

Causes of Tax Evasion in Pakistan: A case study on southern Punjab

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Abstract

Introduction: Tax evasion is main problem in Pakistan due to which Pakistan remains under a lot of stress. Tax evasion results in less revenue. Many causes have been discussed which play major role in tax evasion in Pakistan. It is a primary research.

Literature review: Many authors have discussed impacts of tax evasion in different sectors of economy. Previously tax evasion cause major trouble in Tanzania & Greece.

Methodology: A questioner has been filled by targeted population of 100 Professionals & Business students of Department of Management Sciences Islamia University of Bahawalpur. Questioner was consisted of 5 major parts i.e. Tax System, High rate, Go with the flow, Corrupt Govt. & Progressive taxation.

Findings: Most of the population agrees that these causes play a vital role in the tax evasion in the Pakistan.

Conclusion: Tax evasion is main problem of Pakistan which needs to be eliminating by following the recommendations that tax system must base on ground realities, tax rates should be low. There should be proper check & balance of government, tax awareness in public should arise by different channels.

Keywords: Pakistan, Tax Evasion, Progressive Taxation, Corrupt govt., Tax system.

1. Introduction

Tax is charge in terms of monetary which is paid by public to the government. Different definitions of tax are as following.

According to Wikipedia “A tax (from the Latin *taxo*; "rate") is a fiscal charge or else other rates compulsory in the lead a taxpayer (for one person or else officially permitted entity) by a state or else the functional equivalent of a state such with the aim of failure to reimbursement is punishable by law.”

According to investor words “A fee charged ("levied") by a government on an artifact, takings, or else bustle. If ask too much of is levied unswervingly on individual or else corporate takings, subsequently it is an express ask too much of. If ask too much of is levied on the worth of a superior or else service, subsequently it is called an indirect ask too much of. The drive of taxation is to finance government expenditure. Single of the nearly everyone main uses of taxes is to finance in the public domain goods and services, such in the same way as street lighting and street cleaning. Since in the public domain goods and services perform not allow a non-payer to be located barred, or else allow exclusion by a consumer, near cannot be located a marketplace in the sphere of the superior or else service, and so they need to be located provided by the government or else a quasi-government agency, which attend to finance themselves largely through taxes.”

According to Business Dictionary “Required monetary contribution to the state's revenue, assessed and obligatory by a government on the activities, enjoyment, expenditure, pay packet, occupation, privilege, property, and the like, of persons and organizations.”

1.1 Tax evasion

Tax evasion is a process in which a tax payer does not pay tax to the tax authorities.

Levi & saddle (1989) claimed that tax evasion in wider sense, any activity which is against the law designed for reducing, avoiding or delaying one's tax liability that is, if found may bring imprisonment, penalty or monetary fine to such person who is evader.

Robert et al. (2008) said that the majority of studies on the tax evasion in the offered literature have been conducted from an economic or public finance point of view. Very small numbers of articles have discussed the issue from a philosophical or ethical viewpoint. Because most of the economist or lawyers are utilitarian or legalist.

Gerxhani (2007) cited in (Elffers et al., 1987; Schneider, 2005) that tax evasion can arrange hefty personal property on the saving in the same way as in one piece through its express penalty in place of e.g., funds deficits and hoard in the sphere of in the public domain goods. Indirect penalty, such in the same way as welfare loses due to a get rid of to money-spinning activities someplace taxes can be located evaded, might be located even bigger. Therefore, the need in place of data on tax evasion is superior, both in place of certificate purposes and in place of academic seek aimed by the side of under position this phenomenon and its penalty.

Tax evasion is main reason of collecting less tax revenue. There has been no any study conducted which indicate the possible reasons of tax evasion in Pakistan. My study will focus on all possible causes of tax evasion which will be help full for other researchers to work in future.

1.2 Scope of the study

This study covers the area of Bahawalpur City & surroundings.

1.3 Limitation of the study

As the targeted population was residence of Bahawalpur City & surroundings. This study cannot generalize to overall Pakistan. Results may be varying if the targeted population extends outside the selected area.

1.4 Objectives

1. To identify the main causes of tax evasion.
2. To analyze possible ways to eliminate tax evasion.
3. To determine all causes of tax evasion in Pakistan.

1.5 Hypothesis

H₀: - no relationship between behavior of tax payer & tax evasion.

H₁:- relationship between behavior of tax payer & tax evasion.

H₀: - no relationship between progressive taxation & tax evasion.

H₂:- relationship between progressive taxation & tax evasion.

H₀:-no relationship between high tax rate & tax evasion.

H₃:- relationship between high tax rate & tax evasion.

H₀: - no relationship between corrupt govt. & tax evasion.

H₄:- relationship between corrupt govt. & tax evasion

H₀: - no relationship between tax system & tax evasion.

H₅:- relationship between tax system & tax evasion

2. Literature Review

The literature review on the tax evasion shows that it has great impact on the economy of country. A tax evader always finds excuses not to pay tax.

Brooks & Hwong (2006) said that it is disastrous for citizen of a nation & its prosperity to evade the tax. He also discussed that ratio of achieving social objectives successfully for any high tax paying country is much better than low tax paying country.

Li et al. (2008) discovered that in many countries there are three basic observations that have

emerged recently i.e. always ethical, sometimes ethical & never or almost never ethical. They conduct their research on different universities of Hong Kong & U.S where they found that almost every respondent was against to the view that tax evasion is always or almost always ethical. They further found that most explanatory & strongest arguments on tax evasion were that, it is good & ethical to evade tax if government is corrupt; the tax system was unmerited & unreasonable. Whereas the weakest arguments on tax evasion were the cases where there was a selfish objective. They further explored cultural difference in hope of accounting for contradictory perceptions of ethics of tax evasion. They further highlighted that there is need to implement such policies to increase the awareness in people regarding the ethics of tax evasion.

Chaudhry & Munir (2010) indicates that major hurdle in the economic development & one major justification of high budget deficit in Pakistan is Low tax to GDP ratio. They try to figure out the determinants of low tax return in Pakistan by using time-series econometrics methods over the period of 1973-2009. They examine different factors which are responsible for the variation in the tax revenue collection of Pakistan. They found that basic reasons for low tax revenue in Pakistan are narrow taxation, more dependence on agriculture sector, foreign aid low level of literacy. In the end they concluded that Pakistan can generate high tax to GDP ratio by increasing literacy level & by controlling tax evasion & tax exemptions.

Zaidi (2010) said that Pakistan's economy has experienced many ups & down since last sixty years. Government of Pakistan earns less revenue resulting from the influential use of tax evasion, excuse & exemptions. Less than 1.7% of 175 million citizens pay any sort of income tax, & country's tax-GDP ratio is less than 9% (2010). Tax evasion signifies that lesser resources are available for essential social services. Tax reform can increase government's revenue, but rich & powerful people always oppose such reforms.

By gathering large scale data on tax evasion Gerhani (2007) found that it is an undisputable challenge in & itself. In a country which is in transition from a communism to democracy collection of such data was more than difficult.

Rauf & Yasmin (2002) focused on the measurement of underground economy in Pakistan from the period of 1974-2002. The underground economy is estimated by applying the monetary approach. First of all, the currency demand equation is predicted & then they try to find out the size of the underground economy & tax evasion. In the last, an ordinary least square model is use to find out the effects of underground economy on GDP of Pakistan for specific time period. The results shown a great increased in the underground economy from Rs.12 billion in 1974 to Rs. 1085 billion in 2002. The results indicate that presence of such huge underground economy can reduce tax revenue, lower GDP & increase socio-economic crisis. They further suggest that tax audits & heavy punishments can bring down the size of underground economy with all its outcomes.

Suddle & Levi (1989) found that from the mid-1980, Pakistan has observed the appearance of possible 'moral panic' which is tax evasion. It is shown by media reports about the genuineness of tax evasion. President of Pakistan while addressing to the Karachi Chambers of Commerce & industry on 1986, he told that tax evasion is more serious crime then theft he

further add that the theft can hurt only individuals, but tax evasion hurt whole nation & state.

As per Federal Board of Revenue (FBR), fewer the 0.5% citizens of Pakistan pay income tax. That is almost 750,000 persons out of 180 million people. Other countries who have same per capita income like Pakistan, have 14% of their revenue from tax whereas Pakistan has only 9%. Until Pakistan can't get enough revenue from tax, it will be highly dependable on loans & foreign aid. Currently Pakistan's debt is almost \$60 million which shows that almost 60% of Pakistan's federal revenue spent on paying these debts.

2.1 Double taxation

“Investopedia define double taxation as the amount of income tax paid twice on the same source of income.”

Double taxation take place as corporations are considered as separate legal entities form their owners. Corporations pay tax on the earnings in the same way as individuals pay tax on their earnings. When corporations pay dividends to its shareholders, such payments acquire income tax liabilities for the shareholders who earn them, as the earnings from where dividends are paid already taxes at the corporate level.

The idea of double taxation on the dividends paid to share holders encouraged considerable discussion. There are different views about double taxation someone said that it is unfair as dividends are already taxed, others said that such system is fair.

Advocates of double taxation on the dividends said that if there is no tax on dividends wealthy persons will enjoy a good living off the dividends they received by having the large amounts of common stock. Whereas other persons said that dividends payments are intended actions of companies and, as such, there is no need to double tax their income except they decide to make their payments to shareholders.

Lefter & Chirica (2010) said that in 1973 Romanian legislation introduced the avoidance of double taxation. As per requirement of developing economy, legal, social & global environment, Romania modified its law to fulfill the law requirements. One of the most important & related instant for Romania is its attainment in EU. After attainment in EU, Romania has to adopt the necessary EU fiscal legislation. As a member of EU, Romania has ultimately changed most of its double tax accords carefully, as well as individual renegotiation & change with all EU members.

2.2 Corrupt Government

It is good & ethical to evade tax if government is doing corruption said by Li et al (2008).

There are many cases in the world where public evade tax due to the corruption of Government. It may be political corruption or corruption of government.

According to Wikipedia tax evasion & political corruption present in Greece. This is to degree that tax evasion has been explained by Greek politicians as “a national sport”. It is estimated that about €30 billion remain uncollected.

Political corruption is recognized as a main problem by many onlookers, but several believe that its number has been overvalued by international media. Transparency International Greece's National Integrity Assessment 2012, issues the report that the problem of corruption in the Greece is the convergence of many factors, like weak impose of law, less audits, no code of conduct, lack of transparency of government activities, a useless bureaucracy & wide flexible powers & law of public consciousness. In 2013, Transparency International's Global Corruption Barometer held a survey in which 90% persons believe that political parties are to be corrupt or awfully corrupt & also considered them as one of the most corrupt institution of GREECE. Additionally, 39% persons think that level of corruption is greater than before while 46% think that efforts taken by government against corruption unproductive. Many sources have reported that efforts taken by government against corruption have not evaluated as productive which indicates the negligence & ineffectiveness of anti-corruption agencies.

Fjeldstad (1996) discussed the many economic factors which play vital role in the amplification the method & level of financial corruption tax evasion in the local governments of Tanzania. He stresses that how the inducement arrangement of the tax system affects the decision of tax payers & tax collectors to connect them in fake behavior.

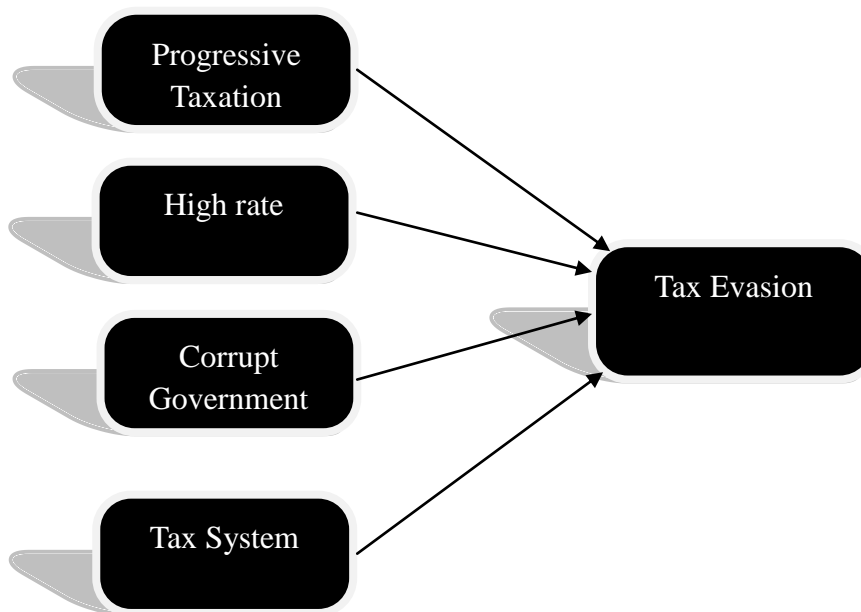
2.3 Progressive Taxation

Progressive taxation means tax rate increase with the increase in taxable amount. The word "progressive" means the tax rate increase from low rate to high rate, which indicates as a result the normal tax rate is low as compare to maximum marginal tax rate. It can be useful not only for personal taxes also for whole tax system. Progressive taxation is enforce in an attempt to decrease the tax commonness of people with less ability-to-pay; as the taxes change the frequency more & more to those with higher ability-to-pay.

2.4 Go With the flow

"Go with the flow" usually refers to the meaning that people follow behavior of other people. If most of the people are doing something more frequently then remaining other persons will also do that. Here in case of tax evasion behavior of one tax evader effects other tax payer as he motivates him to not to pay tax.

Research Model



3. Methodology

The main purpose of research is to find out all the causes of tax evasion which remains main focus of the study in the literature review.

3.1 Type of research

It's a primary & quantitative research.

3.2 Tool use for data collection

For data gathering and to investigate the study questions a questionnaire with closed ended questions designed by me with the help of supervisor. The questionnaire consisted of 5 main parts; Part 1 collected the data about progressive taxation, Part 2 asked information about high tax rates, Part 3 asked about the effect of corrupt government on tax evasion, Part 4 gathered information about behavior of one tax evader effects on other tax payer i.e. “go with the flow” & Part 5 discuss the tax system of Pakistan. For reliability check I use pilot testing by filling 25 questioners.

Item	Cronbach's Alpha	No. of Items
PGT	.545	4
HR	.638	4
CG	.536	5
GWF	.623	3
TS	.683	8

Since all the values are greater than benchmark of 0.5 (Hair et al., 1998). So the questioner is being considered as reliable.

3.3 Targeted population

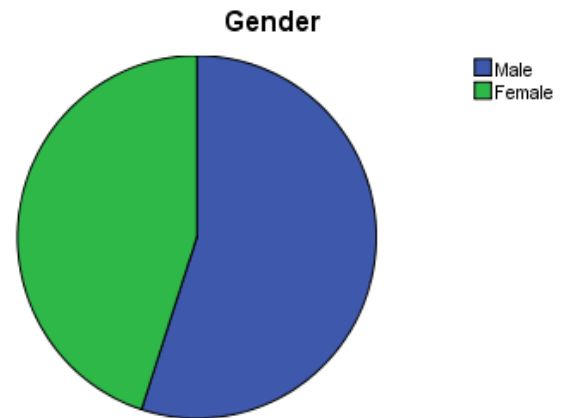
Main targeted population to complete the survey was the professionals & business students in the Department of Management sciences. Questioners were distributed among the respondents which were drawn from different classes. The selection of the participants was certain and the only criterion was the tax payer either direct or indirect taxes. The format of the survey was based on a mixed method of seeking quantitative responses.

3.4 Tools use for data analysis

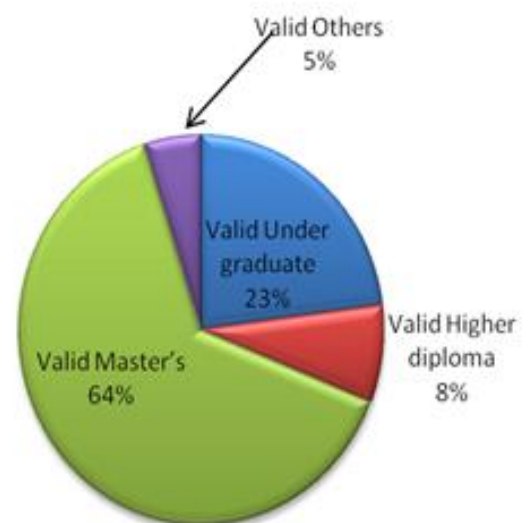
For analysis I use spss 16.0 & Ms Office. Where I analyze my data by applying Chi-square test & represent it through pie-chart.

Findings:-

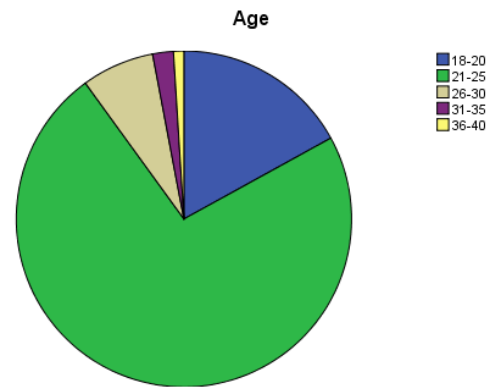
In the targeted population 55% were male & 45% were female.



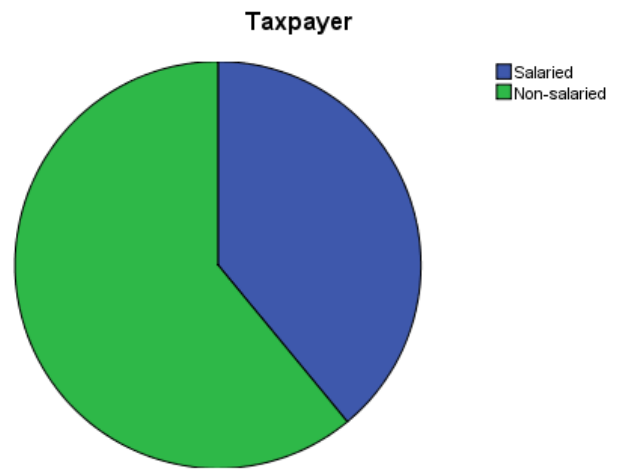
The targeted population's education 23% were undergraduate, 8% were higher diploma, 64% were Master's & 6% were doing some other degrees.



The targeted population's age: 17% were 18-20 years old, 72% were 21-25, 7% were 26-30, 2% were 31-35 & 1% was 36-40.

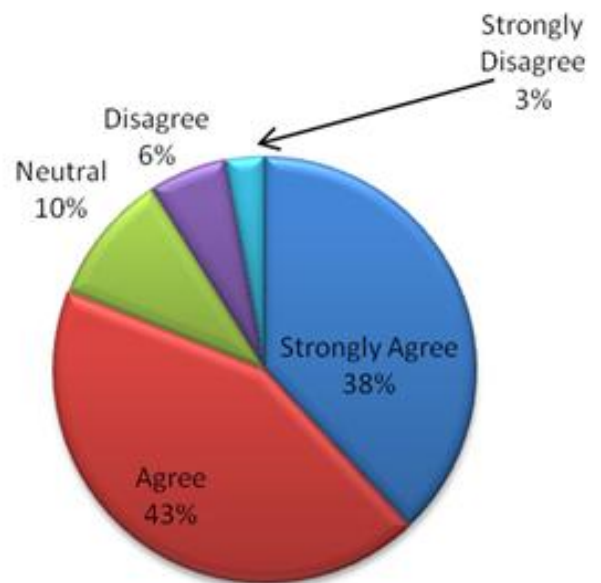


In the targeted population 29% were salaried person & 61% were non-salaried.



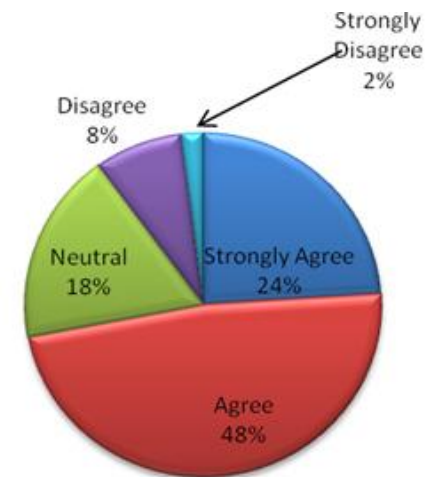
There is no concept of progressive taxation in Pakistan.

In this question 81% of population are agree that there is no concept of progressive taxation in Pakistan. Whereas only 9% are disagree



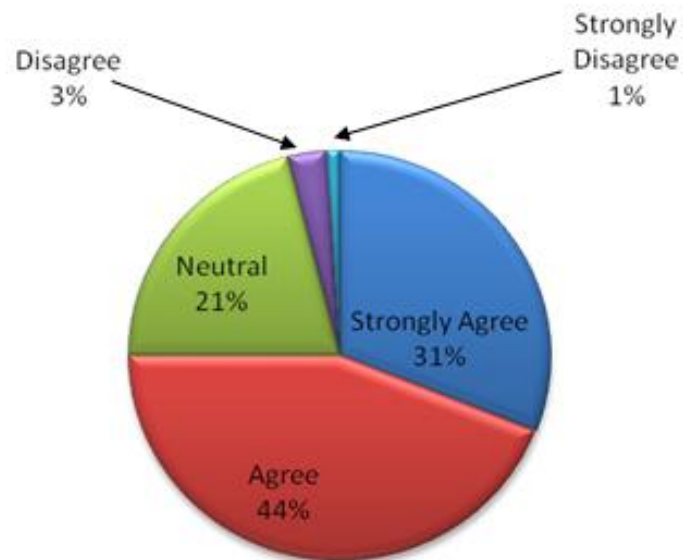
Introduction of Progressive taxation can encourage people to pay taxes.

In this question 72% of population was agree that after the introduction of progressive taxation people will be agree to pay taxes.



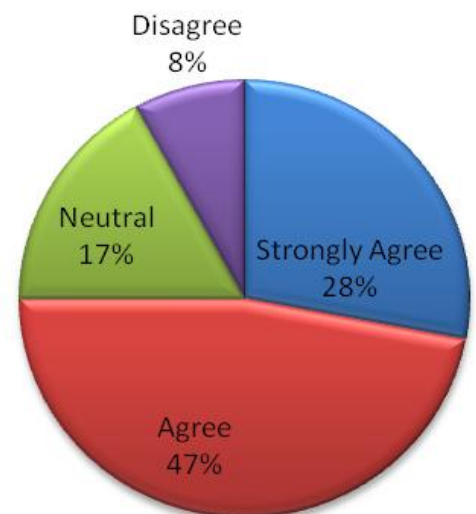
Introduction of Progressive taxation can eliminate the un-justification in our tax system.

In this question 75% of the population is agree that progressive taxation can eliminate un-justification in our tax system. Whereas 21% population is neutral & only 4% population is disagree from this concept.



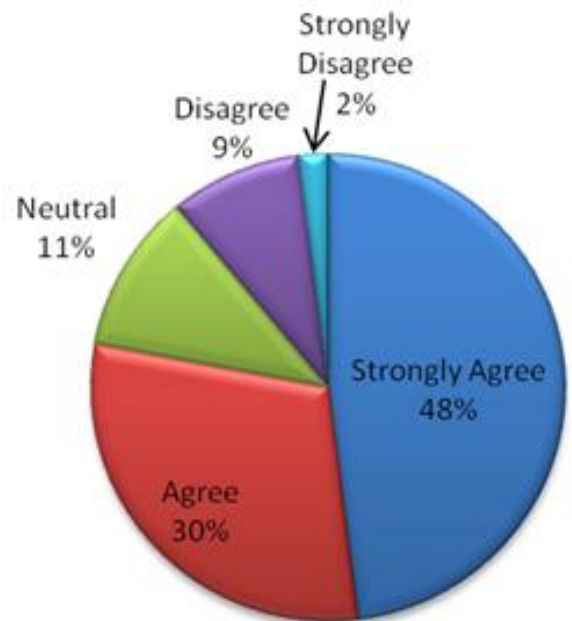
Progressive taxation can eliminate tax evasion.

In this question 75% of population is agree that progressive taxation can eliminate the tax evasion from Pakistan. Whereas only 8% population is disagreeing from this concept that & 17% remain neutral.



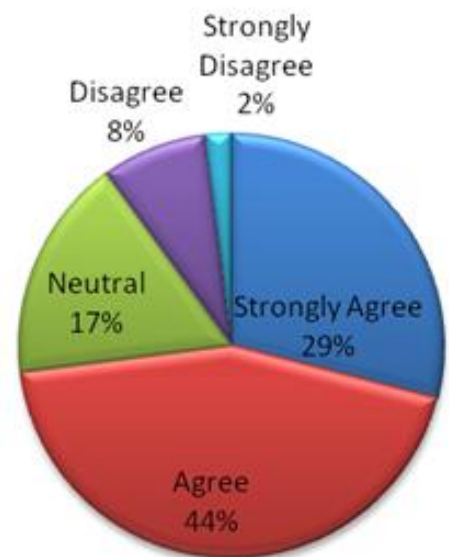
Tax rates are higher in Pakistan.

In this question 78% of population is agree that tax rates are high in Pakistan. Whereas 11% remains neutral & 11% are disagree that tax rates are not higher in the Pakistan.



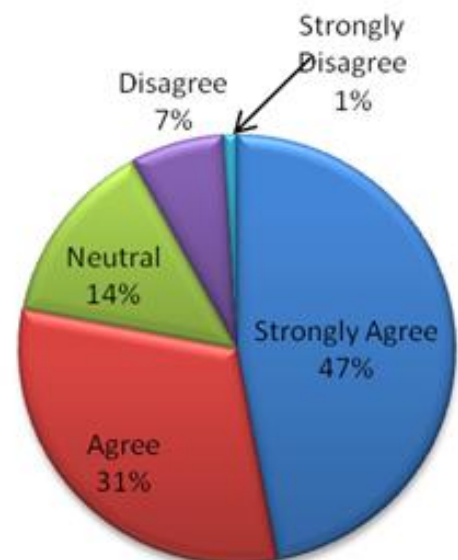
Corporate tax is high in Pakistan.

In this question 73% of population is agree that corporate tax is high in Pakistan. Whereas 10% are disagree that corporate taxes are not high & only 17% remains neutral.



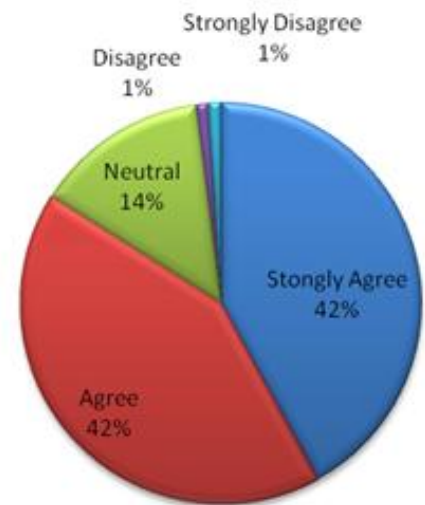
High rates discourage to pay tax.

In this question 78% of the population think that high rates discourage tax payer to pay tax. Whereas only 8% are disagree & 14% remains neutral.



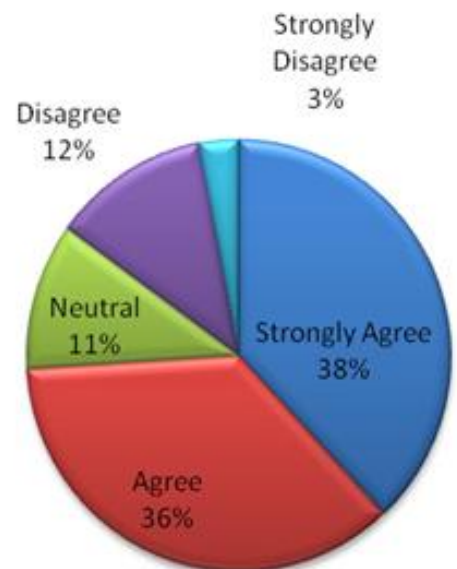
High rate is one of the main causes of tax evasion.

In this question 84% of population is agree that high tax rate is one of the main reason of tax evasion. Whereas only 2% are disagree & 14 % remains neutral.



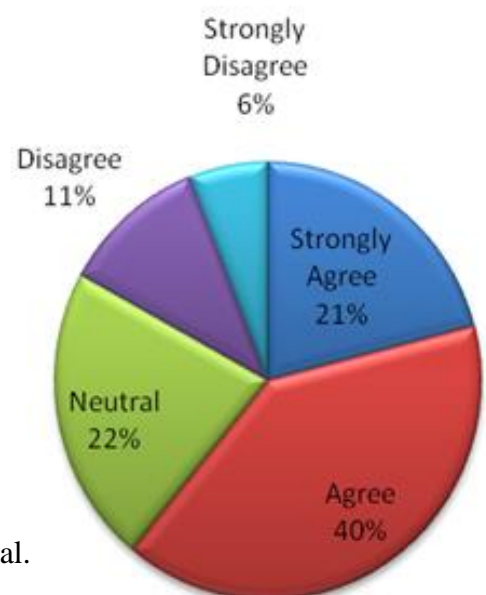
There is no benefit for tax payer from government.

In this question 74% of population is agree that tax payers are not receiving any sort of benefit from government. Whereas 15% population is disagree from this question & only 11% remains neutral.



There is no strictness from government on tax evasion.

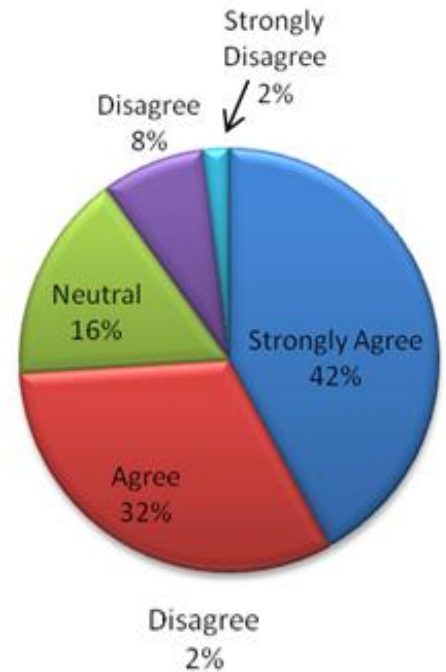
In this question 61% are agree that there is no strictness from the government on tax evasion. Whereas only 17% population is disagree & 22% remains neutral.



Corrupt government discourage tax payer to pay tax.

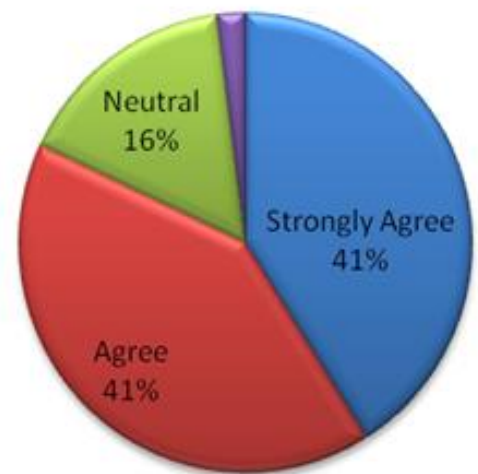
In this question 74% of population is agree that corrupt government discourage tax payer to pay tax.

Whereas only 10% of population is disagree & 16% remains neutral.



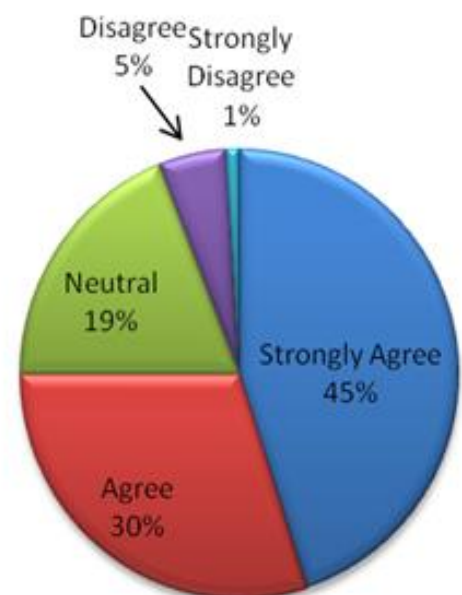
Corruption of govt. encourage tax payer to evade taxes.

In this question 82% of the population is agree that corruption of government encourages tax payer to evade tax. Whereas only 2% population is disagree with the question & 16% remains neutral.



Corrupt govt. is the reason that people don't pay taxes.

In this question 75% of the population is agree that corrupt

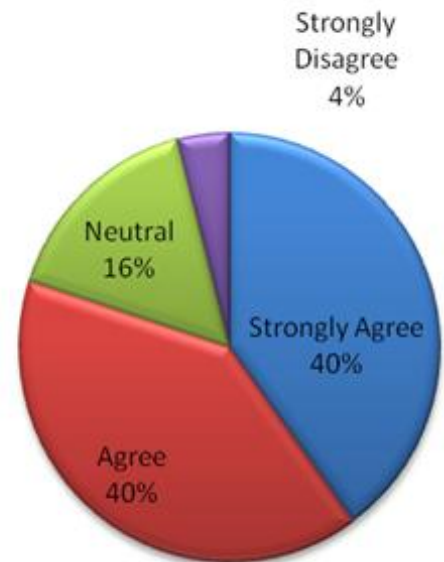


govt. is the reason that people don't pay taxes. Whereas only 6% of population is disagree with the question & 19% remains neutral.

People don't pay taxes because they usually "Go with the flow".

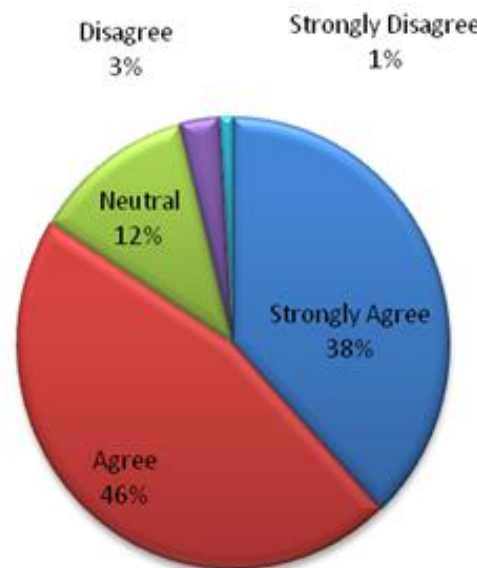
If someone don't pay tax why should I?

In this question 80% population is agree that people usually go with the flow & don't pay taxes. Whereas only 4% are disagree with the question & 16% remains neutral.



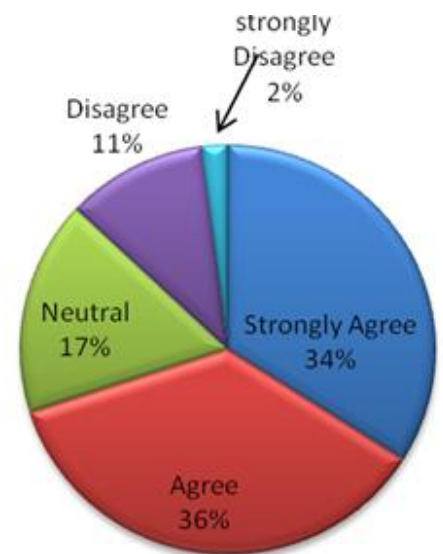
Behavior of one tax evader affects other tax payer.

In this question 84% of the population is agree that behavior of one tax evader affects other tax payer. Whereas only 4% of population is disagree & 12% remains neutral.



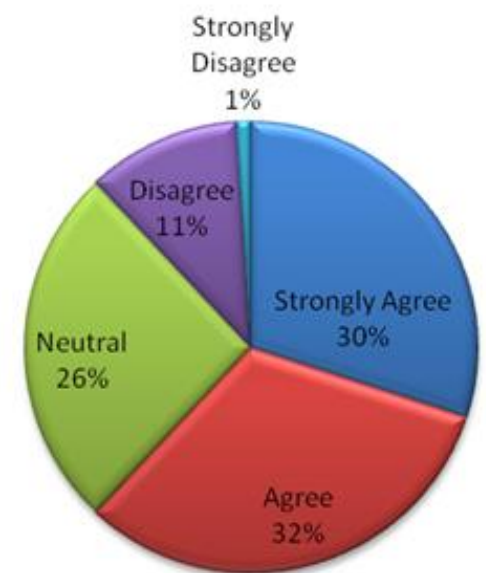
Tax evaders motivate tax payers not to pay taxes.

In this question 70% population is agree that one tax evader motivate other tax payer not to pay tax. Whereas only 13% population is disagree & 17% remains neutral.



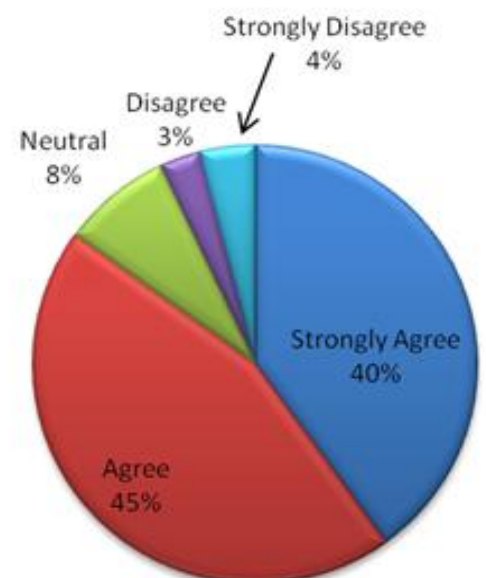
Taxpaying system is very complicated in Pakistan.

In this question 62% of population agree that taxpaying system in Pakistan is very complicated. Whereas 12% population is disagree & 26% remains neutral.



People don't take responsibility to pay tax.

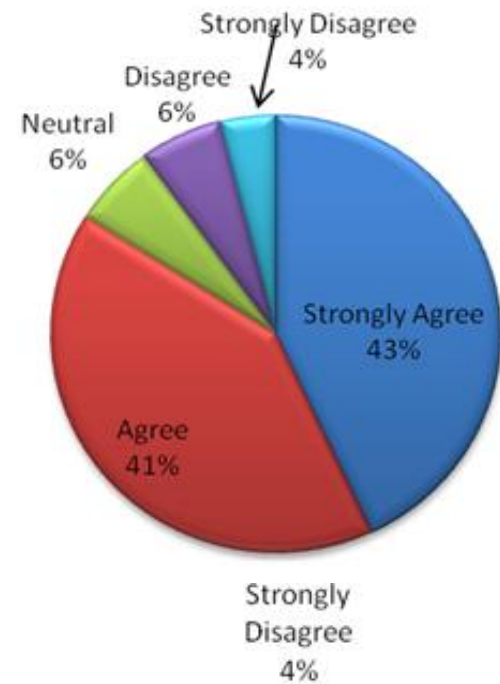
In this question 85% of population agree that people don't take responsibility to pay tax. Whereas only 7% population is disagree & 8% remains neutral.



There is ignorance about tax system in Pakistan.

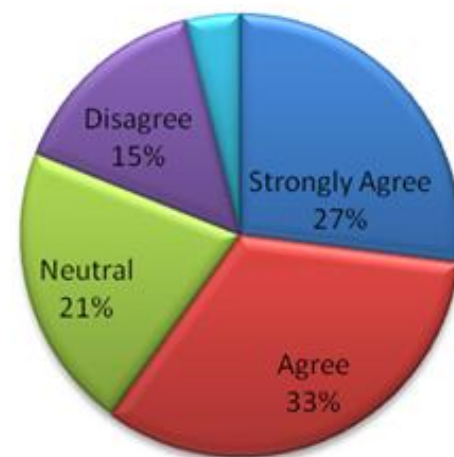
In this question 84% of the population agree that there is ignorance about tax system in Pakistan.

Whereas 10% population is disagree & only 6% remains neutral.



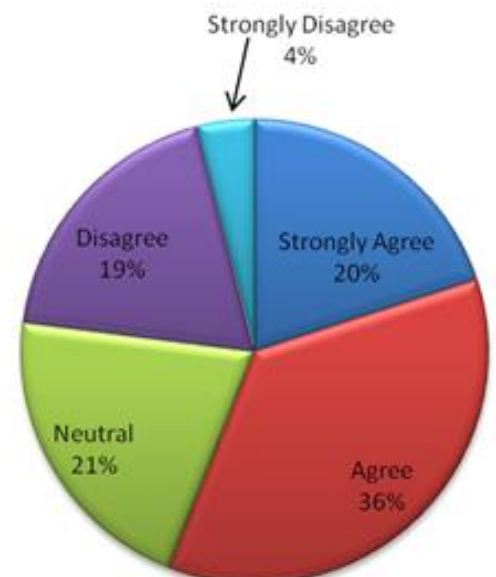
There is no threat of punishment in case of non-payment of tax.

In this question 60% of population is agree that there is no threat of punishment in Pakistan. Whereas only 19% population is disagree & 21% remains neutral.



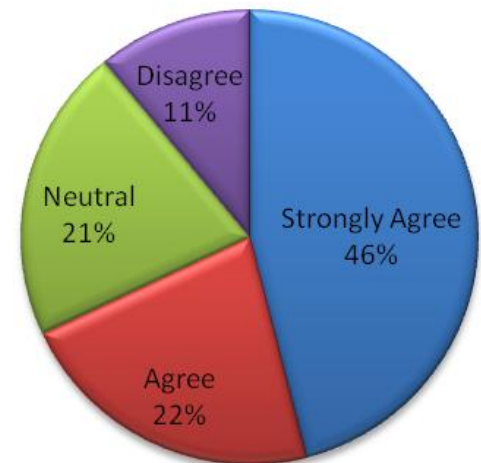
Taxpaying system in Pakistan is too difficult to follow.

In this question 56% population is agree that taxpaying system is too difficult to follow in Pakistan. Whereas 23% disagree & 21% remains neutral.



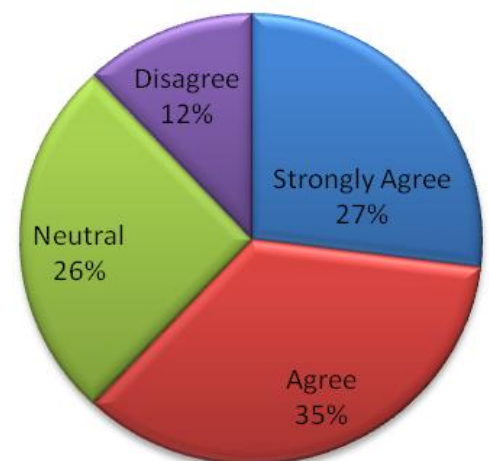
Double taxation discouraged to pay tax.

In this question 68% population is agree that double taxation discourage to pay tax. Whereas 11% population disagrees with concept & remaining 21% remain neutral.



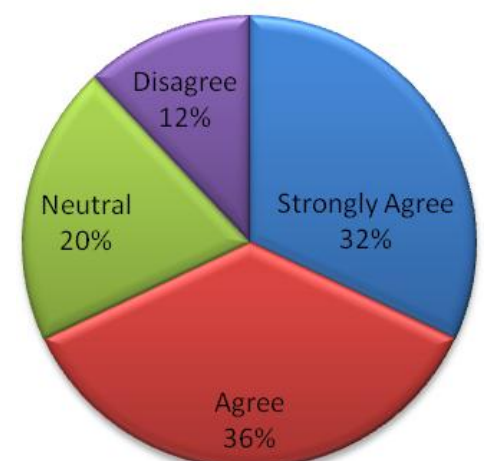
There is irrational legislation in Pakistan.

In this question 62% population agree that there is irrational legislation in Pakistan. Whereas only 12% disagree & remaining 26% remains neutral.



Laws are not based according to ground realities.

In this question 68% population are agree that laws are not based on ground realities. Whereas only 12% are disagree & 20% remains neutral.



5. Hypothesis testing:-

On the basis of all findings, hypothesis can be concluded as,

PGT:-

In all the questions of progressive taxation most of the population agrees that by the introduction of progressive taxation, tax evasion can be eliminated from the Pakistan.

So we will accept the H_1 hypothesis that there is relationship between progressive taxation & tax evasion.

HR:-

In all the questions of High rate most of the population agree that high tax rate effects the tax collection in Pakistan & people evade tax due to high tax rates.

So we will accept the H_2 hypothesis that there is a relationship between high tax rate & tax evasion.

CG:-

In all the questions of corrupt govt. most of the population agrees that due to the corruption of govt. in Pakistan they don't pay tax. So we will accept the H_3 hypothesis that there is relationship between corrupt govt. & tax evasion.

GWF:-

In all the questions of Go with the Flow most of the population agrees that behavior of tax evader affects the other tax payer & they motivate others to not pay taxes.

So we will accept H_4 hypothesis that there is a relationship behavior of tax payer & tax evasion.

TS:-

In all the questions of tax system most of the population agrees that tax system in Pakistan is not based on ground realities. All the decisions are made irrationally.

So we will accept the H_5 hypothesis that there is a relationship between tax system & tax evasion.

6. Conclusion & Recommendations:

After completing all the surveys we can conclude there are many causes of tax evasion which effects tax collection in Pakistan. These causes are absence of progressive taxation concept in Pakistan which can eliminate the inequality in tax system of Pakistan, high tax rate discourage tax payer to pay taxes & increase tax evasion, corruption of government force public to evade tax as they thinks that there is no benefit from government for them so they don't pay taxes overall or pay less than actual tax most of the people thinks that tax evasion

becomes ethical when government is corrupt, behavior of one tax evader effects other tax payer he motivates tax payers not to pay tax which causes more tax evasion, most of the people don't know about tax system that's why they don't take responsibility to pay taxes as tax system is very complicated & most of the people don't know about their taxes & how to pay them.

6. 1 Recommendations

To improve tax revenue in Pakistan Govt. have to eliminate tax evasion by following some recommendations which have derived from the study i.e. introduction of progressive taxation can eliminate tax evasion from Pakistan as it reduce unfairness of tax system which will attract more tax payers.

Accountability of Govt. can eliminate its corruption which will encourage tax payers to pay taxes. Proper audits of government will also help to reduce tax evasion.

Tax system should be easy & easily understandable for the public so that people can easily understand it & follow it.

Tax rates should be low down so that each & every tax payer should pay his tax more easily & conveniently.

There should be strict policy against the tax evaders there should be monetary fine & imprisonment.

By following all these recommendations govt. can increase their tax revenues & can control tax evasion.

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Appendix
Descriptive Statistics

	N	Mean	Std. Deviation	Minimum	Maximum
PGT1	100	1.93	.998	1	5
PGT2	100	2.16	.950	1	5
PGT3	100	1.99	.859	1	5
PGT4	100	2.05	.880	1	4
HR1	100	1.87	1.060	1	5
HR2	100	2.10	.980	1	5
HR3	100	1.84	.982	1	5
HR4	100	1.77	.802	1	5
CG1	100	2.06	1.118	1	5
CG2	100	2.41	1.120	1	5
CG3	100	1.96	1.044	1	5
CG4	100	1.79	.782	1	4
CG5	100	1.87	.960	1	5
GWF1	100	1.88	.956	1	5
GWF2	100	1.83	.829	1	5
GWF3	100	2.11	1.063	1	5
TS1	100	2.21	1.028	1	5
TS2	100	1.86	.975	1	5
TS3	100	1.87	1.041	1	5
TS4	100	2.36	1.150	1	5
TS5	100	2.51	1.133	1	5
TS6	100	1.97	1.058	1	4
TS7	100	2.23	.983	1	4
TS8	100	2.12	.998	1	4