

Tax Base: Hurdles, Opportunities and a way Forward.

Taxation is the system used by governments to impose compulsory levies on the incomes of individuals or entities. The primary purpose of taxation is to generate revenue for government expenditure, although there are other reasons as well. Taxes are not paid to get something directly in return. The system helps in the achieving of Resource Allocation, Income Redistribution and Economic Stability. For the first goal, taxation helps to ensure that resources are allocated in the market in a way that has maximum utility and benefit for all parties involved in trade and production, to whatever extent it is possible. For the second goal, taxes are levied on the more financially stable to ensure that social security is maintained in society, with regards to the homeless, unemployed, veterans, old age beneficiaries and orphans. For the third goal, fiscal and monetary policy is used to ensure 2 things: Maximum Employment and Price Stability.

The taxation system exists in 3 kinds. Firstly, the Proportional tax system imposes the same relative tax burden on all tax payers. Tax liability and income grows by the same proportion. A progressive tax system has a more than proportional rise in tax liability as income grows, while a regressive tax system has a less than proportional increase in tax liability with respect to increase in income.

The tax base is the total amount of revenues and assets that fall under the jurisdiction of taxation. They are the sectors that the government can tax, to raise revenue or for other purposes. The tax base is used to calculate the tax liability of the assets and incomes that fall in it, to measure to what extent certain sectors are taxable and by how much. The tax base is so important because there is a direct correlation between the economic state of a society and the budget of the government. The economic state and condition will decide which sectors of business and revenue generation can be added to the tax base and therefore decide the budget for the government. In turn, the government must take care and consider which sectors are taxable and what will be the effect of taxation on those business sectors. It is a dependent system.

The tax base depends heavily on regional characteristics. Certain business sectors are more strong and stable in a specific region, and are therefore more liable to taxation. For example, if the tax base of a region is derived from property values, an upswing in real estate prices will result in a corresponding increase in property taxes for the governing entity. When a region's tax base fluctuates (as may occur when the area transitions from a growth phase to a recession), the outcome will be corresponding changes in the tax receipts of the applicable government.

The reason the tax base is so important is that it is the factor that decides economic growth and activity. It helps in government planning in 2 ways. Firstly, the tax base decides from where the government will get funds for its expenditure, which is the primary purpose of tax collection. Some sectors may be added and some may be excluded. This is decided by the second helping way, deciding as well as viewing which sectors are stable and which sectors need help. The government has to be careful in this regard. Flourishing of business sectors is heavily dependent on regional factors as well as others, like taste, culture, religion etc. the government analyzes which sectors are stable enough to be taxed and which sectors need tax breaks and need to be cost efficient to survive in the market. Because excluding them from the tax base today will result in those businesses thriving and one day being stable enough to be included in the tax base later on.

Moving to Pakistan, the tax system is not a standard to be followed. Several issues exist. With regards to the tax base, in accordance to the 2001 Tax Ordinance, every business sector with the exception of the Agricultural Sector is liable to taxation. Therefore, the tax base can be considered as broad. However, it must not be forgotten that Pakistan is a 3rd World Agro-Based economy, still somewhere between the primary and secondary sector level economy. Therefore, business contributions are not what they may be predicted to be. This paper analyzes what the main issues are and categorizes them into 3 main headings:

1. Collection

Taxes are used to fund government projects that ultimately benefit the society that is paying those taxes, be it in the form of free healthcare, education, social security, defense or business subsidies. However, such programs hold substantial costs, which cannot be covered if the vast majority of the population participates in tax avoidance, and if possible, tax evasion. Resultantly, even if business sectors that fall within the tax base are generating taxable revenue, it is not collected, as the businesses ensure that their financial matters are positioned in such a way that they pay minimal tax, or not at all if possible. That is why a culture has been developed in which having to pay taxes is regarded negatively. The public deems it as a form of extortion, stating that the tax money is wasted in corruption and there are no returns from it, or if there are, they are not same on the relativity scale as the amounts they collectively pay. In turn, the government and the respective institutions designed to collect those taxes state that the country is in a dire financial position due to this mindset. Majority of the population is still unregistered, as well as businesses, which leads to transactions taking place via untraceable hand-to-hand cash. This leads to invisibility of local trade: billions of Rupees worth of cash dealings take place in markets like Raja Bazar. It is not presumptuous to say that the tax collecting authority, the Federal Board of Revenue, is incompetent in this matter. The FBR is not in a position to ask for taxes due from businesses in fear of strikes from technocrats, who will close their offices in protest, causing social unrest, voicing strong opinions and more importantly, stopping business which leads to the general public not being able to carry on with their daily lives. Today, out of a population of 22 Crore, the tax payers are 2.154 Million. A meagre number compared to the vast population.

2. Political Influence

It is no secret that corruption occurs on all levels on a very large scale in the matter of taxes. While the government is expected to provide to the public social or otherwise benefits, it rarely does. In place, private companies usually do add healthcare plans to their employees, which is a rather large cost in the form of wages. This example explains to an extent why the mindset discussed in the previous point exists. Political interference is a big thing. The agricultural sector is either not or negligibly so outside the tax base. The reason, while stated that Pakistan is an agrarian economy and thus the sector should not be taxed, is that high profile politicians and landowners, who preside over parliament seats and political party positions own most of the land and mills in the agriculture sector. They earn heavily, and thus are unwilling to cut their profits short by making them taxable.

3. Balance of Trade

The government and FBR sometimes voluntarily remove taxes from some sectors and products to increase willingness of businessmen of to boost and encourage trade, usually in exporting products to maintain a positive balance of trade and thus, balance of payments. This is for creating export processing zones. It aims to stand against competition like China which is cost efficient. It is in hopes to generating an export culture.

So, we understand that while the tax base might be extensive in Pakistan, and the plan sound and reasonable, its execution is faulty, and the executioner, meaning the FBR, is incompetent. The solution for this is to introduce the system of Accountability, for those involved in tax evasion and avoidance, for those knee deep in corruption, and for those who use political power and affiliation to ensure that the policies designed are to be favorable to their business models and financial positions.

