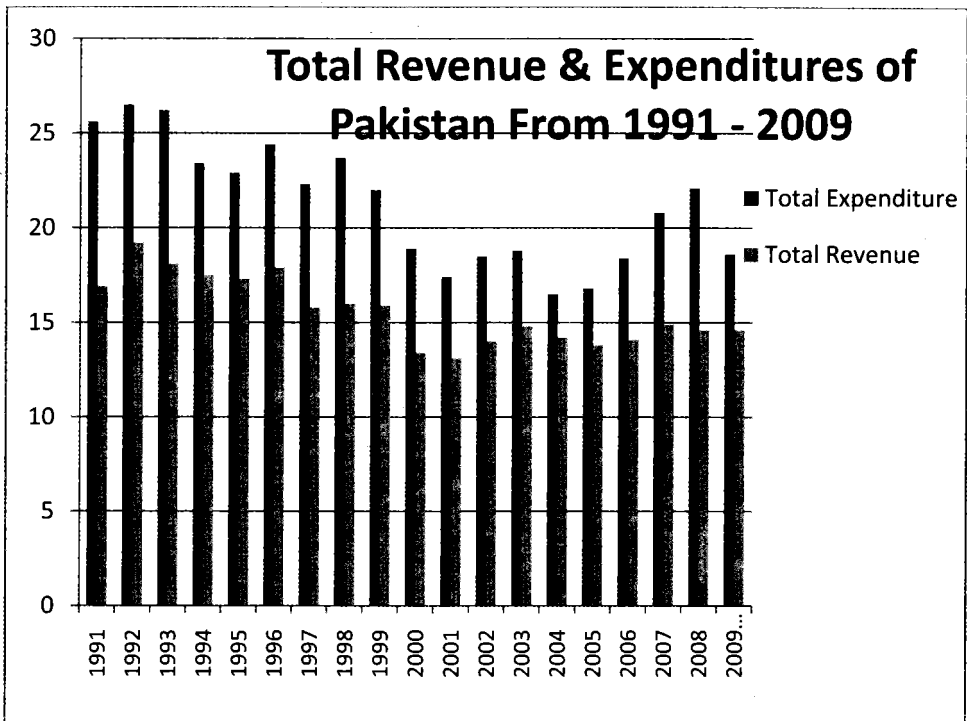


The failure to strike ample direct sources of revenue like income of the well-off; and heavy reliance on indirect taxes, readily imposed on the poor and middle class citizens, is a potent cause behind low tax-to-GDP ratio in Pakistan, because the system fails to obtain taxes from the moneyed class.

### B. Fiscal Deficits

This failure to meet the revenue target culminates into fiscal deficits when the state is depleted of funds for the running of the state machinery, and for public expenditures; and therefore ends up spending more money than it has generated, which is depicted below:<sup>13</sup>

<sup>13</sup> Gul, *supra* note 4.



Year	As % of GDP	
	Total Expenditure	Total Revenue
1991	25.6	16.9
1992	26.5	19.2
1993	26.2	18.1
1994	23.4	17.5
1995	22.9	17.3
1996	24.4	17.9
1997	22.3	15.8
1998	23.7	16
1999	22	15.9

2000	18.9	13.4
2001	17.4	13.1
2002	18.5	14
2003	18.8	14.8
2004	16.5	14.2
2005	16.8	13.8
2006	18.4	14.1
2007	20.8	14.9
2008	22.1	14.6
2009 (P)	18.6	14.6

Pakistan has been experiencing huge fiscal and revenue deficits. Both military and democratic set-ups in their own capacities have contributed to this situation. 'It is an established fact that despite all kind of highhandedness, the financial managers and tax collectors have persistently failed to overcome fiscal deficit and remove fiscal imbalances.'<sup>14</sup>

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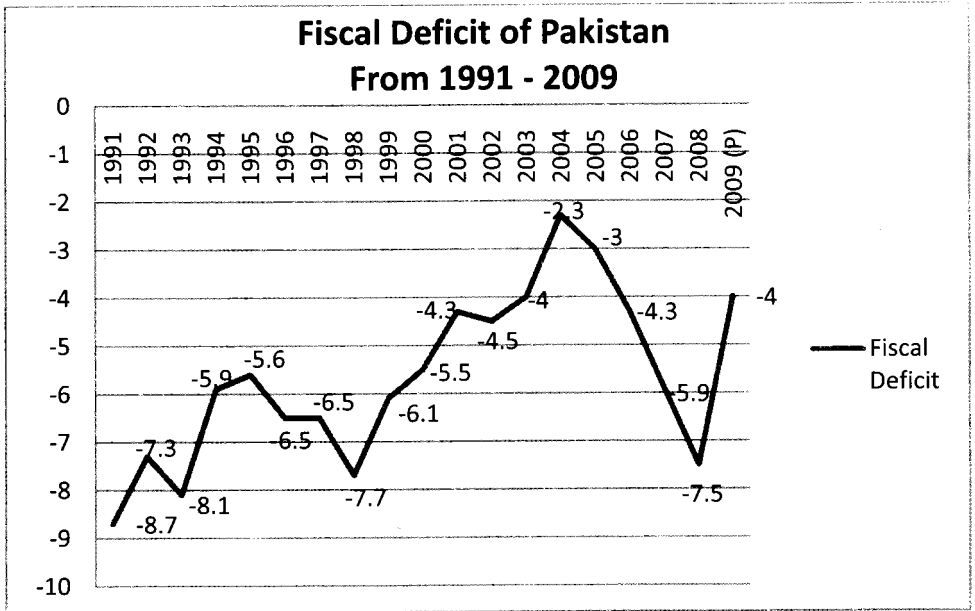
<sup>14</sup> Bukhari, *supra* note 2 at p. 109.

Evidence of such fiscal deficits is given below:<sup>15</sup>

<b>Year</b>	<b>Fiscal Deficit</b>
1991	-8.7
1992	-7.3
1993	-8.1
1994	-5.9
1995	-5.6
1996	-6.5
1997	-6.5
1998	-7.7
1999	-6.1
2000	-5.5
2001	-4.3
2002	-4.5
2003	-4
2004	-2.3
2005	-3
2006	-4.3
2007	-5.9
2008	-7.5
2009 (P)	-4

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<sup>15</sup> Gul, *supra* note 4.



Thus, in essence, there are a number of factors, fiscal deficit being one of the principal ones, which compounds the situation, so that in spite of occasionally meeting the revenue target, Pakistan falls short of the goal of economic development.

Therefore, it is evident that Pakistan's increasing revenue and fiscal deficits have brought the economy to a standstill. This malfunctioning is bent on weakening the economic fabric of the system. Poor tax-to-GDP ratio is one of the causes of the breakdown. Equally, it is this very factor, which if overturned, can help to shoot up the economy; taking it to new heights.



## III.

TAX COLLECTION SYSTEMS OF PAKISTAN IN THE LIGHT OF  
TAXATION POLICY AND ITS PRACTICAL SIGNIFICANCEA. *Aims and Objectives of Taxation*

Taxation has an important role to play in the 'Management of the economy'.<sup>16</sup> '...the use of taxation both as an economic regulator and for the promotion of the public good (or to discourage certain forms of conduct) may also be discerned'.<sup>17</sup> When a country generates revenue from the appropriate sources, offers tax concessions where they are due, and spends the money collected on providing benefits to society, growth and development is a natural consequence.

Moreover, the tax system is a major instrument for mobilizing resources for economic development. If it does not plough back adequate revenue to the exchequer, it may become a constraint to accelerated growth as tax receipts will not keep in step with growing expenditure requirements.<sup>18</sup> 'Systems of taxation can contribute to societies in three main areas: those of revenue, redistribution and (political representation).'<sup>19</sup> All these are geared towards achieving economic success. 'Tax is the most pervasive and privileged exercise of the police power of the state. It determines the directions in which people may become wealthy by determining the directions in which they may not.'<sup>20</sup>

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<sup>16</sup> JOHN TILEY, *REVENUE LAW* (Hart Publishing: 2008) at p.9.

<sup>17</sup> NATALIE LEE, ED., *REVENUE LAW-PRINCIPLES AND PRACTICE* (Tottel: 2008) at p. 4.

<sup>18</sup> Azad Jeetun, *Pakistan's Tax System Structure, Elasticity, Incidence and Fiscal Effort*, (PhD thesis, University of Karachi 1980) available at <http://eprints.hec.gov.pk/867/1/591.htm> (last visited on 18<sup>th</sup> July, 2009).

<sup>19</sup> Alex, *supra* note 16..

<sup>20</sup> Groves, 1 NATIONAL TAX J 23 (1948) ( citing John Tiley, *supra* note 17).

### *B. Practical Application of the Principles of Taxation*

To what extent policy makers in Pakistan provide for these objectives when drawing up a taxation policy requires detailed scrutiny.

#### 1. Redistribution of Wealth

This being the most relevant objective to the cause of economic development in Pakistan, taxes can effectively be used to recast the cycle of wealth as to extend its advantages to the needy. Thus, the tax structure should cater for a spill-over of wealth so that the state can channel it towards the poor. This is the philosophy behind the Islamic concept of *Zakat*, whereby Muslims who are well off, and those who can afford it, are directed to devote a certain part of their capital/assets for the needy. ‘*Zakat*, the alms is a wealth tax’.<sup>21</sup> However, the difference between *Zakat* and income tax is that while income tax is levied on earnings, *Zakat* is due on savings—2.5 percent of a person’s savings emanating from wealth which is owned for a year.<sup>22</sup> In this way, no one is burdened with taxes. This exercise promotes social well-being and equality, combined with ease and convenience for the taxpayer since only the savings are taxed. Giving anything over and above that ceiling of 2.5 percent is optional—totally voluntary and self-motivated. It is not an obligation to give more than the stated amount, and even this amount if paid by each and every mediocre and wealthy Muslim residing in the state of Pakistan, and provided it is properly utilized by the government; coupled with *Sadaqah*, another Islamic conception of charity, could help to eradicate poverty. It is pertinent to mention here that the Islamic notion of taxes while

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<sup>21</sup> Adnan Khan, *Islam and Taxation*, 4 July 2009, available at <http://www.khalifa.com/index.php/the-khalifah/economy/6915-islam-and-taxation> (last visited on 29<sup>th</sup> July, 2009).

<sup>22</sup> *Ibid.*

emphasizing on *Zakat*, that is wealth tax, is devoid of any semblance of income tax.<sup>23</sup>

## 2. Equity

The distinctive keystone of the Islamic notion of *Zakat* is that the poor are not taxed at all; rather the fruits borne by the rich are distributed among the poor. This is the best example of equity to be cited anywhere in the world, if only this *Zakat* collection could be employed for some meaningful output in Pakistan. The total *Zakat* collection is subsumed into the government fund and it would be highly distasteful if it is used politically, as has been the case previously. To quote an example: 'In the past a hash was made of the *Zakat* system put into place by the Zia regime where all these funds were diverted and used for political and 'strategic' gains. This trend has been somewhat arrested but pilferage continues.'<sup>24</sup>

The total *Zakat* collected in the fiscal year 2007-8 was Rs 4 billion,<sup>25</sup> as against income tax collection of approximately Rs 20 billion in the same year.<sup>26</sup> For this reason, *Zakat*, if it is put to constructive use, can make a great contribution to the society.

However, *Zakat* will not bring about a betterment in the life of the community as a whole nor impact upon the economic development of the country unless the government learns to prioritize its issues - demarcate those areas where government spending is absolutely and crucially required, because it is lack of planning that necessitates the imposition of taxes of every genre and hue.

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<sup>23</sup> Ibid.

<sup>24</sup> Raza Rumi, *The Other Side of Ramzan*, in All Things Pakistan 9<sup>th</sup> October, 2007 available at <http://pakistaniat.com/2007/10/09/the-other-side-of-ramzan/comment-page-2/> (last visited on 30<sup>th</sup> July, 2009).

<sup>25</sup> Ahmed Hassan, *Zakat Collection Remains Static at Rs. 4 billion*, Dawn-The Internet Edition (4 February 2008) available at <http://www.dawn.com/2008/02/04/nat2.htm> (last visited on 29<sup>th</sup> July, 2009).

<sup>26</sup> Bukhari and Haq, *supra* note 2.

Pakistan should be a welfare state which has at its heart the interests of all its citizens and not tax everyone left, right and centre. However, this would demand that the entire system be revamped to give way to fruition.

### *C. Progressive System of Taxation*

While there appears to be no choice apart from taxing the populace, on grounds of equity, it has been suggested by renowned theorists<sup>27</sup> that taxes ought to be progressive so that all pay according to their potential; where the richer pay more. When you bridge the gap between the rich and the poor by providing adequate facilities to the underprivileged members of society, like free education, health care and recreational facilities;<sup>28</sup> such that no section of the society is deprived of the basic amenities of life like food, clothing and shelter as a bare minimum, you strike the intended social balance.

However, in Pakistan, the opposite is true. The rich only get richer by the day while the masses are overburdened with taxes, with no respite and no reward. The main focus of the taxation policy in Pakistan has always been on revenue collection through easiest possible means, even at the cost of expanding the social disparity. In the developed economies, taxation laws are designed mainly to steer the economy in the right direction and to create social equality. When the economy moves in the right direction, it automatically generates the tax revenue. The social equilibrium is achieved by distributing the tax burden so that every person contributes up to his or her capacity.<sup>29</sup> With regards to fixing the system, 'Dubai based chartered accountant

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<sup>27</sup> ADAM SMITH, *WEALTH OF NATIONS* (London: 1776).

<sup>28</sup> Known as 'public goods'; see Tiley, *supra* note 17 at p. 8.

<sup>29</sup> Kashif Jahangiri, *Federal Budget 2009 – Yet Another Opportunity Lost*, The Daily Times available at

[http://www.dailytimes.com.pk/default.asp?page=2009%5C06%5C16%5Cstory\\_16-6-2009\\_pg5\\_13](http://www.dailytimes.com.pk/default.asp?page=2009%5C06%5C16%5Cstory_16-6-2009_pg5_13) (last visited on 17<sup>th</sup> July, 2009).

Faisal Qamar said the reform process up till now impacted the lower income groups only, allowing the rich to get richer.<sup>30</sup>

### 1. Income Tax

The only progressive tax currently being levied in Pakistan is income tax and that also is plagued with massive tax evasion by the elite of the country, which defeats the very purpose of progressive taxation. They have reversed the balance of taxation to suit themselves so that they are never held accountable for not paying their due share. 'It is a status symbol amongst our elite to evade taxes and at the same time milk the government. The challenge before any government in power, therefore is to raise money in taxes as much as possible, so that the elite can live off it.'<sup>31</sup> Pakistan has practiced a security state model of governance where the military establishment has chosen to operate a lax tax regime to allow the feudal aristocracy, big business magnets, land and stock speculators and other such vested interests to mint money without much regard to the law so long as they support the military rule and keep the bureaucrats 'happy'. Over the decades, this regressive and corrupt system of taxation has failed to mobilize domestic resources and, as a consequence, increased dependence on foreign aid for even routine development expenditure that otherwise could easily be financed by the government revenues had Pakistan's rich been paying their due share of taxes.<sup>32</sup>

Consequently, the common man has been robbed by successive governments through indirect taxation which is a big disgrace. At present, he is subjected to 16% sales tax on salt alone. An anti-people trio of indomitable civil-military bureaucrats, corrupt and inefficient politicians and greedy businessmen – controlling and

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<sup>30</sup> Mansoor Ahmad, *Tax the Rich, Suggests Economist*, The News International (Lahore: 7<sup>th</sup> July, 2009) Business 18.

<sup>31</sup> Kamal Siddiqi, *Tax Us Till We Die, Fool Us Till You Can*, The News International (Lahore: 20<sup>th</sup> July 2009) Opinion 7.

<sup>32</sup> Yousuf Nazar, *Income in Billions Untaxed, 74p/c Live on Less Than \$2 a Day*, TAX REVIEW (2007) 6:1 LLP at p. 153.

enjoying at least 90% of the State resources – contribute much lower than 5% towards national revenue collection. The common poor are paying exorbitant sales tax of 16% (in fact 45% on finished imported goods after mandatory value addition and income tax at source) on essential commodities but the mighty sections of society such as big industrialists, landed classes, generals and bureaucrats are paying no wealth tax/income tax on their colossal assets/incomes.<sup>33</sup>

This less than satisfactory situation gives rise to the question: What role is the state playing in this regard? Is it alleviating the misery of the people, addressing their grievances, bettering the lives of its citizens or aggravating the plight of the masses? Moreover, whose interests are being served? Interests of those people who are struggling every day of their lives to make both ends meet; or interests of those who are already enjoying all the luxuries of life? Can the same laws and policies be applied across the board for exacting money out of rich and poor alike? If so, then what is justice? Above all, do the policy makers have any kind of consideration for their own people – over 73% of who are living below the poverty line and yet are expected to pay the same amount of taxes as the well off?<sup>34</sup> The high rates and amount of taxes imposed on them have left them bereft of all support and any hope of improving their standard of living.

## 2. Presumptive Tax Regime

All developed countries rely on direct taxes like income tax and property tax for their revenue.<sup>35</sup> In Pakistan the percentage of tax

<sup>33</sup> Bukhari and Haq, *supra* note 2 at pp. 109, 110.

<sup>34</sup> Iftikhar A. Khan, *Over 73p/c Live Below Poverty Line: A Study*, Dawn (Islamabad: 30<sup>th</sup> June, 2008) available at [http://server.kbri-islamabad.go.id/index.php?option=com\\_content&task=view&id=5021&Itemid=43](http://server.kbri-islamabad.go.id/index.php?option=com_content&task=view&id=5021&Itemid=43) (last visited on 3<sup>rd</sup> August, 2009).

<sup>35</sup> In USA, 'The Federal Government relies mainly on income taxes for its revenue. State governments depend on both income and sales taxes. Most county and city governments use property taxes to raise their revenue. US Treasury, Fact Sheets: Taxes, available at

derived from income tax is barely 20%, and even so is misrepresented. Because the reality is that indirect taxes account for a greater proportion of the total income tax collected under the presumptive tax regime (PTR), which distorts the entire picture, and hence the resultant inaccuracy of figures of income tax collected, as shown in statistics compiled by the government. According to official figures, the contribution of income tax [although major portion of it now comprises indirect levies or expenditure taxes] as percentage of GDP is continuously declining; it is merely 2.5% in 2008-09 as compared to 2.8% in 2007-08, 2.9% in 2006-07, 3.0% in 2005-06, 3.01% in 2004-05, 3.04% in 2003-04, whereas in 2002-2003 it was 3.15% [CBR YEAR BOOKS 2003-04 to 2006-07 and Economic Survey 2008-09]. In reality, taxes collected at source on goods and services/contracts/supplies/rent etc, which being full and final discharge are in substance indirect levies. If subtracted from income tax collection for 2008-09, the actual figure would be lower than 2%. The share of income tax as percentage of total revenue is not more than 20%, whereas the same is claimed to be at 31% in Economic Survey of Pakistan. This exposes the so-called authenticity and reliability of official figures. Reliance on indirect taxes that constitute 80% of total collection proves beyond any doubt that the tax system is directly contributing to rising poverty as people who possess enormous income and wealth are not being subjected to income taxation in Pakistan.<sup>36</sup> Blown beyond proportion since the year 1991, under PTR, the state heavily depends on collecting taxes at source on imports, exports, contracts etc., withholding tax on savings accounts, non-tax revenues e.g. tax incorporated in telephone and electricity bills, power tariff, fuel levy etc., to meet its budgetary target and those revenue collections are falsely and incorrectly attributed to income tax to show a higher figure for income tax collection. Thus, the tax originating from indirect sources is not correctly placed and accounted for in the records.

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<http://www.treasury.gov/education/factsheets/taxes/economics.shtml> (last visited on 16<sup>th</sup>, July 2009).

<sup>36</sup> Bukhari and Haq, *supra* note 2.

The presumptive tax regime encapsulates deduction at a fixed rate at source; without any measure of or recourse to what the actual earnings of the taxpayer or profit derived are, and without any type of rebate or refund, which amplifies the regressive nature of such taxation. For example, when semi-processed goods are imported from abroad, the local manufacturer, besides paying customs duty and excise, is also subject to income tax (indirect tax) on the difference between the total value of the consignment and other taxes paid. As the goods are not in their final shape, it is unclear whether the manufacturer will make a profit or loss thereafter. Therefore, the government pulls out more revenue than the rightful amount. Although the manufacturer recovers the whole amount of taxes paid by transferring this burden of taxation onto the end user/consumer (sales tax), it crushes low-income households. Under the normal tax regime, tax is calculated with reference to net taxable profit. Under presumptive mode, tax charge is calculated by multiplying the gross amount of income or receipts with a reduced rate of tax without any allowance for expenses or deductions.

Presumptive tax is a fundamental flaw in the taxation system which changes the character of income tax from a direct tax (tax on income) to indirect tax (tax on sales) as the taxpayer in most cases increases the value of his invoice by the amount of tax whereby the tax is passed on to the customer just as in the case of sales tax. Thus people are not paying tax according to their tax paying potential (profit) and are instead paying on an indiscriminate basis. This system also discourages documentation - the basic ingredient to determine income (profit) and thus the tax paying potential - as tax is calculated with reference to receipts only and expenses and deductions are ignored.<sup>37</sup> 'If presumptive taxes on goods and services and many other transactions camouflaged as income tax are excluded from the collection of direct taxes, the share of indirect taxes touches 75 per cent.'<sup>38</sup> 'The tax burden is unevenly distributed, as over 80 per cent

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<sup>37</sup> Kashif, *supra* note 30.

<sup>38</sup> Huzaima Bukhari and Dr. Ikramul Haq, *Myths and Facts about Direct Tax Collection*, WEEKLY TAX JOURNAL (2007) 6: 1 LLP at pp. 168, 170.



tax revenue is generated through indirect taxes, considered as regressive. Above all, the policy is elitist, benefiting a few.<sup>39</sup> Thus, the presumptive tax regime is the biggest slur on the system.

### 3. Wealth Tax

It is ironic that when the whole world has discovered the value of wealth tax, and is benefiting from it, the government of Pakistan opts out of it. 'Wealth Tax Act, 1963 was abolished through the Finance Act, 2003 on the specific demand of ex-Prime Minister-cum-Finance Minister Shaukat Aziz',<sup>40</sup> although 'its potential for 2008-09 could have been Rs 80 billion'.<sup>41</sup> It completely defies common sense as to why it was removed, under the false pretense that it discouraged investment, when it was clearly advantageous to the future growth of Pakistan. 'From 2003 to date, according to a conservative estimate, we have lost Rs 200 to 350 billion worth of wealth tax that could have been imposed on unaccounted/untaxed wealth'.<sup>42</sup> Since, wealth tax is progressive in nature, had it been allowed to continue, Pakistan would have surely earned more revenue.

Furthermore, Section 111(4) of the Income Tax Ordinance, 2001 facilitates the whitening of black money such that foreign remittances are allowed to be received in Pakistan without any investigation, and hence no liability accrues to anyone, in the form of tax.

### 4. Potential Areas for Taxation

Nevertheless, there are other avenues that can be explored to secure more tax: real estate, agriculture and capital gains on stocks and shares being some of them. The lopsided pattern of taxation in Pakistan is thus evident. In Pakistan, hard-earned business income is

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<sup>39</sup> M. Iqbal Patel, *Income Tax Policy Options and the IMF*, TAXATION J (February 2009) 99:2 TLBP at p. 21.

<sup>40</sup> Huzaima Bukhari and Dr. Ikramul Haq, *Enough of Revenue Losses*, TAXATION J (2008) 97:1 TLBP at p.122.

<sup>41</sup> Bukhari and Haq, *supra* note 2 at 109, 112.

<sup>42</sup> *Ibid.*

taxed at rates up to 35% whereas income which is earned through a soft source without putting in much effort (such as property rental, interest, dividend, etc.) is taxed at rates up to 10% applied on gross amount. Agricultural income and capital gains on immovable properties enjoy a constitutional immunity from taxation. In addition, capital gains on sale of listed shares are exempt from tax. The tax system in Pakistan thus provides enough incentives to not to engage in a trade or business and rather invest in properties (as banks pay very small returns). The result is evident - the most of investment goes into land and people do not engage in business activities.<sup>43</sup>

### 5. Corporate Tax

On the other hand, the corporate sector which should have been accommodated by the government tax-wise is over-taxed. It is argued that in Pakistan, at least, changes in corporate tax rates are probably better instruments for promoting capital formation in comparison to the increased investment tax credits. In particular, cuts in corporate taxes improve welfare more than do increases in investment tax credits.<sup>44</sup>

### 6. Tax on Agricultural Income

Furthermore, the buying and selling of orchards, which has been termed as 'hidden economy'<sup>45</sup> falls outside the ambit of taxation by the state. Yet, some lawyers argue that there are no landlords in Pakistan, as nobody holds more than 100 acres of land.<sup>46</sup> Similarly, it was postulated by the Ex-Deputy Governor State Bank of Pakistan

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<sup>43</sup> Kashif, *supra* note 30.

<sup>44</sup> Andrew Feltenstein and Anwar Shah, Tax policy options to promote private capital formation in Pakistan, available at <http://ideas.repec.org/p/wbk/wbrwps/698.html> (last visited on 16<sup>th</sup> July, 2009).

<sup>45</sup> *The News International*.

<sup>46</sup> Interview with Yousaf Islam, Tax Consultant, Yousaf Islam Associates (Lahore 11 July 2009).

that more than 80% owners of land in Pakistan have land holdings of less than 12 acres.<sup>47</sup>

However, this is a relative concept. It is more likely than not that there exist landholdings greater than the envisaged boundary of 100 acres of land, which is kept discreet by the owners, beyond the notice of authorities. Hence, it would be difficult to deny the presence of the characteristics of land lordship in Pakistan. Yet at the same time it is equally true that no documentary evidence would be available to establish the fact that a landlord owns this vast amount of land, as in most cases they have very astutely transferred the land in the names of various members of their family to avoid declaration of their assets.<sup>48</sup>

In spite of this pitfall, even if someone owns a few acres of land, it is incomprehensible why he should not be taxed. However, a distinction needs to be drawn between 'agriculture' and 'agricultural income' as identified by one of the tax lawyers in Pakistan.<sup>49</sup> When dealing with the question of whether agriculture should be taxed, it has been queried that on what basis will agriculture be taxed? Of what the farmer earns or owns around 9% is livestock contribution.<sup>50</sup> Then how do we decipher in what manner a farmer owning one cow or several cows is to be taxed; and what if one cow is healthier than the other cow, would that entail a higher rate of tax?<sup>51</sup>

Furthermore, it has been proposed that the productive outcome of farming is unpredictable.<sup>52</sup> One year there is flood, one year drought and in some years there are bumper crops in Pakistan.<sup>53</sup> Thus, there

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<sup>47</sup> Statement by Ashraf Janjua, Ex-Deputy Governor State Bank of Pakistan, Television Programme 'Budget FY10 Seminar: Institute of Business Management', CNBC Pakistan aired on 9 August 2009.

<sup>48</sup> Ibid.

<sup>49</sup> Interview with Malik M. Akram, Advocate High Court, Yousaf Islam Associates (Lahore 11 July 2009).

<sup>50</sup> Statement by Ashraf Janjua, *supra* note 48.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> Ibid.

are problems of assessment that interfere with the taxation of agriculture in Pakistan.

In spite of these obstructions in taxation, as far as agricultural income is concerned, it is opined that instead of taxing the poor farmer in terms of taxation of agricultural implements, and agricultural produce (which is not subjected to any further process),<sup>54</sup> the actual perpetrator – the landlord should be taxed. Moreover, it has been also suggested that the basis of taxing agricultural income should be changed ‘from size of the land holding’<sup>55</sup> to ‘actual profit basis’.<sup>56</sup>

This reluctance to tax ‘agricultural income’ is one of the anomalies of the system. It is mainly due to the overriding interest of the landed gentry who for their own ulterior motives are strongly opposed to the proposal. The feudal system is a major hindrance in this respect. While the neighboring country of Pakistan, that is India, got rid of the feudal system at the time of partition of the sub-continent, Pakistan continues to cling onto it, the result of which is the stronghold of landlords in Pakistan, and their adamant attitude towards taxation of agricultural income. Since 70 per cent of the legislators are agriculturists, tax on agricultural income can not be approved in the national/provincial assemblies. Similarly, there are strong anti-tax lobbies to oppose any government proposal for a capital levy or a tax on the real estate sector or professionals such as lawyers and doctors.<sup>57</sup> They use the pretext of high input cost, the load of indirect taxation and poverty in the rural areas to avoid the

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<sup>54</sup> The Sales Act, Sixth Schedule, available at <http://www.cbr.gov.pk/newst/Sales%20Tax%20Act%201990/Schedule%206th.htm> (last visited on 9<sup>th</sup> August, 2009).

<sup>55</sup> Patel, *supra* note 40 at p. 23.

<sup>56</sup> Huzaima Bukhari and Dr. Ikramul Haq, *Tax Collection Target-2007-08: A Critical Appraisal*, TAX REVIEW (2007) 6:1 LLP at p. 277.

<sup>57</sup> Aftab Ahmad, *Macroeconomic Indicators Improve but Poverty Worsens*, BUSINESS AND FINANCE REVIEW available at <http://jang.com.pk/thenews/mar2009-weekly/busrev-02-03-2009/p4.htm> (last visited on 2<sup>nd</sup> March, 2009).

imposition of tax on agriculture.<sup>58</sup> However, the reality is that ‘all sectors pay indirect taxes and are subject to high cost of doing business, but they all pay income tax too.’<sup>59</sup>

Furthermore, some people argue that it is for the provinces to impose tax on agricultural income,<sup>60</sup> or that the constitution needs to be amended to give effect to this eventuality:

This is a misconception. The former Prime Minister, Mr. Z.A. Bhutto had introduced tax on agricultural income through Finance Act, 1977 without making any constitutional amendment. The present government may follow suit provided it has political will to do so.<sup>61</sup>

Therefore, on this basis, the argument that the provinces ought to impose tax on agricultural income does not hold good.

## 7. Tax on Horticulture

Livestock farming and horticulture should also be taxed. A favorable taxation policy should be devised in this regard because:

Pakistan was ranked as the 5<sup>th</sup> largest milk producing country in the world with annual production of over 40 million tonnes. Livestock makes a large contribution to the revenue generated by the agriculture sector. Pakistan has a large livestock resource base and considerable potential for dairy production & export.<sup>62</sup>

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<sup>58</sup> Patel, *supra* note 40 at p. 23.

<sup>59</sup> Ibid.

<sup>60</sup> Interview with Akram, *supra* note 50.

<sup>61</sup> Patel, *supra* note 40 at p. 23.

<sup>62</sup> Islamabad, ‘Pakistan Finalizing Policy For Tax and Duty Exemptions on Agriculture Machinery Import - Syed Naveed Qamar Addresses ME-Pakistan Agri-Dairy Forum Dubai (29 April 2008) <http://www.privatisation.gov.pk/Handout/HO-AR-08/Apr-08/HO2942008%20Pakistan%20Finalizing%20Policy%20for%20Tax%20and%20Duty%20Exemptions%20on%20Agriculture%20Machinery%20Import-Syed%20Naveed%20Qamar.htm> (last visited on 15<sup>th</sup> July, 2009).

## 8. Taxes on the Manufacturing Sector

It needs to be highlighted that ‘...while the tax paid by the agriculture sector is negligible, the manufacturing sector is paying about 50 per cent of all taxes’.<sup>63</sup> This begs the question: Why a different taxation policy for the manufacturing sector as compared to the agriculture sector when both are precious national resources? Why not encourage the local industry in Pakistan by giving them tax incentives and tax breaks to boost production, and hence increase revenue?<sup>64</sup>

## 9. Tax on Industries

‘Recent economic research has shown that economics is about designing incentive systems and values that will increase productivity.’<sup>65</sup> When an industry flourishes, the state is automatically repaid from it. Then it can impose taxes on finished goods and derive revenue when the same is exported. If the government wants to collect more revenue on a long-term basis, it should concentrate on developing various sectors of the economy—the industrial sector—especially the auto-mobile industry and the film industry.

*a) Automobile Industry:* The automobile industry in Pakistan is ‘one of the leading contributors among the large scale manufacturing towards overall economic growth.’<sup>66</sup> However, in 2005, the government’s introduction of a substantial cut on the import of CBU

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<sup>63</sup> Aftab Ahmad, *supra* note 58.

<sup>64</sup> *Ibid.*

<sup>65</sup> Nadeem ul Haque, *Back to Begging Again and Again*, MONTHLY TAX REVIEW (January 2009) 8:1 LLP at p. 3.

<sup>66</sup> Pakistan Times Staff Report, Taxation Policy Makes Imported Cars Cheaper, available at <http://pakistanimes.net/2005/01/28/top10.htm> (last visited on 15<sup>th</sup> July, 2009) (saying that: The auto industry, according to Pakistan Association for Automotive parts and accessories manufacturers, is well poised to produce 300, 000 cars, 3000, 000 motorcycles, 40, 000 tractors within next five years).

caused a huge loss to the automobile industry in Pakistan.<sup>67</sup> Since imported cars were comparatively cheaper than the ones manufactured or assembled locally, majority of the leading auto manufacturers like Indus Motors which produces renowned models of Toyota, Corolla and Cuore or Honda, Deewan and others have started importing CBU units.<sup>68</sup> Therefore, the wrong tax exemption will also undermine tax collection.

b) *Film Industry*: All over the world states derive the greatest sums of revenue from their film industry. Although there is enormous scope of the film industry in Pakistan,<sup>69</sup> the government has levied so many taxes on filming equipment and film-making that they have ruined this industry due to their own short-sightedness. "Pakistan's film industry contributes millions of rupees in the national exchequer through entertainment tax, duty on raw film stock, besides paying income tax at four different tiers, such as production, distribution, publicity and exhibition, all from the single source of receipts at the box office."<sup>70</sup> Also, Pakistani director, Saqib Malik has advised that "Imported Indian films should be taxed in such a way that the money is used to promote and produce Pakistani films."<sup>71</sup> So collection of tax does not apply to domestic sources only. Tax collection systems should make use of international trade as well.

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<sup>67</sup> Ibid.

<sup>68</sup> Ibid.

<sup>69</sup> "The history of this region is rich in tales of man's lust for power, passion for romance, bravery and cowardice, brutality and compassion. With such a legacy, Pakistan's cinema has a rich potential. If it could project even a fraction of this imaginatively and artistically it would rank amongst the finest film centres of the world," Gazdar, author of 'Fifty years of Pakistani cinema' citing *Deserted Cinema Houses*, available at <http://www.onlinenews.com.pk/details.php?id=37674> (last visited on 26<sup>th</sup> July, 2009).

<sup>70</sup> Ibid.

<sup>71</sup> Cover Story: Trouble In Tinsel Town, available at [http://www.pakwatan.com/view\\_detail.php?id=382](http://www.pakwatan.com/view_detail.php?id=382) (last visited on 28<sup>th</sup> July, 2009).

c) *Tax on Raw Materials of Industries:* In similar vein, it is inquired as to why the government taxes the raw materials of industries like steel etc. so heavily when clearly industry is an asset Pakistan should aim to nurture and protect? The 'government is using a utility as source of revenue collection even when industry is suffering and economy is slowing down.'<sup>72</sup> Therefore, taxation experts should bear in mind at the time of formulating a taxation policy that imposing heavy taxes on industry will stultify its growth when due to the global recession, the demand for Pakistani goods and exports have already declined.<sup>73</sup>

d) *Taxing Professionals:* Under UK law, income tax is levied on 'Professions' and 'Vocations' (originally under Schedule D, Case II of ICTA 1988, and subsequently under ITTOIA 2005, Part II).<sup>74</sup> Conversely, in Pakistan there is no system of taxation of professionals such as doctors, engineers, lawyers and the like, who are rolling in money, whereas a teacher who is providing an invaluable service to the nation and has a low/average income is overstrained with taxes. This discrimination between high-wage earners and low-wage earners needs to be removed by instituting an impartial system of taxation on all bodies of professions and vocations alike. 'The effective mechanism of GST collection on services, along with professional tax, could result in additional revenue of more than Rs.300 billion.'<sup>75</sup>

e) *Toll Taxes and Parking Fees:* Even toll taxes and parking fees in Pakistan make a hefty contribution towards the revenue. 'At present toll collection across the country is around Rs3.2 billion, for which

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<sup>72</sup> *Industry says gas price cut not enough*, The News International (Lahore: 8 July 2009) Business 18.

<sup>73</sup> *Pak ranking drops to 100th: Global Enabling Trade Report*, The News International (Lahore: 8<sup>th</sup> July, 2009) Business 15.

<sup>74</sup> Lee, *supra* note 17 at pp. 141, 142.

<sup>75</sup> Fida Hussain and Sohail Sarfraz, *General Sales Tax On Services: Centre May Seek Provinces' Assent For Collection*, TAXATION J (May 2009) 99:5 TLBP at p. 85.



the Punjab is the major contributor around Rs1.9 billion annually.<sup>76</sup> Collection of toll tax in Pakistan is not new. It is being collected on the Super Highway between Karachi and Hyderabad, on the Motorway between Lahore and Islamabad, Band Road in Lahore and the Bridge on the River Ravi near Lahore on Sheikhpura-Lahore Road. Even in Islamabad, the Capital Development Authority (CDA) has been receiving toll tax. The motorists pay road tax every year to the provincial excise department and also pay tax when purchasing gasoline or diesel from the petrol pumps. The captive drivers, once they are on the toll roads are forced to buy food at franchised stores at inflated prices. It is said that perhaps the fuel tax provides enough funds to the government every year to literally convert most of the toll highways into freeways.<sup>77</sup> However, these taxpayer never gets anything in return for contributing towards the tax collection system.

*f) Power Tariff and Petroleum Development Levy:* The recently imposed power tariff and petroleum development levy (POL) speaks volumes about the flaws in the taxation policy. While the prices of petroleum all over the world have plummeted,<sup>78</sup> in Pakistan the government appears to be punishing its citizens for its own failings and lack of foresight by imposing the petroleum development levy, despite the verdict of the Supreme Court against the imposition of carbon tax. The government has merely changed the name of the tax

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<sup>76</sup> Muhammad Bashir Chaudhry, *More Toll Taxes on the Horizon*, Dawn-the Internet Edition (8 March 2004) available at <http://www.dawn.com/2004/03/08/ebr6.htm> (last visited on 3<sup>rd</sup> August, 2009).

<sup>77</sup> *Ibid.*

<sup>78</sup> 'LONDON: Oil dropped well over a dollar to below \$62 a barrel on Wednesday': Reuters, 'Oil falls below \$62 on economic doubts' in *The News International* (Lahore: 9 July 2009) Business 18 (...crude oil price has declined from 147 dollars a barrel to 47 dollars); Fida Hussian, *General Sales Tax On Services: Centre May Seek Provinces' Assent For Collection*, *TAXATION J* (May 2009) 99:5 TLBP at p.85; *Industry says gas price cut not enough*, *The News International* (Lahore: 8 July 2009) Business 18 (Chairman SITE Association of Industry (SAI) opined that 'oil price has come down to \$60 and even if the exchange rate parity is factored in, the present reduction in gas prices is not adequate).

from ‘Carbon tax’ to ‘Petroleum Development Levy’, however the fact remains that it is the same tax. The submissions of the Attorney General in the case were as follows:

‘...the prices of the petroleum products were required to be increased due to many factors, such as the rates prevailing in the international market, the budgetary demands for running the affairs of the country, provision of subsidies on various items, e.g. wheat, etc. He stated that the budget was already deficit.’<sup>79</sup>

However, it was all a sham. ‘...the government had neither the intention nor the technical means nor a programme to limit the vehicles’ carbon emissions to the internationally acceptable standard.’<sup>80</sup> The sole cause was budget calculation on the basis of a potential IMF deal – a standby arrangement. ‘Carbon surcharge is a mere symptom. The real disease is mis-governance...The real government intent is to extort Rs122 billion- and a bulk of that from low-income Pakistanis.’<sup>81</sup> To add fuel to fire, this tax was literally imposed overnight and without prior warning.<sup>82</sup> This dealt a death blow to the absolutely essential pre-requisites of certainty and convenience in the taxation arena. It is this very factor—lack of certainty and consistency in taxation policy that undermines investment: both foreign and public investment although ‘An

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<sup>79</sup> Supreme Court Order 07.07.2009-Islamabad; *Chief Justice Iftikhar Muhammad Chaudhry: Short order of SC on carbon tax*, The News International (Lahore: 8 July 2009) National 4.

<sup>80</sup> Mir Jamilur Rahman, *Taxation by Ordinance*, The News International (Lahore: 15 July 2009) Opinion 6.

<sup>81</sup> Farrukh Saleem, *Carbon tax to fund rulers privileges, junkets*, The News International (Lahore: 9 July 2009) National 4. The author writes that: ‘If I recall correctly it is the first time in Pakistan, except under military regimes, that tax has been imposed by an ordinance – the Petroleum Development Levy (Amendment) Ordinance, 2009, under which Rs122 billion would be collected by imposing higher taxes on petroleum products. If this practice of imposing a tax through ordinance was accepted then it would be possible to announce the budget from the President House as an ordinance. Then the question arises: where is the need of the National Assembly if tax could be imposed by an ordinance?’

<sup>82</sup> Rahman, *supra* note 81.

investing-in-investing phase is even more important in the resource-rich low-income countries.<sup>83</sup> Hence, government must conduct a cost benefit analysis before blindly agreeing to the terms and conditions of foreign donors who have nothing in common with the poor of this country, and cannot in any way relate to their suffering. Government's continuous unscrupulous attempts to put the state's resources at risk under the disguise of generating revenue must be questioned by all quarters of national existence. Answers will have to be provided by those in authority- those elected to serve the people, thus establishing the structure of representation in taxation.

#### IV.

#### SUGGESTIONS FOR THE IMPROVEMENT OF TAXATION SYSTEM IN PAKISTAN

##### *A. Observations and Comments*

'A strong economy cannot be based on short cuts.'<sup>84</sup> The government just wants to fill in the figures, irrespective of the fact that it is resorting to exploitation of the masses to achieve this tax collection. Even though it sometimes manages to meet the target of revenue collection, what policy-makers in Pakistan do not understand is that by the mere fact of increasing the revenue target, Pakistan cannot attain the status of a developed nation, as it is a gradual

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<sup>83</sup> Glenn Gottselig, *Still the Bottom Billion: An Interview of Oxford Economist Paul Collier* available at <http://www.imf.org/external/pubs/ft/fandd/2009/06/people.htm> (last visited on 10th August, 2009).

<sup>84</sup> Nadeem ul Haque, *supra* note 65.

process. This requires independent thinking and planning,<sup>85</sup> keeping in mind the specific requirements of Pakistan and the ever-widening gap between the rich and the poor.<sup>86</sup> Moreover, the government needs to curtail external influences and its myopic approach towards the vulnerable in order to cash these domestic opportunities for economic growth. The system needs to be re-evaluated and reorganized to cater to the common man and to make use of indigenous resources.

It needs to be borne in mind that 'tax-to-GDP spike per se is not public-friendly approach. Rather it is rise in direct tax-to-GDP system which imparts prosperity and equity.'<sup>87</sup> Therefore, the time is ripe to resort to direct taxation as the principal source of revenue generation, specifically income tax, wealth tax, capital gains tax and tax on 'agricultural income'.

However, the question that springs to mind when one is attempting to fit all the pieces together is: What should be taxed in a developing country? Basic food items. Should they be taxed, and if so, at what rate? What about luxuries? People who have that entire one can imagine should they not be giving back to society more than the normal intake of taxes?

While basic food items should be taxed at low rates '...policy makers should heavily tax imported products and luxury items for which there are local alternatives.'<sup>88</sup> Alongside this, the government should adopt a stringent approach towards products that it ought to discourage consumption of, in the public interest, like alcohol and cigarettes. These goods should be taxed heavily, so that the high prices act as a deterrent against their purchase and use. Conversely,

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<sup>85</sup> '...domestically-generated (non-aid) revenues is the only alternative to postulating permanent dependence.'

<sup>86</sup> '...human poverty in middle-income countries is more clearly the result of levels of income inequality than absolutely low income per se.' (Ibid).

<sup>87</sup> Dr. Summaira Riaz, *Tax Revenue from Integrated Model*, TAX REVIEW (March 2009) 8:3 LLP at p. 38.

<sup>88</sup> Yasser Latif Hamdani, *Pakistan's Moment of Economic Opportunity in All Things Pakistani* (30 October 2008) available at <http://pakistaniat.com/2008/10/30/pakistan-economy/comment-page-9/> (last visited on 30<sup>th</sup> July, 2009).

the government in the Finance Act 2009 has only imposed a withholding tax of 1% on the distribution of cigarettes.<sup>89</sup>

Therefore, rather than the government's unreasonable collection of taxes in the shape of POL and power tariff, it would have been far better if the following measures were adopted:

...selective weekend taxes for petroleum products, as much as several hundred percent, will help bring both the burgeoning fuel demand and reduce pollution. Similarly for power, instead of load shedding during the work week, it would be better to increase the tariff by significant amount on Sundays.<sup>90</sup>

If the government plans its budget in advance, bearing in mind the funds available for this purpose, and sets the revenue target in accordance with the existing sources of revenue, and not on the basis of some supposed foreign aid; without hastily adding to the current list of taxes to cater for their own inadequacies, like the present budget shortfall of Rs55 billion which has to be compensated for by unreasonably taxing the public on the recommendations of the IMF,<sup>91</sup> a lot of chaos can be avoided. This is visibly reflective of an unsound tax policy.

In the absence of all forms of development, and with the government only causing physical, mental and financial stress, hardly any compliance of taxation laws can be expected from a taxpayer.

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<sup>89</sup> Ford Rhodes, Sidat Hyder & Company, *Comments on Finance Bill, 2009*, MONTHLY TAX FORUM [May-June 2009].

<sup>90</sup> Hamdani, *supra* note 88.

<sup>91</sup> Shaukat Tarin and Saleem Raza, Pakistan: Letter of Intent issued to IMF (March 16, 2009) available at <http://www.imf.org/external/np/loi/2009/pak/031609.pdf> (last visited on 10<sup>th</sup> August, 2009) (mentioning that as regards fiscal policy, under the heading 'Revenue effort will play a key role in achieving the deficit target', it has been postulated that 'Any shortfall in tax revenues will be compensated by revenues from the PDL, tax administration measures, and expenditure control measures).

Amid this highly volatile situation, people have developed an abhorrence of authority figures. They do not see any advantage flowing to them in terms of security of their person, property and dignity; neither does the majority enjoy any of the perks and luxuries of the upper class. To this scene, taxation adds further strain. “When the government is not delivering, why should people pay taxes?” retorted one of the income tax agents who file returns for taxpayers, when questioned about the level of compliance of taxpayers in Pakistan.<sup>92</sup>

Moreover, loans from the IMF and World Bank do not ease the situation. The high interest rates only add to the burden and complexity. It amounts to a situation where Pakistan has to compromise on its ‘national economic sovereignty’ in the wake of its vulnerable economic position.<sup>93</sup> ‘Instead of the begging bowl, we can introduce a viable educational and health care system in the country over the next few years financed exclusively through income tax on the wealthy.’<sup>94</sup>

Nadeem Ul Haque has argued that it is time for Pakistan to go beyond ‘government planning and allocation’ in order to achieve growth.<sup>95</sup> Moreover, what would be highly feasible for Pakistan would be a kind of borrowing in the form of loans ‘from the public...on the basis of profit-sharing in certain projects or on the basis of their zeal and inspiration’.<sup>96</sup> If only the government would introduce measures to promote its own industries, provide tax breaks and tax holidays to the corporate sector which is paying the most in the form of taxes, and restore peoples’ confidence in the system, there is no reason why people will not pay taxes and the tax collection

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<sup>92</sup> Yousaf Islam Associates, Tax Consultants, Lahore.

<sup>93</sup> Khaleeq Kiani, *Views Hard Decisions or IMF Bailout?* TAXATION J (2008) 97:1 TLBP at p.18.

<sup>94</sup> Ahmed Quraishi, *Taxing Democracy*, The News International (Lahore: 15<sup>th</sup> July 2009) Opinion 7.

<sup>95</sup> Haque, *supra* note 65.

<sup>96</sup> IMAM MUHAMMAD EL-GHAZALI, AL-MUSTASFA, MATABA’AT MUSTAPHA WAHBAH (Cairo: 1937) at pp. 1, 139-140.

systems will definitely deliver. From then on, it will all be smooth sailing.

In addition, the government should face up squarely to the issue of tax evasion in Pakistan. It has been worked out that tax evasion has reached to a whopping figure of Rs. 218 billion which comprise about a fifth of the total revenue targets. The loan default from premier banks has been largely concentrated within the politically powerful clans that control our national destiny through national and provincial elected houses.<sup>97</sup>

### *B. Motivating the Common Man to Pay Taxes*

When the government will spend money on development and people can see what their money is being used for, they will pay their taxes voluntarily, and contribute towards the advancement of their community. However, the general public in Pakistan is being over-taxed. The common man is not a habitual tax defaulter. Rather, he is overburdened with taxes. It is only when he sees no development in the country in spite of him paying his taxes, that he develops resentment towards the system and out of frustration, he tries to bypass the tax collection system.

Thus, it is not just negligible tax collection that hinders economic growth. A nation's confidence and trust once it is shattered, takes an immense amount of time and dedication for it to be reinstated.

Other factors aggravate the situation: 'The prices are out of hand, while fiscal deficit and energy crisis are emerging as a major risk to the current growth momentum.'<sup>98</sup>

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<sup>97</sup> Dr Noman Ahmed, *Caution on Corruption*, The News International (Lahore: 12<sup>th</sup> July, 2009) Policy 3.

<sup>98</sup> Kiani at *supra* note 93.

Therefore, it has been argued<sup>99</sup> that Pakistan is experiencing endemic inflation—a regressive form of taxation which ‘aggravates inequalities, accentuate strains on balance of payments, diverts resources into socially wasteful uses such as luxury housing, speculative investments, bullion and jewelry.’<sup>100</sup>

As far as economic growth is involved, ‘pump priming’ is one suggestion. Under this system, you pump money into the economy: ‘...by decreasing taxation and giving consumers more spending power while increasing government spending in the form of buying services from the market (such as building roads or schools)’.<sup>101</sup>

If the government wants to increase revenue while giving effect to the overruling consideration of proportionality, it ought to tax everyone equally, depending on the earning capacity or profit margin of different taxpayers. However, is flat tax system, whereby everyone is deemed liable to pay the same amount of tax, with no exemptions and reliefs, the solution? Considering the wide income disparities in Pakistan, it will not be workable. As opposed to ‘laissez faire’ theory, the tax system in Pakistan needs government’s attention and intervention. If they simplify the system to remove perverse laws and policies, give people what they deserve and learn to live within their means, they will certainly reap the fruits of their efforts. The situation demands transparent remedial measures,” says senior economist Naveed Anwar Khan, an FCA. He said the government has exhausted its limit to generate revenue from the general masses. “It is time to tax the rich,” he added...Rupee, he added, would stabilize if the government curbs unnecessary imports and taxes luxurious items heavily. Revenue, he continued, could increase by 40 per cent without increasing or imposing new taxes, if the government musters the courage to plug revenue leakages that occur with the connivance of bureaucracy. He added this would require terminating high custom officials that allow clearance of goods at under-invoiced rates or on

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<sup>99</sup> Aftab Ahmad Khan, *supra* note 58.

<sup>100</sup> *Ibid.*

<sup>101</sup> [www.investopedia.com/articles/04/051904.asp?partner=answers&viewed](http://www.investopedia.com/articles/04/051904.asp?partner=answers&viewed) (last visited on 5<sup>th</sup> April, 2009).



wrong declarations.<sup>102</sup> However, the picture that emerges is a combination of government's failure to identify and deal with the immediate crises, along with over-spending on nonproductive projects and concerns.

## V.

### CONCLUSION

Nonetheless, it is apparent that taxation in today's world has far-reaching consequences on the economic outlook of a state. Therefore, this process should not be in vain. Detailed analysis is required and planning ahead of time to maximize output and to circumvent weaknesses in the system. Details need to be precisely etched onto the surface of taxation policy to envelop the whole system, and to bring about a transformation in societal layout and displays where it is needed.

Thus, it is submitted that the root cause of all ills in Pakistan is poor taxation policy. The administrative wing of the state and tax collection system itself functions according to the taxation policy devised and adopted by the concerned authorities. Therefore, they have little or no choice in collecting tax from a marked class of persons and execute that line of policy in conformity with predetermined schemes. Nevertheless, if they act on their own to improve the system, specifically dealing with tax evasion on an individual level, the numerous loopholes and malpractices in the system can be eliminated.

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<sup>102</sup> Mansoor Ahmad, *supra* note 30.