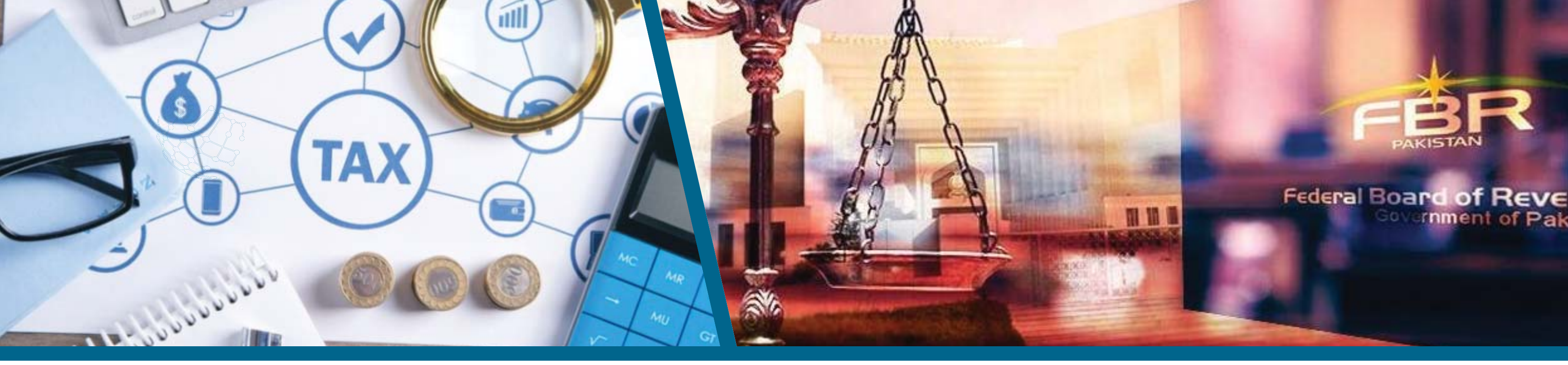


The Price of Complexity: Why Pakistan's Tax System Discourages Compliance

Muhammad Ammad Ansari, ACMA
Manager Litigation and Audit
Sui Southern Gas
Company Limited (SSGCL)

Fiscal sovereignty is grounded in paying taxes. But in emerging economies like Pakistan, ensuring that every person follows the rules is difficult due to systemic issues. The primary issue is the tax structure itself, which is overly complex. The public often blames tax evasion on individuals not understanding or not enforcing the law properly. However, the real issue lies in the way the system is structured—numerous legal layers, bureaucratic hurdles, overlapping government roles, and reforms that do not happen consistently.

Understanding Compliance in Pakistan

Pakistan's tax-to-GDP ratio has consistently remained below 10%. It is one of the lowest in South Asia. This is true even though reforms are ongoing, such as the introduction of digital filing (IRIS), enhanced withholding, CNIC-based registration, and monitoring of point-of-sale transactions. Behavioral theories suggest that people do not follow the rules because they lack trust in the system or perceive it as unfair. In contrast, structural theories place more emphasis on how administrative overwork can prevent people from following rules. Pakistan's tax code consists of the Income Tax Ordinance 2001, the Sales Tax Act 1990, the Federal Excise Act 2005, and the Provincial Sales Tax Acts. Each requires its own registration, filing, and paperwork. You need professional support even to comply with the basics. This intricate system leaves people confused, intimidated, and outside the formal tax net.

Complexity as a Barrier to Voluntary Compliance

The tax system in Pakistan is not just complex—it is deeply entrenched and difficult by design. Taxpayers often pay multiple taxes on the same stream of income, which creates confusion and makes compliance more difficult. Contradictory rules between the Federal Board of Revenue (FBR) and the Provincial Revenue Authorities are another result of overlapping jurisdictions. This fragmentation leads to regulatory ambiguity and redundant efforts. Statutory Regulatory Orders (SROs) change tax responsibilities mid-year and disrupt planning for both taxpayers and practitioners. Routine filings require redundant documentation and repeated disclosure of data that tax authorities already have. Furthermore, excessive reliance on withholding agents shifts the burden of tax collection to third parties, many of whom are either ill-equipped or unmotivated to perform this role effectively. All these factors raise the cost and stress of compliance, undermine public confidence in the system, and eventually drive even well-meaning taxpayers out of the formal economy. The general complications fall into one of the following categories:

- multiple taxes on the same base (e.g., income tax, minimum tax, turnover tax, advance tax);
- overlapping jurisdictions, especially for sales tax on services (FBR vs. provincial revenue boards);
- overly frequent legal changes via SROs;
- redundant documentation for routine filings; and
- excessive reliance on withholding agents.

These issues increase compliance costs, time burdens, and legal ambiguity, becoming key factors that drive even honest taxpayers away.

Major Tax Gaps in the Pakistani System

Effective revenue collection in Pakistan is hampered by four unified and enduring deficiencies in tax compliance.

- The first is the unregistered class, which comprises millions of individuals who earn a living but are entirely exempt from taxes—particularly those who are self-employed or operate informal shops, services, or other businesses.

Table 1: Key Sources of Tax System Complexity in Pakistan and Their Impact on Compliance

Source of Complexity	Description	Impact on Taxpayer Compliance
Multiple Taxes on the Same Base	Income taxed via multiple mechanisms (income tax, minimum tax, turnover tax)	Creates confusion; inflates tax liability unpredictably
Overlapping Jurisdictions	Dual control over services taxation by FBR and provincial boards	Legal ambiguity; duplication of filing and payment
Frequent Legal Changes (SROs)	SROs modify rates/exemptions frequently, often mid-year	Reduces predictability; complicates tax planning
Redundant Documentation Requirements	Repetition in returns (e.g., asset declarations, CNICs, bank data)	Increases filing burden; discourages voluntary participation
Excessive Use of Withholding Agents	Reliance on third parties for tax collection (banks, telcos, utilities, etc.)	Leads to errors, refunds backlog, and mistrust in system fairness

- Second, there are stop-filers—taxpayers who were previously enrolled but have stopped submitting returns regularly, often due to complicated procedures, fear of audits, or financial difficulties.
- Third, there are those who continue to file tax returns but deliberately misreport their income or expenses. They take advantage of insufficient audit coverage and the low perceived risk of detection.
- Lastly, there are the delinquents—taxpayers who file returns and have their tax responsibilities assessed but do not pay on time. They often exploit delays in the appeals process to avoid enforcement.

These categories are not distinct but reflect a wide spectrum of noncompliance. If enforcement focuses on only one or two of these gaps, evaders are likely to shift to the least enforced category. A coordinated and systemic approach is therefore essential to close all gaps simultaneously and discourage evasion across the board.

Administrative Registration Challenges

The Single Taxpayer Registry (STR), a critical component for effective tax administration, is still not fully integrated or implemented in Pakistan. Currently, income tax, sales tax, and provincial taxes all require separate registrations. This leads to redundant administrative efforts, inaccurate taxpayer data, and diminished audit efficiency.

Real-time data integration and verification procedures are lacking in enforcement. Even after the introduction of CNIC-based Taxpayer Identification Numbers, gaps remain. Databases frequently fail to update changes in business addresses, operational status, or jurisdictional reclassifications, resulting in confusion and missed enforcement opportunities.

Small and medium-sized enterprises (SMEs), in particular, are discouraged from remaining within the formal system, as the complexity of compliance outweighs perceived benefits. A dynamic and unified taxpayer registration system across federal and provincial levels is urgently needed to reduce administrative burdens and build public confidence in the tax system.

Stop-filer Crisis and Legal Overload

The growing number of stop-filers in Pakistan highlights a deeper structural problem. Harsh compliance regulations discourage individuals from re-entering the formal tax system. Many taxpayers who previously filed returns are reluctant to do so again due to accrued penalties, interest charges, and the threat of audits. The current legal framework acts as a barrier rather than a bridge by requiring complete payment of all past dues before returns are accepted. This rigid approach undermines efforts to broaden the tax base.

A more lenient strategy is needed, including presumptive assessments based on observable income indicators, time-bound waivers for penalties and interest, and well-structured amnesty programs. Such measures can reduce the financial and psychological barriers to rejoining the tax system and help foster long-term compliance.

Delinquency and Procedural Rigidity

In Pakistan, tax delinquency is driven not just by deliberate avoidance but also by institutional inefficiencies and procedural rigidity. Lengthy appeals, poor coordination between assessment and enforcement units, and delays in tribunal decisions are major contributors.

Taxpayers also face operational challenges such as complex payment procedures, frequent errors in challans, and delayed payment confirmations.

FBR must adopt digital enforcement tools such as automated bank account attachments, property liens, and real-time integration with asset registries. It should also delegate the recovery of smaller arrears to licensed agents and prioritize the timely collection of large dues. These actions will improve the efficiency and credibility of the tax administration.

GST Gap and Sectoral Disparities

Estimates suggest that over 30% of potential revenue is not collected under Pakistan's Goods and Services Tax (GST) regime, indicating a serious compliance shortfall. Several issues contribute to this gap, including widespread non-invoicing practices, misuse of zero-rating provisions, and excessive exemptions that effectively conceal taxable activity. Fraudulent invoicing in business-to-business (B2B) transactions allows companies to falsely claim input tax credits, further weakening the tax base.

Pakistan's complex GST structure, coupled with overlapping federal and provincial jurisdictions, results in double taxation, delayed refunds, and poor invoice cross-verification. These factors deter voluntary registration and compliance. To improve GST efficiency, Pakistan must streamline rate structures, rationalize exemptions, and foster better coordination between federal and provincial tax authorities.

Withholding Tax Overuse and Structural Duplication

Withholding taxes are a major feature of Pakistan's tax system, applied across sectors such as utilities, imports, real estate, banking, and salaries. While they generate substantial revenue, they also add layers of complexity. A large share of these taxes are either non-adjustable or treated as minimum tax, undermining equity and disproportionately affecting individuals and small firms.

Many taxpayers experience long refund delays—sometimes spanning years—and face repeated deductions due to overlapping jurisdictions. Such inefficiencies weaken trust and discourage voluntary compliance. To address this, Pakistan should simplify the withholding tax system, digitize reporting and reconciliation, and restrict withholding to sectors where real-time income tracking is feasible.

Audit Weaknesses in a Complex Environment

Most audits in Pakistan are still conducted manually, with minimal resources and inconsistent execution. The FBR's audit coverage rate remains below 2%. A lack of trained personnel, along with complex and frequently changing laws, leads to subjective interpretations that reduce the effectiveness of audits.

This undermines the deterrent effect of audits and discourages voluntary disclosure, as taxpayers fear arbitrary assessments or prolonged litigation. The absence of a transparent, criteria-based audit selection process further erodes public trust. To remedy this, the FBR should implement a risk-based audit system targeting specific sectors, regions, or income brackets using objective data. Audits should also aim to educate taxpayers and promote consistent enforcement practices.

Tax Evasion, Avoidance, and Legal Ambiguities

Pakistan's disjointed and complex tax system creates exploitable legal gaps, particularly benefiting multinational enterprises (MNEs). These companies often engage in aggressive tax planning—manipulating transfer pricing, exploiting capital gains exemptions, using hybrid mismatches, and shifting profits to low-tax jurisdictions. The FBR lacks a strong General Anti-Avoidance Rule (GAAR), which limits its ability to challenge such practices. Moreover, Pakistan's participation in global tax transparency frameworks like the OECD's Base Erosion and Profit Shifting (BEPS) initiative is underdeveloped, with minimal cross-border data sharing.

To combat this, Pakistan must strengthen its legal interpretation capabilities, create a specialized treaty enforcement unit, and deepen cooperation with international bodies such as the OECD and FATF. These reforms are critical for establishing a fair and enforceable tax regime.

Information Systems and Institutional Fragmentation

Despite initiatives like PRAL, IRIS, and the Tajir Dost app, institutional data silos persist in Pakistan. Key entities such as banks, FBR, SRB, NADRA, and SECP continue to operate in isolation.

This lack of integration hinders real-time profiling, complicates enforcement, and increases reliance on manual follow-ups. To overcome these barriers, all economic databases should be linked to CNICs through a national data warehouse. This will help modernize the tax system and improve compliance outcomes.

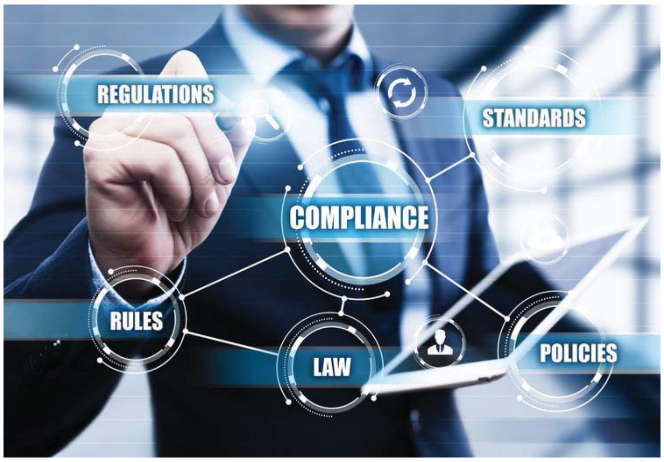
Reform Agenda: Simplification and Integration

The three main pillars of a comprehensive tax reform plan for Pakistan must be taxpayer empowerment, integration, and simplification.

- First, to create a single, cohesive legal framework encompassing income tax, sales tax, and excise duties, a **unified tax code** is essential.
- Second, firms and individuals can reduce compliance costs and errors by adopting **simplified return filing procedures,** ideally auto-filled using third-party data from registrations, utilities, and banks.
- Third, **presumptive taxation schemes** can offer small-scale, low-risk traders a practical route into the formal tax system without excessive administrative burden.
- Fourth, **accessibility**—particularly for less literate or rural taxpayers—can be greatly enhanced by developing user-friendly taxpayer services, including internet portals, mobile applications, and multilingual support.
- Lastly, the use of ad hoc **Statutory Regulatory Orders (SROs)** should be minimized. Instead, legally binding circulars and advance rulings should be issued to ensure predictability and transparency.

By fostering transparency, equity, and trust, these pillars can help transform Pakistan's tax system from one that is overly complex and discouraging to one that supports voluntary and sustained compliance.

Complexity remains a major hindrance to tax compliance in Pakistan. The system must become more equitable, navigable, and integrated. A system that breeds opacity, uncertainty, and penalizes effort cannot expect voluntary compliance. Reforming tax complexity is not merely a technical need—it is a foundational one.



References

- *Ahmad, E. (2010). Why is it so difficult to implement a GST in Pakistan? The Lahore Journal of Economics, Special Issue, 1–30.*
- *Aslam, S., & San, M. F. (2021). Voluntary tax compliance behavior of individual taxpayers in Pakistan. Financial Innovation, 7, Article 67.*
- *Federal Board of Revenue. (2023). Tax expenditure report. Islamabad: Government of Pakistan.*
- *International Monetary Fund. (2016). Pakistan: Selected issues (IMF Staff Country Report No. 16/2). Washington, DC: International Monetary Fund.*
- *Kleven, H. J., Brockmeyer, A., Best, M. C., Spinnewijn, J., & Waseem, M. (2015). Production versus revenue efficiency with limited tax capacity: Theory and evidence from Pakistan. Journal of Political Economy, 123(6), 1311–1355.*
- *Latif, F., Jabeen, M., & Jabeen, M. (2023). The impact of tax knowledge, tax system complexity and tax fairness perception on compliance behavior of a taxpayer in KPK. International Journal of Business and Management Sciences, 4(4), 19–40.*
- *OECD. (2022). Revenue statistics in Asia and the Pacific 2022: Emerging challenges for the Asia-Pacific region in the COVID-19 era.*
- *Pakistan Bureau of Statistics. (2023).*
- *Silvani, C. A. (1997). Improving tax compliance (IMF Working Paper No. WP/97/30). Washington, DC: International Monetary Fund.*
- *Usman, M., Ahmad, A., & Rehman, R. Z. (2024). Tax audit, tax penalty and tax compliance: A case study of Pakistan. Journal of Asian Development Studies, 13(2), 267–281.*
- *World Bank. (2019). Pakistan revenue mobilization project: Diagnostic report. Washington, DC: The World Bank.*

About the Author: *The author is an Associate Member of ICMA and currently serves as the Manager of Litigation and Audit at Sui Southern Gas Company Limited (SSGCL) in Karachi. Prior to this, he held the position of In-Charge of Taxation at the Utility Stores Corporation of Pakistan. With over 17 years of extensive experience in tax operations and litigation in Pakistan, he brings a wealth of knowledge to his current role.*