

## Tax Evasion in Pakistan: Determinants and Requisite Policy Interventions

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### Abstract

Tax evasion in Pakistan is very high that has led to deteriorated economic situation and lack of public service delivery. The paper analyzes four variables of tax morale - feelings of guilt and shame; lack of trust on government; perception about others citizens paying taxes; and level of penalties - as determinants of tax evasion in Pakistan. The paper includes survey carried out through a questionnaire distributed among carefully selected sample of 400 salaried employees to gather responses that were analyzed using t-test. The findings suggest that perception about utilization of money, elements of shame, perception about other citizens' compliance behavior and level of penalties affect tax evasion. 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 evasion at the end of the paper. These policies include motivating taxpayers through methods like hypothecation, imposition of fines and penalties and publishing names of defaulters through media and tax department website.

**Keywords:** Tax evasion, Tax Morale, Taxation, Pakistan, Public Policy

### Introduction

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 (Awan & Hannan, 2014). 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. Workers 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 (SDPI, 2013). Pakistan has been facing the dilemma of poor tax collection. A study carried out by the World Bank in 2009 claimed that the tax gap of the country was 79%, terming it as

one of the lowest in the world (World Bank, 2009). IMF in its report<sup>1</sup> in 2015 claimed that Pakistan's Tax to GDP ratio was only 11% while only 16% of the potential taxpayers were included in the tax base of the country. 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 (Zafar, 2017). This situation in turn increases overall 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 evasion. Tax evasion is a formal expression for pilferage of taxation and includes all those activities of hiding incomes or overstating expenses that lead to deprivation of the authorities from tax revenue (Azhar, 1996). It is different from tax avoidance in the sense that avoidance involves legal ways to reduce the tax burden (p. 657). The issue of tax evasion is not new for Pakistan. Tax evasion and underground economy existed in the country even in the 1960s (Aslam, 1998). Nevertheless the situation worsened as time passed.

Tax evasion in the country increased with time. According to estimates, the total tax evasion in Pakistan was PkR 1.5 billion in 1973 that increased to PkR 152 billion in the year 1996 (PIDE, 1998). In the year 2012, National Accountability Bureau (NAB) – a watchdog for corruption in the country – estimated the loss of government revenue to the national exchequer at PkR 7 billion per day with tax evasion as one of the main causes (Dawn, 2012).

The main purpose this paper is to find out the determinants of tax evasion in Pakistan that has led to such economic and social consequences for the country. The findings of the paper will be helpful as it will enable the government to take care of its economic situation and reduce foreign dependence. Objectives of the study in this regard include:

1. whether feeling of guilt and shame lead to tax evasion in the country
2. whether perception about others in the society paying taxes affects tax evasion behavior
3. whether lack of trust on government leads to tax evasion
4. whether level of penalties on evasion affect tax evasion

### **Review of Literature**

Literature has provided different meanings and definitions of tax evasion. According to (Chiumya, 2006) tax evasion refers to the concealment of incomes and profits; overstating expenditures; and misreporting sources of incomes. (Akram, Ilyas, & Mobin, 2017) claims that tax evasion is considered a criminal action and a violation of law as it involves willful concealment of facts related to income earned through legal sources (Ghafoor & hannan, 2014) terms tax evasion as a global phenomenon that prevails everywhere irrespective of religion or customs and it goes hand in hand with taxation process.

Others have termed lack of trust on government as well as the state institutions and the utilization of their tax money by the political and bureaucratic elite as a determining factor of tax evasion (Saeed 2004), (Sam 2010) and Torgler (2003) while (Ajaz & Ahmed, 2010) and (Syadullah, 2015) termed corruption, poor governance and political instability to be responsible for giving birth to tax evasion behavior among the individuals. While literature also claims that people adhere to tax evasion habits if they consider that the services being provided to them are not sufficient or the masses are being deprived of their right and access to public services (Kemal, 2006).

<sup>1</sup> IMF ninth Review Report (IMF Country Report No 16/1)

Higher tax rates and unfair tax system are also a point of concern as far as relationship to tax evasion is concerned. Much scholarly work has identified a positive relationship between higher tax rates and unfair tax system with tax evasion in the economy. According to (Wadhwa & Pal, 2002) higher tax rates and multiple taxes imposed on a lower tax base has been a determining factor of poor tax collection. (Khan & Ahmed, 2014) claimed that 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 Salman Aslam (1998).

Certain personal characteristics have been identified as the determinants of tax evasion. According to (Slemrod, 2007) male persons who are married evade more as compared to females and people who are unmarried while young people evade more than elderly people. (Richardson, 2006) pointed out gender, age, educational status and income source – among other variables – as contributing factors or determinants of tax evasion which have a significant relationship with tax evasion.

Literature has also pointed out other variables that contribute to tax evasion. An important determinant that leads to tax evasion included fear of punishment and penalties on tax evasion and had a direct and positive relationship (Sandmo 2004). According to some scholars, people evade taxes if they consider that other people are also doing the same Eric M. Uslaner (2003). People evade their share of taxes whenever they perceive that such a practice is being carried out by people in their vicinity or even if they believe such practice is going on in the country as a whole (Hanousek & Palda, 2004).

Tax evasion is a global phenomenon has been in the world and Pakistan is not an exception to it. Literature suggests that corruption, lack of trade openness, low per capita income and lack of political stability as some of the causes of poor tax collection in the country (Amin, Nadim, Perveen, Kamran, & Anwar, 2014). Others also suggest that 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 (Chaudhry & Munir, Dec 2010).

Some scholars are of the view that political elite are the main cause of injecting tax evasion behavior among the masses. According to (Bukhari & Haq, 2014) 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. A study carried out on the parliamentarians of the country claimed that only two percent of them had their NTN (National Tax Numbers) while only one-tenth of them actually paid their taxes (CPDI & CIRP, 2011).

Much literature has stressed upon unfair and higher tax rates, regressive tax system, poor administration, corruption and lack of trust on government as the main causes of tax evasion in Pakistan (Awan & Hannan, Oct 2014) and (Khan & Ahmed, 2014). 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 (Feltenstein & Cyan, 2013).

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 (Best, Brockmeyer, Kleven, Spinnewijn, & Waseem, 2015). Moreover, (Awan & Hannan, Oct 2014) highlighted complexity in tax system; unproductive expenditures; corruption in tax administration and misuse of tax money as some of the determinants that led to an anti-tax culture in Pakistan.

As evident from the literature, at global level, much emphasis has been laid on the personal characteristics of the taxpayers and tax morale and their relationship with tax evasion. studies car-

ried out by (Recardson, 2006), (Recardson, 2008), all have stressed upon the behavioral aspects i.e; they all have related tax evasion with personal characteristics including age, gender, marital status, education and even source of income. Some studies like that carried out by (Philip & Palda, 2004) have went to the extent of carrying out surveys to find out behavioral responses along with their perceptions and personal characteristic to measure the relationship with tax evasion. Moreover, these studies have included tax morale and its relationship with tax evasion.

However, in case of Pakistan studies have considered macroeconomic variables and secondary data for the calculation of tax evasion in the country. There are some studies that have considered some micro economic variables and behavioral responses of respondents through surveys, like the one carried out by (Ghafoor & Hannan, 2014). However, such studies have also remained confined to asking questions regarding political views and have completely ignored the relationship certain personal characteristics and other behavioral responses of tax payers with tax evasion patterns of individuals.

The current study includes circulating a questionnaire to gather hands on information directly from the taxpayers. In this way, certain indicators for tax morale have been extracted. Using special econometric techniques, the relationship of these indicators with tax evasion has been established. This study will be helpful for the policy makers and legislators to enact laws so that they are able to enhance tax collection and reap the benefits of higher revenue generation that can then be spent on the welfare of the citizens and the government of the country can fulfill its obligations and provision of public services to the masses in an effective and an efficient manner.

### **Methodology**

The paper contains cross sectional survey study in which primary data has been gathered by distributing structured questionnaire to selected respondents and their responses had been taken on the variables of interest. The population of the research includes salaried class individuals from the twin cities i.e; Rawalpindi and Islamabad region. The main rationale to consider the salaried class in the study is the fact that mostly salaried class individuals are exposed to third party reporting hence reducing their chances of being out of tax net. Moreover, it is obligatory as per the Income Tax Ordinance 2001 to deduct tax at source (FBR, 2013). This makes these salaried personnel de-facto taxpayers.

A total of 400 respondents were approached for the purpose of the study. The respondents were selected through Stratified Random Sampling in which the population was first stratified into four sectors and then fifty respondents from each sector in each city had been selected for the survey. The sectors included Private, Public, NGO as well as the Education Sector including teaching and administrative staff of universities only.

The survey instrument included a 5-point likert scale questionnaire in which certain questions had been asked from the respondents in order to measure the effect of tax morale on tax evasion as perceived by the respondents. According to (Luttmer & Singhal, 2014) tax morale includes:

1. Concern about guilt and shame in non-payment of taxes
2. Concern about services being provided by the state
3. Concern about others paying their share of taxes
4. Perceived penalties and punishments on Tax evasion

The data gathered through survey had then been inserted into SPSS v 18 for the analysis stage. The analysis stage included taking frequencies, percentages and Mean to study the trend of responses. In the second stage "One Sample t-Test" had been taken to measure the mean difference from the Test Value and hence categorizing the variables in order of importance for the dependent variable. Conbrach's Alpha was also used to check the reliability of the data collected. The same

data had then been analyzed through analysis techniques as mentioned above and was then compared with the information obtained from journals articles, books and even newspaper articles.

## Results and Discussion

### 1. *Perceived Shame and Guilt*

Shame refers to an emotion in which a person feels degraded or embarrassed when his act of wrongdoing is exposed whereas guilt is the feeling of repent one feels after one becomes of the wrongdoing for which he or she think is responsible for (Markel, 2001 , P. 2179). Sentiments of guilt and shame do change the tax compliance behavior of the individuals (Erard and Feinstein 1994). Whenever an individual evaluates his choice of tax evasion the factor of shame is considered while doing the cost and benefit analysis (Kirchler, 2007) as shame and moral costs are positively correlated with the tax compliance of an individual (Dulleck et al., 2016).

For the purpose of the study, two indicators for guilt and two for shame had been taken during the course of survey. The indicators for shame included “do you fear that your name will be included in the defaulters’ list by FBR” (**DEFLST**) and “do you think someone else will report if you evade your share of taxes” (**OTHREP**) while those for guilt included “do you think others will have to pay for the amount that you evade” (**OTHRPY**) and “do you think evading taxes is the Right thing to do”( **RGHTHG**). The results of the survey for shame and guilt are appended in Table 1. The table includes responses of the respondents for the questions regarding shame and guilt. The question-wise detail of variables is appended as under:

**Table 1: Summary of Elements of Shame and Guilt**

Variable	Indicator	Responses						TOTAL
		Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Don't Know	
Shame	DEFLST	56	73	94	48	54	6	331
	OTHREP	38	72	101	45	48	25	329
Guilt	OTHRPY	48	66	92	46	52	25	329
	RGHTHG	159	102	46	12	11	4	334

#### *Indicators for Shame*

As a proxy for shame, the respondents were asked to give their opinion regarding acceptability of their name being published in the defaulters’ list on the Federal Board of Revenue website. The answer was required on a 5 point likert scale with 5 as highly acceptable and 1 being not-at-all acceptable. A majority of 39% respondents were on the acceptability side of the table while only 30.8% had opinions discouraging the act. Most of the respondents making 28.4% or 94 out of the total sample size selected option 3 meaning that they showed neutrality to the question. The mean of 3.0 also proves the same. The response to the question is given in Table 2.

Similarly the second question of *whether it was acceptable for the respondent that someone else reports his tax evasion* also produced similar results. A vast majority of 30.7% or 101 respondents selected option 3 thus remained neutral while the responses remained skewed in favor of the question asked. A mean score of 2.8 also showed that the respondents were neutral to the second question as well.

**Table 1 : Fear of name in Defaulters' List**

S No.	Indicator	Response	Frequency	Percentage	Mean
1.	Do u fear that your name will be included in the defaulters' list for non-payment of taxes? (DEFLST)	5	56	16.9	3.0
		4	73	22.1	
		3	94	28.4	
		2	48	14.5	
		1	54	16.3	
		Don't know	06	1.8	
		<b>Total</b>	<b>331</b>	<b>100</b>	

This peculiar trend of neutrality can be attributable to the fact that honest responses to the issues like tax evasion are difficult to be obtained. People usually try to hide their actual responses and give responses that are biased. (Schneider, 2003). However, the survey indicates that people did not even accept the factor of shame (as determined by the responses of the two questions asked). It is also pertinent to mention here that Pakistan has a very low tax to GDP ratio of just 12.4% of GDP while the tax gap stands at 9.8% making a total of PKR. 3.2 trillion (Hassan, 2018). This shows a high culture of tax evasion in the country. Moreover, the findings are also in conformity with (John Cullis, 2012) and (Alm, 2012) who state that individual behavior of tax compliance are shaped by the social norms prevailing in the society.

**Table 2 : Fear of Someone reports Evasion**

S No.	Indicator	Response	Frequency	Percentage	Mean
2.	Do you consider it acceptable if someone reports your tax evasion to the authorities? (OTHREP)	5	38	11.5	2.8
		4	72	21.9	
		3	101	30.7	
		2	45	13.7	
		1	48	14.6	
		Don't know	25	7.6	
		<b>Total</b>	<b>329</b>	<b>100</b>	

#### *Indicators for Guilt*

The other variable of 'Guilt' was also measured with the help of two indicators namely; *is it acceptable that other pay your share of taxes if you evade?* and *is it the right thing to evade taxes?* The responses to the two questions are appended below in Table 4:

**Table 4: Fear of Someone reports Evasion**

S No.	Indicator	Response	Frequency	Percentage	Mean
1.	In your opinion, is it acceptable that someone else bears the burden of tax evasion on your part? (OTHRPY)	5	81	24.7	2.4
		4	76	23.2	
		3	62	18.9	
		2	48	14.6	
		1	36	11.0	
		Don't know	25	7.6	
		<b>Total</b>	<b>328</b>	<b>100</b>	

It is evident from the table above that an absolute majority of respondents fall in the disagreement range of the scale. According to the figures, a total of 24.7% strongly disagreed while another 23.2% disagreed to the statement of whether it was acceptable to transfer their burden of tax to others by the way of evading taxes. The percentage of respondents falls as the table moves from disagreement towards the agreement side. This is evident from the fact that only 7.6% strongly agreed to the statement. Although the mean of 2.4 falls somewhat near to the neutral side, still it shows an inclination towards the disagreement side of the table.

The second and somewhat a more direct indicator for guilt had a stronger trend towards the disagreement side. Almost half of the respondents making almost 48% of the respondents strongly disagreed to the statement of *whether it was the right thing to evade taxes* while another 30.6% fairly disagreed to the statement. Only around 20% of the respondents were on the rest three points on the likert scale. A stronger skewness is shown by the mean of 1.8, hence rejecting the statement altogether. The responses to the questions regarding guilt are appended in Tables 4 and 5.

**Table 5: Indicators of Guilt**

S No.	Indicator	Response	Frequency	Percentage	Mean
2.	Do you think it is the right thing to evade taxes? (RGHTHG)	5	11	3.3	1.8
		4	12	3.6	
		3	46	13.8	
		2	102	30.5	
		1	159	47.6	
		Don't know	4	1.2	
		<b>Total</b>	<b>334</b>	<b>100</b>	

There is a decreasing trend as we move towards acceptability side on both the indicators as shown in Table 5 above. The result is in consistence with a study carried out by (Baumeister, Stillwell, & Heatherton, 1994) that states that when people believe that their actions will over burden others or when they think that the actions would be looked down upon by others, people try to alter their behavior that will be in line with what they think is accepted by others (p. 247).

Moreover, literature also suggests that religion also has an impact on the tax evasion behavior of individuals (Murtuza & Ghazanfar, 1998) and (McGee, 1997) have established a relationship between the ethics of tax evasion and Islam and have claimed that Islam teaches to be law abiding citizens and follow rule of the land. However, according to (Bank, Mcgee, & Yüzbaşı, 2015) Muslims are to strictly abide by the tax laws when the state is following the Shariah Law.

In case of Pakistan, the constitution states that Pakistan is an Islamic Republic and all laws will be made in the light of Shariah, therefore, following tax laws in Pakistan is the responsibility of every citizen of the country.

## 2. *Trust in Government*

Trust is the expectation that other person's behavior will not affect the interests of oneself negatively (Paxton & Smith, 2008). Trust in this research refers to the response of individuals' tax evasion behavior to the perception of services being provided by the state. Trust in government has a direct link with compliance behaviors of the citizens including their decisions to comply with tax regulations (Levi & Stoker, 2000). If the taxpayers have trust in the government and they perceive the government to be working in their interest, they will go for tax compliance even if evasion has

been a better option for them (Levi, 1998). According to (Alm & Togler, 2004) there is a positive relationship between trust in government and the parliament and the tax compliance behavior of the individuals. This means that cheating government especially through tax evasion is found to be less justifiable in countries where level of trust in government is higher and vice versa.

For the purpose of measuring trust in government, two indicators have been taken first being satisfaction with the services being provided by the government. The question asked in this regarding states *do you think taxes paid are being utilized for providing adequate services by the government to its citizens?* Second indicator to measure trust included asking respondents regarding their perception of corruption. The question asked was *to what extent do you think your tax money is being used to fill pockets of politicians and officials?* The responses are presented in the Tables 6 and 7.

**Table 6: Perception about utilization of tax money**

S No	Indicator	Response	Frequency	Percentage	Mean
1.	Do you think that tax evasion is more when people perceive taxes paid are NOT being utilized to provide for the required public services for the citizens?	Strongly agree	8	2.5	4.12
		Agree	23	7.1	
		Neutral	34	10.5	
		Disagree	105	32.4	
		Strongly Disagree	152	46.9	
		Don't know	2	0.6	
		<b>TOTAL</b>	<b>324</b>	<b>100</b>	

**Table 7: Perception about corruption**

S No	Indicator	Response	Frequency	Percentage	Mean
1.	Do you agree that that people don't pay taxes because the tax money is being used to fill up the pockets of politicians and officials?	Strongly agree	209	62.6	1.5
		Agree	85	25.4	
		Neutral	26	7.8	
		Disagree	5	1.5	
		Strongly Disagree	7	2.1	
		Don't know	2	0.6	
		<b>TOTAL</b>	<b>334</b>	<b>100</b>	

The above table shows an increasing trend while moving towards disagreement side of the statement. Almost half of the sample size of 46.9% strongly disagreed to the statement that their tax money was being utilized for the public services being provided by the government. The mean of 4.12 rejects the statement about provision of public services by the government.

The second indicator has produced the same results. An absolute majority of 62.6% strongly agreed to the statement while around a quarter agreed but to a lesser extent. The mean of 1.5 shows that the response pattern is skewed towards agreement side hence the response trend accepts the statement. The findings are in line with the fact that when there is a large possibility of politicians and public servants eating away public money for their own vested interests, there is less left to spend on public services that results in the inclination of citizens more towards tax evasion (Litinaa & Palivos, 2015).

In Pakistan corruption is on the rise. According to Transparency International, Pakistan ranked 117 in Corruption Perception Index with the index of 32 in two consecutive years of 2016 and 2017. The corruption in Pakistan is so much that the sitting Prime Minister of the country was



charged with corruption and removed from office in 2017 after accusations being proven on him and his close allies. This led to an increased perception about corruption in minds of the citizens that decreased the level of trust for the government in the minds of the masses. Moreover there has been an increasing gap in the government and citizens of the country as far as public service delivery is concerned. According to a report published by Pakistan Poverty Alleviation Fund (PPAF) in 2017, there is much gap between the requirement and provision of public services in the country especially to the poor population away from the main cities (Naveed, 2017).

### 3. *Perception about others paying taxes*

Social norms and culture have an impact on the tax evasion habits of its citizens (Cullis, Joanes & Sloviao, 2012). Individuals comply with the rules when they are aware that compliance is a social norm (Alm, 2012). When a person observes unethical behavior in his or her vicinity, ones perception about the social norms regarding honesty and ethics change (Gino, Ayal and Arely, 2009). Literature shows that the taxpayers conditionally comply with the rules (eg; tax rules) till the time others in the society are doing the same (Fray & Torgler, 2007 and Traxler, 2010). Therefore, perception about the tax compliance behavior in the social circle has a direct impact on the tax compliance behavior of an individual.

In order to measure the impact of perception about others paying their share of taxes on tax evasion, the question asked included '*in your opinion, do you think other people in your neighborhood are paying taxes honestly?*' The answer to the question is appended in Table 8. As evident from the tabulated figures, most respondents are in the neutral to fairly agree region of the scale. According to the statistics, 30% of the respondents remained neutral to the statement while 26.4% fairly agreed to the statement. The mean score of 2.7 also indicates the same region of acceptability of the statement. Hence the statement is not strongly supported by the survey.

**Table 8 : Perception about others evading taxes**

S No	Indicator	Response	Frequency	Percentage	Mean
1.	Do you think tax evasion increases when others in your neighborhood are evading their taxes?	Strongly Agree	45	13.6	2.7
		Agree	87	26.4	
		Neutral	99	30.0	
		Disagree	36	10.9	
		Strongly Disagree	47	14.2	
		Don't Know	16	4.8	
		<b>TOTAL</b>	<b>330</b>	<b>100</b>	

**Table 9 : Perception about level of Penalties**

S No	Indicator	Response	Frequency	Percentage	Mean
1.	Do you think penalties are adequate enough on tax evasion in the country?	Strongly Agree	66	19.8	2.52
		Agree	102	30.5	
		Neutral	80	24.0	
		Disagree	37	11.1	
		Strongly Disagree	37	11.1	
		Don't Know	12	3.6	
		<b>TOTAL</b>	<b>334</b>	<b>100</b>	

#### 4. *Penalties on of Tax Evasion*

Penalties and fines have shown to have a significant impact on tax compliance behaviors. However, large fine on tax evasion has shown to be more detrimental for tax compliance as compared to large probability of being caught (Christiansen, 1980) and (Nourzad & Crane, 1986). However a study by (Obid, 2004) concluded that audit probability and penalties have significant effect on the tax compliance behavior of individuals till the time effective tools are used by the government. Although penalties and probability of being caught help shape compliance behavior of individuals, these effects vary based on demographic factors like gender, age and even occupational status of the taxpayer (Devos, 2008). The present survey also checked the impact of perceived penalties on tax evasion behavior of individuals. The results are shown in Table 9.

The response indicates that the majority of individuals agreed to the statement that penalties were adequately enough on tax evaders. A total of 102 respondents making 30.5% agreed while 19.8% strongly agreed to the statement making a total of almost 50% or half of the sample size on the agreement side of the table. Disagreement was only 22.2% of the total response rate while 24% remained neutral. The mean figure of 2.5 shows an inclination towards disagreement (although not strongly agreeing) side.

According to Section 183 of the Income Tax Ordinance, 2001<sup>2</sup> penalty for income tax default is 5% in first default, additional twenty percent in the second, additional twenty five percent in the third and fifty percent in the fourth time on the amount of tax evaded. However, the penalty cannot go above 100% of the total amount. This situation when compared to the neighboring India is a bit change as the penalty for non- payment of taxes can lead up to 300% of the tax evaded<sup>3</sup>. In USA, the IRS fines up to 25% on tax evaded per month.

Having viewed the penalty situation of the two countries, the comparison shows that the penalty on tax evasion in Pakistan is high but not to that extent. Coincidentally, the results of the survey prove the same as most respondents were on the agreement side of the scale while not going for strong agreement.

#### *Reliability Test*

##### **Chronbach's Alpha Table**

<b>Chronbach's Alpha</b>	<b>No of Items</b>
.602	8

The test score of .602 shows proves the data to be reliable as anything more than 0.50 means that the data is reliable.

#### *T-Test*

T-Test statistics were also calculated to check the significance of the data. The results are tabulated in Table 10.

The results of the t-test indicated that three out of eight variables have mean values less than the test value of 2.5. These variables include perception about tax money being used to fill pockets of officials and politicians and both the variables of guilt. Moreover, perception about the level of penalties on tax evasion also does not bother the tax evasion behavior much. Whereas the other variables including both the indicators of shame and perception about other paying honestly has more impact on the tax evasion behavior. Perception about utilization of tax money has the greatest impact on tax evasion as seen from Table 10. It is pertinent to mention here that all results are significant at 1% level of significance.

<sup>2</sup> Income Tax Ordinance 2001 amended by Finance Bill 2013

<sup>3</sup> Section 261(c) of Income Tax Act of India

**Table 10: T-Test**

Variable	Test Value = 2.5			
	t-value	Mean	P-Value	Mean Difference
Utilization of money	-20.077	4.12	0.000	1.62
Filling pockets	-30.752	1.50	0.000	-1
Name in defaulter list	-1.903	3.00	0.000	0.5
Someone will report	-3.174	2.80	0.000	0.3
Others paying honestly	-3.848	2.70	0.000	0.2
Doing RIGHT THINGS	-21.070	1.80	0.000	-0.7
Others will pay more	-3.251	2.40	0.001	-0.1
Penalty on evasion	-6.574	2.50	0.000	0.00

All values are significant at 1% level of significant

### Political Intervention for Tax compliance

Despite the fact that much work has been carried out in the field of tax evasion and compliance, less contribution has been made in the literature focusing on the role of politics in shaping compliance behavior of individuals. However, literature related to Public Choice has touched upon the issue of contribution of politicians and the ruling class in shaping and controlling the economy (Ben-Porath, 1975), (MacCraken, 1977), and (Tuftte, 1978). A study carried out by (MacRae, 1977) concluded that politicians have a role in shaping citizen behavior as a tool to get political favors by manipulating economic situation during election years. This model is known as election cycle model and is part of the *Political Business Cycle* theory. According to (Moore, 2015) the government targets only those segment of taxpayers whom it considers more revenue generating.

One of the tools to affect economy by the ruling elite of the country includes influencing the tax administration and structure (Kim, 2008). Therefore role of politics cannot be ruled out in shaping the tax evasion behavior in a society. Moreover, as seen from the above discussion, a total of four determinants of tax morale that proved to be significant contributors of tax evasion have been so far discussed in the paper and out of the four variables, three have direct relationship with the government that include utilization of tax money; name to be included in the defaulters' list; and someone will report the income to the government. However, the fourth variable '*others*' paying *their share of taxes honestly*' also can be attributable to the role of government. Therefore, politics has an important role to play in this regard.

The results of the survey indicate that perception about utilization of tax money plays an important role in the tax compliance behavior of the taxpayers. The government needs to focus on provision of public services to the masses in return for them to comply with the tax laws of the land. In order to gain trust of the governments, the taxpayers need to know where their taxes are being utilized. One of the methods is hypothecation (Seely, 2011). This process involves earmarking a portion of taxpayers' money on certain projects or allows taxpayers to utilize their tax money on the area of their own interest (Brockmann, Genschel, & Seelkopf, 2015). One such example as quoted by Brockmann is of Spain where the taxpayers were allowed to utilize part of their tax money for charity for the church while the other example is of Japan where taxpayers are allowed to pay part of income tax for the betterment of any rural area of the country.

The other variable that has an impact on tax compliance is the element of shame. One of the methods to control evasion is by targeting the individuals evading taxes emotionally. A study carried out by (Coricelli, Joffily, Montmarquette, & Villeval, 2010) suggested that publically mentioning

the names of defaulter taxpayers, has a direct effect on the tax compliance behavior of individuals. Therefore the Federal Board of Revenue needs to public the names of tax defaulters on its website or through print and social media to exploit the element of shame in order to ensure tax compliance. However, care must be taken that the evaders should be reintegrated rather than stigmatized for a longer period of time because stigmatization or putting stigma on an individual for being a tax evader has proven to be deteriorating for tax compliance efforts for the governments (Coricelli, Rusconi, & Villeval, 2014).

It is also pertinent to mention here although penalties and fines do play role in shaping the compliance behavior of taxpayers but such policies do not prove to be much significant as much as culture (perception about others complying to tax laws) of tax compliance (Guerra & Harrington, 2017). Although the government has the authority to impose fines and penalties, and even decide whether to enforce compliance through motivating by the process or rewards or by triggering the element of shame as mentioned in the preceding paragraphs. However, it is not possible for the governments to enforce directly a culture of compliance. All that the government needs is to put in place a culture that encourages tax evasion. According to (Cummings, Martinez-Vazque, & McKee, 2001) the state and the tax authorities need to convince the taxpayers that the tax system is fair so that the compliance rate is high. The study showed that countries where the people perceive tax authorities to be fair, tax compliance is high, and hence due to cultural affect, more people will comply.

### Conclusion

From the above discussion it can be concluded that a total of six variables had been selected as possible determinants of tax evasion. A questionnaire was distributed to check the perception of respondents about these selected variables and their perceived effect on tax evasion. The results indicate that variables of guilt, corruption and perceived penalty did not have much impact on tax evasion whereas variables containing utilization of tax money, shame and perception about others in the vicinity paying their taxes had much impact on tax evasion respectively. In view of the survey it is recommended that the policy makers and tax authorities have to focus very much on making people realize that their taxes are being utilized in an efficient and an effective manner. Political intervention in this regard has been suggested in the paper. Some efforts in this regard include earmarking portion of tax for some specific cause and even to go to the area of choice of the taxpayer. Moreover, publishing names of defaulting taxpayers will also improve tax compliance. Similarly creating an environment of compliance by the government will also encourage people to comply with the tax laws. This in turn would create a culture of tax compliance and people will comply more due to the cultural affects.

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