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Drawbacks in Pakistan's Taxation System vis-a-vis Circular Debt

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The Constitution of Pakistan empowers the government to collect the taxes for revenue generation and the attainment of an adequate standard of investment in accordance with the effective public services at federal as well as provincial level. To administer the tax system Central Board of Revenue (CBR) and its subservient units are functioning. The tax system in Pakistan is taken into consideration as complex, rigid, non-neutral and ineffective.

Since last many decades, Pakistan has been gone through various evolutions regarding tax system with the assistance of academic as well as international donor agencies like

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World Bank and International Monetary Fund (IMF).The National Finance Commission (NFC) award (2009) and the 18th amendment to the constitution (2010) are observed as two significant expansions in the process of fiscal devolution and policy framework. Like most of the taxation systems functioning all around the world, our taxation system is classified into two main categories of direct tax, which is directly paid by the individuals, organizations and indirect taxes like custom, excise, sales tax, etc. The taxation system is dealing with some drastic set of issues since last thirty years. Direct taxation is preferred in most of the states but in Pakistan, few efforts have been taken to improve the direct taxation regime[1].

Analysis of Current Taxation System

Ironically, Pakistan has transformed the direct taxation system into an indirect one. The policy makers and tax planners avoid the necessity of generating a genuine base for direct taxation. The ratio of direct tax collection in our country is at 11.21% in comparison with the 88.79% of indirect tax generation of country's revenues.

The remarkable ratio of direct taxation in South Asian region has been examined in Bangladesh, where their government achieved the revenues consisting of 46.33% direct taxes as well as 53.66% generation of indirect taxes. India is also not less behind in this regard and successfully achieved the level of 33.45% direct and 66.55% of

[1] Pakistan's Taxation System: A Critical Appraisal. qurtuba.edu.pk/jms/default_files/JMS/2_1/05_Shah_khan.pdf.

indirect taxation. So, if Pakistan needs an economic boost, solid steps should be taken towards raising the direct taxation system[2].

The indirect taxation system applies equaly on rich and poor, which effects the purchasing power of the lower income groups consisting of the major chunk of Pakistan's population. The wealth of our elite class rests undocumented and untaxed, that's why Pakistan is lacking behind in economic stability and sustainability. This underprivileged tax culture is pushing our country towards financial crises.

In Pakistan there is extreme tax avoidance, a limited number of people pay tax. Pakistan Bureau of statistics report presents that among 180 million population, shockingly only 3.4 million are tax registered but only 1.7 million file their returns and 0.75 million are those who actually pay tax, which leads to the shortfall in central power purchasing sector and burdens the government with huge circular debt[3]. This shows the miserable condition of tax avoidance on a large scale including politicians, landlords, businessmen, traders and even working class are enlisted as the non-tax payers. Despite tax amnesty scheme initiative in 2015, approximately 1.4 million, 1% out of 200 million population filed their tax return. The prevailing insufficient revenue generation from taxes is the basic reason for government's inability to deliver what we expect.

[2] "Direct Tax Collection Ratio Very Low." Daily Pakistan Observer -. April 26, 2017. Accessed January 10, 2019. https://pakobserver.net/direct-tax-collection-ratio-low/.

[3] "The Causes and Imacts O Power Sector Circular Debt in ..." Accessed January 10, 2019. http://climateinfo.pk/frontend/web/attachments/data-type/USAID (2013) The Causes and Impacts of Power Sector Circular Debt.pdf.

The existing tax to GDP percentage is estimated 11 to 12% in Pakistan, which is lowest among the SAARC states, compares with India who reaches at the level of 17.7%. By relating this ratio with the economic powers, our state is far behind in numbers. In Australia, they have achieved the ratio of 25.8% of total tax to GDP. America has met the level of 26.9% and Europe is at the level of 37 to 39%[4] .

The growing deficit in GDP and budget discrepancy has pushed Pakistan under increasing debt burden. The government policy shows that their main focus is on revenue generation through indirect taxation rather on the direct one. The indirect taxes may have provided more revenues to the system but have worse effect on the poor population of the country as well.

In order to finance the ongoing developmental projects, our government already have the burden of loan from local as well as international banks and financial institutions and may be gone for another IMF loan to pay the previous ones. These respective loan approvals derive the country not only towards financial debt but also brings other conditions like placing pressure on the government to take certain drastic decisions which affect the public[5].

[4] The Nation, Naveed Ahmed. "Taxation System in Pakistan and Govt Functions." The Nation. July 16, 2016. Accessed January 10, 2019. https://nation.com.pk/17-Jul-2016/taxation-system-in-pakistan-and-govt-functions.
[5] Azhar, Hammad. "The Economy in 2019." World | Thenews.com.pk |. January 01, 2019. Accessed January 10, 2019. https://www.thenews.com.pk/print/413356-the-economy-in-2019.

A way forward Benchmark for Future Conduct

- The incentive to improve the taxation system in Pakistan needs the channelization of all transactions, money transfers and salaries issuance from banking system for record collection and documentation. The government should encourage expansion of banking network at tehsils and district levels to discourage the functioning of black markets.
- The trilateral linkage should be made among NADRA, CBR and banking system to increase the number of tax registers and to identify the non-tax filers.
- The initiative to register the non-commercialize properties which are being used for commercial purposes should be taken to increase the direct tax ratio.
- The most vital step in this regard is to acquire the services of highly qualified and trained people in tax related departments like the Federal Board of Revenue. The example of Australia can be taken in this regard, where a tax advisor should hold a degree in taxation. The same attribute can be implemented in Pakistan. The civil servants should only be allowed to engage with the tax concerned departments if they have a certification in tax laws and policies to enhance the effectiveness of our taxation system.
- It is necessary to provide the entire access of banking details of all the citizens to the Federal Bureau of Revenue (FBR). In this regard, the State Bank of Pakistan has to play a vital role by linking banking system with FBR, to monitor all the transactions.

- The government should initiate policies to increase direct taxation rather than the indirect one to facilitate the lower class and identify the rich chunk of tax exempted group of citizens. Charging provision is necessary for the effective tax policy generation.
- Withholding tax regime as a major source of federal revenue collection at national level, need to be analyzed and identify the gaps in its implementation. The Federal Tax Authority (FTA) prerequisites need to be reconsidered.
- Legislation for electricity theft and penalties regarding it needs a strong implementation system also the fuel adjustment policy requires modification.

Conclusion

In Pakistan, the tax policy is squeezing the tax payers through enforcement of indirect taxes. Tax reforms need the process of legislation, authorization, documentation and compliance. There are three stages of developing tax reforms, charging provision: relates to the required tax ratio, machinery to implement and standard procedure to be followed. To formulate the tax reform policy there must be a strong mechanism of record collection. In Pakistan, only 75000 people are the tax filers out of 180 million population. The economic destruction which is ongoing since last 30 years entails a solution for its reemergence. GDP ratio is in its radical condition. Policy essentials contain only the right direction for economic stability and state survivability. Finally, each recommendation requires the will of the government and tax concerned

departments and their cooperation is required. A strong implementation system is required to enforce all the suggested policies to acquire the expected outcome.

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