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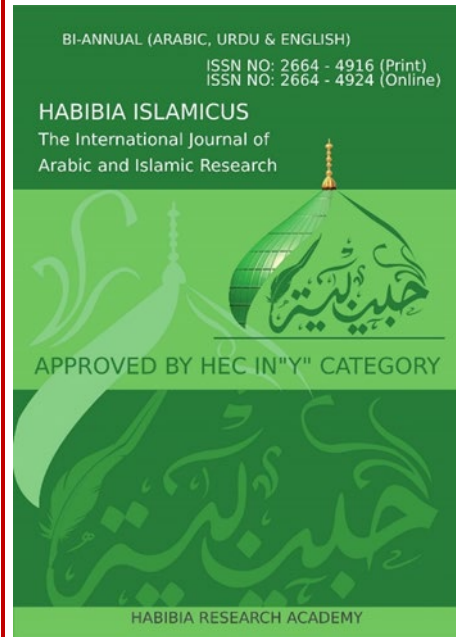
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TOPIC:
TAX EVASION IN PAKISTAN
(WITH SPECIAL REFERENCE TO ISLAMIC CONCEPT)

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TAX EVASION IN PAKISTAN

(WITH SPECIAL REFERENCE TO ISLAMIC CONCEPT)

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ABSTRACT

Tax violation in Pakistan is very high that has led to deteriorated economic situation and lack of public service delivery. The four variables of tax morale are; feelings of guilt and shame; lack of trust on government; perception about other citizens paying taxes; and level of penalties- as determinants of tax evasion in Pakistan. The perception about utilization of money, elements of shame, perception about other citizens' compliance behavior and level of penalties effect tax violation. However, variables of guilt and perception about corruption do not have significant impact on evasion behavior. Some policy interventions have been suggested to curb the menace of tax violation. These policies include motivating tax payers through methods like hypothecation, imposition of fines and penalties and publishing names of defaulters through media and tax department website. Tax violation is a crime in almost all developed countries, and the guilty party is liable to fines and/or imprisonment. In Pakistan, many acts that would amount to criminal tax violation in other countries are treated as civil matters. Dishonestly misreporting income in a tax return is not necessarily considered a crime. Such matters are handled in the tax courts, not the criminal courts. In Pakistan, however, some tax misconduct (such as the deliberate falsification of records) is criminal. Moreover, civil tax transgressions may give rise to penalties. It is often considered that the extent of violation depends on the severity of punishment for violation.

KEYWORDS: Tax violation, Tax Morale, Taxation, Pakistan, Public Policy.

INTRODUCTION:

According to Islamic belief the following direction should be considered: *Take, [O, Muhammad (saw)], from their wealth a charity by which you purify (tazkiah) them and cause them increase, and invoke [Allah's blessings] upon them. Indeed, your invocations are reassurance for them. And Allah is Hearing and Knowing. (Surah Al-Tawbah: 103).*

حُدَّ مِنْ أَمْوَالِهِمْ صَدَقَةً تُطَهِّرُهُمْ وَتُزَكِّيهِمْ بِهَا وَصَلَّ عَلَيْهِمْ - إِنَّ صَلَاتَكَ سَكَنٌ لَهُمْ وَاللَّهُ سَمِيعٌ عَلِيمٌ (توبه: ۱۰۳)

ترجمہ: ”آپ ان کے مالوں میں سے صدقہ لے لیجئے.....“ اس آیت میں مسلمانوں کی زکوٰۃ کو باقاعدہ اسلامی حکومت کی تحویل میں دینے کا قانون نازل ہوا ہے۔ گو کہ ہم موجودہ انکم ٹیکس کو زکوٰۃ کے متبادل نہیں سمجھتے اس لیے کہ انکم ٹیکس صرف آمدنی پر ٹیکس ہوتا ہے جب کہ زکوٰۃ اصل سرمائے پر عائد ہوتی ہے۔ (قرآن میں نظام زکوٰۃ: از: حضرت مولانا مفتی محمد شفیع صاحب و مولانا محمد رفیع عثمانی صاحب) البتہ یہ

بات اپنی جگہ ہے کہ عوام کی فلاح کے لیے فنڈنگ ریاست کی ذمہ داری ہے جو ٹیکس کی صورت میں حکومت جمع کرتی ہے اور اس کی ادائیگی میں ہیرا پھیری ریاست کے ساتھ دھوکہ دہی ہے۔

Taxes play an important role in the economic development of the country as it enables the government to achieve its objectives like defense, education, justice and social welfare to its citizens Taxes also enable the government to save itself from foreign dependence and to support its industry by taxing imports. The importance of taxes in countries like Pakistan is immense as more than ninety percent of the revenue generated is through taxation. According to the Ministry of Finance, Government of Pakistan, the tax structure of Pakistan is divided into two broad categories:

1. **Direct Taxes:** These taxes are further divided into:
 - a. Income Tax
 - b. Worker Welfare Fund
 - c. Capital Value Tax
2. **Indirect Taxes:**
 - a. Sales Tax
 - b. Customs Duty
 - c. Federal Excise Duty

The Constitution of Pakistan states that Pakistan is a federation with four provinces. The Federal Government generates ninety-five percent of the total taxes while the provincial share is just five percent in the total revenue collection. The Federal share is further divided among the provinces according to certain criteria as given in the Article 160(1) of the Constitution of the country. Pakistan is a country that has a Tax to GDP ratio of just 13% which is the lowest in emerging economies. Pakistan has been facing the dilemma of poor tax collection. The consequences of such poor collection are many folds. First of all this reduces revenue collection as the government in order to enhance revenues has to go for more indirect taxation that is regressive in nature. This situation in turn increases over all prices in the country and the general public suffers as a result. One of the main reasons for poor tax collection in Pakistan is Tax violation. Tax violation is a formal expression for pilferage of taxation and includes all those activities of hiding incomes or over stating expenses that lead to deprivation of the authorities from tax revenue. It is different from tax avoidance in the sense that avoidance involves legal ways to reduce the tax burden. The issue of tax violation is not new for Pakistan. Tax violation and underground economy existed in the country even in the 1960s. Nevertheless, the situation worsened as time passed.

CAUSES OF TAX VIOLATION:

- i) **Concealment of Facts:** Tax violation refers to the concealment of incomes and profits; overstating expenditures; and misreporting sources of incomes. Tax violation is

considered a criminal action and a violation of law as it involves willful concealment of facts related to income earned through legal sources. Tax violation is a global phenomenon that prevails everywhere irrespective of religion or customs and it goes hand in hand with taxation process.

ii) Corruption, Poor Governance and Political Instability: Lac of trust on government as well as the state institutions and the utilization of their tax money by the political and bureaucratic elite is a determining factor of tax evasion. Corruption, poor governance and political instability is to be responsible for giving birth to tax violation behavior among the individuals. People adhere to tax violation habits if they consider that the services being provided to them are not sufficient or those assets are being deprived of their right and access to public services.

iii) Higher Tax Rates and Unfair Tax System: Higher tax rates and unfair tax system are also a point of concern as far as relationship to tax violation is concerned. Much scholarly work has identified a positive relationship between higher tax rates and unfair tax system with tax violation in the economy. Higher tax rates and multiple taxes imposed on a lower tax base has been a determining factor of poor tax collection. When the tax rates are higher and people perceive that the benefits in return of the taxes being paid are not as much, they avoid paying taxes and hence evade taxes. The higher rate of direct taxes in the economy leads to underground or informal economy as people go for informal and undocumented transactions to avoid their income being taxed by the authorities.

iv) Determinants of Tax Evasion: Male persons who are married evade more as compared to females and people who are unmarried while young people evade more than elderly people. Gender, age, educational status and income source-among other variables-as contributing factors or determinants of tax violation which have a significant relationship with tax violation.

v) Evasion of Customs Duty: Customs duties are an important source of revenue in developing countries. Importers attempt to evade customs duty by (a) under-invoicing and (b) mis-declaration of quantity and product-description. When there is ad valorem import duty, the tax base can be reduced through under-invoicing. Mis-declaration of quantity is more relevant for products with specific duty. Production description is changed to match a H.S. Code commensurate with a lower rate of duty.

vi) Smuggling: Smuggling is import or export of products by illegal means. Smuggling is resorted to for total evasion of customs duties, as well as for the import and export of contraband. Smugglers do not pay duty since the transport is covert, so no customs declaration is made.

vii) Evasion of Value-Added tax (Vat) and Sales Taxes.: During the second half of the 20th Century, value-added tax (VAT) emerged as a modern form of consumption tax throughout the world. Producers who collect VAT from consumers may evade tax by under-reporting the amount of sales. Pakistan uses both a VAT at the federal level (the

Goods and Services Tax) and sales taxes at the provincial level; some provinces have a single tax combining both forms.

viii) Government Response: The level of evasion depends on a number of factors, including the amount of money a person or a corporation possesses. Efforts to evade income tax decline when the amounts involved are lower. The level of evasion also depends on the efficiency of the tax administration. Corruption by tax officials make it difficult to control evasion. Tax administrations use various means to reduce evasion and increase the level of enforcement: for example, privatization of tax enforcement or tax farming.

ix) Corruption by Tax Officials: Corrupt tax officials co-operate with the taxpayers who intend to evade taxes. When they detect an instance of evasion, they refrain from reporting it in return for bribes. Corruption by tax officials is a serious problems for the tax administration in Pakistan.

x) PSI Agencies: Pre-shipment inspection agencies like Societe General De Surveillance S.A and its subsidiary Cotecna are in business to prevent evasion of customs duty through under-invoicing and mis-declaration. However, a large number of these agencies have cooperated with importers in evading customs duties.

CONSTITUTIONAL VIOLATION IN TAXATION:

The federal government unlawfully and exorbitantly enhanced rates of sale tax through statutory regulatory order (SRO)-693(I)/2015 dated September 30, 2015-issued under section 3(2)(b) of the Sales Tax Act, 1990. This was in utter violation of Constitution of Pakistan that is Article 77 read with Article 162. Unfortunately, the Parliament and the Supreme Court have not taken note of this flagrant violation of the supreme law of the land. It also exposes oft-repeated claims of the government that power to levy taxes or grant exemptions through SROs is no more available to the executive branch of State. Section 3(2)(b) of the Sales Tax Act, 1990, first substituted through Finance (Amendment) Ordinance, 2015 dated April 30, 2015, was approved by the Parliament by passing the Finance Bill, 2015. This approval was in direct conflict with Article 162 of the Constitution as no such Bill could have been tabled in the Parliament before the prior approval by President. In the wake of this insertion or even prior to it, the federal government has been enhancing sales tax rate on many items through SROs despite giving an impression that these powers are no longer available to it. The fact remains that the government has been and is still increasing sales tax rates on many items, especially petroleum products, without seeking the approval of Parliament, required under the Constitution. Issuance of repeated SROs to enhance sales tax rates contradicts the claim of the Finance Minister, made in a press conference held on May 11, 2015, that “through Finance (Amendment) Ordinance, 2015, power of FBR to issue SROs has been withdrawn”. He told the media that such powers were transferred to the Economic Co-ordination Committee of Cabinet (ECC) in “exceptional circumstances”. The worthy Minister is not tell the whole truth as that was

only in respect of section 13 of the Sales Tax Act, 1990 granting exemption and not in respect of enhancing tax rates under section 3(2)(b) of the Sales Tax Act, 1990. None from media exposed it as well till today! This shows hollowness of their claim that they are acting as watch dog and their knowledge of everything is “up-to-date”. The reality is that under section 3(2) (b) of the Sales Tax Act, 1990k, as substituted by the Finance (Amendment) Ordinance, 2015 (Ordinance No IX of 2015), promulgated on April 30, 2015 by the President and later made part of the Finance Bill 2015, the federal government is empowered, without approval of HEC or Parliament, to enhance tax rates. Let us see whether media now takes note of it or not!

Section 3(2) (b) of the Sales Tax Act, 1990 It says:

“The Federal Government may, subject to such conditions and restrictions it may impose, in the official Gazette, declare that in respect of any taxable goods, the tax shall be charged, collected and paid in such manner and at such higher or lower rate or rates as may be specified in the notification.” This power available to the Federal Government by the Parliament is violation of Article 162. The Parliament itself cannot vary rates of sales tax unless a Bill to this effect gets the prior approval of President, what to speak of delegating such powers to the Federal Government. Since, section 3(2) (b) of the Sales Tax Act, 1990 was approved by the Parliament vide the Finance Act, 2015, it was also guilty of violating the supreme law of the land. The very insertion of this provision through the Finance Act, 2015, without first laying down the Finance (Amendment) Ordinance, 2015 in the National Assembly as required under Article 89 of the Constitution of Pakistan, speaks volumes about adherence of Constitution in Pakistan by the elected members, who claim to be the champions of democracy and rule of law. It also confirms how much the present government respects the supreme law of the land, what to speak of rule of law! As regards granting exemptions under section 13(1) of the Sales Tax Act, 1990, it is also kept intact in utter violation of Article 77 of the Constitution. It says: “Notwithstanding the provisions of section 3, supply of good or import of goods specified in the Sixth Schedule shall, subject to such conditions as may be specified by the federal government, be exempt from tax under this Act.” The power to grant exemption under section 13(2)(a) of the Sales Tax Act, 1990, first amended through the Finance (Amendment) Ordinance, 2015 and later made part of the Finance Act 2015, reads as under: “The Federal Government may, pursuant to the approval of the Economic Coordination Committee of Cabinet, whenever circumstances exist to take immediate action for the purposes of national security, natural disaster, national food security in emergency situations, protection of national economic interests in situations arising out of abnormal fluctuation in international commodity prices, removal of anomalies in taxes, development of backward areas and implementation of bilateral and multilateral agreements.” The above provisions are ultra vires of Article 77 of

the Constitution which clearly ordains that the right to levy taxes is the sole prerogative of the Parliament and in emergent situation when Senate and National Assembly are not in session, it can be done through Presidential Ordinance subject to conditions laid down in Article 89. No other organ of State can levy taxes or extend concessions/exemptions through delegated powers. The power to issue exemptions under section 13(2) (a) of the Sales Tax Act, 1990 through SROs given to the federal government with the approval of ECC under “exceptional circumstances” violates the supreme law of the land and dictum laid down by the Supreme Court in Engineer Iqbal Zafar Jhagra and Senator Rukhsana Zuberi v Federal of Pakistan and Others which reads as under: “It is well settled preposition that levy of tax for the purpose of Federation is not permissible except by or under the authority of Act of Majlis-e-Shoora (Parliament). Reference in this behalf may be made to the case of Cyanamid Pakistan Ltd. V. Collector of Customs, wherein it has also been held that such legislative powers cannot be delegates to the Executive Authorities. Also see Government of Pakistan v. Muhammad Ashraf and All Pakistan Textile Mills Association v. Province of Sindh.” It is an undeniable fact that the Finance (Amendment) Ordinance, 2015, promulgated by the President on April 30, 2015, was not presented before the House as required under Article 89(2) (i) of the Constitution. All the provisions contained therein were later made part of the Finance Bill 2015, which was approved by the Parliament and after receiving accent from the President on June 29, 2015 became the law of the land, unfortunately, however, nobody has challenged it in any court of law till today. It was a clever trick on the part of the government to hide the fact from the Parliament that powers to vary sales tax rates could not be delegated and that Ordinance issued by the President was not laid down before the House. It is mockery of law that even after claiming withdrawal of power to vary tax laws through executive orders, the government has been issuing SROs and Ordinances to usurp the powers of the Parliament. For example, Income Tax (Amendment) 2015 was issued on July 11, 2015 and laid down before the National Assembly on July 30, 2015. Adding insult to the injury, the government even did not bother to get it approved by National Assembly and further extended the concession contained therein through SRO 946 (I)/2015 dated September 30, 2015 while the Ordinance was still pending in the Assembly! This is a naked and blatant, rather shameless, violation of the supreme law of the land. It is strange that neither the Opposition, nor the members from treasury bench have taken notice of it. Even the Supreme Court is not taking notice of perpetual violations of Constitution by the Federal Government in tax matters. Since majority of independent power plants run on furnace oil and high-speed diesel and around 50% electricity generation is thermal based, these exorbitant sales tax rates are bound to deprive the people of cheap electricity. It also makes industries uncompetitive as they are forced to pay more for electricity. While oil prices in the international market are going down, the government for avoiding a massive shortfall in revenues is constantly increasing sales tax rates without evaluating its overall impact on economy. The question is how did they make the estimates

of taxes from petroleum products at the time of making budget? Were they not aware of declining trends in prices? Why do they rely mainly on consumption tax vis-à-vis petroleum products? Is it good fiscal governance? We suggest the worthy Finance Minister and his team to study the models of other countries where fiscal stabilization vis-à-vis oil and gas sector taxations is successfully achieved. In this regards, two important papers are: Revenue from the Oil and Gas Sector: Issues and Country Experience and what is the role and challenges of progressive taxation in achieving stability and equitable distribution of oil profits? The enhancing of sales tax rates without the approval of Parliament is not only unconstitutional but also a highly lamentable act. While the economy and less-privileged people are victims of unjust, indirect taxation of petroleum products, the rich and mighty sections of society have been amassing unbelievable wealth through exemptions and concessions. For example, buying and selling of plots at DHA and other lucrative housing societies were not taxed till 2013 and even now at much concessional rate. The same is the position at stock markets. In the last seven years alone, exemptions and concessions given to the rich and mighty were to the tune of Rs.3500 billion as admitted by Chairman FBR before the Senate Standing Committee on Finance and Revenue. Can the present and earlier governments justify huge borrowings in the face of this fact? Bureaucracy is also beneficiary of concessions through SROs. For example, SRO 569(I)/2012, issued on May 26, 2012 with the approval of Finance Minister, provides the government officials in grade 20-22 a concessional rate of just 5% on their monetized transport allowance as a separate block of income. The other employees, in private sector, pay full tax according to the applicable slab. The FBR wants taxes from all, but not from mighty civil servants. It is further alleged that the high-ranking officials are getting transport allowance as well as using the official vehicles! Our worthy Finance Minister and Chairman FBR keep on giving sermons on ethical values and transparency and express resolve to get taxes from all, but are allowing this unlawful concession to those who are responsible for destroying the governance in the country. The Parliament will also not take note of it as majority of its members declare low of incomes but FBR has not conducted audit. By merely publishing Tax Directories accountability is not done! But who can compel FBR, NAB and other to take action against the rich and mighty in the country? Even media has failed to do so after exposing many scandals. The issue of SROs levying taxes or varying tax rates or granting exemptions and concessions has yet not been debated from the constitutional point of view. For cartels possessing enormous money power, reduction of duties and tax concessions by FBR and then extending them by using its executive authority available in the form of SROs, has created innumerable tax distortions in the tax system. The burden of taxes in the wake of such concessions is invariably shifted on the middle-lower-classes and poor people. Pakistan is a unique country where the executive authority can conveniently undo tax laws passed by the Parliament, which is a gross violation of Article 162 of the Constitution of Pakistan that reads as under: 162. Prior sanction of President required to

Bills affecting taxation in which Provinces are interested: - No Bill or amendment which imposes or varies a tax or duty the whole or part of the net proceeds whereof is assigned to any Province, or which varies the meaning of the expression “agricultural income” as defined for the purposes of the enactments relating to income-tax, or which affects the principles on which under any of the foregoing provisions of this Chapter, moneys are or may be distributable to Provinces, shall be introduced or moved in the National Assembly except with the previous sanction of the President. Enhancing of sales tax rates of petroleum products under section 3(2)(b) of the Sales Tax Act, 1990 is a blatant violation of above Article and Article 77 of the Constitution as elaborated by the Supreme Court in Engineer Iqbal Zafar Jhagra and Senator Rukhsana Zuberi v Federation of Pakistan and Others. But even the Supreme Court, being the protector of people’s rights and its judges under oath to safeguard Constitution of Pakistan, is not taking any action though its above-cited judgment stands violated flagrantly by the government and Parliament.

COMBATING TAX VIOLATION:

Since Pakistan’s economy is currently not performing well, the government should avoid taking any harsh taxation measure which would adversely affect the country’s economic growth and business activities that are already at a low ebb. It is, therefore, advisable the government shouldn’t make those bear the burden of more taxes who are already paying taxes in some way. Instead, the government should focus on plugging the loopholes in the existing tax system to prevent tax evasion and leakages. At the same time, there should be taken some serious and affective measures to significantly broaden the direct tax base by bringing the affluent but non-tax paying individuals into tax net. So, there should be a massive crackdown against the tax evaders and tax dodgers.

CONCLUSION:

Tax violation is a global phenomenon has been in the world and Pakistan is not an exception to it. Corruption, lack of trade openness, low per capita income and lack of political stability are some of the causes of poor tax collection in the country. The main causes of poor tax collection in Pakistan include meager tax base, dependence on sectors exempted from taxation (the agriculture sector), lack of knowledge about tax system and foreign aid. Political elite are the main cause of injecting tax evasion behavior among the masses. The tax authorities are not empowered to enforce their powers on the rich and the elite class of the country who run away by making use of their own political and economic powers. Moreover, this elite class joins hands in their designs and enjoy amenities and perks on public money. The unfair and higher tax rates, regressive tax system, poor

administration, corruption and lack of trust on government are the main causes of tax violation in Pakistan. As a result of higher tax rates and huge costs of compliance, individuals indulge themselves in underground activities and hence the government is deprived of revenue generation. In turn the government, in order to generate more revenue, goes for inefficient tax schemes that further leads to evasion and the vicious cycle continues. Moreover, the highlighted complexity in tax system; unproductive expenditures; corruption in tax administration and misuse of tax money are some of the determinants that led to an anti-tax culture in Pakistan.



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