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Presumptive Tax as an Alternate Income Tax Base: A Case Study of Pakistan

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INTRODUCTION

There is a general consensus that an efficient means of mobilising revenues is necessary for improved public infrastructure and for preventing disruptions in the economy [Wilfried (1991)]. Inappropriate and unsustainable expenditure and revenue policies, on the contrary, cause disappointing economic performance. Hence, the concern with mobilising adequate resources through improved taxation and better pricing of public services. A review of the existing taxation systems of several developing countries suggests that these are distortionary in nature and contribute to a number of economic problems including production inefficiency, capital flight and fiscal and balance of payments disequilibria [Asher (1990)]. They are generally complex (difficult to administer and comply with), inelastic (non-responsive to growth and discretionary policy measures), inefficient (raise little revenues but introduce serious economic distortions), inequitable (treat businesses and individuals in similar circumstances differently) and, quite simply, unfair (tax administration and enforcement are selective and skewed in favour of those capable of defeating the system) [McLure and Zodarow (1991)]. Further, there is heavy reliance on taxes on international trade (approx. 80 percent for India and Thailand, 84 percent for Sri Lanka, 70 percent for the Philippines, 50 percent for Turkey). User charges and taxes on income, property and capital contribute only a small proportion of the overall revenues (Pakistan 20 percent, Thailand 19 percent, India 17 percent, the Philippines 19 percent). Agricultural incomes are not taxed. personal and corporate income taxes are levied on narrow bases at high rates. These tax structures impose varying levels of taxation, depending on the form of income, type of assets, size and legal status of businesses, and the kind of business activity (i.e. are 'schedular' in nature). As a result, the average effective tax rate and the marginal effective tax rate substantially vary across assets and section–thereby distorting individual choices with respect to the form of income, the sector of investment activity, and the time profile of investment [Bulutoglu and Thirsk (1991)].

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Author's Note: This paper is essentially my personal reflection based on my close association with the tax policy and administration, and the conceptual framework of the policy changes in income tax base, its revenue implications, and the future direction which the tax laws may take if the present trend continues.

It has further been observed that fiscal instruments (in the form of 'tax expenditures and tax preferences') are used for advancing wide-ranging but, often, conflicting tax policy objectives. The poorly conceived tax preferences (also serving as 'tax shelter') coupled with rampant tax evasion and avoidance, result in several economic activities going untaxed while the rest are taxed at inefficiently high levels e.g., around 5000 corporate taxpayers in Pakistan contributing 80 percent tax were taxed at over 50 percent marginal tax until Fiscal Year 1991-92. The high tax rates (due to the after-tax rate of return being often below the opportunity cost) encourage tax avoidance and compromise the fairness of the tax system. Further, poor tax compliance introduces considerable inequity and inefficiency in the tax system and makes it as an ineffective instrument of public policy [Choi (1990)].

EXPERIENCE OF DEVELOPING COUNTRIES

Faced with mounting budgetary deficits and other macro-economic instabilities, governments need to either reduce their expenditures, particularly on public investments and social spending, or in the alternative, restructure their tax systems to seek higher revenues and/or to improve the revenue elasticity and buoyancy of the tax structure. Having cut their expenditures as far as prudently possible, several countries have in the recent years embarked upon tax reforms to raise additional revenues. Some of these countries include Colombia [McLure and Zodarow (1991); Musgrave and Gillis (1971)], Republic of Korea [Choi (1990)], Turkey [Bulutoglu and Thirsk (1991)], Indonesia [Asher (1990), Ahmad (1984)], and Malawi [Shalizi and Thirsk (1991)]. Whereas, primarily their tax reforms were geared towards improving the resource position, these were also aimed at eliminating the disincentive effects of onerous levels of taxation; reduce economic inefficiencies induced by distortionary taxation of capital and sectors; minimise the effects of forward shifting of taxes; and provide partial relief from the adverse effects of inflation. For instance, the net result of various reforms enacted in Colombia since 1960 is a tax system that has significant broad base (highly equitable and neutral)), comprehensive system of inflation adjustment, and simpler to administer.. Taxation based on presumptive income covering individuals and companies–income presumed at least 8 percent of wealth, and any unexplained increases in wealth included therein was introduced in 1974 [Musgrave and Gillis (1971)]. Tax reforms in Malawi attempted to reduce tax-induced inefficiencies (through creating a system that would interfere less with the efficient allocation of resources); reduce inequities (by shifting a larger fraction of the overall tax burden to the rich); and identify the instruments and promote institutional changes that would improve administrative efficiency [Shalizi and Squire (1988)]. Indonesia, which carried out the tax reform in a single episode in 1983, broadly speaking, simplified the income tax base (more on a presumptive income and fixed income basis) and the tax rate structure; and addressed the intersectoral and inter-asset distortions by eliminating special preferences and by replacing cascading turnover and sales taxes by more neutral value-added taxes [Shalizi and Squire (1988)].

SELECTED ISSUES ON THE TAX REFORM AGENDA

Tax Reform is a sensitive and difficult process. The pay-off tends to be of a long-term nature and, therefore, it is difficult for political governments to commit to a comprehensive reform. The pragmatic course is, therefore, to strive for incremental reforms in a consistent manner over time [Shalizi and Wayne (1991)].

Recent experience with the reforms process suggests that revenue enhancement, economic efficiency, horizontal equity and simplicity issues have dominated the world agenda on tax reforms. Other relevant issues such as vertical equity and international income taxation have received only scant attention. The emphasis on the redistributive role of the tax system is gradually waning due to the fact that tax evasion is so pervasive. Progressivity remains high on the political agenda, although often the political will to enforce income tax compliance is lacking. Vertical equity is increasingly perceived as an elusive goal and, hence, assigned a lower order of priority in undertaking tax reforms. To reduce the disincentive effects of taxation, reduction of average and marginal tax rates by eliminating ineffective tax preferences and thereby broadening the bases is being explored [Musgrave (1991)]. Intersectoral and inter asset distortions are also being reduced as countries endeavour to eliminate tax preferences. Indexation of the tax system, for instance, through an increase in the minimum threshold for tax purposes, is being pursued to mitigate the effects of inflation.

Thus, although the broad directions of reforms are remarkably similar, several unresolved and controversial issues still remain. The central problems with the tax systems of developing countries as earlier pointed out, is tax evasion and a parallel economy. The questions of efficient implementation of taxes, how an efficient information system can be set up in tax administrations or how tax withholding can be expanded or presumptive taxation made more palatable are part therefore, of the strategy to improve compliance. The questions of retaining tax preferences or to do away with the selective measures and generalise the incentives by lowering the tax rates; and taxation of capital are also on the tax policy agenda. Discussion of tax reforms within the framework of the integration of revenues and expenditure, administration, the role of presumptive taxation, the funding of social security, environmental taxes, and the dynamic aspects of taxation is also considered imperative. In Summers's (1991) view the tax reform issues expected to dominate during the 1990s include: design and administration of taxes, the taxation of foreign investment, financial and resource taxation, the incidence of taxes, tax policy and economic growth and the quantitative tools for tax policy analysis. In Eduardo Wiesner's views the relationship between tax policy reform and tax administration and its relationship with fiscal policy and stabilisation programmes is important and needs to be carefully looked into. Along with the conceptual framework and design of the tax instruments, administrative efficiency is also one of the vital components of the reform process. Richard Bird on the other hand, observes that "the key to successful tax reform is a tax structure that can be administered adequately with the available resources while at the same time making the best possible use of those resources from a long-term perspective" [Bird (1991)]. Therefore, simplicity of tax designed and the ease of administration must be one of the fundamental criteria for choosing amongst alternate reform proposals. This will, of course, also mean the choice between alternate tax bases.

The design of tax systems in terms of an appropriate and easily implementable tax base, the timing for taxation of an economic transaction, the methodology for charging tax, and the rate structure as stated above are, thus, the key issues in tax reform. The decision in respect of each of these vital issues determines the progressivity and equity of the tax system implemented, and efficacy of the tax administration in determining and collecting the fair and correct amount of tax from economic activity. It is, therefore, critical to design taxes that are, so to speak, robust to poor administration, eliminate unproductive taxes and unproductive tax incentives, and keep differentiated rates to a minimum. For instance, a good withholding system supplemented by some sort of legally based presumptive assessment on hard-to tax groups with not too high or steeply progressive rates could work well [Bird (1983)].

TAX DEVELOPMENTS IN PAKISTAN

Tax on income, over the years, has been levied on the net income at progressive rates and on a global basis. Determination of net income has involved the application of suitable parameters on 'production', turnover and manufacturing and trade-related expenditures. These parameters reflect the 'expected profits' from various businesses more on the basis of an historical appreciation of each trade rather than on a scientific basis. Revenue efficiency of this system of taxation has, on conceptual grounds, depended on the efficiency of tax administration and its inherent capability to 'match' taxpayers' reported income with the relevant market data, determine and collect correct taxes, and reach the tax delinquents and non-reporters of income.

Theoretically speaking, taxation of net income at progressive but differentiated tax rates on a global basis signified the underlying principles of equity and neutrality in tax matters. The introduction of tax concessions for promoting preferred economic activities through measures such as investment and tax credits, tax rebates and tax exemption of selected incomes, particularly during the 1970s and the 1980s, however, led to the use of several of the 'tax preferences and expenditures' instruments as 'tax shelters' by unscrupulous taxpayers. Consequently, the tax system has gradually lost its fairness, and 'equity' aspects and also become rather complicated in the process of reconciling diverse, multiple economic objectives.

The tax policy changes brought about in the wake of relatively increased economic activity, particularly during the 1980s were, however, not part of a well-considered tax reform programme but adhoc changes addressed to the specific issues. The changes in tax policy were not accompanied by appropriate improvements in tax administration. The tax assessment and collection procedures/norms and the organisation set-up was marginally improved. The shift from 100 percent audit of taxpayers' returns to selected 'test audit' in the short-run improved tax compliance but the inherent weakness in tax policy and administration did not permit adequate broadening of the tax base. The number of taxpayers on a national basis has, therefore, remained between 650,000 to 700,000 during the Eighties and Nineties.

Inspite of the inadequacy of the system, the direct taxes over 1980, however, increased three-fold, i.e. from Rs 5 billion in 1979-80 to Rs 15 billion in 1990-91. As a percentage of overall Federal Tax Receipts, the share of direct taxes remained around 15–20 percent, the main focus of the Government policy being on taxes on international trade and manufacturing. The improvement of revenues from Rs 5 billion to Rs 15 billion was primarily brought about through an extended withholding tax and improved economic activity.

It is in this background that a comprehensive tax policy reform programme was undertaken in Pakistan in 1991. The Committee on Tax Reforms was appointed in November 1990 "to review the existing taxation system and recommend a system that will substantially increase Government's revenues". While making its recommendations in February 1991, the Committee affirmed the need "to restructure the entire taxation system taking into account the revenue generating aspects, economic growth potential, removal of anomalies, complexity of law and procedures, and the inadequacy of tax administration" [Government of Pakistan (1991)]. A wide range of recommendations on tax policy, procedures and administration were made. Fundamental direction of the tax reforms was stated to aim at "broadening the tax base and simplification of the tax system by removing causes–both legal and administrative, which may inhibit voluntary tax payments and mitigating exposure of the taxpayers to protracted and open-ended assessment and appellate procedures" [Sidat (1991)].

The changes in tax design introduced in 1991 (as continued during 1992 and 1993) have attempted to partially reverse the existing distortions in resource use, inequities and revenue loss by phasing out some of the tax exemptions, streamlining the tax rate structure, adjusting the basic exemption for personal taxes to price indices, and expanding the withholding taxes to several economic activities otherwise not contributing to the revenue effort [Khan (1992)]. Major changes in the design of the taxation system have been introduced in the form of presumptive basis of income taxation schedular basis for taxation of dividends, bank profits and interest, prizes, winnings from lottery, etc.; fixed tax on small business enterprises; and minimum taxation on companies and registered firms based on turnover.

(a) Presumptive Income Tax

The concept of 'presumptive income' was, first introduced in Pakistan in 1980 for taxation of income of foreign shipping and air transport enterprises (to mitigate the adverse effects of tax foregone as a consequence of huge depreciation allowance while computing income on a net basis, and also to eliminate the comparative disadvantage Pakistani enterprises faced, particularly in the South East Asian countries following presumptive taxation on such profits). Gradually and imperceptibly, this concept was extended to the technical services/know-how fees received by the non-residents. The tax reforms initiated in the 1990s attempted, on a selective basis, presumptive taxation of resident and non-resident taxpayers, e.g. payments for supply of goods, execution of work contracts, imports and exports, etc.

The vital aspect of the new basis of taxation introduced in the wake of significant level of administrative inefficiency is that it is both presumptive and schedular in nature, particularly where the taxpayer's income source is limited to the above-stated economic activities. The new tax regime essentially provides that the value of imports and exports and payments for contracts execution and supply of goods constitute the 'presumed income' of the taxpayer and is taxed at the prescribed rates (through the withholding tax at rates lower than the normal progressive rates). The tax so deducted/paid is treated as final discharge of tax liability. The 'presumptive' income, however, is taxed on a global basis where the recipient also derives income from activities not covered under the 'presumptive' or 'schedular' taxation.

(b) Schedular Tax

The 'Schedular tax' on a 'presumptive income base' covers dividends, interest on bonds, certificates, debentures, securities or instruments, interest on deposits with banks, financial institutions and finance companies; prize money on bonds, and winnings from raffle, lottery and cross word puzzles received by both resident (except for the corporate taxpayers) and non-resident taxpayers. Such incomes are treated as a separate block of income, no allowances or deductions permitted and subjected to a flat tax rate varying in respect of each type of income. The tax deducted at source at the prescribed rates is treated as the discharge of final tax liability. The requirement of filing a tax return has been waived.

(c) Minimum Tax on Income of Companies and Registered Firms

Minimum tax of 0.5 percent on the declared turnover of companies was introduced in 1991 and extended in 1992 to the Registered Firms. It is levied where these entities are either tax exempt (for any reason) or the tax paid is less than 0.5 percent of their turnover–the amount of tax so paid being the final tax liability. "Where no tax is payable or paid" conceives of even those situations where tax is not payable or paid due to losses of current year or carry forward losses, tax holiday, exemption due to any credit or tax rebate, or any allowances or deductions allowed. The design of the 'minimum tax' concept envisaged aggregated turnover from all sources deemed to be income of a company and charged to the prescribed tax.

(d) Fixed Tax on Small Businesses

Introduction of a fixed tax on small businesses, viz. small shopkeepers, traders and establishments engaged in any business or profession in 1991, represented the Government's view that the existing tax procedures are too cumbersome for small taxpayers to comply with [Government of Pakistan (1991)]. It also signifies administrative inability to reach 'small business' otherwise liable to Tax. The scheme envisages a fixed tax charge–separate for rural and urban areas–on the basis of 'presumptive income' determined by the taxpayer himself and payable in the Post Offices rather than the Income Tax Department. This scheme was now been extended to the selective markets, with no reference to the 'smallness' of the business in 1992, but has since been abandoned.

The National Tax Reforms Commission Report (1987) had also recommended a similar scheme but on somewhat different basis viz. Small retailers whose annual income and turnover does not exceed Rs 36,000.00 and Rs 350,000.00 respectively should pay Rs 600.00 per annum as fixed income tax for three years after which selective tax audit was to be carried for the continuation of fixed tax for another three years. This concept was, however, rejected by the Fixed Tax Committee since it was considered "against the basic principles of taxation of income and that the response from public and traders was far less enthusiastic than expected". The Tax Reform Committee of 1991, nevertheless, proposed the fixed tax to reach the hard-to-tax groups and to facilitate small traders to comply with their tax obligations [Government of Pakistan (1991)].

Revenue Performance of Presumptive Tax

The policy changes given above are part of the Government's policy of all citizens participating in the resource mobilisation effort in whatever modest way they can [Government of Pakistan (1992)]. These policy changes underline the on-ground economic realities rather than following the difficult-to-implement conceptual norms.

Comparison of the revenue estimates against the actual budgetary measures adopted in 1991 and 1992 (Tables 1 and 2) generally reflects a positive contribution of presumptive taxes and extended withholding taxes to the overall revenues, i.e. over 3 1/2 increase over each of the preceding year. The minimum tax regime on turnover basis contributed no more than 50 percent of the expected revenues.

The schedular taxes on interest, dividends, prizes, etc. have shown increases, ranging from 200 percent to 300 percent compared with each of the previous year–although in absolute terms the amounts are not very impressive. The minimum tax on companies yielded Rs 470 million as against the budget amount of Rs 800

Table 1

Comparative Analytical Statement of Income Tax Collection for FY 1989-90 to 1991-92

(Million Rupees)

Description	1989-90	1990-91	1991-92
Income Tax			
Budget Targets	15880.0	19101.0	25811.0
Tax Collection	15000.0	19078.8	27913.2
Percentage with Budget	94.5	99.9	108.1
Performance (During 12-Months)			
Collection of Demand	**3417.3**	**4824.2**	**3373.2**
(a) Arrear Demand	876.6	992.1	793.0
(b) Current Demand	2540.7	3832.1	2580.2
Payment with Returns	**6364.4**	**6828.0**	**7804.3**
(a) Adjustments out of Deposits u/s 53	3494.1	3801.6	3658.1
(b) Cash/Cheques	2870.3	3026.4	4146.2
Deduction at Source	**8014.0**	**10165.5**	**18174.5**
(a) U/s 50(1)	929.8	1395.4	1732.0
(b) U/s 50(2)	1850.1	1673.2	4608.7
(c) U/s 50(2A)	0.9	13.8	1019.5
(d) U/s 50(3)	231.2	494.4	2077.1
(e) U/s 50(3A)	–	0.1	3.2
(f) U/s 50(4)	2833.2	3822.4	5079.6
(g) U/s 50(4A)	–	334.6	54.7
(h) U/s 50(5)	1951.8	2070.6	3038.8
(i) U/s 50(6)	105.8	121.3	127.8
(j) U/s 50(6A)	–	3.2	99.8
(k) U/s 50(7)	27.0	74.5	117.0
(l) U/s 50(7A)	84.2	139.3	138.1
(m) U/s 50(7B)	–	1.7	11.8
(n) U/s 50(7C)	–	21.0	46.5
(o) U/s 50(7D)	–	–	19.9
Miscellaneous	27.4	25.1	567.1
Total (Gross)	17823.1	21842.8	29919.1
Less Refunds	2823.1	2764.0	2005.9
Total (Net)	**15000.0**	**19078.8**	**27913.2**
Collection as Percentage of Budget	94.5	99.9	108.1
Wealth Tax	**419.4**	**495.9**	**631.8**
Capital Value Tax	**53.9**	**105.6**	**140.1**
Workers Welfare Fund	**163.8**	**187.9**	**166.0**
Corporate Assets Tax	–	–	**176.5**
Total	**15637.1**	**19868.2**	**29027.6**

Table 2

Income Tax Collections Under Various Sections of Income Tax Ordinance, 1979 for Various Regions

(Fiscal Year 1991-92)

(Rs in Million)

Section	Southern Region	Central Region	Northern Region	National
50(1)	967.8	370.5	393.7	1732.0
50(2)	4258.6	218.0	132.1	4608.7
50(2-A)	459.4	181.4	378.7	1019.5
50(3)	426.4	1388.4	262.3	2077.1
50(3-A)	–	0.1	3.1	3.2
50(4)	2796.3	326.0	1957.3	5079.6
50(4-A)	44.1	6.8	3.8	54.7
50(5)	2676.3	294.6	67.9	3038.8
50(6)	59.5	20.0	48.3	127.8
50(6-A)	86.1	5.2	8.5	99.8
50(7)	79.9	20.6	16.5	117.0
50(7-A)	41.2	38.3	58.6	138.1
50(7-B)	7.9	2.8	1.2	11.9
50(7-C)	26.0	11.6	8.9	46.5
50(7-D)	1.6	10.3	7.9	19.8
Total	**11931.1**	**2894.6**	**3348.8**	**18174.5**
Adjustment from deposits u/s. 53	2178.1	759.0	721.0	3658.1
Paid with returns u/s. 54.	2742.5	688.4	715.3	4146.2
Tofal	**4920.6**	**1447.4**	**1436.3**	**7804.3**
Out of Arrear Demand	377.4	319.8	95.8	793.0
Out of Current Demand	1703.8	664.5	212.0	2580.3
Miscellaneous	550.6	6.3	10.2	567.1
Total	**2631.8**	**990.6**	**318.0**	**3940.4**
Gross Collection	**19483.5**	**5332.6**	**5103.1**	**29919.2**
Refund Issued/ Adjusted	1238.9	500.1	266.9	2005.9
Net Receipts	**18244.6**	**4832.5**	**4836.2**	**27913.3**

million. Similarly, expected increase of Rs 150 million in consequence to the extension of this principle to the Registered Firms materialised only to the extent of 50 percent.

The response under the 'Fixed Tax Scheme' has been totally disappointing (Table 3). Only 12,214 tax returns (including 10,332 existing taxpayers) were received under this scheme, which paid Rs 9.297 million income tax. New taxpayers contributed only Rs 1.5 million. This was in spite of the fact that the Government generously advertised the new scheme, dispensed with the condition of filing the tax returns and the amount of tax was fixed at Rs 600.00 for rural and Rs 900.00 for urban businesses (less than Rs 2.50 per day).

Table 3

Fixed Tax Scheme, 1991-92

Information	First Instalment due on 15-9-1991	Second Instalment due on 15-3-1992	Total
(i) No. of Existing Tax Payers who Opted for the Scheme	8800	1532	10332
(ii) No. of New Tax Payers who Availed of the Scheme	1459	423	1882
Total	**10259**	**1955**	**12214**
(iii) Total Amount of Tax Collected under the Scheme	7.79	1.500	9.279

CONCLUSIONS

Pakistan has experimented with the 'presumptive basis' of income, flat tax rates and fixed taxes for two years. There are certain aspects of the design of the tax/tax base which lead to the following conclusions.

Firstly, the new taxes are seemingly not based on any relationship between the objectively determined factors (for example, size and location of premises) and taxable income leading to a series of tables relating to the objective indicators to taxable income. Policy-makers have either treated the withholding taxes as the discharge of final tax liability; or adjusted them upward or downward; or treated the turnover as deemed income subject to an ad hoc tax rate without any consideration of the type, size, corporate status, profit margins, etc. For instance, in case of the minimum tax of 0.5 percent of turnover for companies and registered firms the rate does not reflect any objective basis. At the present corporate tax rate of 45 percent of net income, imposition of the 0.5 percent tax rate assumes an average net income of 1.1 percent of the turnover which is completely unrealistic.

Secondly, while in principle, these measures should expand the size of the tax base, raise total revenues, improve both horizontal and vertical equity and produce gains in economic neutrality, in Pakistan's case, the efforts at introducing presumptive taxation have taken the form of special tax regimes which have just the opposite effect, viz. presumptive income base, schedular taxes, minimum taxation, fixed taxes, etc. Whereas, in the first year of their introduction, the number of taxpayers added into the tax base is marginal (only 1882 under 'fixed tax' and less than a few hundred under 'minimum tax' regime), they have created new tax-evasion opportunities for other taxpayers (10332 in case of fixed tax and several hundred thousands deriving investment income, etc.) who were induced to seek reclassification as members of 'hard-to-tax' group. We may in future see instances of taxpayers trying to shelter their taxable income in more lightly taxed activities. Mexico is a relevant example where, similar to Pakistan, trucking services are taxed on a per unit basis. As a result, many companies used transfer pricing techniques to channel their taxable income into this fixed tax category. Our attempts to encompass construction activity in the overall tax base by levying a 3 percent tax on gross construction receipts (as the final tax liability), may lead to many companies responding by issuing false invoices to corporations and facilitate significant reductions in their taxable income and corporate tax liabilities.

Thirdly, the extension (through the 1992 Budget) of 'fixed taxes' to the selective urban markets is a kind of *forfeit system* found in many countries of Francophone Africa. The essence of the *forfeit system* is that it depends upon face to face negotiations with taxpayers to determine the tax due. The process is susceptible to corruption.

Fourthly, the introduction of presumptive taxes in all forms–fixed, minimum tax or withholding tax as discharge of final tax liabilities have done away with the requirement of filing of tax return, even the need to get registered with the Tax Administration. With such a simplistic approach in the background, the Government's efforts to build a comprehensive data base with the National Tax Number serving as the focal reference point may not materialise. Further, Government efforts in mopping up the revenue potential may in the long run, fail as once accustomed to a simple and generous tax regime, the process will be difficult to reverse for determining true income for tax purposes. Thus, the short-run gains in revenue, if any, will be more than offset by the huge revenue losses in future.

Fifthly, the criteria of horizontal equity is also no more valid as simultaneously several tax bases and tax rates have been injected into the taxation system.

In brief, the system of presumptive taxes as introduced in Pakistan is fraught with the possibilities of ultimately complicating the system more than simplifying it, and reducing the revenue base rather than realistically expanding it, eroding the administrative efficiency as against improving it. The final answer to several questions on resource, efficiency, equity, etc. will, however, be available only after Pakistan has experimented with the system for several years. In the meantime, it will be advisable to proceed patiently and not to expand the concepts of presumptive income/tax any further.

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Comments on
"Presumptive Tax as an Alternate Income Tax Base: A Case Study of Pakistan"

Mr. Ahmad Khan's paper is both timely and relevant as Pakistan is currently grappling with reforming its tax structure to raise both more tax revenue and minimise distortions caused by the tax system. Mr Khan's main message that the presumptive basis of income taxes, as experimented in Pakistan, may have reduced both the income tax base and complicated its structure, cannot be ignored by any tax reformer.

The limited but growing evidence on the impact of taxes on the economy as traditionally levied in Pakistan shows that the tax system is neither equitable nor efficient. It has also not been an elastic source of revenue for the government. The structure of income tax is progressive as tax rates rise with taxable income. The discrepancy between the intent and the outcome, as noted above, is due to administrative difficulties in the assessment and collection of the income tax and the flaws in the tax structure that lead to corruption on the part of both the tax payers and the tax officials. The shift to presumptive taxation under which the desired base for taxation is inferred by the tax officials from some simple easy to measure indicator is a natural response to the emerging reality of the tax structure being inimical to stated goals.

The author's caution that it is advisable to proceed patiently and not to expand the concepts of presumptive income tax any further in Pakistan warrants three points that need to be considered before finally accepting the author's recommendations regarding freezing the scope of presumptive income taxation.

First, there is a need to have an empirical analysis of the desirability of the extension of the presumptive basis of taxation to different taxes imposed by federal, provincial or local governments as the basic rationale of shifting to presumptive income taxation is equally applicable to all other taxes.

Second, in case a decision of shifting to the presumptive basis of taxation for any tax is made, there is a need for careful work on the estimation of indicators that aim at measuring the base for the tax under consideration. The more appropriate the indicator, the better would be the collections from the taxes.

Third, withholding and treating the taxes withheld for any tax payer on account of any particular transaction as the final tax liability in Pakistan has generated large tax revenues. The tax payers so reached, by and large, belong to the high income classes. In the past, evasion and/or avoidance by the rich people had virtually meant that such people reached by presumptive taxes were outside the tax net. The presumptive basis of income taxation may, therefore, have promoted and not violated the equity objective as is argued by the author.

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