TAX EVASION, LOW TAX REVENUE AND NON-COMPLIANCE IN PAKISTAN: A FOCUSED GROUP DISCUSSION

Muhammad Omer Farooq Jajja, Arshad Ali Bhatti *

School of Economics, IIIE, International Islamic University, Islamabad, Pakistan

ARTICLE INFO

ABSTRACT

The increasing culture of tax evasion and non-compliance leads to revenue losses for governments and impacts both the government and the citizens of a country. This paper uses a focused group discussion method to explore the issues pertinent to the prevailing tax system in Pakistan, such as non-compliance, increasing evasion, and low tax revenue. It is found that education, development of good social values, justice by state institutions, and improvement in the role of media are necessary for nurturing a tax-compliant society. The other causes of a low tax-to-GDP ratio include the cash economy, the underground economy, and the influence of interest groups (lobbyists, feudal, corporate houses, and politicians) on policymaking. This study suggests taxing the high-income class more and redistributing among the poor to attain parity. It is also suggested that efforts be made to introduce the value-added taxation system into the economy and that the federal board of revenue focuses on segmenting the economy/industries to increase revenue collection. Apart from that, they should also reinvest a reasonable percentage of collected tax revenue in the upgradation of tax machinery. However, this study does face some limitations. The major limitation is that despite invitations and our best efforts, the panel of experts did not have representation from women, media, the business community, and participants living outside the city of Islamabad.

INTRODUCTION

Adequate tax collection is vital for the smooth functioning of an economy as it provides the necessary funds for meeting routine requirements, public expenditure, infrastructure development, redistribution, and addressing deficits in a non-distorting manner (Cobham, 2005). However, the increasing culture of tax evasion and non-compliance leads to revenue losses for governments and impacts both the government and the citizens of a country. Cobham (2005) identified leakages in the economy, including offshore profit shifts and unrecognized foreign and domestic income. This results in direct loss of government revenue, increased current account and fiscal deficits, decreased domestic savings, and increased income inequality. To increase revenue, governments may need to incur additional administrative costs by raising unpopular direct taxes or resorting to indirect taxes, which may have adverse effects on the overall economy and result in the average taxpayer bearing the burden of additional taxes, both direct and indirect, and facing inflationary costs.

Pakistan requires fiscal space to achieve higher growth targets and fund public expenditure, which cannot be achieved without enhancing tax collection. According to IMF (2016), the tax-GDP ratio in Pakistan has varied since 1973. The ratio began at 10% in the 1970s, reached a peak of slightly over 13% by the late 1970s, and remained at that level until the late 1990s with fluctuations. Subsequently, it declined to around 10% and has stayed between 8% and 9%. Pakistan's revenue mobilization lags behind other developing nations, even though the tax revenue-to-GDP ratio increased by 1.5% in the past three years to reach 11% in 2015. This ratio still falls significantly short of comparable market economies. The weak performance in mobilizing tax revenue is a result of narrow tax bases, the extensive use of tax concessions and exemptions, weaknesses in revenue administration, and low taxpayer compliance through informal economic activity and underreporting of formal income resulting in substantial loss of revenue relative to the potential (IMF, 2016).

The government's primary sources of revenue include taxes, domestic and foreign borrowings, deficit financing, profits from loans, profits from Public Sector Entities (PSEs), sales of assets, and aid. These funds are used to cover various expenditures, including development expenditures, non-development expenditures, defense expenditures, and transfer payments. However, the government often faces a revenue deficit, primarily due to a low number of taxpayers in the tax net. If the target revenue from taxation is not met, the government may have to turn to alternative sources, which come with costs. Expanding the tax base has always been a critical challenge for tax authorities in developing countries. This entails bringing non-compliant individuals and businesses into the tax net and identifying untaxed sectors.

The authorities face numerous obstacles in revenue collection. Increasing tax revenue solely by raising the tax rate puts excessive pressure on current taxpayers. The key to enhancing revenue collection is by implementing measures that will enhance tax morale and bring new entities into the tax net. This not only reduces the burden on current taxpayers but also includes non-compliant individuals, improving the efficiency of the redistribution mechanism and increasing the welfare of current taxpayers. The decreasing number of active taxpayers highlights the need for concrete measures to broaden the tax base.

Green (2008) identifies the reasons for weak norms against tax evasion as differentiation between evasion and avoidance, the complexity of tax laws, weak enforcement, discriminatory tax code, and dissatisfaction with revenue usage. To rebuild the norm against tax evasion, Green (2008) proposes rebranding it as cheating and stealing. Cheema (2012) analyzes income and tax records of winning candidates in the 2013 general elections in Pakistan. The Election Commission of Pakistan (ECP) obtained the data based on national tax number (NTN), income tax payment, differences in tax declarations in nomination papers and tax returns, and declared annual income. Out of 1,070 winning candidates, 12% lacked NTN status, and 5% had no record with the ECP. Only 51% paid taxes, while 43% did not pay taxes, and the record of 6% was not available with the ECP. Out of 680 candidates with declared income, 75% had consistent records with FBR, but the records of the remaining 25% were not consistent. The elimination of corruption in the system necessitates reforms in administration and the motivation of employees to perform their duties effectively. The Oxford Committee for Famine Relief conducted a study on inequality in Pakistan and found that over half of the tax revenues are comprised of indirect taxes, which are passed on to the end-users. A survey conducted by the Sustainable Development Policy Institute (SDPI) in 2013 revealed that approximately three-fourths of non-compliant citizens do not pay taxes due to corruption by officials and a lack of trust in the government[1].

Tax evasion is widely regarded as a criminal act in a civilized society. However, in Pakistan, the enforcement and penalization mechanisms of the Federal Board of Revenue (FBR) and provincial tax authorities have faced criticism. To address this issue, there is a need to change prevailing perceptions, as well as modernize the revenue collection agencies to better serve the country's specific needs. Pakistan's tax structure is largely based on indirect taxes, primarily sales tax. While direct tax collection has increased in recent decades, the situation calls for further improvement in this area. The low number of active taxpayers, including public servants and parliamentarians, is a cause for concern. To address this, policy initiatives should focus on expanding the tax base, restructuring tax administration, increasing the number of taxpayers and revenue collection, and fostering a culture of tax compliance.

In reference to the empirical literature, Gorodnichenko et al. (2009) studied the effects of flat income tax rates in Russia, which remain a threat to many countries, and found that

reforms in this area helped increase revenue and decrease tax evasion. A 9-12% decrease in the income-consumption gap was observed for families with reduced tax rates, indicating a positive shift in voluntary compliance. The authors conclude that a flat tax rate increase results in a reduction of tax evasion and a positive relationship between lower tax rates and lower evasion. Bello (2014) reviews the literature on taxpayer compliance behavior and concludes that intentional and unintentional non-compliance in the form of tax avoidance or evasion ultimately decreases tax revenue. Similarly, Alleyne and Harris (2017) attempt to measure intentions to engage in tax evasion rather than focusing on the actual behavior. Mehrara and Farahani (2016) find a U-shaped relationship between tax evasion and income tax rate, indicating higher tax evasion with higher tax rates. Christie and Holzner (2006) also report a positive association between tax evasion and the rate of tax.

Jamali and Ahmed (2016) recommend discontinuing the fragmentation of tax collection in Sindh (Pakistan), similar to the Punjab province, by merging the three revenue collection agencies. Additionally, they highlight the need for a professional workforce with improved forecasting and audit capacities, a census of service sector establishments, automation of land records, updated land valuation tables, broadened jurisdiction of revenue bodies, revised professional tax rates, and a grievance redressal system. In another policy brief on tax reforms in the Punjab province, Ahmed and Naqvi (2016), emphasized the need for a grievance redressal system and identified high tax rates as a key factor contributing to tax evasion.

Studies have been conducted to understand the factors that influence tax compliance. Palil et al. (2013) find that the audit probability, the role of tax institutions, the tax rate, and the perception of government expenditure have an impact on tax compliance. Saad (2012) investigates the reasons for non-compliance behavior in New Zealand, which still faces issues despite having a well-established self-assessment system. The study reveals that knowledge of taxes, income sources, fairness perceptions, attitude, and tax complexity contribute to non-compliance behavior. Alkhatib et al. (2019) analyze the relationship between tax fairness, peer influence, corruption, and income tax evasion using the *Social Influence Theory* and find that tax fairness and peer influence had a negative impact, while corruption had no significant effect. Górecki and Letki (2021) conclude from a survey experiment that tax rate has a negative association with an individual's tendency to evade when they believe that the society is paying taxes honestly, but the relationship is positive when the society is perceived to not be paying taxes honestly. The results for the latter case, however, are not significant. Meanwhile, Alshira'h (2019) finds no significant effect of peer group influence on sales tax compliance in the SME sector in Jordan.

Further, research into tax compliance has also attributed significant effects to various tax policy and administration parameters. Plumley (1996) finds that factors such as audits, matching of third-party information, targeted non-filer notices, criminal tax convictions, marginal tax rates, the

---

[1] Rationale for Tax Reforms in Pakistan, Policy Brief Prepared by Sustainable Development Policy Institute, March 26, 2015

burden of completing tax forms, and the preparation of returns by the IRS Taxpayer Service all contribute to compliance. Additionally, Christie and Holzner (2006) find a positive association between evasion and the rate of tax and support Bloomquist's (2003) hypothesis that higher income inequality leads to higher evasion. Furthermore, the quality of the judicial system is found to play a role in explaining value-added tax (VAT) evasion. Muhrtala and Ogundeji (2013) examine the determinants of evasion in Nigeria and show that tax structure complexity, expected economic benefits from evasion, and government trust influence evasion decisions.

Gillman (2021) suggests that tax avoidance and evasion will persist as long as individuals rationally compare the marginal cost of paying taxes to the expected marginal benefit of avoiding or evading them. He argues that fiscal policy should consider the reporting requirements, which depend on income elasticity, tax rate, and evasion. Richardson (2006) finds that non-economic factors have a greater impact on tax evasion, with complexity being the most critical determinant. Education, income source, fairness, and tax morale are also identified as important factors contributing to tax evasion. The results of the regression analysis suggest that lower complexity, higher levels of education, services income source, fairness, and tax morale lead to reduced tax evasion across countries. In a Nigerian context, Uadiale et al. (2010) find a positive correlation between enforcement and government trust with tax evasion.

Kong and Wang (2014) review the literature on the factors influencing tax evasion. They highlight that tax evasion reduces tax revenue and leads to unequal distribution of public services. Additionally, it causes a loss to the government and increases the cost of tax compliance. They suggest that researchers should consider non-economic factors such as demographic, behavioral, cultural, tax fairness, and tax morale, along with traditional determinants, to fully comprehend tax evasion. Uadiale et al. (2010) examine the correlation between culture (represented by legal enforcement, trust in government, and religiosity) and personal income tax evasion in Nigeria. They find that legal enforcement and trust in the government have a positive impact on personal income tax evasion in Nigeria. However, the study could not find a significant relationship between tax evasion and religious variables. Alabede et al. (2011) observe that race is a factor affecting tax compliance behavior in highly ethnic fractionalized and polarized societies. The study found a significant difference in compliance behavior between taxpayers of different races. However, the results also showed an insignificant difference in compliance behavior between taxpayers of different religious faiths.

Torgler and Schneider (2007) examine the relationship between tax morale and culture and institutions in three multicultural European countries - Switzerland, Belgium, and Spain - using datasets from the *World Values Survey* and the *European Values Survey*. They find that cultural and regional differences impact tax morale in Switzerland and Belgium, and that factors such as trust in the legal system, government, and parliament; national pride; and pro-democratic attitudes have a positive effect on tax morale in all three countries. Sarker (2003) emphasizes the importance of providing high-quality services to taxpayers during peak return filing season,

including conducting tax education programs, developing tax education curriculums, assisting taxpayers with correctly completing tax returns, providing consulting services, and fostering positive relationships with taxpayers. Mukhlis et al. (2015), in their survey of the SME sector, find that tax education plays a crucial role in shaping and increasing tax knowledge, which ultimately leads to increased tax compliance through greater fairness. Kwok and Yip (2018) also find a positive association between tax education and tax compliance in Hong Kong.

In an attempt to study the determinants of tax morale in Pakistan, Cyan et al. (2016) find that labor force participation, education, population center, and gender impact tax morale. Educated respondents exhibit higher tax morale than illiterate ones, and tax morale is highest in major industrialized centers. However, females' tax morale tends to decrease with age. The study suggests potential gains from increasing female labor force participation rates. Cyan et al. (2017) then assess the effectiveness of Federal Board of Revenue (FBR) mass media campaigns to increase tax compliance and morale, using survey data collected immediately after the campaigns. They find that respondents exposed to the TV and newspaper advertisements exhibit improved perceptions towards tax compliance and the choice of the delivery device affects campaign effectiveness. Fišar et al. (2020) further study the effects of media on tax compliance in an experimental setting, concluding that positive news leads to increased compliance, while negative news has detrimental effects and shapes future tax compliance decisions.

Alabede (2014) analyzes the differences in individual taxpayers' compliance behavior across demographic variables in Nigeria using survey data. The results reveal significant differences in compliance behavior based on age, income, employment status, and ethnicity. However, no significant differences were found in compliance behavior based on gender, education, or religious faith. Oti et al. (2017) analyze the trend of internally generated revenue and its relationship with demographic factors like population, age, gender, employment status, and ethnicity using descriptive statistics. They find that revenue generation is not influenced by population, age, and gender but by employment status, income, and natural resource endowments.

METHODOLOGY

This paper uses the qualitative approach of the focus group discussion. Focus group discussion is a flexible technique that can be adapted at any stage of the research. Contrary to more conventional methods such as individual case studies, interviews, and surveys, it provides an opportunity to explore, in more detail, economic issues that are not well understood or where there is little prior research on the topic. The focused group discussion (FGD) is regarded as an effective tool for eliciting information. The FGD process was informal and straightforward, divided into two sessions. During the first session, general questions were posed to the participants to gather brief responses. These initial responses allowed the researchers to establish broad discussion points and lay the foundation for the more detailed discussion in the second session. Participants were asked to respond briefly and precisely to questions under broad categories, guided by the

questions provided to them. The FGD aimed to uncover the specific factors in Pakistan contributing to tax evasion and assess the importance of taxes as a source of revenue for financing government expenditure, including the provision of public utilities, development of infrastructure, defence/ security services, and overall welfare. Participants were selected through purposive sampling, a method that involves selecting informants with varying experiences in tax matters in Pakistan. Three representatives from FBR were included, two of whom were retired, to obtain input from the key tax department and to have varied and independent perspectives on the subject. Additionally, a tax consultant was included to provide practical insights into taxation as an intermediary. Four participants from academia with expertise in the micro and macro aspects of the economy and public financial management were also included. The final participant was selected to provide insight into Islamic economic thought and the prevailing misconceptions about taxation in the guise of Islam (profiles of participants can be found in Appendix A).

The FGD, comprising 160 minutes, was arranged in two sessions on the same day, 16 June 2017, in the School of economics, IIUI. In the first session, the general importance of tax revenue and factors affecting voluntary tax compliance was discussed. In the second session, the determinants of evasion of tax, along with its social and economic effects, were explored in detail. Questions seeking the opinions/ expertise of the experts on tax evasion were used to guide FGD. Topics covered include the importance of taxes as a source of revenue, general challenges to revenue collection, degree of reliance on direct and indirect taxes, factors affecting voluntary tax compliance, determinants of tax evasion (political, behavioral, cultural, religious, and institutional factors) and the possible socio-economic effects of tax evasion in Pakistan. The group techniques employed to conduct the FGD include group discussions and brainstorming. The sessions were moderated by a management consultant having adequate experience in his field. The detailed role of the moderator is shown in Table 1.

Table 1. The role of the moderator.

- To guide the discussion by employing the prescribed guidelines.
- To provide relevant background information and clarification to related issues or questions of understanding.
- To provide open space for the participants.
- To maintain focus on the activity objectives.
- To keep the discussion on track.
- To provide every participant with reasonable time and chance to have his say.

RESULTS AND DISCUSSION
The recording of the data was done with the permission of the participants. The data and input were transcribed as it is for further analysis. Analysis of data was done manually by the rapporteur using the principles of systematic text condensation. This implies a repeated review of the transcripts to gain a thorough sense of the overall content in the texts, identifying central meaningful units in the material, condensation of the content through coding of the text, and,

finally, creating categories that contain the condensed meaning of the main themes in the material.
The results of the discussion are reproduced below:

Importance of Taxes as a Source of Revenue for Pakistan
Pakistan faces limited revenue resources and significant expenditure. To bridge the deficit, a robust system of revenue collection is necessary. Taxation remains the primary source of revenue in the yearly budgetary estimates. A significant portion of government expenditure is allocated for interest payment and defence, with the tax-to-GDP ratio standing at 10-11%. While the tax-to-GDP ratio may not be alarming, it is crucial to broaden the tax base. Direct taxes may be avoided, but everyone pays indirect taxes, contradicting the notion that people do not pay taxes. The reasons for tax avoidance may vary.
Taxation serves as a means of correcting income distribution. In Pakistan, the reliance on indirect taxes results in negative redistribution of income, causing the middle-income class to shrink. The government's incentives and priorities often benefit the rich class at the expense of the middle class. Taxes play a crucial role in financing welfare programs, such as education and healthcare, and can aid in alleviating poverty through effective redistribution mechanisms. The twin deficits and high poverty levels in the economy pose significant challenges, with government borrowing from private banks crowding out private investment. Expanding the tax base and increasing revenue collection is crucial for the growth of the economy, as it allows for investment in the social sector and infrastructure value addition. The allocation of taxes towards development or non-development expenditure is a crucial aspect that should not be ignored if a country aims to bridge the gap between expenditure and revenue. The summary of important attributes about the tax is provided in Table 2.

Table 2. Importance of tax.

- Tax is the lifeblood of the economy.
- Tax is the biggest revenue source.
- Tax as a source of an income redistribution mechanism.
- Tax helps in discharging the welfare responsibilities of the state.
- The development and non-development expenditures of the government are primarily financed through taxes.

General Challenges to Revenue Collection
The persistent behavior of evading the law perpetuates a negative image and promotes tax dodging as a symbol of status. The worth of offshore assets held by Pakistanis, which exceeds billions of dollars, is more than enough to cover the budget deficit. However, unlike India and several African countries, Pakistan has failed to bring these funds back. This has led to increasing pressure from international financial institutions, such as the IMF and World Bank, to expand the tax base. To address this, the current regime has taken significant policy measures to encourage tax filing and discourage non-filing. However, visionary leadership is needed to take these efforts to the next level and make difficult decisions.
The prevalent issue of rent-seeking and corruption among parliamentarians, bureaucrats, and the tax machinery must also be addressed, as it undermines efforts to broaden the tax base and overshadows the work of honest elements within the

system. Additionally, increasing the tax rate is not feasible, as it imposes a burden on existing taxpayers rather than expanding the tax base. To ensure balanced policies, efforts must be made to separate the influence of lobbyists, feudal lords, and industrialists from politics. Furthermore, the media has not played a supportive role in promoting compliance. Institutions such as the media, universities, schools, and homes should educate the public on the importance of a balanced revenue and expenditure system and how to increase the tax base to improve the quality of state-provided services.

At independence, Pakistan inherited several elements from its colonial legacy, including a lack of prioritization in education, leading to limited development of national character. The country falls under the category of an underdeveloped nation, both socially and in terms of infrastructure. Good citizenship, including honest payment of taxes, is a crucial component in the development of a nation. However, in Pakistan, individuals have low confidence in the government machinery, which leads to a lack of willingness to maintain necessary financial documents and a distrust of legal or financial intervention. This may result from fears of exploitation. Pakistan has a cash economy system, which has resulted in a low tax-to-GDP ratio and a significant share of the economy existing in the untaxed sector. This lack of government knowledge of the national wealth can compromise the nation's security, as the wealth can be used to undermine the nation's sovereignty. It may be channelled into illegal activities such as terrorism or organized crime, and the government must take measures to effectively crack down on these emerging threats. To successfully address these issues, the government must have moral courage and political will. Table 3 provides the list of the factors impeding the revenue collection.

Table 3. Factors impeding revenue collection.

- Dodging and bypassing the system as a status symbol.
- Absence of material efforts to bring back illicit funds from tax havens.
- Narrow tax base.
- Ineffective role of media in promoting tax culture.
- Low taxpayers' confidence.
- Trust deficit in government and government machinery.
- Low literacy and tax education to promote good citizenship.
- The size of the cash economy/ informal sector.

Degree of Reliance on Direct and Indirect Taxes
Direct taxation, although viewed as unfavourable by the public, is a crucial aspect of revenue collection for the government. To mitigate this challenge, indirect taxes are often utilized as an alternative solution. However, direct taxes, specifically those levied on an individual's income, are considered the most ideal form of taxation from a theoretical perspective. Despite this, direct taxes are difficult to collect due to their lengthy and complex procedures, which involve extensive research and analysis by the tax authorities. The Federal Board of Revenue (FBR) compares data on tax returns with data obtained from independent sources to examine exemptions claimed. A robust direct tax system can bring equality in income redistribution through the implementation

of a progressive tax system, where those who earn more pay more taxes.

Pakistan has a cash-based economy, and direct taxes, despite constituting a significant portion of the country's tax collection, are collected indirectly through withholding tax agents. This reliance on intermediaries can pose challenges to the efficiency of the direct tax collection system. To enhance the economy and expand the middle-income group, the country must focus on strengthening its direct taxation system, which requires simultaneous efforts on political, behavioral, and institutional fronts.

From a practical perspective, the authorities in Pakistan adopt a hybrid approach to revenue collection, considering the special needs and dynamics of the economy. The long-term goal is to increase revenue and move towards a direct form of taxation. However, tax auditors tasked with assessing individuals' tax compliance face limitations in their ability to access third-party information. As a result, they mainly rely on the information provided by the taxpayers themselves, which may not include comprehensive details such as travel expenses, children's expenses, hospital expenses, hotel expenses, and asset acquisitions.

Factors Affecting Voluntary Tax Compliance
According to research, high tax rates hinder voluntary tax compliance as they impose a heavy burden on existing taxpayers. To attain fairness, taxes should be levied at a lower rate on lower incomes and vice versa. Academic institutions, including religious institutions (Madrassas) and media, can play a role in promoting understanding and awareness of tax collection, the benefits of tax revenue, and the consequences of non-compliance through both formal and informal means. The traditional tax audit system in Pakistan requires individuals to file their returns, and a selected percentage undergoes detailed scrutiny and audit. With the introduction of the self-assessment scheme, the role of the tax department in detailed scrutiny has become less effective. The self-assessment scheme, as per section 120, deems a return as self-assessed if filed. However, the law still requires that some cases be selected for detailed scrutiny, which faces challenges in higher courts. In some cases, audits are carried out, while in others, they linger on. The Tax Administration Reform Program (TARP), with financial support from the World Bank, was introduced in Pakistan to facilitate taxpayers by creating Regional Tax Offices (RTOs) and Large Taxpayers' Units (LTUs) and automating and interfacing third-party data.

Despite the introduction of TARP, the number of return filers has declined every year, as individuals believe that if their case is selected, they can obtain a stay order from the courts. The manual system, combined with a weak enforcement mechanism, results in ineffective audit deterrence, leading to negative peer influence and tax evasion. Further research is necessary to understand the declining number of filers, including the number of declared income cases and those below the taxable limit. The total cases selected for audit by tax authorities in the last five years also require exploration.

Once a case undergoes audit scrutiny, it proceeds to the Commissioner's Appeal Forum if a tax demand is created. If it is a legal question, it goes further to the Higher Court. The

answers to three crucial questions are vital for understanding the tax collection process: the amount of tax demand created, the decrease in demand after the appeal, and the amount collected thus far.

Determinants of Tax Evasion

The determinants of tax evasion discussed and identified during the FGD are summarized below:

Political factors

The prevailing trust deficit between the government and citizens is a critical issue affecting tax compliance in Pakistan. The public perceives trust as tied to the government's priorities, credibility, and policies, whereas the government aims to increase revenue by setting appropriate tax rates and bringing a maximum number of taxpayers into the tax net. In theory, the government can only improve services with the revenue generated from taxes, and the public will only be tax compliant if the government gains its trust through honest efforts and improved services. This trust deficit can only be bridged by the simultaneous enforcement of tax laws and the provision of services. However, negative influences from politicians and corporations regarding non-disclosure of income and assets reinforce tax evasion behavior. Furthermore, the tax structure is highly uneven, overburdening existing taxpayers and increasing non-compliance. A transparent and equitable tax structure is necessary to win the confidence of taxpayers. Some sectors of the Pakistani economy, such as agriculture and industry, are exempt from taxes, which creates disparity. Poor management, ineffective enforcement, and dishonest government have also led to a credibility gap.

The tax behavior of citizens does not solely depend on the form of government, whether democratic or dictatorship. Rather, it depends on the government's will, vision, and initiative. Value-added tax is considered a solution to multiple taxation problems, and efforts are underway to upgrade the economy to this system, but it requires serious efforts and strong political backing as it resists the more one spends, the more one pays in taxes. In the era of globalization, a large number of goods and services are imported, presenting new challenges to the federal revenue agency. Additionally, black money flows out of the country through illicit channels, and developed countries, especially OECD, have implemented anti-corruption measures under US pressure. A feasible socio-economic environment is necessary to retain existing investors and attract new investment, as tax rebates are widely available in the global market.

Behavioral and cultural factors

The capacity of taxpayers to pay must be taken into consideration before implementing indiscriminate tax increases. The current tax structure is inequitable, and taxpayers may not pay beyond their perceived willingness. Taxpayers may deliberately avoid registration with tax authorities out of fear of intervention or scrutiny, leading to overburdening of existing taxpayers and weak enforcement. This also results in the free-riding problem as non-registered individuals take advantage of services without contributing. The cultural perception surrounding tax evasion and avoidance play a crucial role. People may evade taxes if they believe it is easily avoidable and vice versa. Social status and peer pressure also influence tax compliance. Education can serve as a tool to raise awareness and positively reinforce a tax-compliant culture. However, in areas such as Quetta and Peshawar, where cultural and regional perceptions pose a challenge, the outreach and enforcement of tax authorities may be compromised.

Religious factors

The misunderstandings surrounding the imposition of taxes require attention. Tax serves the same purpose as zakat in the modern nation-state system in any Muslim country. Although tax and zakat are not interchangeable, as tax is a secular levy and zakat is a religious obligation, both require compliance with the laws and social contract of the region. The prevalent belief in certain religious communities that tax is un-Islamic and should not be paid is rooted in the lack of trust in the state's internal and foreign policies. However, Islam values selfless service to humanity and considers benevolence a civic duty. Taxation is based on justified needs, as upheld by the dominant opinion in Islamic political thought (Jamhoor). In the caliphate of Hazrat Umar (R.A), a poll tax (import duty) was imposed on foreign convoys to align with the fees charged on Muslim convoys. Investment in education is crucial, particularly in re-prioritizing the budget allocation to encompass teaching civic responsibility, including the declaration of income, filing tax returns, and paying taxes. Madrassas and academic institutions across all disciplines should be required to impart this knowledge. The general perception of not paying taxes also stems from a lack of trust in the government's commitment to abolish an interest-based economy and realign its international relations. This sentiment extends to zakat, with people preferring to pay for it themselves.

Factors pertaining to public institutions

The Federal Board of Revenue (FBR) is a sub-legislative body of the government of Pakistan, and its duties are defined in its charter. Although it does enjoy some degree of internal autonomy, it must operate within the bounds of the constitution. The FBR cannot determine the features of the taxation system unilaterally. The inability of the institution to enforce tax laws may stem from various legal, political, cultural, and personal factors. The lack of enforcement further distances taxpayers from the tax departments and creates a credibility gap between the institution and citizens and vice versa. Citizens expect to receive good service and even policies in terms of enforcement, intervention, and prosecution in return for paying taxes. International tax management principles dictate that 2% of tax revenue should be dedicated to upgrading and expanding the tax machinery, whereas in Pakistan, this amount is less than 0.6%. This cash economy system has resulted in Pakistan having a low tax-to-GDP ratio. The black economy sector, which is largely untaxed, accounts for almost 67% of the country's GDP, unknown to government agencies at the federal, provincial, and district levels. This can have serious consequences for national security if not properly addressed. The FBR should also focus on segmenting the economy and industries for revenue collection and expanding the tax machinery accordingly.

Nepotism and connections with FBR officials may result in unfair benefits for taxpayers. Corruption cannot be ruled out as a factor in the weak enforcement of tax laws. It is necessary to continuously maintain salaries at market levels and incorporate ethics into regular training for officers. Weak enforcement may also stem from inadequate training and capacity building and the lack of modern tools, such as access to third-party data that limit the ability of officers to perform their duties. As a result, taxpayers either pay less than their actual potential or do not pay taxes at all. In Pakistan, factors such as corruption, inefficient tax machinery, and intermediation by tax officers negatively impact the country. Tax auditors are not equipped with modern tools or access to third-party information, relying primarily on information provided by taxpayers. They lack information about a taxpayer's expenditures, such as travel, healthcare, and assets. To overcome this issue, coordination with international agencies and businesses must be developed for information exchange. Tax practitioners may also conceal or camouflage the true income declared, as evidenced by the discrepancy between declared and actual data during raids. Penalties for tax evasion may include fines or an increase in the financial obligation to resolve the matter. The sales tax law provides for arrest and criminal proceedings, while the Income Tax Ordinance allows for prosecution of misdeclaration and under-declaration. A special judge custom court has recently been introduced under the ITO.

The media's negative representation of tax issues reinforces the public's avoidance of taxes. Taxpayers' education can be improved through media coverage, seminars, and the involvement of the business community. This can help instill the idea in the public's mind that a compliant citizen is a good citizen. The decision to offer tax incentives, such as inland tax havens, must consider the economic reality, political vision, national interest, the interest of the local industry, and international factors. The existing legal frameworks do not provide protection against all possible avenues of tax evasion, such as through multi-lateral or bilateral double taxation treaties. In these treaties, the nature of activities to be taxed is not comprehensively defined.

Factors pertaining to private institutions

The high corporate tax rates in developed countries have motivated efforts to reduce these rates in order to increase competitiveness in the market. Similar tax incentives are expected in Pakistan, as they are expected to result in positive responses from the industry. To tackle the issue of transfer pricing, the adoption of arm's length pricing methods, commonly used worldwide, is suggested. Under-invoicing imported goods to avoid taxes and duties remains a common form of tax evasion and requires both a skilled team and efficient intelligence, as well as access to modern tools for data availability. Another form of evasion involves importing machinery in parts or concealing products under different codes, which is challenging but cannot be ruled out. Sectors such as real estate, often referred to as black money reservoirs, and the tourism and travel agent industry, both heavily undertaxed, deal primarily in cash and make limited tax contributions despite their growth. Table 4 provides the overall list of factors that may affect tax evasion.

Table 4. Determinants of tax evasion.

Political factors	Trust deficit
	Absence of a role model for the general public in tax compliance
	Extending tax benefits or subsidies to selected sectors.
	Globalization
	Business conducive environment is required to attract investment.
	Uneven tax structure
Institutional factors (FBR)	Weak enforcement
	Credibility gap
	Limited out-reach of tax authorities (tribal belts)
	Lack of resources to expand tax machinery.
	Modernization of tax approach, by increasing focus on the segmentation of economy
	Capacity building of tax officers
	Anti-corruption mechanism
	Access to modern tools, including third-party information/ data
Business	High corporate rates
	Transfer pricing problem
	Under invoicing
	Sectors in an economy that deal mostly in cash (black money reservoirs)
	Misrepresentation may lead to sales tax evasion (if it is not deducted at source)
	CSR activities need to be regulated
Behavioral factors	Willingness to pay.
	People are reluctant to get themselves registered with tax authorities.
	Free-riding problem
	Perceptions of the people need to be reshaped about the consequences of tax evasion/ avoidance.
	Excess burden.
Cultural factors	Non-compliant family/ peer groups
	Dodging the tax system is seen as a status symbol
Religious factors	Tax is resisted as it is viewed as a levy in addition to a religious levy.
	Lack of investment in tax education and clearing misconceptions.
	Tax resistance may also be due to the policies of the regime not fulfilling the expectations of religious circles

Businessmen tend to profit from the sales tax not withheld at source but by misrepresenting the tax is not only evaded but also misrepresented. In manufacturing products, where taxes are not collected by way of withholding tax agents, the manufacturer may evade taxes by under-reporting the sales, that is, collecting the tax amount from the consumer but not transferring it to the authorities. Government extends some concessions/exemptions to the industries/ firms who engage themselves in the social sector for provisions of services such as schools, health, and orphanage houses as part of their corporate social responsibility. This side of the activity needs to be regulated properly as it is done in the West.

The Possible Socio-Economic Effects of Tax Evasion in Pakistan

Tax evasion is both a social and financial issue. On the one hand, it deprives the government of crucial resources to fulfill its fiscal obligations and creates difficulties for tax collection institutions to increase revenue and address non-compliance. On the other hand, it exploits taxpayers who not only pay for themselves but also for those who engage in tax evasion. This leads to various socio-economic effects, as depicted in Table 5.

Table 5. Socio-economic effects of tax evasion.

Institutional	- Non-broadening of tax net/ tax base. - The ever-increasing burden on the tax compliant citizens - The morale of the compliant citizens will continue to diminish due to the excessive burden. - Ever-increasing deficits - Tax-to-GDP ratio, as envisaged in vision 2020, will not be achieved. - Inflationary pressures on the economy as a result of alternate financing/ indirect taxes. - No regulation of income sources of business/ individuals may lead to smuggling/ terror and drug financing/ human trafficking. - Corruption and inefficiency in the system will prevail
General Public	- The free-riding problem will prevail. - Rich will remain under-taxed, and the poor will remain overburdened. - Discrimination in income distribution will prevail. - Parallel economy / underground economy will increase.

CONCLUSIONS AND RECOMMENDATIONS

The study, based on a focus group discussion, concludes that the collection of taxes with minimal leakages is crucial for any economy as it is essential for meeting various needs, including public expenditure, infrastructure development, welfare, and reducing deficits. The belief that people do not pay taxes may not be accurate, as most individuals end up paying indirect taxes, even if they avoid or evade direct taxes. However, a shift from indirect to direct taxes is necessary for a better tax system. The low tax revenue has significant implications, particularly for developing countries. To increase tax morale, the government must improve services and raise income

levels while ensuring that taxes do not become too burdensome. The decline in tax literacy, education as a low priority, and deterioration of social values all contribute to a lack of national character and good citizenship. Addressing these issues, such as revising syllabi and improving the media's role, will help in cultivating a tax-compliant society. Other factors affecting the low tax-to-GDP ratio include the cash economy, the underground economy, and the influence of interest groups like lobbyists, feudals, politicians, and corporate houses. To tackle this issue, the government must crack down on black markets, limit the influence of interest groups, and digitize the cash economy. The Federal Board of Revenue (FBR) plays a crucial role in collecting taxes. The current self-assessment scheme and audit system may not be effective, but a sample of returns is selected for scrutiny. The parameters for scrutiny are challenged in higher courts, leading to prolonged audits. The number of filers has been declining, which may be due to various reasons such as political, institutional, cultural, economic, and religious factors.

To achieve parity, the government must tax the higher class and redistribute the proceeds to the poor. The introduction of value-added tax is also recommended. The FBR must segment the economy and industries for revenue collection and expand its machinery accordingly. The officers should be well-trained and equipped with third-party data interfacing. The anti-corruption mechanism must be strengthened, and academic institutions and media can contribute to creating understanding and awareness of tax collection, its purpose, and the cost of non-compliance. The government should aim for a mix of direct and indirect taxes and eventually fully transition to direct taxes, dedicating 2% of tax revenue to upgrading the tax machinery. Encouraging tax compliance and fostering pride in it among citizens is crucial. The role of the Federal Tax Ombudsman is also important.

Researchers need to carefully explore the causes of the declining number of taxpayers, such as changes in tax rates, taxable income, and trust in government. They also need to study tax audit cases to determine the tax demand created by the FBR, how much of the demand decreased after appeal, and how much of the tax amount has been collected. Note that the focus group discussion project was limited by time constraints, recruitment was limited to experts living in Islamabad, Pakistan, through peer referral, and the panel did not include representation from the media. Despite these limitations, the objective of the focus group discussion was still achieved.

REFERENCES

Ahmed, V., Naqvi, A., 2016. Tax Reforms in Punjab. Policy Brief No. 53, Sustainable Policy Development Institute, Islamabad. www.sdpi.org.

Alabede, J.O., 2014. An exploratory analysis of individual taxpayers' compliance behaviour in Nigeria: A study of demographic differences and impact. Int. J. Account. Tax. 2, 39–64.

Alabede, J.O., Zainal Affrin, Z., 2011. Does ethnicity matter in individual taxpayer's compliance behaviour?: Empirical evidence from Nigeria. Econ. Financ. Rev. 1, 18–30.

Alkhatib, A.A., Abdul-Jabbar, H., Abuamria, F., Rahhal, A., 2019. The effects of social influence factors on income tax evasion among the palestinian SMEs. Int. J. Adv. Sci. Technol. 28, 690–700.

Alleyne, P., Harris, T., 2017. Antecedents of taxpayers' intentions to engage in tax evasion: Evidence from Barbados. J. Financ. Report. Account. 15(1), 2-21. https://doi.org/10.1108/JFRA-12-2015-0107

Alshira'h, A.F., 2019. The effect of peer influence on sales tax compliance among Jordanian SMEs. Int. J. Acad. Res. Bus. Soc. Sci. 9, 710–721.

Bello, K.B., 2014. Evasion and avoidance as forms of tax non-compliance: A critical review. Sains Humanika 2. https://doi.org/10.11113/sh.v2n3.433.

Bloomquist, K.M., 2003. Tax evasion, income inequality and opportunity costs of compliance, in: Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association. JSTOR, pp. 91–104.

Cheema, U., 2012. Taxation by Misrepresentation: A Comparative Study of Public Representatives. Income Tax Declar. 2012. A joint publication of Sustainable Development Policy Institute (SDPI) and Center for Investigative Reporting in Pakistan (CIRP). https://sdpi.org/sdpiweb/publications/files/Taxation_By_Misrepresentation.pdf

Christie, E., Holzner, M., 2006. What explains tax evasion? An empirical assessment based on European data. WIIW Working Paper No. 40. The Vienna Institute for International Economic Studies, Vienna. http://hdl.handle.net/10419/203905

Cobham, A., 2005. Tax evasion, tax avoidance and development finance. QEH Working Paper Series – QEHWPS129. Finance and Trade Policy Research Centre, Queen Elizabeth House, University of Oxford. 1-20.

Cyan, M.R., Koumpias, A.M., Martinez-Vazquez, J., 2016. The determinants of tax morale in Pakistan. J. Asian Econ. 47, 23–34.

Cyan, M.R., Koumpias, A.M., Martinez-Vazquez, J., 2017. The effects of mass media campaigns on individual attitudes towards tax compliance; quasi-experimental evidence from survey data in Pakistan. J. Behav. Exp. Econ. 70, 10–22.

Fišar, M., Reggiani, T., Sabatini, F., Špalek, J., 2020. Media bias and tax compliance: Experimental evidence. IZA DP No. 12938. Discussion Paper Series, IZA Institute of Labor Economics. www.iza.org.

Gillman, M., 2021. Income tax evasion: Tax elasticity, welfare, and revenue. Int. Tax Public Financ. 28, 533–566.

Górecki, M.A., Letki, N., 2021. Social norms moderate the effect of tax system on tax evasion: Evidence from a large-scale survey experiment. J. Bus. Ethics 172, 727–746.

Gorodnichenko, Y., Martinez-Vazquez, J., Sabirianova Peter, K., 2009. Myth and reality of flat tax reform: Micro estimates of tax evasion response and welfare effects in Russia. J. Polit. Econ. 117, 504–554.

Green, S.P., 2008. What is wrong with tax evasion. Hous. Bus. Tax LJ 9, 221-233.

IMF, 2016. Pakistan: Selected issues paper, IMF Country Report No. 16/2 2016. www.imf.org

Jamali, S., Ahmed, V., 2016. Tax Reforms in Sindh. Policy Brief No. 54, Sustainable Policy Development Institute, Islamabad. www.sdpi.org.

Kong, F., Wang, C., 2014. The determinants of tax evasion: A literature review. Gdańskie Stud. Azji Wschod. 2014, 70–78.

Kwok, B.Y.S., Yip, R.W.Y., 2018. Is tax education good or evil for boosting tax compliance? Evidence from Hong Kong. Asian Econ. J. 32, 359–386.

Mehrara, M., Farahani, Y.G., 2016. The study of the effects of tax evasion and tax revenues on economic stabilities in OECD countries. World Sci. News 43–55.

Muhrtala, T.O., Ogundeji, M., 2013. Professionals' perspective of tax evasion: some evidence from Nigeria. Europe 18, 1–511.

Mukhlis, I., Utomo, S.H., Soesetio, Y., 2015. The role of taxation education on taxation knowledge and its effect on tax fairness as well as tax compliance on handicraft SMEs sectors in Indonesia. Int. J. Financ. Res. 6, 161–169.

Oti, P.A., Effiong, S.A., Ferdinand, I.O., 2017. Demographics and taxation in rural Cross River State. Int. J. Econ. Financ. Manag. 2, 13–26.

Palil, M.R., Hamid, M.A., Hanafiah, M.H., 2013. Taxpayers Compliance Behaviour: Economic Factors Approach. J. Pengur. 38, 78-85.

Plumley, A.H., 1996. The determinants of individual income tax compliance: Estimating the impacts of tax policy, enforcement, and IRS responsiveness. Harvard University.

Richardson, G., 2006. Determinants of tax evasion: A cross-country investigation. J. Int. Accounting, Audit. Tax. 15, 150–169.

Saad, N., 2012. Tax non-compliance behaviour: Taxpayers view. Procedia-Social Behav. Sci. 65, 344–351. https://doi.org/10.1016/j.sbspro.2012.11.132.

Sarker, T.K., 2003. Improving tax compliance in developing countries via self-assessment systems-What could Bangladesh learn from Japan. Asia-Pacific Tax Bull. 9, 3–34.

Torgler, B., Schneider, F., 2007. What shapes attitudes toward paying taxes? Evidence from multicultural European countries. Soc. Sci. Q. 88, 443–470.

Uadiale, O.M., Fagbemi, T.O., Ogunleye, J.O., 2010. An empirical study of the relationship between culture and personal income tax evasion in Nigeria. Eur. J. Econ. Financ. Adm. Sci. 20, 116-126.

Appendix A. Brief profile of the participants of FGD.

S. No.	Name	Designation	Education	Experience
1	Abdul Jaleel	Chief Administrator (Rtrd.) FBR	Ph.D. (in progress), NUML, Islamabad	Income Tax Service – (1982 – 2010)
2	Ms. Rukhsana Yasmin (Shaukat Mehmood Director General (Rtrd) FBR (Income Tax Service – (1984 – 2016) represented the officer as she was unavailable on the date of FGD due to an important official commitment).	Commissioner FBR, Islamabad	MBA	Income Tax Service – (retired as Chairperson FBR on 29.08.2018)
3	Mr. Malik Tauqeer	Addl Commissioner RTO Rwp	M.A English 1994 LLB 2014	Income Tax Service(1999-date)
4	Kaleem Arshad	Tax and Corporate Consultant	LLM Corporate Law (2010), IIUI, Islamabad	Advocate High Court (2011-17) Audit Manager (2004-2010) Chief Accountant (2003) Finance Manager (2001-2003)
5	Zakir Munir	Management Consultant	MBA, MAJU, Islamabad	RIZ Consulting (2009-2017)
6	Dr. Atiq-uz-Zafar	Assistant Professor / Ex-Director General IIIE / Head Islamic Banking and Finance	PhD Economics IIUI, M.Sc (Eco) IIU,M.A. (Eco.) University of Waterloo, Canada-1989	Area of Specialization: Islamic Economics, Islamic Finance
7	Dr. Abdul Jabbar	Assistant Professor	Ph.D. Economics, Univ. of Hawaii, USA-2005	Area of Specialization: Microeconomics, International Trade
8	Dr. Arshad Ali Bhatti	Assistant Professor	Ph.D. (Economics), University of Manchester UK	Area of Specialization: Macroeconomics, Applied Econometrics
9	Dr. Faiz-ur-Rahim	Assistant Professor	PhD (Economics) IIUI 2014, M.Phil (Economics) IIUI 2006	Area of Specialization: Public Sector Economics
10	Dr. Mirajul-Haq	Assistant Professor	Ph.D. Economics	Area of Specialization: Economic Growth
11	Dr. Babar Hussain	Assistant Professor Ph.D. (Economics)	University of Manchester UK, MPhil Economics, QAU, Islamabad, M.Sc Economics, IIUI, B.Sc(Hons) Economics, IIUI	Area of Specialization: Macroeconomics, Applied Econometrics
12	M. Omer Farooq Jajja	Rapporteur	Ph.D. Economics (candidate)	