

TAX EVASION

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KEY TERMS USED

APTMA	All Pakistan Textile Mills Association
CBR	Central Board of Revenue
NUS	National University of Singapore
Ordinance	Income Tax Ordinance 2001

PRELUDE

Tax evasion is a global phenomenon. Tax collection is based on the theory that not many people wish to voluntarily pay taxes. Therefore tax collection system must be developed in such a manner as will ensure flow of taxes into the coffers of the State to enable it to not only meet operating / running expenses but also finance development expenditure. Our position in Pakistan is a difficult one. The public needs to be educated about financial security aspects of the country. Non-payment of taxes, enjoying the luxury of liberal exemptions available in laws and deciding to avoid paying legitimate and due taxes is not in the interest of stability and integrity of the country. Print and Electronic media needs to disseminate these thoughts to persuasively motivate people to positively respond to paying taxes.

At present, the Government of Pakistan has difficulties as internal financial cushion is not available to finance the operating and development needs as is apparent from table No. 1.

Table: 1

Financial Needs and Availability of Financial Resources 2003-2004

	<u>Needed</u>	<u>Rs. billion</u>
1.	Recurring Expenditure	645
2.	Development Expenditure	160
		805
	Less: Available	513
	Shortfall	292

The above shortfall necessitates borrowings (at home and abroad). This creates tremendous pressures on the recurring budgets in the shape of debt servicing and cripples economic sovereignty of Pakistan. We cannot afford this luxury any more. Therefore, there is a need to properly understand tax evasion dimensions and

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develop a sound strategy to tackle it for adding strength to financial frontiers of our beloved country.

A sum of Rs. 10 billion was collected as income tax which hitherto was evaded tax. However, the general perception was that the amount ought to have been Rs. 100 billion. We wonder whether the tax machinery was geared to achieving higher amount. In any case, the collection was much higher than all amounts of the previous declarations of tax evasion and consequential collection.

TAX EVASION: INRETROSPECT

Table 2 presents an abridged position of declaration of black money in the past in the history of our country. These declarations were made thrice in the past. The announcement of 1958 related to Ayub era. The 1969 event occurred in Yahya Khan's era. The 1976 event was in the tenure of Zulfikar Ali Bhutto's Government.

Table: 2

Declaration of Black Money: 1958 to 1976

Year	Amount (Black Money declared)	Pertinent Comments
1. 1958	Rs. 1,350 million	Rs. 1,120 million related to areas which constituted Pakistan (excluding East Pakistan which later became Bangladesh).
2. 1969	Rs. 920 million	Rs. 780 million related to areas which now constitute Pakistan (excluding East Pakistan which later became Bangladesh).
3. 1976	Rs. 1,500 million	Rs. 270 million was paid as tax on declared income till August 31, 1976.

GOVERNMENT TAX AMNESTY SCHEME

The then Chief Executive of Pakistan, in his historic speech delivered on December 15, 1999, announced a tax amnesty scheme on the following lines:

1. On truthful disclosure of all tax evaded assets, a payment of only 10% as tax allowed people to bring these assets into their books. This amnesty was available until March 31, 2000.
2. The Government decided that no black money whitener schemes were to be allowed in the future. However, the Chief Executive of Pakistan assured that the immunities, protection and exemptions on existing investments, deposits,

bonds, foreign currency accounts etc. would be fully honored. The Federal Finance Minister provided further details in this respect.

CANONS OF TAXATION

Guidance has been provided by several economists and the scholars in the past for proper payment of taxes. These have been popularly known as canons of taxation. A summarized version of these is given below:

ADAM SMITH'S CANONS OF TAXATION

Adam Smith's contribution to economic theory is regarded as classic. His statement of canons of taxation has hardly been surpassed in clarity and simplicity. Four canons of taxation are as under:

A: Ethical Aspects

The Canon of Equality

This is based on the following concept:

"The subjects of every state ought to contribute towards the support of the Government as nearly as possible in proportion to their respective abilities that is in proportion to the revenue which they respectively enjoy under the protection of the state".

This canon embodies the principle of equity or justice. It lays moral foundation of the tax system. Adam Smith, writing in his renowned book namely, Wealth of Nations, stated: "It is not unreasonable that the rich should contribute to the public expense not only in proportion to their revenue but something more than that proportion".

Accordingly the tax will be in proportion to the ability to pay.

B: Administrative Aspects

1. The Canon of Certainty

The Principle of Certainty is very important and can get reflected in reality by implementing the guidance provided in the following statement of Adam Smith: "The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person. Where it is otherwise, every person subject to tax is put, more or less, in the power of tax-gatherer, who can either aggravate

the tax upon any obnoxious contributor, or extort, by the terror of each aggravation, some present or perquisite to himself”.

Certainty is needed not only from the point of view of the tax-payer but also from that of state.

2. The Canon of Convenience

Every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it.

3. The Canon of Economy

Every tax ought to be so contrived as both to take out and to keep out of the pocket of the people as little as possible, over and above what it brings into the public treasury of the State.

Some later writers added a few more canons to Adam Smith’s four described above. Among these are: Elasticity, Flexibility, Simplicity and Diversity.

A good tax system should comprise taxes which conform to the above canons of taxation.

BUDGETARY POLICIES

Several cornerstones of budgetary policies were announced in the past. Table 3 sums up pertinent aspects:

Table: 3
Cornerstones of Budgetary Policy

Focus	Operational Details
Productivity Capacity	Optimal utilization of productive capacity and maximization of agricultural and industrial production to boost exports.
Revenue Base	Ability to meet all the expenditure and a substantial part of the development cost of both Federal and Provincial Governments from revenue resources.
Investment	Maintenance of a favorable investment climate, encouraging investment and promoting savings.
Taxation Structure	Streamlining taxation structure and administration of revenue collection departments to put a check on tax evasion.
Social Justice	Advancement of concept of social justice by putting a check on concentration of wealth in a few hands, and the building up of a strong middle class.
Five Year Plans	Practically shaping the guiding principles enunciated in various Five Year Plans with emphasis on resource mobilization.

These remained as ideals without getting crystallized in reality. Perhaps this stays agenda of tomorrow. A summarized position of sources of revenue of Federal Budget 2003-2004 is as under:

Table: 4
Federal Budget 2003-2004: Revenue Components

Revenue Sources	Billion Rs.	%
1. Indirect Taxes	349	48
a) Sales Tax	223	30
b) Custom Duties	78	11
c) Federal Excise	48	7
	349	48
2. Direct Taxes (mainly Income Tax)	161	22
	510	70
3. Non-Tax Revenue	157	22
4. Surcharges	61	08
	728	100
Less: Transfer to Provinces	215	
	513	

Source: Computed from: Budget Documents 2003-2004,
Islamabad: Ministry of Finance, Government of Pakistan.

FEDERAL BUDGET 2003-2004

Table 5 presents an abridged position relating to the above budget:

Table: 5
Financial Position of Federal Budget 2003-2004: Revenue Expenditure

Revenue Expenditure	Billion Rs.	%
1. Debt Servicing	256	40
2. Other Expenditure	229	36
3. Defense Expenditure	160	24
	645	100

Source: Computed from: Budget Documents 2003-2004,
Islamabad: Ministry of Finance, Government of Pakistan.

A review highlighting strategic directions to reduce tax evasion is now presented below:

A: **Indirect Taxes**

1. Sales Tax:

This is expected to be the future tax of Pakistan. Over the years upward growth has been registered in collection. However vast scope exists in mobilizing more amount. The sales tax rate is high and

encourages tax evasion and demotivation to pay due sales tax. An effective dialogue between enlightened CBR officials and the potential sales tax payers through institutionalized approach appears to represent a strategic direction to pave the way to tackle sales tax evasion.

2. Custom Duties:

Amount to be collected from custom duties (import and export) will water down with effective implementation of WTO regime w.e.f. January 01, 2005. Tariff rationalization and strengthening moral values in custom officials are two directions requiring careful attention. This can have healthy impact of reduction in tax evasion.

3. Federal Excise:

The Federal Government has announced that federal excise will be merged into sale tax over time. Process has been initiated and steadily the amount under this head is watering down.

B: **Direct Taxes:**

Substantial amount of direct taxes include income tax. To handle tax evasion, comments have been offered separately in this piece.

TAX PAYEES – NUMBER

Fifty Two (52%) population in Singapore pay income tax. Their total population is around four (4) million and their Universities have ranked very high in Asia and Pacific region. In fact for the last several years, National University of Singapore (NUS) has ranked as number one in Asia and the Pacific (including Australia and New Zealand). Their exports have exceeded US \$ 130 billion against Pakistan's exports of US \$ 11 billion during 2002-2003 with a target of US \$ of 12.10 billion. Hong Kong, with a population of 6.2 million people have twenty five (25%) as tax payers.

Our position in Pakistan appears to be highly dismal. In a total population of 145 Million, only 1.5 million are income tax payers representing only 1%. Perception of this figure appears to be high in terms of potential tax payers.

A strategy with firm determination to achieve substantially higher percentage is the crying need of today. CBR is fully aware of this challenge but needs full and willing support from all stakeholders. If this is done, encouraging results will follow and the hitherto tax evasion regime will start shrinking.

CBR RESTRUCTURING

With support from multilateral financial assisting institutions, CBR has been undergoing major restructuring. Members have been inducted from the private sector. Efforts are being made to boost efforts for an accelerated approach to ensure domestic resource mobilization. However there is a crying need to substantially increase the number of tax payers which is said to be around 15 million and this number is expected to increase to 1.8 million and later 2.0 million. This augers well for the economic sovereignty of Pakistan.

In fact there is a need to tackle tax evasion on war footing basis. In our opinion, synergy needs to be created through harmonious relationship between the government and tax payers (present and potential). Periodical dissemination of uses of revenue may inspire confidence. The general perception is poor relating to Government's approach of spending the state revenues. Austerity needs to be practiced in expenditure. Demonstrated results of accomplishments need to be publicized to inspire confidence in the public. Accordingly the people are likely to be motivated to pay taxes. The role of institutions like CBR, Federation Chamber of Commerce and Industry, various chambers of Commerce and Industry in all provinces of Pakistan, various stock exchanges, All Pakistan Textile Mills Association (APTMA) and various trade bodies need to be solicited on institutionalized basis. The earlier this is done the better.

TAX EVASION SECTORS

It is generally believed that there are three sectors which are not appropriately paying taxes and not contributing to income tax in Pakistan. These are: transporters, traders, and agriculturists. Transporters earn considerable money but evade payment of taxes. Traders enjoy the luxury of no documentation or poor documentation. Consequently there is a calculated move on their part not to pay income tax. Agriculturists enjoy income tax holiday for ever under the Income Tax Ordinance, 2001. Since the Assemblies have been beefed up with landed aristocracy, no effort

has been made by them to bring the income earned from agricultural directly into Income Tax net.

For any Government, the above three sectors pose a challenge. Who will tax them?

General Musharaf's Government made a good start to include agriculture income for income tax to be administered by Provincial Governments as authorized in the 1973 Constitution of Pakistan. We wish to see its true implementation.

TACKLING TAX EVASION

Comprehensive and concerted efforts are needed to tackle tax evasion. Tax Laws should be simplified. Public needs to be properly educated. Tax machinery is required to be re-oriented for developing capability, capacity and credibility. Government ought to be firmly determined for tackling tax evasion. A momentum needs to be built whereby tax rates are reduced and tax base is broadly widened. Collection drive should be improved. Domestic resource mobilization through revenue collection needs to be accelerated. A target-oriented program for tackling tax evasion is the crying need of today.

RECOMMENDED STRATEGY

- 1) Tax Evasion should be given as priority number one monster and a strategy be worked out to effectively tackle it.
- 2) There is a need to educate people in Pakistan for developing tax culture.
- 3) Income Tax rates should be substantially reduced with quantum jump in the number of income tax assesses. Lafer's Curve should be translated in reality with solid work by the Central Board of Revenue. Marketing efforts need to be institutionalized.
- 4) All exemptions available under the Second Scheduled annexed in the Income Tax Ordinance, 2001 should be withdrawn and subjected to income tax at declining rates, except for pensioners.
- 5) Tax structure be simplified to encourage potential assesseees to deposit the income tax into the coffers of the state.

- 6) A national movement must be launched with the slogan: "Let us all pay income tax".

CONCLUDING COMMENTS

It is high time that all stakeholders must comprehend the gravity of the situation and extend their full support to uproot the tax evasion in Pakistan and enable Pakistan to wear a new outlook – Sovereign Pakistan. The financial stability will enable Pakistan to stand on her own footing and the incidence of debt service on budget will substantially reduce and will facilitate fiscal space to allocate funds for allocation to social sectors. A motivational approach should be followed to ensure that tax evasion is tackled with sense of concern and as high priority agenda.

