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Who Bears the Burden of Taxes in Developing Countries? A Case of Pakistan's Tax Structure

Hina Ali[1], Malik Ayaz Mahmood[2], Ruqia Bajwa[3]

[1] *Department of Ecoomics, The Women University Multan ,Pakistan*
[2] *Department of Management Science Islamia University Bahawalpur, Pakistan*
[3] *Department of Psychology Bahauddin Zakariya University Multan, Pakistan*

***Corresponding author email**
hinaali@wum.edu.pk

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Abstract

The major obstacle in the way of economic development of underdeveloped countries is heavy dependence of indirect taxes. This problem occurs because there are only few taxpayers who participate in lowering the burden of direct taxes. This study shows the Pakistan's tax structure. The basic objective of present study is to find out how the burden of direct and indirect tax is allocated among the taxpayers. This study found that the total population of Pakistan is about 180 million and just 750,00 pay taxes. Only 82% sales tax is paid by 100 companies, 25% tax pay by Pakistan official limited at different stages.Approximately 55% of sales tax on local goods was paid by Pakistan official limited and Pakistan Telecom Participate, 37.5% tax collected by ports, 12 percent income tax collected in the Karachi port under the presumptive income regime, 3.1% tax come from salaried class, and around 61% parliamentarians do not pay income tax. The Tax laws in Pakistan are full of allowances and exemption, and tax base is too narrow. Pakistan's agriculture sector provides employment around 43.70% of the population that contributes just less than 1% of tax revenue of GDP. At last the study represents some reforms that are required in Pakistan's taxation system.

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1 Introduction

Pakistan and numerous other underdeveloped nations are additionally attempting to rebuild their tax structure. An enormous part of Pakistan's populace living in the neediness. And imbalance is additionally presented in the distribution of income. A weight of duty is beard by a predetermined number of individuals and enterprises. In this manner, a wide based and most positive income tax framework accomplishing is a much desirable work for the administration.There are many main sources of mobilizing internal resources of an economy.

The tax system of Pakistan tolerates a disorder.Oftensaid that there are few individuals even among the employed tax payers can pay the tax in developing countries. Primary portion of the Pakistan's income tax originates from the commercialarea and there is constantly uneasy feeling having its higher tax rates. Generally tax forced in dynamic rates and primary duty gathering is done under withholding outlay structure.

Government workers pay less income tax rather than private employees , in the case of private sector, they pay additional payments, due to that the private investment reduced.

The selected taxation facts includes,

- Pakistan's total population is about 180 million and just 750, 00people pay taxes.
- 82% of sales tax pays by100 Companies.
- Only 25% of tax was paid by POL at various stages.
- Telecom pays around 55% of sales Tax on Domestic goods and the Services provided by POL.
- Effective sales tax rate was 3.63%.
- Tax collected from ports was 37.5%.
- Tax comes from salary class was 3.1%.
- 12% of income tax claimsat Karachi Port.

- About 61% of tax was not paid by parliamentarians.

Accordingly a limited class bears the burden of tax and this situation brings main trouble for the government of Pakistan to allocate the tax burden in a fair manner among different types of taxpayers. So this article is vital for scheming a fair tax system in Pakistan, which would be favorable for all developing countries.

2 Review of Literature

2.1. General Review

Gillani (1986) examined the revenue expenditure activities of the federal government to find out the performance of the fiscal system on the basis of revenue productivity. This study used two techniques to observe the short run and long run elasticity and buoyancy for tax revenue

- Division Index method.
- Proportional adjustment method.

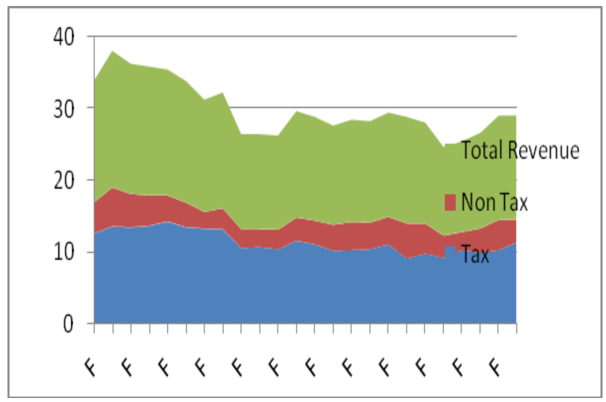
This study concluded that built in elasticity of Pakistan's tax was greater than 1.

Mukarram (2001) examined the resilienceand elasticity of main taxes in Pakistan from 1981 to 2001, by using the method of chain indexing. This study discovered that elasticity and buoyancy is greater for direct taxes followed by sales taxes, and customs and excise duties are relatively inflexible, due to low tax elasticity.

Bilquees (2004) analyzed the elasticity and nimbleness of taxable income structure in Pakistan over the period of 29 years i.e. 1974 - 2003 by employing theDivisia Index Approach and inspected the variables in charge of the subsequent size of elasticity coefficients. This study recommended that adjustment in duties did not prompt significant income collection. In any case, high coefficient of backhanded duty like deals expense concerning total national output (GDP) based on uncovered expansion of the administration, division and utilities in net deal charges, that have extreme corollaries for poor people.

Sarkar (2006) expressed heavy reliance on indirect taxes in developing countries like Bangladesh. In instance of individual's income tax only 13% citizens pay the tax. This study demonstrated the same results on account of corporate income tax. Only 25% Exclusive, unregistered organizations pays 84 percent tax and around 13% of small organizations don't pay anything. Alongside the enrolled organizations only 1.15 percent of them pay 53.28% expense and the main 40 percent of them pay 96.56% which was earned by the means of this area. Time series data used for income and corporate taxes.

Figure: 1 Total Revenue Percentage of GDP from 1991-2014



Ahmed and O'Donoghue (2009) examined the relocation effect of Pakistan personal income tax, by using Kakwani and Reynolds-Smolensk indices. They decomposed overall tax system in order to find out the rate of contribution, deductions, exemptions, allowances and credits. This study revealed that deduction for salaried tax payer contribute more towards progressivity, and income tax ordinance resulted in greater redistribution. Income redistribution effect increases from 2002 to 2005.

Chaudry and Munir (2010) analyzed that one major explanation of high budget deficit was low tax ratio to GDP. Time series econometric techniques used to find out the major factors that lowers the tax revenue in Pakistan. This paper concluded that Pakistan's economy can collect revenues by increasing literacy levels, political stability and broadening the tax base culture and by decreasing income inequality, tax evasion and tax exemptions.

Ijaz and Hassan (2010) pointed out that the institutional problems in the process of revenue collection in developing countries. There were many reasons but one of the first main reason was corruption in the administration and secondly the bad governance in revenue collection. This study analyzed the effect of structural and institutional variables like governance and corruption on tax revenue by using a panel data set of 25 under developed countries from 1990 to 2005. They just used “Generalized Method of Moments” technique. This study revealed that good governance plays a vital role in thetax collection procedure, while corruption has adverse effects on tax collection.

Patoli, Zarifand Sayed (2012)inspected the relationship in the tax revenue and inflation in Pakistan furthermore measured the rate of advancement in the stochastic assortment of the evaluation, i.e. indirect, immediate and aggregate harges with a unit change in the expansion of Pakistan’s income. The study proposed that the relationship in the middle of assessments and the swelling is certain, so any build (diminish) in expansion will likewise bring about to expand (diminish) in duties. To put it plainly, duties and swelling move in the same bearing, yet with diverse extent. They utilized optional information for the time of 2000-2010 was utilized. The relationship among the variables was inspected at yearly impact of the same period. They additionally utilized some measurable instruments like relationship, relapse and essentialness test for the mistake term to test the speculation and close same conclusion.

Atif, Shahaband Mahmood (2012) explored the effect of inflation, taxes and bank advances on financial development and speculation. They utilized a period of arrangement for the model of Pakistan, and connected OLS system on stationarity information of development model, furthermore utilized Johnson's co mix strategy for speculation mode furthermore find that assessments have not straightforwardly huge impact on financial development, This study found that higher salary expenses obstruct development and came about low venture due to sparing channel. It is recommended that administration ought to bring down the assessments on capital and the channel of advances for private area for speculation purposes ought to be successful with appropriate observing channel.

Mehmood and Chaudhary (2013) checked out the impact of FDI (foreign direct investment) on tax revenue in Pakistan, by taking FDI and GDP per person as an explanatory variable and tax revenue as the explained variable. This study used a time series data to find out the level of integration by applying Dickey Fuller, Phillips-Perron, Ng-Perron and Zivot-Andrews URT(unit root tests). This study suggested that FDI and gross domestic product per person employed had a positive and considerable impact on tax revenue in Pakistan.

2.2. Tax Administration and Revenue Structure

Federal board of revenue (FBR) is the central authority for Tax administration in Pakistan. As shown in Table 1 that Tax has more contribution in total Revenue than Non tax. Non tax revenue contribute only 6% in total revenue, so we can say that tax is the main source for Pakistan’s revenue Structure

Table: 1Pakistan Total revenue Percentage of GDP

Periods	Tax	Non Tax	Total Revenue
FY91	12.6	4.3	16.9
FY92	13.6	5.4	19
FY93	13.5	4.6	18.1
FY94	13.7	4.2	17.9
FY95	14.3	3.6	17.5
FY96	13.5	3.4	16.9
FY97	13.3	2.3	15.6
FY98	13.2	2.9	16.1
FY99	10.6	2.6	13.2
FY00	10.7	2.5	13.2
FY01	10.4	2.7	13.1
FY02	11.6	3.2	14.8
FY03	11.1	3.3	14.4
FY04	10.2	3.6	13.8
FY05	10.3	3.9	14.2
FY06	10.4	3.7	14.
FY07	11.1	3.8	14.5
FY08	9.1	4.9	14.8
FY09	9.8	4.2	14
FY10	9.2	3.1	12.3
FY11	10.3	2.5	12.6
FY12	9.9	3.4	13.3
FY13	10.3	4.2	14.5
FY14	11.4	3.1	14.5

2.3. Trends in direct and indirect taxes

There are lots of structural weaknesses in Pakistan’s tax system. First, because of comprehensive concessions, exemptions and extensive tax avoidance as well, the Pakistan’s tax base economy was so contracted and punctured. Second, tax rates have been pitched at abnormal states, which made an endless loop of assessment base disintegration and higher duty rates. Third, there is another issue of variety of taxes, with an individual, firm confronting numerous sorts of taxes. Fourth, there is more reliance on circuitous charges, which as of not long ago, represented about 60 percent offer in incomes. This has expanded the backward of the expense framework and forced a higher weight of tax assessment. Fifth, the tax framework is more convoluted and dull, which alongside high rates, has expanded defilement and empowered shirking.

These weaknesses create the small and sluggish tax to GDP ratio on one hand, and low tax elasticity on the other. The tax ratio to GDP, which shows the country's fiscal exertion, has stayed stagnant in the area of 12 to 14 percent in the course of the most recent three decades

Direct Taxes include the income of the corporate and the non-corporate sector together with the preservation taxes. Averaging 2% of the gross domestic product largely, till 1980's the share of direct taxes remain very low, because of addition in tax exemptions and holidays in the early 1960s and in the 1970s, but after that increased in the start of1990s.These increase was more than 3 percent of the GDP in the begin of 1990s and average was 3.6 percent of total national output somewhere around 1995 and 2003.The offer of indirect charges found the value of inflation between 11-15 percent from the late 1970s to mid of 1990s, and decrease after that approximately 9% of GDP.

However, over the time, there was quite considerable shifting the share of indirect taxes to direct taxes. The share of direct taxes increased from 9% to 42% in 2014-2015, and indirect taxes considerably declined from 86% to 58%.The point to be noted that increment in the share of direct taxes in the 1990s was because of huge increment in the withholding taxes. Withholding tax was imposed on 3 sources like wage, pay rates, enthusiasm on securities and installments to non-inhabitants in the late 1990s. Till 1979, 6 types of payments were focused to include in withholding tax, which gave increase withholding tax 9 to 25% from 1994-2000.

There are many considerable changes have been experienced over time, in indirect taxes. In the late 1980s the custom duties which had a major part of taxes have been rationalized from 52% to 17% 1987-2015. As a result, the offer of traditional obligations altogether indirect taxes from 54% to 17% in 1990-2015. Now, it has been planned that the customs duties will be used just for the purpose of protecting the home industry But, drop in the excise and the custom duties has been jumped up by the quick increment in the tax on sales revenue in imports and on a local production.

Till the sales tax in late 1980s, on imports and local production was considered no difference from excise duties on local products and customs duties on imports. After that generalized to introduced sales tax that was very expensively in1989-1990 and its rates have been adjust quite often to the expansion charges consistence by the unregistered citizens to produce further taxable incomes. In 1974-1975 there were just 11.3% of total indirect taxes, but with the passage of time it sharply increases around 50% in 1996-1997, after that it decreased again and then again rises to 70% of total indirect taxes The slow growth in sales tax revenues was because of the readjustment in tax rates for some products In the budget for 2003-2004, 12.5 percent sales tax fixed in the budget for 2003-2004 for all entities, but again continually increment in sales tax to 70% in 2014-2015.

Figure No 2: Percentage share of Individual Taxes

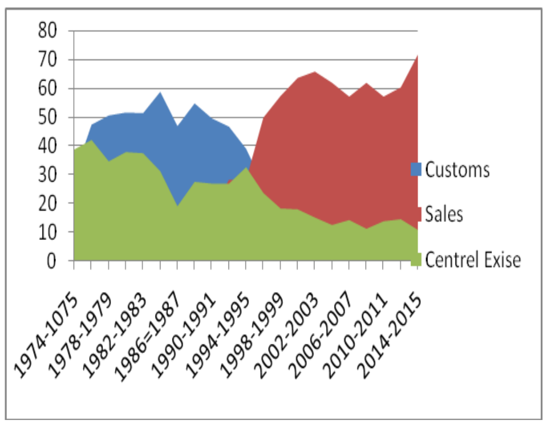


Figure 3: Percentage Share of Direct and Indirect Taxes in Total Taxes

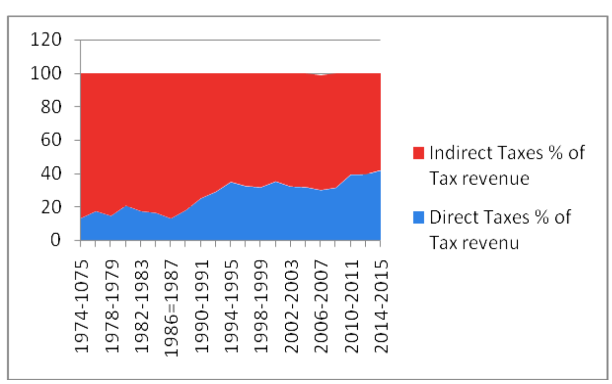


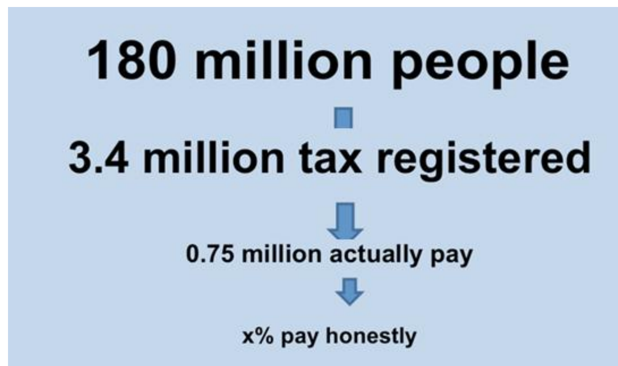
Table 2: Federal & Provincial Taxes in Pakistan

Periods	% share of individual taxes in indirect taxes			% share of total taxes	
	Customs	Sales	Central Excise	Direct	Indirect
1974-1975	30.0	11.3	38.7	13.2	86.8
1976-1977	47.5	10.5	42.0	17.4	82.6
1978-1979	50.7	9.7	34.6	14.6	85.4
1980-1981	51.7	10.5	37.8	20.7	79.3
1982-1983	51.5	11.1	37.4	17.4	82.6
1984-1985	58.9	9.9	31.2	16.4	83.6
1986-1987	47.0	10.8	19.1	13.0	87.0
1988-1989	54.9	17.6	27.5	18.0	82.0
1990-1991	49.7	23.5	26.9	25.1	74.9
1992-1993	46.8	26.3	26.9	29.1	70.9
1994-1995	39.1	28.3	32.6	35.0	65.0
1996-1997	26.4	49.9	23.7	32.5	67.5
1998-1999	24.3	57.4	18.3	31.8	68.2
2000-2001	18.3	63.7	18.0	35.3	64.7
2002-2003	18.9	65.9	15.2	32.2	67.8
2004-2005	25.4	62	12.6	31.9	68.1
2006-2007	28.5	57.2	14.3	30.1	68.9
2008-2009	28,3	62	11.3	31.5	68.5
2010-2011	25.8	57.2	13.9	39.4	60.6
2012-2013	24.7	60.4	14.6	39.6	60.4
2014-2015	17.2	71.8	10.0	42.0	58.0

In the late 1990s there were many indirect tax reforms suggested by the government of Pakistan like, income tax act in 2000 included the bookkeeping requirements under the Self-assessment proposals whereby 25% of the 1.2-1.5 million returns were to be subjected to irregular assessments The assertion of 25 percent arbitrary reviews under self-judgment was to draw in people in general everywhere to enlist their benefit without a second thought of undue disturbance by the duty powers. In the FY 2002 only 2% of the benefits were reviewed, keeping in mind the FBR said this was not an irregular review, this didn't bring up whatever other premise for it. This was vital to reduce the basic protest against the expense organization that they unnecessarily focused on the citizens in the private division on the base of nitty gritty examination.

In such a manner, the forces of the assessment officers were likewise extremely lessened they were not allowed to open the profits documented. In any case, the evacuation of diverse tax reduction, for example, the extraction of expense whitener recommendations, that guaranteed invulnerability from assessment tests, making the interest wage of national sparing endorsements assessable, getting kind reimbursement of the representatives inside of the ambit of salary duty, and distinctive step taken to make farming pay charge totally operational have shown signs of improvement duty accumulation and the assessment framework to some sum. These dynamic measures normally, would prompt an addition in the quantity of citizens later on.

2.4 Pakistan: A country with limited tax payers



2.4.1 About 3.4% labor force is registered as a taxpayer

The number of total filed taxpayers about 1.7 million out of the about 58 million workforce.

2.4.2 Most of the Pakistan's lawmakers and Parliamentarians do not pay tax

About 61% Pakistan's parliamentarians and lawmakers did not pay taxes, and about 51% senators did not pay tax, even 62% Cabinet Ministers did not registered tax returns

2.5 In Pakistan number of income tax payer is high because of withholding tax regime: Withholding tax

- Over the 120 million mobile subscribers pay withholding tax
- There are almost 17.7 million account holders, and around 36,500 millionaire accounts holder who contribute in income tax through withholding tax on interest income

- Over the 120,000 vehicles are sold every year and withholding tax also paid on their purchase
- Over 2.9 commercial enterprises and over 306,800 industrial units pay withholding tax on electricity tax

2.6 Tax reforms suggested for Pakistan

The tax policies must be fair and equal for everyone for the smooth economic growth, the following policies must be required for good tax structure listed below:

- The New methods should beintroduce for the agricultural income tax system, together with improvement of capability of revenue collecting administration.
- To facilitate the economic growth, corporate tax should be declined less than 30% for next 2 to 3 years
- To eliminate the distortions in the tax system then there is need to immediate decline in tax credits and exemptions. To reduce the burden on low income individual's withholding tax regime should be rationalized to improve the comparativeness in the economy. Custom duties should also be efficient and for the Individuals having large wealth the tax system should be rebooted.
- A wide system of VATshould startthat would supplant the present General-Sales-Tax (GST) administration together with its achievement and organization arrangement.
- In the Finance bill, tax outlays should be reported as a part of it, to the public and all parliamentarians with knowledge about tax exemption, credits and deductions. More accurate information about tax lead to a decline in government provided exemptions.
- The parliament should be vested to grant the exemptions.
- National Revenue Commission should be established to boost dialogues and discussions on policy options between the Federal and Provincial governments.
- The FBR should be made free on the lines of the State Bank of Pakistan and an arrangement of execution administration needs mindfulness.
- A risk based assessment and confirmation system should be launched.
- The tax rules and procedures should be make simpler for taxpayers, the taxpayer'sperceptibility should be encouraged and should be given different incentives to catch the attention of additional taxpayers.
- Such Management system should be introduce the incorporate or connect tax system with a national database to enhance visibility of tax avoidance.
- The tax policy and authorities should be isolated.
- The revenue board or revenue authorities should be gradually empowered to take control of all the taxes from the excise taxation and Board of revenue departments.
- The tax collector officers should be powerful at the federal and provincial levels.
- The National finance commission (NFC) Award should focused on asystem of equal grants to encourage each province to increase their taxrevenues.
- The government should reestablish deregulation policies for the departments that are under the influence of government like utility companies, airlines, railways etc. This will boost the competition and generate new investments.

3 Conclusion

The objective of this study is to evaluate the current situation of the poor tax structure in Pakistan, like many other underdeveloped countries, the management of taxation in Pakistan is incredibly poor. As taxes are the main sources of government's income or to generate higher GDP. The main reason of this poor management is the corruption. We must identify the facts that any tax reform will work if government should ready to cut down the wasteful expenditures. So that taxpayers will happily pay their taxes. Government supposed to be very careful in taxing the citizens so that the burden of taxes could be reasonable. The administration of underdeveloped nations needs to gather more returns either by means of VAT (value added tax) or from direct charges. At that point the VAT will substitute the current GST administration together with its achievement and organization arrangement. Government must take some proper and strict steps to promote tax culture and to make the mind of people to pay tax rather than tax cut. They must provide opportunities for the tax payers and to stop corruption by making tax system fair and just. The selected tax payer officers should be honest and true patriotic.

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