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PAKISTAN'S TAXATION CONUNDRUM

ISSUE PAPER 1

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Abstract

This Issue Paper examines Pakistan's revenue raising deficiencies and weak fiscal architecture as a security problem, one that requires proactive remedial measures and an effort towards public value co-creation. It examines the current state of the taxation system, comparing this with the ideal traits of a healthy fiscal net. It then considers the culpability of social agents in perpetuating dismal tax outcomes, and then provides recommendations on what to remedy in the tax system. The findings of the paper suggest that the responsibility for Pakistan's taxation conundrum has multiple causes of culpability, which can be addressed in numerous ways; and that a robust fiscal net should be the utmost priority of the national government, with long-lasting implications for both national security and society.

INTRODUCTION

Introduction

The aim of this paper is to recontextualize Pakistan's tax conundrum as a security problem, for although much discussion goes on about the fiscal repercussions of weakness in the nation's tax system and its welfare implications, few articulate the extent of the threat that low tax collection poses for national security. To lose one's fiscal sovereignty is to leave oneself at the mercy of outsiders who have their own agendas to pursue, and a feeble fiscal architecture forces difficult choices and tough trade-offs among competing requirements and often urgent priorities.

The thesis of the paper is that rebuilding a broad-based tax system that reflects best practices or traits will help guarantee Pakistan's overall security and bolster other elements of national power.

A significant portion of this Issue Paper seeks to compare Pakistan's current taxation system to a set of traits that represent an idealized form – a tax system that would be fair, neutral, simple, certain, efficient, flexible, and effective. The deficiencies and shortcomings, across each of these traits, are demonstrated through relevant tables and figures, to build an argument that tax reform in Pakistan should be undertaken in a manner that strives towards the idealized form. This, then, leads to questions about where the blame for this broader security lapse through a weak tax system lies. The answer, as the current study finds, lies in the public value failure of all parties: the bureaucracy, the politicians, the private sector, and citizens as a whole (see public value in Alford and O'Flynn 2009; Bryson et al. 2016; Chohan 2019, 2020). Blame ascription is not as much a condemnatory act as it is an important lesson-drawing exercise, because it then generates recommendations and remedial measures that recognize where the problems lie in society. The analysis is then extended to a reform effort based on Thirsk (2008)'s framework.

From this, certain nuanced discussions are raised regarding the types and breadth of taxation, tax structures of the future, interagency and governmental setup for tax collection, and the need (or desirability) of using coercion as well as incentives to coax Pakistanis, both as individuals and as organizations, into fulfilling their fiscal responsibility. The paper does not assume an expertise in taxation law or taxation mechanics, and it provides essential definitions early on and as required.

The subject of the paper is an important consideration within the wider national security paradigm. If the path towards a robust taxation architecture is not pursued proactively and wholeheartedly, it is somewhat futile to discuss other elements of national security.

Without resolute fiscal mechanisms, Pakistan will not have the sustainable and indigenous fiscal resource base to pursue any other form of defense. That is why central taxation is required for assuring the nation's security through fiscal sovereignty.

FISCAL SOVEREIGNTY AND SECURITY

Fiscal Sovereignty and Security

A fiscally sovereign country is one that does not unduly rely on external sources to meet its public expenditure requirements through excessive borrowing, and is able to generate sufficient amount of financial resources through the economic activities of its people to pursue its objectives in a sustainable manner (Kopits 2012; Chohan 2017c-d, 2018).

Conversely, a country that is not fiscally sovereign leaves itself vulnerable to outside lenders, who can (and often do) have an agenda of their own. These outside interests can impose their will upon a country that is not fiscally sovereign, and can, thus, extract its resources or subjugate its people through nonviolent means (Roos 2019). Debt traps, as they are often called (Karlan et al., 2019), offer financially buoyant powers a useful means to subdue adversaries without firing a shot (see debt theorizations in Graeber 2014). They can even use their impositions to replace local taxation authorities to weaken the country, and leave it further impoverished, thus, perpetuating a downward spiral from which it is often difficult to escape (Varoufakis 2018).

In the South Asian context, the ability to impose a legitimate tax regime has often been at the very center of the power equation (Birla 2009). The Mughals built and enforced an extensive revenue collection system to draw upon a large subject population's productive efforts and surpluses. They diversified their revenue base beyond land titles into areas such as commerce and trade (Moosvi 2011). Although some of this was used to fund their opulence, a very large portion went into public value creation. Granaries were stocked for cyclical food disruptions, roads were maintained and kept safe, along with many other achievements, while redistribution to the people themselves was accomplished through the Mughal fiscal regime (Hasan 1993). The assurance of peace and security throughout the realm was also a direct function of taxation as an input.

It was, in fact, the surrender of these taxation powers (fiscal sovereignty) to the East India Company, through the Treaty of Allahabad (1765) during the rule of Shah Alam II, that the Mughals began to decline as an empire (Dalrymple 2019). According to the Treaty, the East India Company would replace all Mughal tax officials in the Eastern Province (Bihar-Bengal-Orissa) with its own henchmen (Booth 2014). In the ensuing decades, the British systematically subdued this region, and then the rest of South Asia, in a zero-sum fiscal extraction (Dalrymple 2019).

The mass pauperization of the Subcontinent ultimately undermined the locals' security. The aftershocks of that colonial fiscal regime are still being felt today. Yet unlike their Mughal forebears, Pakistanis are not in the throes of colonial reign, which is why it is so perplexing why the free people of Pakistan remain unwilling to contribute towards bolstering their own security and prosperity – their own fiscal sovereignty - through a well-funded fiscal architecture.

Even as its economy offers immense potential, part of which is being realized through projects such as the China-Pakistan Economic Corridor (CPEC) (Chohan 2018), the taxpaying culture and system is in so abysmal a state that fiscal sovereignty, and therefore, national security, are in immediate jeopardy. There is also a troubling moral aspect to this. [1]

This study will show that revenue collection falls short of targets, and the budget cannot be balanced or maintained at a sustainable level due to increasing expenditures. The technical language describes this as tax effort, which is the ratio between the share of the actual tax collection in GDP and taxable capacity (Le et al., 2012), by which account Pakistan has low tax effort. Indeed, Pakistan's tax-to-GDP ratio has hovered in the 6-8% range for the past decade, while the average even for South Asia during that period was more than 10%, and certainly for other regions it was much higher: nearly 20% in the European Union (EU), 15% for the Organisation for Economic Co-operation and Development (OECD) countries, and 12% for Latin America. Beyond this, the fiscal architecture departs significantly from international best practices.

Pakistan's tax system is not neutral, efficient, stable, simple, effective, flexible, or fair. These are not adjectives in the abstract, but in fact reflect the principles of a good tax system and contain fuller meaning.

It is, therefore, important to understand why these principles are important to bring the national system in-line with the principles of a good tax system as part of comprehensive reform. With that in mind, the next section seeks to lay emphasis on them.

[1] The paper "Panama Papers and Tax Morality" sought to examine the literature from several regions regarding a "just" form of taxation, and how many cultures have sought to grapple with the problem through the lens of common and divine morality. The moral aspect of taxation is very important, and we would argue that the lack of taxpaying culture in Pakistan is a moral failure, but this is not delved into in this paper as the focus here is on weak fiscal systems as a security concern (Chohan 2016).

PRINCIPLES OF GOOD TAXATION: IDEALIZED FORM

Principles Of Good Taxation: Idealized Form

There are seven general principles of a good taxation system,[2] and they emerge from the work of the Organization of Economic Cooperation and Development (OECD) as presented in the 1998 Ottawa Ministerial Conference (OECD 2014). They have arisen as part of a consensus among Finance Ministries of developed countries with larger, more transparent, and well-functioning tax systems, and help to frame the dimensions of the problem that a country such as Pakistan confronts today. They are expressed diagrammatically in Figure 1, and are examined below:

Figure 1: Principles of a Good Tax System

Source: OECD (2014).

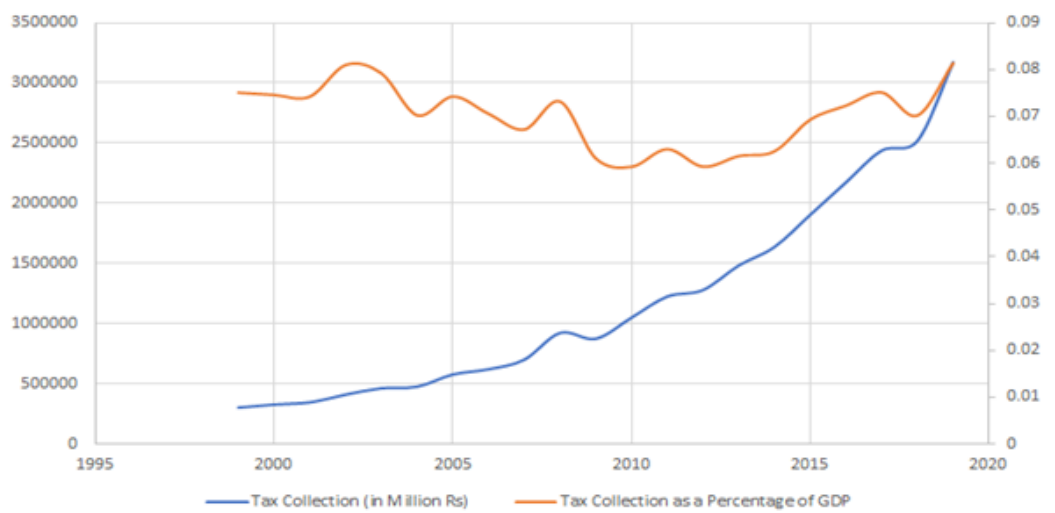
[2] At times, these principles can be put together as five principles: neutrality, efficiency, certainty-simplicity, effectiveness-fairness, and flexibility. Other major bodies have also come up with their own principles or tenets of taxation, but there is considerable overlap between these standards, and some tend to add principles which are not necessarily applicable. The OECD's 7 (alternatively 5) points are more encompassing. For a lengthier but strong alternative, see the ACCA's 12-points (ACCA 2011).

Efficiency

A tax system is said to be efficient if it minimizes the administrative costs incurred by a government or other tax collecting body and the compliance costs borne by the businesses and individuals. In this context then, most countries around the world have started to optimize their tax efficiency, but there is still room for improvement. However, when it comes to Pakistan, the situation is worrisome as it is one of the least tax-efficient countries in the world. We begin our analysis by perusing the individual and corporate sector's cost of compliance, which is a major tax efficiency metric.

First, tax filing itself is a convoluted and cumbersome process that compels individuals and companies to hire expensive tax attorneys and other specialists, thereby raising costs. Because of these intricacies, the tax filing system takes a long time to complete, along with frequently occurring technical glitches Second, the excessive use of exemptions, tax credits, and frequently changing Statutory Regulatory Orders (SROs) make it harder for individuals and businesses to calculate their tax payments accurately, and they thus spend more time not just in the filing process but also in following up. These indicators are reflected in Pakistan's low score in the global Ease of Doing Business 2020 report, where Pakistan score is a paltry 10/100 points on follow-up, more than 283 corporate hours' worth of time to prepare taxes, and an overall score of 53/100 (low) in tax ease (Figures 2, 3 and Table 1):

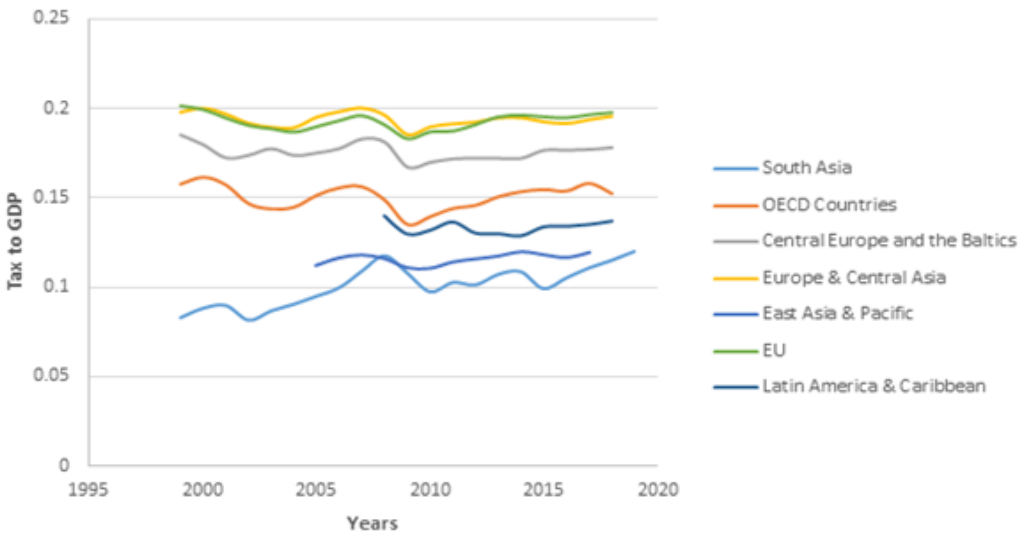
Figure 2: Pakistan's Revenue Figures (1999-2019)



Note: Left axis: Tax Collection (in million PKR.); Right axis: Tax Collection as % of GDP.
Source: Pakistan Bureau of Statistics [PBS] (2020a). Gross Domestic Product of Pakistan (at current basic prices).

Pakistan tax collection may well have risen over the past two decades in nominal and absolute terms, but its relative tax collection as a percentage of GDP has hovered largely in the 6-8% range over this period. This reflects a growth in the size of the economy, but does not reflect well on the proportion of tax collected from the economy itself.

Figure 3: Average Tax-to-GDP by Regions (1999-2019)



Source: World Bank Databank. (2020). Tax Revenue as % of GDP by Region.

Pakistan's tax to GDP ratio looks even more worrisome when seen in an international context. Typically, developed countries have a tax-to-GDP ratio of 15% (the OECD average), while the number is even higher in Europe where it touches nearly 20% of GDP. Among developing countries, the tax ratio is lowest in South Asia at roughly 10%, while for East Asia it is closer to 12% and for Latin America closer to 14%. This indicates that, even within the limited context of South Asia, Pakistan's tax-to-GDP ratio is below average, and within the scope of the developing world, it certainly fares poorly in terms of tax revenue collection.

Table 1: Ease of Doing Business 2020 Indicators

Tax Indicators	Score
Paying Taxes Ranking (/200 countries)	161st
Score of Paying Taxes (0-100)	52.9
Payments per Year	34
Time Spent Preparing Taxes (Corporate Hours)	283
Total Tax and Contribution Rate (% of Profit)	33%

Next, we turn our attention to the efficiency of administrative machinery deployed by the Federal Board of Revenue (FBR) and its contribution to Pakistan's economy. This is, in fact, what the OECD most precisely refers to in its focus on tax "efficiency." As one can imagine, the system is highly inefficient with a plethora of cogs that act as productivity drainage.

First, the FBR has 21 main formations spread throughout Pakistan, and according to an estimate by the Tax Reform Commission (TRC), these field offices collect merely 5% of the total tax revenue. In other words, if FBR was closed today, the Ministry of Finance and Revenue Affairs will still be able to raise 95% of current tax revenues. Second, the administrative costs, overheads, and salary expenses of certain field offices (especially those located in smaller cities) far exceed the amount they collect in taxes. This was true of 15 formations out of 21 in 2015. Lastly, the FBR employs around 20,000 employees, and their salary expense is more than double than the expense of other government officials (Rana 2015).

In this context, Pakistan's tax system ranks 161 out of 190 countries in the Ease of Doing Business 2020 Report as mentioned earlier. Besides, Pakistan ranks poorly in nearly all metrics used in the report. For instance, for a medium-sized company, there are a total of 34 different numbers of tax payments per year as compared to 27 for South Asia, and 10 for the OECD developed economies. Similarly, it takes 283 hours per year for a Pakistani company to collect information and file returns as compared to a mean of 273 hours for South Asia, and 159 hours for the OECD countries. Given these statistics, Pakistan's tax system earned a paltry 53 percentage points which is among the lowest scores in South Asia.

Certainty and Simplicity

The characteristics of an ideal tax system is the simplicity and certainty of rules, regulations, and the overall tax code. This means that the taxpayers are able to easily understand the tax regime and trust its continuity so that they can plan the taxes on their transactions, thereby optimizing their decision-making. It also means that the taxpayers respond adequately to the policy cues while minimizing any potential conflict with the taxman. Besides, a simple and fairly certain tax regime is more efficient as it leads to a reduction in compliance costs and other externalities (OECD 2014).

Using these parameters, even a cursory analysis of Pakistan's tax regime reveals that it is anything but a certain and simple system. For instance, there are 8-12 different brackets in the individual income tax category, which complicates the tax brackets unnecessarily. This applies to an extent to corporate taxes as well. The Income Tax Ordinance 2001 and its derivative Finance Acts, are written in a nebulous language, which makes it harder for the average citizen to understand and comprehend the text. This problem is exacerbated by the fact that these

vital tax documents are not available in any local or regional language such as Punjabi, Pashto, etc. The Income Tax Ordinance 2001—which lays all the rules and regulations of the tax regime—is a hazy document, which is difficult to comprehend and even to read, let alone use for preparing or anticipating future tax returns.

This problem is aggravated by the frequent introduction of amendments in the Income Tax Ordinance 2001, in the form of Finance Acts. Since 2001, the Federal Board of Revenue (FBR) has introduced 17 Finance Acts averaging approximately one per year. The Federal Board of Revenue (FBR) customarily introduces Statutory Regulatory Orders (SROs), which are mostly arbitrary and revolve around exemptions and tax credits. Moreover, the FBR enjoys full discretion over the release of SROs without any parliamentary or budgetary oversight. The above-mentioned structural issues in Pakistan's tax regime makes it difficult for individuals, Association of Persons (AOPs), companies, and traders to prepare for their tax returns or transactions in advance as their efforts are frustrated by rapidly changing laws governed by the Finance Acts and SROs.

Effectiveness and Fairness

A key feature of a successful tax system is its ability to charge the right amount of tax from relevant stakeholders at the right time (effective), and do so in a manner that is seen to be "fair," which involves no value judgements. Moreover, it also accounts for the tax incidence, that is, who bears the ultimate tax burden and in what proportion. If powerful special interests can pass on the burden of taxation to other parties, then even if they are nominally charged the tax, it is, in fact, other parties that bear the incidence. However, a tax can only be fair and effective if it is enforceable, that is, if the tax authorities are able to appropriate revenues from a target group without providing them with an opportunity to pass tax incidence to their customers, employees, partners, etc. (OECD 2014).

Unfortunately, the tax code of Pakistan is marred by inequity, ineffectiveness, and inadequate enforcement. For instance, the incidence of individual income tax falls on the salaried class in a disproportionate manner. Meanwhile, the poor are more exposed to taxation in the form of regressive indirect taxation (the sales tax). Indirect taxes, in fact, comprise 61% of the total revenue (Ali 2019). On the other hand, the elite and propertied classes, as well as the bourgeoisie trading class, are routinely able to dupe the tax authorities and evade their due share.

However, tax officials are partly to be blamed, as this scheme doesn't work without their connivance. For example, the reprobate tax officials benefit heavily from the under-invoicing of imports and under-reporting of goods produced and services rendered by different businesses. This scheme is beneficial for the

companies as well, who pay nothing in tax, but charge the full amount from customers and other clients. Besides being unfair, this is also an example of tax non-neutrality in action (Ahmad 2020). To add insult to the injury, businesses routinely transfer 70% of the incidence of direct tax (such as withholding and presumptive taxes) on the final consumer who already has to pay an exorbitant amount of sales tax. This is an example of ineffectiveness in action as the Federal Board of Revenue (FBR) fails to collect the tax owed by traders, businesses, and big companies. In 2018, 91% of all companies in Pakistan paid less than PKR 1 million in taxes (Rana 2020a).

In conclusion, the tax regime in Pakistan is highly ineffective, unfair, and lacks the muscle to enforce rules, regulations, and compliance.

Recognizing this stark reality, successive governments—both military and civil—have sought to increase revenue collection by deepening rather than broadening the tax base as it is the path of least resistance.

It appears that the Pakistani legislators and policymakers have wholeheartedly embraced the taxation policy of Jean-Baptiste Colbert—the Finance Minister of King Louis XIV—who believed that the art of taxation was to "pluck the maximum number of feathers from a goose which hisses the least" (Bukhari and Haq 2019).

Neutrality

The foundations of a just, fair, transparent, and equitable tax system lie on the principle of tax neutrality. The term implies that the basic tenets of taxation should be applied uniformly to all businesses and consumers engaged in similar transactions in a particular geographical area (such as a state, province, or a county). Furthermore, the non-neutrality of tax also erodes the economic efficiency and productivity of a country, while simultaneously leading to a fall in consumer utility.[3]

In Pakistan's case, one can find a plethora of examples from its economy and business sectors and analyze the distortions that it creates. For example, petroleum companies charge different rates on their products based on the location and consumer market, with considerable variation in the pricing structure (Thirsk 2008). Similarly, in a letter written to Advisor to Prime Minister

[3] Let's try to understand this concept further with the help of two examples. Suppose two garment retailers, one selling in a physical market while the other selling her product online using digital marketing. Now, the government—eager to promote online businesses—offers a tax rebate to the online retailer even though she is selling the same product as her counterpart, who sells in the physical market. This is an example of tax non-neutrality as tax treatments are different for individuals in the same businesses, selling an identical product and engaging in similar transactions.

on Finance & Revenue Affairs Dr Abdul Hafeez Shaikh, the Pakistan Broadcasters Association (PBA) demanded that all news channels and broadcasters be given a tax exemption similar to the favourable tax treatment given to ARY News after the Federal Government caught its embezzlement of funds amounting to PKR 1 billion (The News 2020). This was actually an attempt by the Federal Government to bring the massive chunk of black money into the tax net. Though this latter example does not pertain to the market, it nevertheless shows the incidence of tax non-neutrality playing out in the realm of governance and administration. Thus, as the above examples show, the tax system of Pakistan is highly non-neutral, with various discrepancies in tax regime and rates applicable to different transactions and groups of people. There are also administrative, governance, and reform issues pertaining to the functioning of the FBR, which is further perpetuating the problem.

PAKISTAN'S TAX SYSTEM: FAR FROM IDEAL

Pakistan's Tax System: Far From Ideal

In light of the ideal taxation principles highlighted by the OECD, it becomes evident that the tax system in Pakistan falls considerably short on each metric. The system cannot be described as efficient, certain, simple, effective, fair, flexible, or neutral. There are underlying reasons for each category shortfall, but there are interrelationships among them, and they culminate in the taxation conundrum that goes on to generate a security concern.

In FY2019, the Auditor General of Pakistan (AGP) found PKR 166 billion in deliberate tax evasion across Pakistan's various tax categories (Zeb Khan 2020), according to a presentation made to the Public Accounts Committee (PAC).[4] Tax evasion is of course a much more serious problem than tax avoidance, at least from a legal standpoint.[5] According to the report, 199 cases of tax evasion on taxable services and supplies amounted to PKR 16.7 billion; 77 cases of sales tax evasion amounted to PKR 5.6 billion; 188 cases of adjudged government revenue amounted to PKR 5.3 billion; inadmissible input tax in 255 cases without fulfilling legal requirements caused a loss of PKR 5.7billion; concealed income in 144 cases led to PKR 25billion in losses; while 8 cases of incorrect loss carry-forwards (tax manipulation) led to PKR 17 billion in losses.

Such issues cannot persist as they do now since the risk posed to national security is too great. But as alluded in each taxation principle, the underlying causes speak to the actions of different agents and the manifestation of different elements within the tax architecture (or its absence).

For this reason, it is important to consider the culpability of each public value agent in terms of their destructive role: politicians and elite; public managers (bureaucrats); civil society; and the private sector.

[4] PACs have an important oversight function over the tax system in parliamentary systems (see Chohan 2016; 2017a-b).

[5] Tax avoidance can be considered legal (but immoral) since it involves loopholes and ostensibly legal tax measures. Tax evasion is both illegal and immoral, and refers to deliberate violations of tax law. The fact that the AGP found such a large scope of tax evasion is truly worrying.

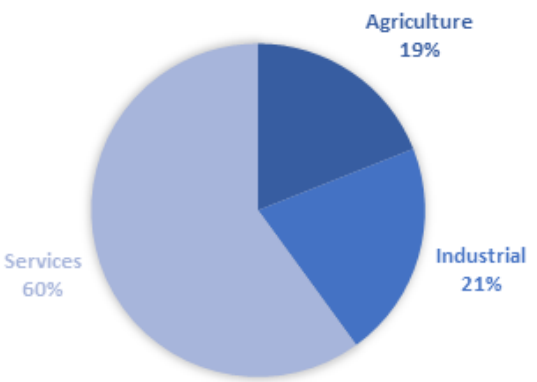
Who is to Blame? Culpability in the Security Gap

We have so far discussed the structural issues of Pakistan's tax system and the policy gaps that create lacunas and facilitate corruption, evasion, and other procedural distortions. No single person, group, or institution is exclusively responsible for such an abysmal state of affairs. Rather, it is the work of a range of different stakeholders (public value agents) that include the political and the elite class, the private sector (or the business community), the general public (and civil society), and the state institutions (not limited to the FBR). The culmination of their actions has wreaked havoc on Pakistan's fiscal architecture.

Politicians & the Elite

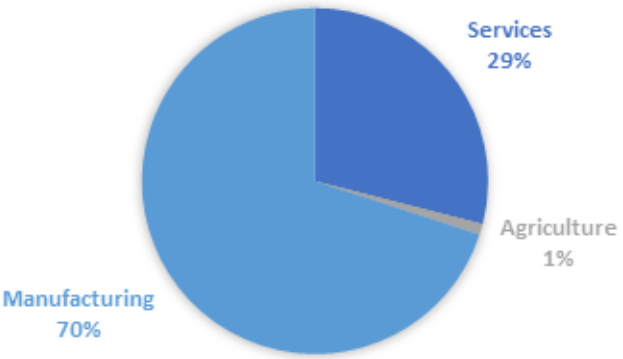
The political, socioeconomic, and class structure of Pakistan epitomizes the notion of 'elite capture' with the top 30 percentile owning and controlling approximately three quarters of all the wealth and resources of the country (Knoema 2020). Politicians are central to understanding the taxation conundrum through their office-holding functions (see Stapenhurst et al., 2017): legislation, representation, and oversight. As legislators, politicians have shaped taxation policy in ways that exempt their interests from taxes. As a landed elite of neo-feudal temperament, many Members of National Assembles (MNAs) and Member of Provincial Assembles (MPAs) from rural districts deliberately keep the large economic sector of agriculture exempt from taxation (see agriculture contribution to GDP and taxation in Figures 4 and 5).

Figure 4: Pakistan's GDP by Economic Sector (2019)



Source: Pakistan Bureau of Statistics [PBS] (2020b). Sectoral Shares in GDP.

Figure 5: Pakistan's Tax Revenues by Economic Sector (2019)



Source: Pakistan Bureau of Statistics [PBS] (2020b) Sectoral Shares in GDP.

The politicians who drafted Pakistan's constitution in 1956 showed this as well in leaving many key items off the list of taxable items, and created a worrying distortion in that the federation could only tax a limited range of goods (but not services). As representatives, they have engaged in mutual class representation rather than that of the peasants whose values contradict their interests.

The feudal composition of the political class also helps to explain why the burden of taxation has been shifted to the manufacturing sector, even though strong industries are a much more secure and advanced bedrock for development and should, therefore, be burdened less.

The politicians have also encouraged the regressivity of indirect taxation as opposed to creating antagonisms that reduce their political capital (direct taxation of constituencies). This ultimately disfavours the poor. In addition, the massive lists of exemptions existing in the tax code across categories demonstrates political point-scoring and quid pro quo at the expense of the country's fiscal sustainability.

Beyond this, rampant corruption by subsets of politicians has meant that the tax morality of the country has been compromised. The people are unwilling to contribute to a tax system which they suspect (sometimes correctly) will simply line the pockets of crooked politicians.

For all the taxation imposed on the people, the quality of public services gives them a fine excuse of wondering why they should pay taxes when service delivery (public value creation) will not be granted to them.

Such distortions also play out in geographical terms, where even though Karachi is the engine of Pakistan's economy and its largest taxpaying jurisdiction, the quality of life in the city has deteriorated.

Therefore, in order to create a more balanced, just and fair tax system, it is imperative that the government and policymakers immediately take bold steps to bring ruling elite into the tax net without coming under any pressure or duress. Martial Law Administrations (MLAs) would have been a good counterweight in the past, but the track record of MLAs has shown that they quickly sought accommodation with powerful subgroups of entrenched politicians. This meant that they could not be the vanguard for change in Pakistan's fiscal position. Secondly, the FBR should identify all the defaulters and tax evaders—regardless of their institutional identity and political clout—and share the data with NADRA and NAB so as to bring these individuals into the tax net and hold them accountable. Rule of law, an often rhetorically abused phrase (Chohan and Jacobs 2018), is still a paramount consideration in reigning in the security risk that the country faces from a weak fiscal architecture.

Private Sector

As Figure 5 illustrates, the manufacturing and industrial sectors pay the highest amount of tax, and their share in the total tax revenues is 70%. While this is laudable, the fact is that one sector of the economy has been disproportionately burdened, due to gross inefficiencies of the tax authorities and a lack of proper tax structure. Similarly, it is also a reality that a significant portion of Pakistan's trader class is still operating in the informal sector as they are unregistered with no tax returns filing and no payment of the General Sales Tax (GST). According to data shared by the FBR, out of a total of 3.5 million traders in Pakistan, a mere 312,361 file tax returns, while only 300,000 have registered for the General Sales Tax (Bukhari and Haq 2020). However, these traders routinely charge the GST and other business income tax from their customers, thus adding a thick layer of corruption over well-entrenched tax evasion.

Unfortunately, however, this trend of evading tax is pervasive across all segments of the business community besides the petite-bourgeoisie merchants. Take the case of the tech-savvy and sophisticated telecom sector as an example. According to chairman National Accountability Bureau (NAB), the telecom sector as a whole is guilty of evading PKR 400 billion. Similarly, another study indicates that the Pakistani telecom operators routinely charge more tax from their customers than they pay to the government (Shahid 2018). Besides evading tax, the corporate sector usually passes any increment in tax to their customers. This is a practical demonstration of that fact. In fact, such transgressions of the telecom sector have grown to such an extent that recently, the FBR was forced to seal the headquarters of telecom giant Jazz after they failed to pay PKR 25.393 billion due for the FY 2018-19 (Khan 2020).

The tobacco industry of Pakistan is another segment of the corporate sector that is responsible for large-scale tax avoidance. For example, consider the following statistics:

The two major tobacco companies in Pakistan, i.e., Philip Morris (PM) and Pakistan Tobacco Company (PTC), possess 60% of the market share and pay 98% of the total tax for the industry. On the other hand, 21 smaller tobacco companies that control 40% of the market share pay a paltry 2% of the industry's tax.

These figures represent gross tax distortions in the tobacco sector, which can partially be understood by the fact that some of the small tobacco companies are owned by politicians and sitting members of the parliament. Due to their political clout, they routinely pressurize the government to put all the tax incidence on the big companies while giving them a free hand (Siddiqui 2019). This ties into the previous subsection on politicians and their inequities against the people.

Another sector of Pakistan's industry that is grossly undertaxed without being conspicuous is the textile sector. According to the Prime Minister's Advisor on Finance & Revenue Affairs, the local sales of textiles amount to PKR 1200 billion, but the tax payment from this segment is a derisory PKR 6 billion, which is roughly equal to 0.005% (Baloch 2019). The textile sector evades taxes by taking the plea that it is the largest contributor to the export basket of the country and hence, should be given exemptions or breaks from the tax net.

While it is certainly true that textiles play a very instrumental role in earning foreign exchange, there is no excuse for evasion or tax concessions given to local sellers of textile products.

As the numbers indicate, the local sellers of textiles are earning handsomely and enjoy a local competitive advantage as well, as Pakistan's textiles are world-renowned. However, they are not paying their due share, which is a national disgrace and can be corrected by FBR's strict action on the defaulter textile businessmen.

In addition, private schools and hospitals also need to be brought into the tax net as these entities have transformed from welfare service providers to big businesses.

Indeed, even a cursory look at the functioning of any big private school or hospital shall reveal that these organizations are essentially operating on corporate principles, making huge profits while exploiting their customers, workers (including underpaying teachers), and paying no taxes.

In fact, according to an estimate, the early entrants into the private school and hospital business have multiplied their wealth several times over since starting up and are still on track for enormous growth. Moreover, they have also been able to purchase some of the most expensive real estate in the posh neighbourhoods of Pakistan's big cities (Subohi 2019). However, when it comes to paying taxes, they take the plea that they operate as a charity or a trust or a non-for-profit, thus evading tax. They came under the pretext that the public education and healthcare systems were dismal and that they could fill the gap as a kind of social contribution.

Private schools and hospitals are now extorting the people, and their well-lined pockets should be seen for what they are, serial exploiters.

Even when the government has been able to levy occasional charges on them, these schools and hospitals have passed a hundred percent of the tax incidence on the parents and the patients, respectively. Besides, they exclusively cater to the rich while claiming to serve the middle class and the poor, which is not true. For instance, in a recent survey, it was revealed that the most expensive private school in Karachi charged its student PKR 182,000 per month, while the least expensive of them still charges PKR 25,000. In a country where the minimum wage is PKR 16,000, these educational institutions are certainly not for the working class and are increasingly getting beyond the reach of the professional middle class. Thus, it is high time that these schools and hospitals be taxed heavily, and the FBR should ensure that the tax burden falls completely on the organizations and not on their customers.

Civil Society

Apart from the elite and the business class, the general public of Pakistan also exhibits a strong aversion towards paying taxes. Although they still end up paying the bulk of the tax, in the form of indirect taxes, they nevertheless evade and avoid paying direct taxes. This is attributable to several factors.

First, Pakistan is not a welfare state, and people do not receive basic welfare services from the government, even though this is a chicken-and-egg game. Therefore, people reason that if they are themselves paying for education, healthcare, necessities, private security, civic services, etc., then why should they pay taxes as they get nothing in return (a public value problem of legitimation and recognition of value). They perceive the benefit principle of taxation being violated in Pakistan's case, which stipulates that "I pay for what I get". Besides, people in Pakistan generously donate to charities, beggars or needy people, free food centers, schools, and hospital trusts, etc. but are highly suspicious and skeptical of paying the government. This perception needs to be dispelled.

Second, there is a large segment of the general populace that still sees the government and its bureaucratic apparatus from a colonial perspective where the rulers are cast the outsiders who are trying to extract rent via taxation and other exploitative means. This phenomenon is common in post-colonial societies, and leaves a large part of Pakistan's economy to fester in the informal sector; and it explains why certain segments of society vehemently refuse to pay taxes and get registered, for example, the petite-bourgeoisie trading class.

Moreover, the post-colonial structure of Pakistan's bureaucracy, especially the customs, excise, and tax departments also perpetuate this image, whereby the bureaucrats reinforce perceptions of being rulers of the common people rather than their servants and facilitators.

Public Managerial Institutions

Pakistan gained independence from the British colonists in 1947, but its bureaucratic, political, judicial, legislative, executive and even defense institutions were shaped and formulated in the Anglo-Saxon tradition. 74 years later, one would hope that the institutions would have made significant progress by adapting to 21st Century models of governance, administration, and development but unfortunately, that is not the case.

Pakistan's state institutions are still operating in the post-colonial shadow with civil servants acting as sahib bahadurs (masters) charged with policing and controlling the population – especially in legacy redundant services such as the District Management Group (DMG), which makes no sense outside of a colonial administration.

In this context, it is not surprising at all that the country's tax, revenue, and customs departments have consistently underperformed and failed to achieve even the most basic of targets.

Public managerial institutions in the developing world, including Pakistan, exhibit a race for perks, privileges, and financial rewards that risk creating an 'entitlement mentality' among the officers. The tax administration exhibits deficiencies in this regard, as 70% of the taxes in Pakistan are composed of withholding and indirect taxes, which are collected by private institutions, government departments, and companies.

Similarly, the collection by FBR accounts for only 5% of the total tax revenue in Pakistan. This means that if the FBR closed today, the Government of Pakistan would still be able to collect 95% of its revenues. In light of these statistics, it has been recommended that the elite CSP officers of FBR should be fired immediately and be replaced by modern, competent, and tech-savvy professionals (Haque 2020).

To make the process of tax collection more smooth, efficient, and timely, interagency coordination is extremely important. In this context, it is encouraging to hear that the government is pushing for coordination among agencies, and for the purview of responsibilities of NADRA and NAB be expanded to include cooperation with FBR. For a country of 210 million, it is not clear to anyone just who resides, works, and dwells in this country. Large swathes of the population live in a sort of economic shadow, in an informality where documentation, oversight, and public administration is difficult. This is a problematic condition for a 21st Century society.

In terms of institutional cooperation, there is also a need in Pakistan for enormous improvements in the judicial system, in terms of the provision of speedy justice ("judicial performance," see Chohan 2019b). Tax pending cases remain stuck up for years, sometimes even decades. The FBR itself contends that PKR 1.856 trillion is stuck in revenue due to pending cases of defaulters and evaders, which points to judicial inertia and inefficiency.

While this may be a low priority for the legal community, the fact that more than 50% of Pakistan's total tax collection is stuck up in legal cases makes it urgent from a fiscal perspective. Finally, the Income Tax Ombudsman needs to play a more proactive role in the revamping and reform of the FBR.

The Ombudsman is an organization that is responsible for addressing any complaints or grievances vis-à-vis the tax collection process, FBR officials, etc.

The Ombudsman should increase its efficiency via automation and digitization so that they can entertain more complaints as well as resolve them speedily, a point that applies equally to judicial performance and to the FBR.

Besides, they should draw lessons and recommendations from every case and forward it to FBR's senior management, who can then implement it to raise their standards and operational procedures.

There is also the question of rampant corruption, particularly at the middle-levels of the bureaucracy. This problem has been identified by many internal and external observers, and creates the moral conditions in which each form of tax (individual, corporate, sales, excise) fall prey to misuse or are left uncollected. The solutions to corruption in public administration in Pakistan are a question of intense formal and informal debate. It is beyond the remit of this paper to propose any solutions to that sort of moral erosion, but until corruption is brought to heel, the ability of public managers to create value for the public will remain constrained.

Collective Guilt

It emerges from an examination of the role played by each of the major public value agents: politicians, bureaucrats, civil society, and the private sector, that there is a shared culpability behind the way the tax system has performed so poorly in seven decades. If tax is framed as a security concern, as this paper has sought to do, then the people responsible for this security lapse are all hiding in plain sight: they represent everyone to some degree or other.

We are as a collective culpable, with some (notably the powerful) more guilty than others. Any reform agenda for Pakistan must proceed with this recognition that we are, as a people, responsible for our own security, and also our own worst enemies in terms of insecurity.

Public value focuses on a strategic triangle (Alford and O'Flynn 2009; Benington and Moore 2011; Chohan 2017a-c, forthcoming), which comprises:

1. legitimacy,
2. a recognition of value, and
3. operational resources.

All three of these are deficient, and hence there is scant value for the public created through the tax system. The question of legitimacy is that people do not accord sufficient legitimization to tax authorities and to politicians, the latter being perceived as venal and corrupt. The question of recognizing the public value of taxation is also left moot by the public.

The public also does not recognize that if they avoid their duties then they cannot expect a national working system to emerge, and the country will be condemned to borrowing until it cannot even do so. They are also culpable in the weakening of the nation's security by shirking their responsibility within and to the public that they collectively comprise. The question of operational resources, i.e., what public managers can work with to create value, is inherently limited by low rates of contribution to the tax net. The strategic triangle of public value, thus, helps to show the underlying problem of taxation from multiple perspectives in a summary fashion. Beyond the collective guilt of all agents in the public value system, it is also important to present a reform agenda and way forward, as the next section proceeds to do.

A REFORM AGENDA

A Reform Agenda

In terms of reforming a system in such deep disrepair, it helps to disaggregate the tax system by the major categories of tax, as presented in the summary schema in Annex 1. By looking at each tax type, it is possible to consider the current base, rate structure, and category-specific reform issues. From this, in turn, it is possible to postulate sound recommendations that address each tax type, which is a much more appropriate approach than rhetoric and tropes such as "reduce corruption" or "tax the rich." The remainder of this section examines four tax types: individual income tax, corporate tax, sales tax, and excise & import tax.

Individual Income Tax

The salaried class in Pakistan is subject to vigorous taxation with personal income tax rates varying from 5% to a maximum of 35%. The 35% tax rate on the upper-most slab of salary earners represents the highest amount of taxation on any class in Pakistan, with previous rates averaging a modest 20% in the last decade. The precipitous rise in the personal income tax rates is the policy directive of incumbent government at the behest of the International Monetary Fund (IMF) owing to the latter's emphasis on fiscal consolidation and a tight fiscal policy characterized by an increase in taxes and a sharp reduction in deficit spending. Moreover, personal income tax is usually charged at the source (i.e., on a withholding basis), with the employers of salaried individuals responsible for collecting and paying the tax to the government.

While the collection of salaried tax on a withholding basis ensures greater compliance and less evasion, it nevertheless provides the government and policymakers a convenient way to further milk an already over-taxed segment of society.

The system is furthermore marred by countless exemptions which seem either redundant or frivolous (see also Thirsk 2008). [6]

Similarly, the capital gains of individual earners are also taxed, albeit at a rate considerably lower than their salaried incomes. The rates vary considerably, depending upon the nature and type of capital asset, but generally remain in the bracket of 2.5% to 20%. Besides enjoying a lower rate, capital income is also subject to generous exemptions and tax credits. Although there are market-based justifications for this, there are nonetheless two drawbacks worth mentioning.

[6] There are, in fact, multiple schedules for different types of income owners, which adds various dimensions of complexity to the income tax system.

Table 2.1: Individual Income Tax Issues

	CURRENT BASE	RATE STRUCTURE	REFORM ISSUES	RECOMMENDATIONS
Individual Income	1- Salary / Wages 2- Business/ Agricultural Income of Individuals 3- Income from Foreign Sources 4- Capital Gains	1- Generally progressive tax structure 2- 8-12 income slabs for salaried individuals and Associations of Persons (AOP) 3- Rate varies from 5% to 35% on personal income 4- Capital income tax of 2.5% to 20% depending upon the asset category	▪ Large number of income brackets (8-12) ▪ Tax threshold is too high, missing a substantial number of people ▪ 'Notch' issues still prevail ▪ Increased exemptions or tax credits given to individuals. Generous exemptions on capital gains. ▪ Heavy reliance on a large number of withholding taxes ▪ Cumbersome and nebulous language used in the Tax Ordinance. Non-availability in local languages ▪ Courts: Litigation, stay orders in favor of defaulters obstruct a large chunk of revenue ▪ No certainty vis-à-vis exemptions and tax credits ▪ Amnesties alter incentives	▪ Decrease the tax threshold to bring a larger number of people into the tax net ▪ Reduce the tax brackets to a range of 3-5 maximum ▪ Fix notch issues by taxing incremental income rather than the entire slab ▪ Make the e-filing system simple and widely accessible; allow paper-filing ▪ Minimize exemptions and tax credits ▪ Use of simple and effective language ▪ Translation of the Income Tax Ordinance in Urdu and all regional languages ▪ Data sharing between NADRA & FBR to streamline the tax collection process ▪ Reform of judicial performance so as to distinguish genuinely aggrieved from tax evaders and defaulters. ▪ Reconsider the pros and cons of amnesties ▪ Reconsider absence of agricultural income tax for large landholdings ▪ Remove non-filer category

First, the capital gains are taxed less vigorously than salaried income, with the policymakers fully aware of the fact that there is a greater incidence and opportunity for corruption and tax evasion in capital assets than salaried income. Secondly, the generous exemptions and concessions act as a leaky bucket for tax revenues, with an estimate that the government could lose PKR 212 billion in FY 2020-21 due to them (Akhter 2020).

In addition to these, a plethora of structural problems still plague the individual income tax category, with successive governments failing to introduce long-lasting reforms despite their political sloganeering and repeated assurances. For instance, there are still too many income tax brackets (8-12) that unnecessarily burdens and complexifies the system. Moreover, the income tax threshold is too high, which means a considerable size of the population is still out of the income tax equation. However, those who are included in the threshold (i.e., the salaried class) face another kind of structural problem called the 'notch' issue, as identified by Thirsk (2008). This means that the tax is charged on an income

slab as a whole rather than on incremental income, which is distortionary for those entering into a new income slab, or those on the lower ends of a slab, as the amount of tax charged is more than the increment in income. Finally, the litigations and lawsuits filed by defaulters and the resultant stay-orders pose a structural issue for the FBR besides draining its coffers. For instance, a recent estimate suggests that PKR 1.856 trillion worth of tax revenue is stuck in pending cases, thus acting as a bottleneck in the process of streamlining Pakistan's financial system (Asad 2020).

It is also important to consider the pros and cons of tax amnesty policies. Low tax effort has meant that governments try to offer amnesties to individuals who have not filed their taxes in time (or at all), or not reported income appropriately or in its entirety.

In theory, amnesties, encourage people to join the tax net without penalties or questions being asked about their past history. In practice, however, amnesties do not seem to encourage a wider population to report.

In the 2019 tax amnesty, only 110,000 people signed up (Zeb Khan 2019), which is a paltry amount equivalent to a rounding error given the size of the population. In addition, "most of them had been rich people who had declared their massive assets to whiten them," (Ibid.), which is a milder phrasing for what is technically money laundering. This is a carrot approach, and the government should consider whether it is not time for big sticks instead of small carrots – which is a wider debate in Pakistan's tax attitudes.

Beyond this, filling out tax forms and filling taxes in Pakistan can best be described as a headache at best, a nightmare at worst. Not only are procedures cumbersome, but they are situated in unintelligible language, with countless exceptions that one does not know if they apply to them.

Tax information is also not available in regional languages, making the process generally inaccessible to the citizens who may struggle with English-language documentation, and that too written in an inaccessible accounting jargon.

The e-filing system underlying FBR's efforts is somewhat piecemeal, relying on multiple systems (such as IRIS) that remain somewhat cumbersome for users, and they hinge on mass digital adoption which is still not forthcoming – even though digital growth rates in Pakistan are high, they are still not at a sufficiently high threshold of user penetration. Paper filing should be allowed for people who cannot access computerized systems. In addition, the entire notion of a "non-filer" is dubious, because it is tantamount to a tacit acceptance of tax avoidance. This non-filer status should be paid short shrift because of the negative signalling effect.

Corporate Income

Table 2.2: Corporate Tax Issues

	CURRENT BASE	RATE STRUCTURE	REFORM ISSUES	RECOMMENDATIONS
Corporate Income	1- Profits (Business Income) 2- Passive Sources of Corporate Income 3- Firms registered in Pakistan and abroad.	1- 35% for banking companies 2- 29% for other large corporations 3- 23% for small companies[7]	▪ Too many exemptions and tax credits ▪ Complex corporate tax code ▪ Long-time required to prepare taxes ▪ Inter-agency coordination issues ▪ Lax enforcement[8] ▪ Small business tax notch issues still prevail ▪ Widespread corruption especially among FBR officials assigned to collect and administer property taxes ▪ No certainty vis-à-vis exemptions and tax credits	▪ Minimize exemptions and tax credits ▪ Simplify the tax code ▪ Improve coordination issues and add data sharing provisions for all key agencies (NADRA, FBR, NAB, etc.) ▪ Strict enforcement of tax code and improvement in the tax collection mechanism ▪ Reduce distortions from small business notch issue ▪ Diversify to extremely profitable sectors who take a free-ride: private schools and hospitals ▪ Curb corruption within FBR and other agencies ▪ Reduce uncertainty vis-à-vis exemptions

As discussed in an earlier section, there is a very strong case to go after sectors that have eased their way into tax-exemption despite being run entirely on the profit motive. Private schools are one example, charging high fees per child per month to parents who are held hostage by their aspirations to give their children an education – a basic human right. This happens while teachers are underpaid and the owners of these schools, while touting that they are providing a public service and meeting a gap in the public education system, are hoarding the vast profits earned by squeezing desperate parents and overworked teachers. Some of that surplus would certainly do the government's revenues some good, especially if the earnings from that taxation would go towards building a better public school infrastructure across the country.

Rules must be instated to ensure that the taxes on private schools are not passed on to the parents (capping tuition fees), or to teachers (setting higher minimum salaries). An analogous approach should be taken towards private hospitals, who feast on desperate patients and their families, all while the public healthcare system lays in tatters.

In addition, the government also needs to be more pragmatic in doling out generous concessions, exemptions, and tax credits to businesses who are

[7] The tax rate for small companies will fall to 20% from 2023 onwards.
[8] In 2018, 91% of Pakistani companies paid less than PKR 1 million on average.

already paying far less than they owe. While there may be some argument in giving rebates to early payers (both in individual and corporate tax categories), this study veers towards tougher government enforcement through sticks rather than additional carrots. These concessions only exacerbate the problem and unnecessarily drain the national exchequer. Although a select few of these exemptions follow reasonable economic logic in theory, in practice they reflect elite bargains and vested political interests. These exemptions should be judiciously revoked. In addition, the tajir (trader) and retailer communities, who have a habit of behaving abusively and violently towards tax authorities, and blackmail the state with protests, should be penalized. The worst-case scenario would be that their racketeering shops would be demolished, to pave the way for better downtown facilities and infrastructure, and the best case is that their unscrupulous practices are hemmed in with contributions towards the state and society.

The capital income (or profits from direct operations) of all businesses and companies is subject to taxation. In addition, the capital gains from other sources or assets (i.e., the passive income) are also taxed, albeit under different rates and schedules. The corporate tax rates vary and differ considerably depending upon size, scale and type of the business. So, for instance, a large private or public limited company is taxed at 29%, while a small or medium enterprise (aka SME) is charged lower at 23%. Historically, the corporate tax rate in Pakistan has averaged 35%, and reached an all-time high of 43% in FY 2000-01. However, the incumbent government gave tax relief to the business sector by cutting the rate from 35% to 29%. Similarly, the SMEs are charged much lower at 23%, and by 2023 this rate shall drop further to 20%.

The policy of tax cuts given to the corporate sector by the government has both pros and cons. On the plus side, the tax cuts given to businesses should boost local and foreign direct investment (FDI), which will boost employment as well, at least theoretically. On the other hand, however, one can question the fairness of such a policy considering that the taxation on personal income has been increased to an all-time high and with the Sword of Damocles of IMF consistently hanging over the head of Pakistani authorities to collect more in taxes.

This policy context is further complicated by the fact that the companies in Pakistan are already paying an amount in tax far lower than their capacity and actual potential. For instance, according to an estimate, in the FY 2018-19, more than 90% of companies in Pakistan paid an amount less than PKR 10 Lakhs on average and with an average businessman paying PKR 131,000; while an average salaried employee paid PKR 114,000 in taxes (Rana 2020b). Similarly, another estimate suggests that in the FY 2016-17, around 65,734 companies (approximately 81% of all registered companies) failed to file tax returns suggesting large-scale tax evasion and corruption (Amin and Rehman 2019).

Large-scale tax evasion is certainly impossible without the connivance of the FBR officers. Indeed, corruption is another structural issue of Pakistan's convoluted tax system that needs to be addressed on an immediate basis. This is because a country that controls corrupt practices can generate 4% of GDP more in taxes than a corrupt state at a comparable level of development (Mauro et al., 2019).

Sales Tax

Table 2.3: Sales Tax Issues

	CURRENT BASE	RATE STRUCTURE	REFORM ISSUES	RECOMMENDATIONS
Sales Tax	1- Consumption of local and imported goods 2- Sales tax on (local) services[9] 3-Agriculture, medicines & pharma exempt	1- 17% sales tax on all local and imported goods 2- 16% tax on services on average 3- 0% sales tax on exports	▪ Heavy reliance on regressive tax ▪ Collection issues ▪ Uncooperative trader class ▪ Widespread corruption facilitates retailers to evade a large chunk of sales tax ▪ Retailers switching to cash economy to further dodge tax authorities ▪ Sales Tax Code and guidelines quite old[10] ▪ Constitutional problem: Sales tax on services a provincial matter[11] ▪ Abrupt and frequent changes through SROs reduce tax certainty	▪ Improve interagency coordination among SECP, NADRA, FBR & NAB to trace retailers and businesses evading sales tax ▪ Curb corruption within provincial revenue collection authorities ▪ Switch to digital modes of transactions (relevance for COVID-19 as well) ▪ Review constitutional change in the Sales Tax Ordinance for services ▪ Update the Sales Tax Code to make it timely and easier to understand ▪ Update SROs based on objective conditions and not as political gambits ▪ Enforce more punitive measures on trader class evasion ▪ Improve collection from other tax types to reduce dependency on sales tax

The sales tax is a substantial component of Pakistan's tax system, and the General Sales Tax (GST) has been characterized as the "used and abused of all taxes" in Pakistan. According to Bukhari and Haq (2016), the GST comprises almost half of all the tax revenues collected in Pakistan (p. 47). This is because it is administratively easy and politically more feasible to levy an indirect tax such as the GST, as it targets the common man and gives relatively quick results. Unsurprisingly then,

[9] Such as catering, restaurants, marriage halls, country clubs, television and radio ads, etc.
[10] Last updated in 2008.
[11] Lack of a Federal Ordinance creates distortions and lacunas in the collection of sales tax on services; tax on services is levied as per the Islamabad Capital Territory Ordinance (2001) and respective Provincial Ordinances.

for the masses, it is burdensome as the GST is a highly regressive tax which cuts into their purchasing power, hence causing a net welfare loss. Besides, this reduction in the aggregate demand—directly attributable to the GST—is also harmful to the businesses who rely on the consumption propensity of the common folk to run profitably.

The GST becomes even more regressive if one accounts for the corruption, irregularities, and other unscrupulous activities of different stakeholders. For instance, a large number of retail businesses have switched their operations on a cash basis exclusively to avoid paying the sales tax. However, most of them still charge the exorbitant GST, thus exploiting their customers and cheating the tax authorities. This is true even of the most upscale, sophisticated, and elitist retail businesses such as coffee shops, restaurants, marriage halls, country clubs, etc. located in the most bourgeoisie neighbourhoods of the country. Such establishments should be an important source of direct corporate tax and indirect sales tax, and should be pursued accordingly. But anti-elite sentiment should not drive such actions, since there is massive tax evasion at the scale of traders and retailers who cater to middle- and working-class households. Bringing them to task is equally (if not more) important, since the volume of their goods sold is far larger.

Under the current tax regime, the sales tax is charged on all goods, local and imported. Similarly, services are also subject to sales tax, albeit at a different rate and guided by different rules. However, pharmaceuticals, medicines, agricultural products, and export items are all exempt from paying the GST. It is charged at a rate of 17% for all goods and 16%, on average, for most services. However, according to some estimates, the actual rate of the GST is close to 40% after accounting for mandatory charges such as those related to customs, value-addition, regulatory duty, and advanced collections for income tax (Bukhari and Haq 2019). Similarly, only a handful of companies—about 100—pay almost 90% of the amount in the GST indicating serious distortions and evasions.

Finally, there are juridical and documentation issues, vis-à-vis sales tax, which have not been addressed in decades. For instance, as per the 1956 Constitution, the sales tax on services is a provincial mandate with the regional authorities responsible for its collection and tabulation. Similarly, the Islamabad Capital Territory Ordinance (2001) is the document that guides sales tax on services within the territory of the federal capital. The total exclusion of the federation from any role in the collection and record-keeping of sales tax on services creates giant lacunas that need to be addressed.

Excise & Import Taxes

Table 2.4: Excise & Import Tax Issues

TAX TYPE	CURRENT BASE	RATE STRUCTURE	REFORM ISSUES	RECOMMENDATIONS
Excise & Import Taxes	1- Goods: local and imported[12] 2- Services are also subject to duties[13]	1- 15% ad valorem excise tax[14] 2- Rate on most imports varies from 1% to 5.5%	▪ No green tax measures for anti-pollution (environment) [15] ▪ Excessive red tape[16] ▪ Widespread smuggling & corruption ▪ Excessive protectionism[17]	▪ Implement tough anti-smuggling regime, break up smuggling syndicates, tighter border controls ▪ Tax the high pollution businesses and industries ▪ Curb corruption via purges, as well as interagency coordination and cooperation ▪ Use digital counters and portals to accelerate the process of customs clearance and goods delivery ▪ Liberalize trade to make it freer ▪ Relinquish unnecessary protectionism

Excise and import taxation is a tax category riddled with issues, but one where significant progress can be made by working among agencies both domestically and in neighbouring countries. This tax is levied on all imported items, i.e., goods and services, regardless of their destination within the country. The rate of imports varies according to the product category but remains generally low in a range of 1% to 5.5%. The excise rate, on the other hand, is higher at 15% ad valorem, with certain "sinful" items (such as cigarettes, carbonated drinks, etc.) taxed even higher owing to negative externalities attached to them.

In terms of structural issues, smuggling with the complicity of customs and excise officials is the most serious issue plaguing this category.

For instance, one estimate suggests that smuggling costs Pakistan USD 2.63 billion per year owing to porous borders, weak security, and ubiquitous corruption in the custom and excise departments. More startling is the fact that the above figure is an estimate of the smuggling of only 11 specific products. So, this amount will be even higher if we were to consider the full range of all smuggled products (Rana 2016). Perhaps, it is safe to assume that if Pakistan's security

[12] All locally manufactured goods and goods imported from abroad (regardless of their destination within Pakistan).
[13] Services liable regardless of origin.
[14] The excise tax rate is 15% ad valorem with few exceptions which are charged to discourage its use.
[15] No implementation of 'green taxes' to penalize businesses and industries polluting and degrading the environment. This was true in 2008 and is still true in 2020.
[16] Excessive red tape and administrative bottlenecks unnecessarily delay the clearance of imports and other items arriving from overseas.
[17] High tariff rates and other 'protectionist' tendencies aimed at protecting the domestic industry is making Pakistan extremely uncompetitive in the world market. The situation is so flagrant that Pakistan is the only country in South Asia whose share in international trade declined by 19% in 2019.

authorities can effectively check and eliminate the menace of smuggling, then the recovered revenues will be sufficient enough to meet all of the country's budgetary needs. Also, note that a typical tranche of the IMF is generally in the neighbourhood of USD 2.5 to USD 3 billion, which is precisely equivalent to the lost revenue in smuggled goods from Pakistan. In other words, Pakistan could break the proverbial "begging bowl" forever just by curbing the crime of smuggling.

Recent announcements from the government suggest that work is being done in coordination with the Afghan and Iranian governments to rework tax policies to curb smuggling (Nasir 2020a). This involves a strong liaison with the neighbouring countries to establish clean (legal) markets, and also forces tax authorities to push back against local warlord-type elites who have enriched themselves through the smuggling racket. In September 2020, the Prime Minister chaired a meeting on the establishment of border markets, and announced establishment of 18 border markets on the country's international frontiers with Afghanistan (12 markets) and Iran (6 markets), three of which were to have been completed and activated by February 2021 as a pilot project, but which have not yet been activated. This effort should be coupled with digitization efforts to reduce administrative costs and pilfering, while improving oversight and ease of transacting.

On the excise side, one glaring absence is in the practice of "green taxes" practiced abroad. This usually involves taxing heavy pollutant industries to help mitigate the size of their negative externality. Any number of observations about pollution runoff and effluent in the country indicate that it is not properly managed, ultimately harming local populations residing in proximity to polluting industries (tanneries, kilns, factories etc.).

As part of the government's commitment to improving the environment and strengthening its response to climate change, green taxes should be seriously mulled as part of the excise regime.

On traditionally taxed items in the excise category, cigarettes present an interesting example because the brunt of this tax is borne by two major multinationals as discussed earlier. In the future, there may be a more prudent set of policies to mitigate social evils through excise tax policy, rather than turning a blind eye to them and letting them persist amidst the silence of a conservative society. For example, drug use is rampant in urban areas, but their control is not subject to strict enforcement. Prudent excise tax regimes would legalize their production and sale (at least for milder substances), and then subject them to an excise tax that generates revenues and dissuades excessive use through differences in user elasticities of demand.

DIGITAL TAXATION

Digital Taxation

Aside from the aforementioned four categories of taxation: individual income, corporate, sales, and excise & import; a separate but brief mention must be made of the forward-looking problem of digital taxation.

The notion of digital taxation is an interesting avenue of policy debate internationally (Chohan 2017d; forthcoming), and here it refers to the taxes applied to large multinational companies with a largely digital means of providing goods and services, such as social media companies (e.g., Facebook), search and browsing services (e.g., Google/Alphabet), and e-commerce (Amazon/ Alibaba). At present, no single country has resolved the question of taxing such digital giants in a manner that conforms to the aforementioned seven principles of good taxation (see earlier section).

The European Union is most proactive in this field, and is attempting to get other countries on board, but finding international agreement is difficult due to:

1. a diversity of economic situations and levels of digitalization around the world; and,
2. opposition from the United States, where most of these companies are headquartered (Bauer 2018).

In the meantime, some countries are attempting to issue national policies such as equalization levies (India), or base-rate taxes (France), on the major digital giants (Becker and Englisch 2018).

Pakistan should seriously mull the taxation of digital giants in a manner that is appropriate to the scale of value that these giants extract from Pakistani users. The basic raw material of these giants is data, which Pakistanis hand over for free by consuming their services and using their platforms.

Yet Pakistan does not gain from that exchange, and given how much of economic life is now digital, it is necessary to act on digital taxation, which is why this paper highlight the problem, even though greater policy attention and academic treatment from around the world must provide bigger answers (see Chohan forthcoming).

FISCAL FEDERALISM

Fiscal Federalism

Another issue that warrants separate attention is that of fiscal federalism (Ahmad and Brosio 2008). Fiscal federalism is, in fact, an entire sub-discipline within political economy, and a separate study is warranted on the subject of fiscal federalism in Pakistan, but for the purposes of discussion here it is necessary to highlight the condition of the federation in terms of its fiscal resources. Currently, the provincial governments collect and provide only 4% to 7% of the tax revenues to the Federal government. On the other hand, they receive approximately 35% in revenues from the Federal government under the 18th Constitutional Amendment (Shah 2012). In addition, a major part of the modern economy, the service sector, is not a federal subject due to the provision of the Constitution of Pakistan which relegates federative taxation power only to certain types of goods, which is left to the interpretation that provincial governments can tax services. Because of this imbalance, provinces receive an award from the federation, and they also tax the major sector of the urban economy.

Before 2018, this distortion in fiscal federalism caused by the 18th Amendment was not as apparent, but since tax revenues have not kept up with expenditures, the problem now appears acute. Worse yet, the intended devolution of powers has not gone all the way down to the district level, but rather congealed at the provincial level. In addition, the largest taxpaying jurisdiction is Karachi, which is not an independent federating unit, but rather a part of the province of Sindh. Because of the constitutional restriction and the 18th Amendment, the federation is fiscally being hollowed out, while provincial bureaucracies become bloated with awards from the federation as well as widespread taxation powers. What is missing from the fiscal federalism problem in Pakistan is a Surplus Recycling Mechanism [SRM] (Varoufakis 2015, 2017; Chohan 2018b). An effective SRM, as Varoufakis described it, would take the surpluses of productive portions of a federation and recycle them through the less productive regions, thus increasing the productivity of these regions and making the federation more viable. Such an SRM does not exist in Pakistan, and the burden on the federation is now very large. The means of building a surplus recycling mechanism are both extremely sensitive and politically explosive.

As a first step, a constitutional amendment is necessary to expand the taxation remit of the federation towards larger sectors, particularly services. As a second step, major surplus producing regions, especially Karachi, might have their jurisdiction altered into a federal territory status – much as this might roil some local constituencies. As a third step, the federation should have its internal borders redrawn to comprise not 4 provinces, but rather 12-15 provinces.

In redesigning the federation from a fiscally sustainable perspective, there is a powerful structural endowment that the people of Pakistan can create – a prudent design to supplant ethnocentricity and parochialism. Unfortunately, the technocratic ethos of reshaping fiscal federalism will clash against an ocean of vested parochial interests, thus impeding meaningful progress on this front.

Policy Recommendations Framework

PROBLEM	The tax system in Pakistan faces acute dysfunction, leading to government fiscal imbalances that constrain its economic resources, which limit its ability to address all other security concerns.
Framing	Frame tax reform as a security issue of utmost national concern. Requires a shift in narrative and dissemination of message.
Targets	Identify targets that may improve system in terms of efficiency, certainty, simplicity, fairness, effectiveness, neutrality, and flexibility.
Breadth	Increase tax *breadth* rather than tax *depth* [1] Lower individual tax and corporate thresholds. [2] Reduce the distortion caused by notch issues in individual income tax and small business corporate tax. [3] Expand direct taxation to reduce regressivity of tax system through current dependence on the sales tax. [4] Remove non-filer category (tantamount to accepting tax avoidance).
Simplicity	Bring simplicity to the system [1] Reduce the number of tax brackets in individual income tax. [2] Minimize exemptions and tax credits for individual and corporate tax. [3] Revert to a single individual tax schedule. [4] Update the Sales Tax Code to make it timelier, and easy to understand.
Access	Improve accessibility [1] Make documentation available in regional languages. [2] Make the e-filing system simple and widely accessible. [3] Use simple language in the tax code and in tax forms.
Inter-Institutional Cooperation	[1] Data-sharing among NADRA and FBR on individual tax filer records [2] Reform of judiciary / improved judicial performance, to adjudicate on disputed cases more quickly and to distinguish genuinely aggrieved persons from tax evaders and defaulters. [3] Coordination among accountability institutions (NAB, FIA, etc.) with FBR. [4] Coordination among federal (FBR) and provincial revenue boards. [5] Coordination among Customs, Border Enforcement agencies, and FBR. [6] Interagency coordination among SECP, NADRA, FBR & NAB to trace retailers and businesses evading sales tax.
Amnesties	Reconsider the pros (slight broadening of base) and cons (money laundering, semi-permanent deferral) of amnesties.

Broaden taxable sectors	[1] Reconsider absence of agricultural income tax for large landholdings. [2] Diversify to extremely profitable sectors who take a free ride, e.g. private schools and hospitals. [3] Reduce exemptions on textile industry. [4] Go hard on the retailers and traders. [5] Mull a digital tax for major digital multinationals (like the EU is doing).
Enforcement	Strict enforcement of tax code and improve the tax collection mechanism, including through punitive measures.
Digitalization	[1] Switch to digital modes of transactions (relevant to COVID-19 as well). [2] Excise and Imports: use digital counters and portals to accelerate the process of customs clearance and goods delivery. [3] Portals: consolidate online portals and make them more user-friendly. [4] Ensure data privacy & data protection of citizens / take strong anti-hacking measures.
De-politicization of tax rules	[1] Update SROs based on objective conditions and not as political gambits. [2] Go after large landholding estates (feudals). [3] Minimize vested interest interference in bureaucratic and parliamentary stages of tax law implementation and formulation.
Fight rampant corruption	Curb corruption within FBR and provincial revenue collection authorities.
Constitutional Changes	[1] Make constitutional change in the Sales Tax Ordinance for services at federal level (currently a provincial mandate only). [2] Recognize that the 18th Amendment is causing unsustainable balance in country's *fiscal federalism*, hollowing out the Centre.
Green Taxes	Tax high pollution businesses and industries.
Excise & Import Taxes	[1] Implement tough anti-smuggling regime, break up smuggling syndicates, enforce tighter border controls. [2] Coordinate with Iranian and Afghan authorities to mitigate and regularize cross-border trade. [3] Strike better balance between trade liberalization and protectionism.
Public Value Agents	[1] Politicians: especially Legislature (Federal & Provincial) [2] Public Managers (Bureaucracy): FBR, Provincial Boards, Judiciary, NADRA, Customs, Cabinet Division, Inland Revenue, Police, Ministry of Finance, Ministry of Planning [3] Citizens & Civil Society [4] Private Sector: Manufacturing Industry, Services Sector, Agriculture *particularly: textile sector, private schools, transport sector (smuggling), private hospitals, medium trader class, retailers, large landholders*

CONCLUSION

Conclusion

The people of Pakistan rank among second in the world in terms of their patriotism – defined as their willingness to fight and die for their country (Rizvi 2019). However, while they are willing to die for their country, they are not willing to live for it. The tax effort in Pakistan is among the lowest in the world, and this Issue Paper has sought to highlight the various underlying problems and possible solutions going forward.

Fiscal sovereignty is an utmost national security priority. This sovereignty derives from the power to tax which, when ceded as the Mughals did, sees a people come to ruin. Colonialism was built on usurping such taxation powers, but this is why it is shocking that Pakistan, as a free people, are unable to stand behind a sound fiscal architecture, thus wallowing away collective economic potential and trotting on the slow path to financial abyss. To some degree, the nation as a whole is culpable in the emergence of this morass, and it is a public value failure by all key agents: politicians, public managers, civil society, and the private sector.

The recommendations made here are extensive and cover four tax categories: individual income tax, corporate tax, sales tax, and excise and import taxes. They are mindful of the seven principles of good taxation: efficiency, neutrality, simplicity, certainty, effectiveness, fairness and flexibility. The news flow in Pakistan from time to time suggests that measures are being taken here and there to help eventually realize, at least, some of the recommendations made. But a more concerted effort will help Pakistan achieve economic security in a more comprehensive and timely manner.

Any combination of the posited reforms, with some fruit being particularly low-hanging, could change the fiscal trajectory. Pakistan's security emanates from a robust internal economy, with a sound fiscal architecture lying at its core. If this core is carefully shaped, protected, and curated over time, the nation can forge the basis of a lasting social contract for generations to come.

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ANNEXURE

Summary Schema

TAX TYPE	CURRENT BASE	RATE STRUCTURE	REFORM ISSUES	RECOMMENDATIONS
Individual Income	1- Salary / Wages 2- Business/ Agricultural Income of Individuals 3- Income from Foreign Sources 4- Capital Gains	1- Generally progressive tax structure 2- 8-12 income slabs for salaried individuals and Associations of Persons (AOP) 3- Rate varies from 5% to 35% on personal income 4- Capital income tax of 2.5% to 20% depending upon the asset category	▪ Large number of income brackets (8-12) ▪ Tax threshold is too high, missing a substantial number of people ▪ 'Notch' issues still prevail ▪ Increased exemptions or tax credits given to individuals. Generous exemptions on capital gains. ▪ Heavy reliance on a large number of withholding taxes ▪ Cumbersome and nebulous language used in the Tax Ordinance. Non-availability in local languages ▪ Courts: Litigation, stay orders in favor of defaulters obstruct a large chunk of revenue ▪ No certainty vis-à-vis exemptions and tax credits ▪ Amnesties alter incentives	▪ Decrease the tax threshold to bring a larger number of people into the tax net ▪ Reduce the tax brackets to a range of 3-5 maximum ▪ Fix notch issues by taxing incremental income rather than the entire slab ▪ Make the e-filing system simple and widely accessible; allow paper-filing ▪ Minimize exemptions and tax credits ▪ Use of simple and effective language ▪ Translate the Income Tax Ordinance into Urdu and all regional languages ▪ Streamline data sharing between NADRA & FBR ▪ Reform judicial performance so as to distinguish between the genuinely aggrieved from tax evaders and defaulters ▪ Reconsider the pros and cons of amnesties ▪ Reconsider absence of agricultural income tax for large landholdings ▪ Remove non-filer category
Corporate Income	1- Profits (Business Income) 2- Passive Sources of Corporate Income 3- Firms registered in Pakistan and abroad.	1- 35% for banking companies 2- 29% for other large corporations 3- 23% for small companies	▪ Too many exemptions and tax credits ▪ Complex corporate tax code ▪ Long-time required to prepare taxes ▪ Inter-agency coordination issues ▪ Lax enforcement ▪ Small business tax notch issues still prevail ▪ Widespread corruption especially among FBR officials assigned to collect and administer property taxes ▪ No certainty vis-à-vis exemptions and tax credits	▪ Minimize exemptions and tax credits ▪ Simplify the credits ▪ Simplify the tax code ▪ Improve coordination issues and add data sharing provisions for all key agencies (NADRA, FBR, NAB, etc.) ▪ Strictly enforce tax code and improve the tax collection mechanism ▪ Reduce distortions from small business notch issue ▪ Diversify to extremely profitable sectors who take a free-ride: private schools and hospitals ▪ Curb corruption within FBR and other agencies ▪ Reduce uncertainty vis-à-vis exemptions

Sales Tax	1- Consumption of local and imported goods 2- Sales tax on (local) services 3- Agriculture, medicines & pharma exempt	1- 17% sales tax on all local and imported goods 2- 16% tax on services on average 3- 0% sales tax on exports	▪ Heavy reliance on regressive tax ▪ Collection issues ▪ Uncooperative trader class ▪ Widespread corruption facilitates retailers to evade a large chunk of sales tax ▪ Retailers switching to cash economy to further dodge tax authorities ▪ Sales Tax Code and guidelines quite old ▪ Constitutional problem: Sales tax on services a provincial matter ▪ Abrupt and frequent changes through SROs reduce tax certainty	▪ Improve interagency coordination among SECP, NADRA, FBR & NAB to trace retailers and businesses evading sales tax ▪ Curb corruption within provincial revenue collection authorities ▪ Switch to digital modes of transactions (relevance for COVID-19 as well) ▪ Review constitutional change in the Sales Tax Ordinance for services ▪ Update the Sales Tax Code to make it timely and easier to understand ▪ Update SROs based on objective conditions and not as political gambits ▪ Enforce more punitive measures on trader class evasion ▪ Improve collection from other tax types to reduce dependency on sales tax
Excise & Import Taxes	1- Goods: local and imported 2- Services are also subject to duties	1- 15% ad valorem excise tax· 2- Rate on most imports varies from 1% to 5.5%	▪ No green tax measures for anti-pollution (environment) ▪ Excessive red tape ▪ Widespread smuggling & corruption ▪ Excessive protectionism	▪ Implement tough anti-smuggling regime, break up smuggling syndicates, tighter border controls ▪ Tax the high pollution businesses and industries ▪ Curb corruption via purges, as well as interagency coordination and cooperation ▪ Use digital counters and portals to accelerate the process of customs clearance and goods delivery ▪ Liberalize trade to make it freer ▪ Relinquish unnecessary protectionism

Sources: Authors' compilation with FBR, PBS, Thirsk (2008); and framework adapted from Thirsk (2008).

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