

# TAX COMPLIANCE, TAX BEHAVIOUR AND TAX MISPERCEPTION: EVIDENCE FROM FAISALABAD

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## **ABSTRACT**

Pakistan's challenges on the economic front are mammoth. The current account deficit, fiscal deficit, and high levels of public debt stand out as critical concerns that have led to volatile exchange rates and economic uncertainty. These problems are exacerbated by Pakistan's persistently low tax-to-GDP ratio, which is attributed to a restricted tax base, a high rate of tax evasion, and an alarmingly low tax filing rate. In cities like Faisalabad—one of Pakistan's key commercial hubs- low tax compliance is influenced by a complex mix of behavioral, structural, and misperception factors. Thus, this study investigates the underlying factors affecting tax compliance, tax behavior, and tax misperceptions in Faisalabad, utilizing both qualitative and quantitative data collected through surveys of traders, tax consultants/lawyers, and tax officials. The study critically evaluates the policy initiatives, such as TajirDost scheme. Study outcomes emphasized the importance of providing incentives and tangible benefits to the traders who comply with tax obligations. In addition, study findings necessitate a pivotal policy shift designed for broadening the tax base, nurturing a tax compliance culture, and simplifying the tax system for general taxpayers at large to enhance tax equity, efficiency, and revenue.

**Key Words:** Tax compliance, Tax Complexity, Tax incentives, Tax misperception

## **PREFACE**

This study examines the key factors driving tax non-compliance among small-scale traders, including wholesalers and retailers, operating in Faisalabad. The primary focus is on understanding traders' tax behavior and the role of tax misperceptions in shaping compliance decisions in Pakistan's complex tax environment. Tax evasion remains a major challenge in Pakistan due to weak enforcement and structural deficiencies in the tax system. In response, the Federal Board of Revenue (FBR) introduced the TajirDost Scheme in 2024 to broaden the tax base by simplifying procedures and offering reduced tax liabilities for small traders. Using a mixed-method approach combining structured surveys and qualitative interviews, the study analyzes traders' awareness of tax laws, perceptions of fairness and efficiency, trust in government institutions, and responses to recent policy initiatives such as the TajirDost Scheme (TDS). By identifying the behavioral and institutional constraints that limit compliance among small traders, the findings highlight the importance of simplifying tax procedures and reducing tax rates. These insights enable policymakers to refine tax reform initiatives, strengthen voluntary compliance, and broaden the tax base. This research was funded and supported by the RASTA Competitive Grants Program (CGP), and the authors gratefully acknowledge its financial support and facilitation of this project.

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## INTRODUCTION

Taxation is inherently complex, and individuals and companies often use strategic financial planning to reduce their tax liabilities (Bame-Aldred et al., 2013). Income tax is a legal obligation that supports public goods and services, while tax evasion is a deliberate violation of this duty. Businesses that intentionally underreport revenue, inflate expenses or deductions, and conceal funds overseas are engaging in tax evasion (Sandmo, 2005; Khlif & Achek, 2015). Tax compliance, the fulfillment of tax obligations, is shaped by a complex set of economic, psychological, institutional, and social factors that vary across development contexts. In developed countries, economic, psychological, and social determinants are increasingly recognized as crucial in explaining taxpayer behavior. Empirical evidence indicates that tax rate, perceptions of fairness, social norms, and tax morale have a significant influence on compliance decisions, suggesting that traditional deterrence-based economic instruments alone are often insufficient to achieve sustained compliance (Tilahun, 2019). Similarly, cross-country evidence indicates that trust in authorities and the perceived power and legitimacy of tax institutions are universal drivers of compliance intentions, regardless of differences in economic development, socio-demographic characteristics, and cultural or political contexts (Batrancea et al., 2019).

In contrast, studies in developing economies emphasize structural and administrative constraints, including weak tax administration, complex tax procedures, limited taxpayer awareness, and pervasive informality. In such contexts, behavioral factors interact more strongly with institutional deficiencies, intensifying misperceptions about tax obligations and reducing trust in tax authorities (Hassan et al., 2021; Azmi&Daud, 2024). Similarly, deterrence-based models emphasize that audit probability and penalty severity influence compliance decisions, but their effectiveness depends critically on taxpayers' perceptions rather than objective enforcement alone. When taxpayers perceive tax systems as unfair or overly complex, compliance declines even in the presence of strong enforcement mechanisms (Kirchler et al., 2007; Alm & Torgler, 2011). Similarly, deterrence-based models emphasize that audit probability and penalty severity influence compliance decisions, but their effectiveness depends critically on taxpayers' perceptions rather than objective enforcement alone. Moreover, in developing countries, tax evasion is a significant problem, often exacerbated by inadequate institutional capacity, misperceptions about legal compliance, and lax enforcement of tax laws (Alm & Torgler, 2011). The term "tax misperception" describes misconceptions or false perceptions regarding the tax program, tax rates, or the use of tax revenue. These misperceptions are often driven by low levels of transparency, inadequate communication between governments and taxpayers, and inconsistent tax policies (Blaufus et al., 2022).

Such misperceptions are acute in the case of developing economies, where low-income groups are systematically more prone to tax evasion. In a developing nation such as Pakistan, the share of taxes (direct) increased to 48% during the fiscal year 2023–24, indicating a move toward a more progressive tax system. Furthermore, the budget deficit has decreased to less than 4% of the GDP (ibid), indicating better fiscal management and increased revenue. Pakistan's tax-to-GDP ratio, however, is still in the single digits despite these improvements in tax collection, underscoring the continued difficulties in broadening the tax base, reducing tax evasion, and improving overall tax compliance. Tax misperception frequently catalyzes low tax compliance. High tax compliance rates

are essential for both building public institution confidence and producing government revenue. In contrast, massive tax evasion undermines the tax base, slows economic growth, and feeds into a vicious circle of distrust of the tax system (Alm, 2019).

These elements are interrelated; misperceptions about the fairness and complexity of the tax system reduce compliance, and compliance is affected by perceptions of enforcement and risks of evasion. Tax evasion is rampant in Pakistan owing to the combination of a lack of enforcement and ill-conceived tax configurations (Batool et al., 2022). In response to the major evasion of taxes and the small base of taxpayers, the Federal Board of Revenue (FBR) designed the TajirDost Scheme (TDS) in 2024 to introduce small-scale businesses and traders to the formal tax system. Aimed at widening the tax base and not burdening compliance, especially from small enterprises in cities like Faisalabad, the scheme is offering simplified procedures and lower tax rates as a function of indicative income. However, despite these incentives, the scheme has had very low participation, with only about 58,000 traders registered by September 2024. Moreover, tax contributions under the scheme were way below Rs. 1.3 million against the target of Rs. 10 billion (GOP, 2024). This reflects the ills of tax evasion fueled by complex systems, a lack of trust, and lax enforcement. Improving awareness, engagement of stakeholders, and administrative efficiency is crucial to improve compliance and achieve policy objectives (Tilahun, 2019).

### **1.1. Objectives of the Study**

The primary purpose of this study is to investigate the underlying factors contributing to non-compliance with tax regulations among small-scale traders, including wholesalers and retailers in Faisalabad, with a particular focus on tax behaviour and misperceptions about the tax system. The first objective of this paper is to investigate the factors behind non-tax compliance and tax misperception, and how the tax misperception mediates the relationship between tax compliance and tax complexity, using a quantitative data set, with the support of a questionnaire from traders whose income falls in the taxable zone. The second objective of this paper is to find these determinants of tax compliance and possible solutions by gathering qualitative data from tax consultants and Tax officials. The study's scope includes both qualitative and quantitative methods, utilizing structured surveys and interviews to provide a comprehensive understanding of tax compliance dynamics.

## **LITERATURE REVIEW**

Pakistan, as an emerging economy, faces persistent and complex tax-related challenges. A major concern is the widespread misperception among taxpayers regarding tax rates, liabilities, and the use of public funds, which further exacerbates compliance behavior. The basic economic model of tax compliance proposed by Allingham & Sandmo (1972) assumes that taxpayers are rational actors who base compliance decisions on audit probabilities and penalty severity. However, this deterrence-based approach cannot fully explain high compliance in low-audit environments. This limitation led to research that focused on the psychological, social, and institutional dimensions in shaping tax compliance behavior (Kirchler et al., 2007). Palil & Mustapha (2011), in a study of Malaysia's self-assessment system, emphasize that tax knowledge, perceived justice, and trust in tax authorities are important determinants of voluntary compliance. Findings suggest that taxpayers are more likely to comply without enforcement when they view the system as equitable, transparent, and clearly understand their obligations. This perspective aligns with Kirchler et al. (2007), who argues that voluntary compliance is achievable when taxpayers are mentally prepared and willing to adhere to the rules and expectations set by tax authorities. Natrah (2012) states that a taxpayer's mindset may lead to tax-related actions, such as tax evasion, which is commonly referred to as tax non-compliance. In a survey-based qualitative study, Saad (2014) investigated taxpayers' views on tax complexity, knowledge, and compliance behavior. The findings revealed that taxpayers often lack adequate technical knowledge and perceive the tax system as complex, which contributes to non-compliance behavior. These findings are directly applicable to countries like Pakistan, where low tax awareness and bureaucratic inefficiencies create substantial barriers to compliance.

Tax morale, as defined by the intrinsic motivation to pay taxes, is a crucial non-pecuniary determinant. Cross-national surveys and experiments, such as those by (Alm & Torgler, 2011), have shown considerable variation in tax morale across countries, which is related to social norms, perception of fairness, and the level of institutional trust. Findings suggest that when social contracts are strong, as is the case with high-trust societies such as Switzerland and Austria, compliance levels are always high. Hassan et al. (2021), using the Theory of Planned Behavior, examine the socioeconomic and psychological determinants of voluntary tax compliance in Pakistan. The study finds that attitudes, subjective norms, and perceived behavioral control are significant predictors of compliance intentions, and all are adversely affected by perceived institutional corruption and unfairness. The findings underscore the importance of taxpayer education, simplified procedures, and greater institutional transparency in strengthening voluntary compliance. Additionally, tax morale and patriotism raise the costs of compliance behavior and the positive aspects of complacency. Another study using data from Pakistan concludes that employment status, demographic factors, and regional characteristics significantly influence tax morale. In turn, tax morale plays a crucial role in shaping tax compliance, acting as a mediator through these variables (Cyan et al., 2016). Numerous studies have emphasized the importance of tax morale and trust considerations for generating tax revenues more efficiently (Kirchler et al., 2010; Luttmer & Singhal, 2014). Zhang et al. (2016) found that tax morale is influenced by the type of employment, regional differences, and most importantly, by perceptions of how tax revenues are

utilized. When taxpayers feel money is misappropriated or being spent inefficiently, their intentions to comply plummet. According to Kemme et al. (2020), nations with high tax morale also have low rates of tax evasion.

Despite an increase in the tax filing ratio, the tax revenue has not risen significantly, which indicates low tax morale among individuals (IMF, 2015). Shafiq & Sheikh (2020) provide valuable insights into the behavioral dynamics of tax compliance by focusing on the salaried class in Pakistan. Behavioral characteristics such as the perceived fairness of the tax system, enthusiasm, and procedural simplicity influence taxpayers' willingness to comply. Conversely, administrative complexity and a lack of transparency are significant barriers that discourage compliance and foster mistrust. The empirical evidence regarding heuristic behavior in Pakistan is sparser. Heuristics and cognitive biases significantly influence tax compliance behavior, often leading individuals away from rational decision-making. Fišar et al. (2021) explored the impact of media negativity bias on tax compliance, finding that positive news about government actions significantly increases compliance. In contrast, negative news has no comparable effect. Setiyani & Septiani (2024) studied tax decision-making, focusing on the impact of heuristics and cognitive biases. In Indonesia, these biases have contributed to tax compliance challenges, with public prejudices prompting tax evasion and overconfidence among officials, leading to ineffective tax policies.

One issue for low tax compliance is the complexity of tax legislation. Forest & Sheffrin (2002) argue that simplifying tax legislation can significantly enhance taxpayer compliance by reducing the complexity that often deters individuals from fulfilling their tax obligations. This is supported by empirical research on developing countries: for example, Khan & Ahmad (2014) identify tax system complexity as a key driver of tax evasion in Pakistan. Supporting this view, Gambo et al. (2014), through a cross-country analysis of African nations with self-assessment tax systems, found a strong negative correlation between tax complexity and tax compliance. Bernard et al. (2018) examined the impact of tax knowledge and awareness on tax compliance among investors in Kenya's Export Processing Zones. Utilizing a cross-sectional survey design, the study revealed a strong positive relationship between tax knowledge, awareness, and tax compliance. Specifically, firms with well-trained finance or accounting staff, adequate knowledge of tax laws, and procedures were more likely to voluntarily comply with tax obligations. Musimenta (2020) highlights that tax compliance in Uganda is significantly hindered by limited taxpayer knowledge, a complex tax system, and high compliance costs. The study recommends targeted strategies such as public awareness campaigns, digital simplification, and improved taxpayer education to promote voluntary compliance, particularly among small businesses and informal sector operators. Hantono (2021) found that tax awareness, knowledge, and morale all collectively have a statistically significant positive effect on tax compliance, indicating that higher awareness correlates with better adherence to tax obligations.

Although tax morale, perceived fairness, and tax complexity have been widely examined in the literature. Tax misperception may be an important factor that can mediate the relationship between tax compliance and its determinants, such as cognitive capacity, tax complexity, behavioral bias. This notion is supported by the study of Blaufus et al. (2022). They reviewed several studies to identify determinants of tax misperception, such as heuristic behavior of the taxpayers, behavioral

bias, salience, complexity of the tax system, tax uncertainty, cognitive capacity, and the presentation of tax information, as well as individual characteristics including intellectual ability, education, income, and experience. Concomitantly, tax misperception may have an impact on risk-taking behavior, investment decisions, real effort, tax planning, consumption, and retirement. Despite its importance, this cognitive channel remains underexplored in developing-country contexts such as Pakistan. Moreover, Tax rate progressivity may reduce the incentive to work more, as stated by the theory of the Laffer effect. However, a study by Stantcheva (2020) indicates that efficiency concerns, such as belief in the Laffer effect, play a minor role in explaining support for income tax and state tax policies. Tax compliance, especially among the wealthier, can be achieved by instruments based on legitimacy and coercive policies such as obligatory legal environment, responsive regulation, marketing campaigns, and reputation mechanisms by establishing bodies that are specifically designed to enhance tax revenue (Gangl & Torgler, 2020).

The size of the informal economy is an important determinant of tax revenue. Informal economy size is positively related to inflation and negatively related to tax burden, which supports the notion that the government shifts its revenue from taxes to seigniorage (Mazhar&Méon, 2017). Although the ethical behavior of the firms and auditing standards are both important to alleviate tax evasion. Benkraiem et al. (2021) find that ethical behavior is more effective in dealing with tax evasion after controlling for a global financial crisis, especially for low-income countries with low investor protection and low-efficacy corporate boards. At the micro level, it has been observed that a more complex tax system with more tax exemptions provides the basis to avoid taxes legally. Hence more complex tax system discourages work in the shadow economy and results in reduced size in the shadow economy. Opportunism is mainly determined by the perception that one has of the tax system's justice and justice in terms of its benefits to the public (Molodykh&Rubezhnoy, 2017). However, tax compliance is not explained by institutional trust, liberty of tax evasion, information, and awareness of the tax system (Taing& Chang, 2021). According to Riaz et al. (2023), voluntary tax compliance is significantly increased when people believe that taxes are fair and supported by strong social networks. This underscores the importance of both institutional justice and its effect on communities. Murad & Siddiqui (2024) assert that tax complacency positively influences tax attitudes, but tax knowledge enhances voluntary tax behavior and trust. Both of these elements contribute to higher tax compliance.

The existing literature on tax compliance predominantly addresses factors such as tax evasion practices, compliance costs, tax knowledge, and system complexity within international contexts. While some studies have examined the direct effects of these determinants within the specific socio-economic and institutional frameworks of developing countries, such as Pakistan. Particularly, there is a paucity of research investigating the mediating role of tax misperception in this relationship. Tax misperception, defined as taxpayers' inaccurate understanding or interpretation of tax laws and obligations, can significantly influence compliance behavior, yet it remains unexplored in the Pakistani context. Furthermore, existing studies often adopt a unidimensional approach, focusing solely on economic or psychological factors. There is a lack of comprehensive research that simultaneously considers economic, social, institutional, and behavioral dimensions to provide a holistic understanding of tax compliance behavior. Therefore,

this study aims to fill these gaps by adopting a comprehensive approach that integrates multiple perspectives to examine tax compliance behavior. By focusing on small-scale traders in Faisalabad, this study examines various factors, along with the mediating role of tax misperception, that influence compliance decisions. This multifaceted approach is crucial for developing effective policies that consider not only the economic aspects of taxation but also the psychological and social dimensions that drive taxpayer behavior.

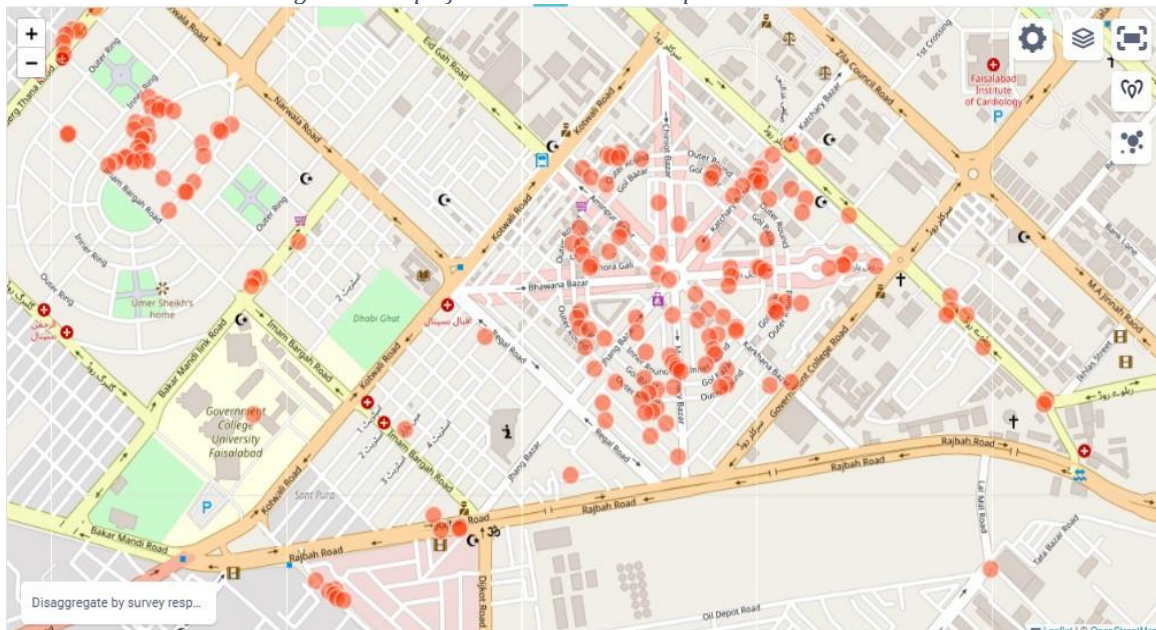
## RESEARCH METHODOLOGY

### 3.1. Data Collection

Data for this research have been gathered from primary sources. For the first objective of this research, data from traders of diverse products, including both retailers and wholesalers, have been collected using a well-designed questionnaire. The questionnaire has been carefully structured by taking into account previous studies on tax misperception and compliance, including Blaufus et al. (2022), Hassan et al. (2021), Blaufus et al. (2017), Alm & Torgler (2011), and Torgler (2007). It has strategically combined both open-ended and closed-ended questions to capture a comprehensive understanding of taxpayer behaviour, attitudes, and perceptions. Additionally, some questions have been self-constructed after detailed discussions with tax officials to ensure relevance to Pakistan's context. The face and content validity of the questionnaires have been ensured by expert opinion. A sample of 387 traders, including both wholesalers and retailers, has been approached for participation in the survey. A mixed design combining stratification and clustering has been applied in the survey. Respondents were chosen based on availability and willingness to participate from each stratum and cluster. Data has been collected from both income tax filers and non-filers whose income is above the taxable threshold. Moreover, it was ensured that the annual turnover of each trader chosen for the sample was above 10 million, which in Pakistan makes a trader obligatory for sales tax registration.

Data was gathered from various parts of Faisalabad as shown in the following map. Most of the data was gathered from the eight bazaars located in the centre of the city around the clock tower. However, other main areas/roads of the city were also covered in the survey.

Figure 1: Map of Faisalabad with Respondent's Location



Source: Respondent location generated by Authors by using kobo tool box.

For the second objective of this research, information has been gathered by conducting structured as well as unstructured interviews with tax consultants and tax officials to get advice for better tax compliance. About 30 tax consultants/lawyers were interviewed. About twenty tax officials and 5 traders' representatives were also interviewed. Questions have been related to income tax, advance tax, general sales tax, and special government schemes such as the TajirDost Scheme (TDS). Moreover, questions have been asked about tax exemptions, tax complexity, legal and illegal tax avoidance methods, targeted audits, digitization, and suggested solutions. This qualitative information has been analysed by performing the triangulation method and thematic analysis. Moreover, a Focus Group Discussion was conducted between representatives of the traders, the tax bar, and tax officials.

### **3.2. Logistic Regression**

In the logistic regression analysis, four separate equations were estimated, each corresponding to a distinct binary dependent variable. In the first equation, the dependent variable captures whether the respondent is a registered income tax filer. Since all surveyed respondents were legally required to register for sales tax, the second equation uses sales tax registration status as the dependent variable. The third equation examines traders' willingness to pay the turnover tax. Finally, the fourth equation considers respondents' willingness to accept a presumptive tax regime.

### **3.3. Structural Equation Modelling**

The primary goal of this paper is to investigate the factors that contribute to non-tax compliance. Tax complexity is a significant factor affecting tax compliance (Taing& Chang, 2021), which can directly influence taxpayers' behavior, as business owners may be hesitant to fulfill their tax duties in a complicated tax system. On the other hand, a complex tax system also leads to tax misperception (Blaufus, 2022), which is itself a key factor impacting tax compliance behavior. To empirically capture these direct and indirect pathways, the Structural Equation Modelling (SEM) technique was applied to conduct mediation analysis on the quantitative data. SEM is particularly suitable as it allows for the estimation of multiple interdependent relationships simultaneously, accounts for both observed and latent variables, and flexibly handles different data types (continuous, categorical, and binary). By employing GSEM, this study will rigorously test the hypothesized causal links between tax complexity, tax misperception, and tax compliance behavior, thereby providing robust evidence on the mechanisms underlying non-compliance. For this purpose, the following hypotheses will be tested.

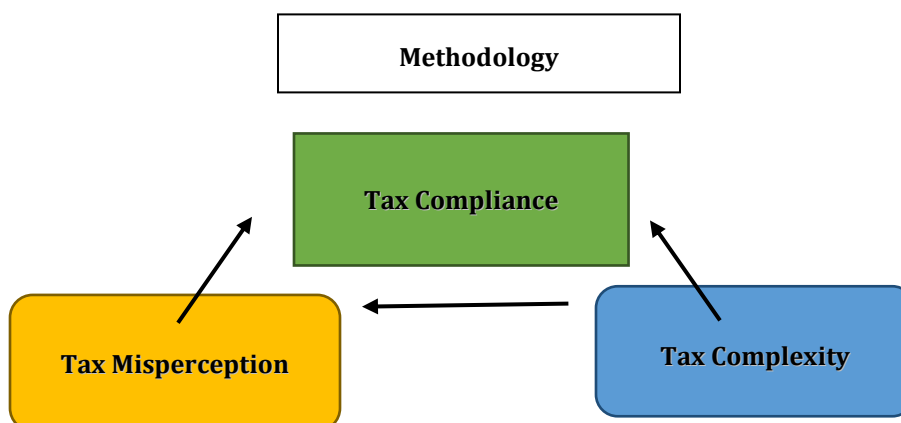
***H<sub>1</sub>***: Tax complexity is a significant determinant of tax misperception.

***H<sub>2</sub>***: Tax misperception is a significant determinant of tax compliance.

***H<sub>3</sub>***: Tax complexity affects tax compliance directly.

***H<sub>4</sub>***: Tax complexity affects tax compliance behaviour through the mediation of tax misperception.

Figure 2: Mediation Analysis



- The relationship between tax compliance, tax misperception, and tax complexity can be visualized as a triangular dynamic, where each factor influences the others.

Source: Authors' computations.

The following models will be estimated.

Tax misperception =  $f$ (tax complexity, cognitive ability, employees, experience, heuristic behaviour, tax salience, behavioural bias, homogenous environment, trader's union).

Tax compliance =  $f$ (tax misperception, tax morale, tax fairness, perceived tax benefits, institutional trust, quality of tax information, tax knowledge, Laffer effect perception, Tax rate perception, conduct disorder, cognitive ability, locus of control).

Table 1: Variable Definitions

Variable	Definition	Source
Tax compliance	The taxpayer's obligation to pay taxes	Kirchler (2007)
Tax complexity	Ambiguity, and excessive changes in tax law	Saad (2014)
Tax morale	An individual's moral and ethical obligation to pay taxes, beyond legal requirements	Alm & Torgler (2011); Cyan et al. (2016)
Perceived benefits	Perception of the benefits received by the community as compensation for paying taxes	Torgler (2007)
Quality of tax information	The clarity, accuracy, timeliness, and accessibility of tax-related information provided to taxpayers	Saad (2014)
Tax knowledge	An individual's understanding of the tax system, including tax laws and procedures	Murad & Siddiqui (2024)
Tax rate perception	A taxpayer's subjective understanding or belief about the level and burden of tax rates	Benkraiem et al. (2021)
Tax misperception	The gap between taxpayers' perceived and actual tax obligations	Blaufus et al. (2022)
Institutional trust	The degree to which taxpayers trust tax authorities/ Government's ability to use tax revenue for the public good	Murad & Siddiqui (2024)
Cognitive ability	An individual's ability to process, understand, and correctly apply complex tax-related information	Blaufus et al. (2022)
Tax salience	The visibility and cognitive prominence of a tax to	Blaufus et al.

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	taxpayers when economic decisions are made	(2017)
Heuristic behavior	The use of mental shortcuts or simplified rules of thumb by individuals when making decisions	Blaufus et al. (2022)
Subjective norms	Perceived social expectations from significant others that influences an individual's behavior	Hassan et al. (2021); Taingf & Chang (2021)
Behavioral bias	Systematic cognitive and psychological tendencies that cause taxpayers to misperceive tax information	Taingf & Chang (2021)
Laffer effect perception	The idea that there is a non-linear relationship between tax rates and tax revenue	Stentcheva (2020)
Banking channel		
Conduct disorder		
Locus of control		

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*Source: Authors' computations.*

The table above shows the definitions and explanations of each variable. The variable of tax compliance has been computed by factor analysis based on tetra-choric correlations among the four binary response variables, including income tax filer, sales tax registration, willingness to accept turnover, or presumptive tax regimes. Tax misperception has also been measured by factor analysis based on tetra choric correlation on the dichotomous response variables explained in the next section. Social norms have been measured by both respondents' perception and by spatial lag. Spatial lag has been created by taking the average of the 5 nearest traders identified by geo-coordinates. The rest of the variables have been measured by Likert scale questions, explained in the next section.

### 3.4. Triangulation

Triangulation uses multiple methods, data sources, investigators, or theoretical perspectives to strengthen credibility and validity in qualitative research (Denzin, 1978). According to Carter (2014), it provides a more comprehensive and in-depth knowledge of the topic being studied and is often used to validate and confirm qualitative results. It compares and cross-verifies data from interviews, focus groups, and observations. This process reduces bias and improves the robustness of results. In triangulation, information gathered from different sources is used to corroborate, elaborate, and illuminate the research problem (Donkoh& Mensah, 2023).

### 3.5. Thematic Analysis

Thematic analysis has been employed as a flexible and robust qualitative method to identify, analyze, and interpret recurring patterns within the data. It systematically organizes responses into meaningful categories that address the research objectives. It helps manage complex data by transforming raw interviews, field notes, and focus group discussions into meaningful insights, as it supports systematic theme development (Braun & Clarke, 2006). This process typically follows six key steps: selecting keywords and quotations, coding, theme generation, refinement, and naming of themes. Moreover, thematic analysis can be applied both inductively, allowing themes to emerge from the data, and deductively, guided by established theories and frameworks (Nowell et al., 2017; Rosairo, 2023). This duality enhances the method's applicability across various research contexts,

enabling researchers to either explore new phenomena or validate existing theories (Ahmed et al., 2025).

## RESULTS AND DISCUSSION: QUANTITATIVE DATA ANALYSIS

### 4.1. Data Reliability Test

Table 2: Reliability Test

Variable	Coefficient alpha	Coefficient Omega
Tax complexity	0.9059	0.9068
Tax morale	0.8645	0.8746
Perceived benefits	0.8939	0.8978
Quality of tax information	0.8613	0.8692
Tax knowledge	0.6471	0.6841
Tax rate perception	0.4689	0.5629
Tax misperception	0.7773	0.7913
Tax compliance	0.611	0.6722
Institutional trust	0.8119	
Cognitive ability	0.4184	

Source: Authors' computations.

The reliability analysis using both Cronbach's alpha ( $\alpha$ ) and McDonald's omega ( $\omega$ ) indicates that most constructs in the study demonstrate satisfactory to excellent internal consistency. Variables such as tax complexity, perceived benefits, tax morale, quality of tax information, and institutional trust exhibit good to excellent reliability, showing strong internal consistency among items. Similarly, tax misperception falls within the acceptable range, suggesting moderate consistency. Although tax knowledge shows poor reliability, it approaches acceptability under omega. Overall, the findings confirm that most constructs are measured reliably, with omega generally providing slightly higher and more robust estimates than alpha.

### 4.2. Descriptive Analysis

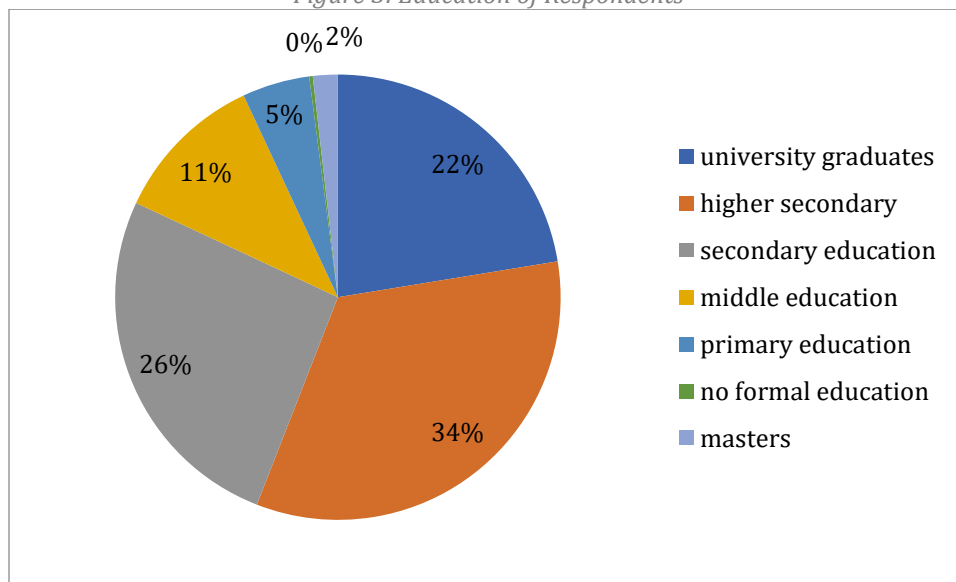
Table 3: Descriptive Analysis of Categorical Variables

Variable	Categories	Frequency
Education	merged into 3 categories, (elementary or less, secondary or higher secondary, university education)	see the figure below
Income	merged into 3 categories (lower middle, middle, upper middle)	lower middle = 202, middle = 98, upper middle income = 87
homogenous environment	having a homogenous environment with similar businesses around or not	109 yes and 278 no
Union	operating in the market having a traders union or not	139 yes and 248 no
Filer	income tax filer or not	259 yes and 128 no
STRN registered	sales tax registered or not	220 yes and 167 no
willingness to pay turnover tax (WTOT)	willing to pay turnover tax or not	185 yes and 202 no
Willingness to pay Presumptive tax (WPTR)	willing to pay presumptive/fixed tax or not	242 yes and 145 no
business type	wholesaler/retailer	209 wholesalers and 178 retailers

Source: Authors' computations.

Above table shows the descriptive statistics of categorical variables. It has been observed that the traders under reported their income. About 52% of the traders reported their annual income below 1.6 million Pak Rupee and categorized as the lower middle income group. About 1/4<sup>th</sup> of the respondents reported their income between 1.6 million to 3.2 million and categorized as the middle income group. Upper middle income group category was assigned to the traders who reported their income more than 3.2 million. About 1/3<sup>rd</sup> of the traders belonged to the markets having separate trader’s union. About 109 traders were working in a homogenous environment with similar businesses working around them. It was ensured that we take a significant sample of filer/non-filer, sale tax registered/non-registered, and wholesalers and retailers for the comparison purpose. all participants in the study were male, reflecting the male-dominated nature of the trading community in the region.

Figure 3: Education of Respondents



Source: Authors’ computations.

The figure shows that most traders have a higher secondary education, followed by those with a secondary education and graduate degrees. This indicates that a majority of traders have at least a moderate to good level of formal education. A smaller number of respondents have a middle education level or primary education, while a few traders hold master’s degrees. Only one trader reported having no formal education.

Table 4: Tax Misperception

misperception question	sale tax determination	income tax liability	minimum taxable income	progressive/regressive	Advance tax adjustment
wrong answer	256	285	212	87	267
correct answer	131	102	175	300	120

Source: Authors’ computations.

As the above table shows that there is a high tax misperception among the traders with regard to different dimensions of the tax system. About 3/4<sup>th</sup> of the traders were unaware of their income tax liability and 2/3<sup>rd</sup> of the traders were ignorant of sale tax determination. It is worth mentioning that

more than 2/3<sup>rd</sup> of the traders were ill-informed about the adjustment of advance tax in the income tax under the section 236 G/H of the income tax ordinance.

*Table 5: Descriptive Statistics for Continuous Variables*

Mean	Median	Min.	Max.	Std. dev.
<b>Age</b>				
40.705	40	20	80	10.194
<b>Number of employees</b>				
3.814	3	1	20	2.686
<b>Number of years in the present business</b>				
14.993	12	0.2	65	11.816
<b>Number of years in the overall business</b>				
22.214	20	1	70	13.061
<b>If you employ a manager or accountant, what is their average monthly salary?</b>				
38385.416	40000	1000	120000	20650.756
<b>Average value addition</b>				
10.413	10	0.3	45	10.413

*Source: Authors' computations.*

Table 2 presents the statistics of the continuous variables. The age of respondents ranged from 20 to 80 years, with the majority falling above 35 years of age (39.82%).

Traders in the sample represent a wide range of sectors, including textiles, groceries, the IT industry, electronics, and construction, etc. Traders were either retailers or wholesalers, with value addition varying significantly across sectors, ranging from less than 1% to as high as 45%. Retailers of grocery items added, on average, about 10% of their product value. In contrast, traders dealing in electronics and the IT industry showed significantly higher value-added margins. Meanwhile, wholesalers operating in the textiles and grocery sectors generally contributed less than 1% in value addition.

#### **4.3. Indicators Measured on Likert Scale**

Tables 3 and 4 provide the descriptive analysis of various tax-related aspects assessed through Likert scale questions. It displays the mean, standard deviation, as well as minimum and maximum values for all variables. Each indicator reflects respondents' perceptions and attitudes toward tax compliance, tax complexity, tax morale, perceived benefits, and institutional trust.

All variables were measured using a five-item Likert scale. All responses were assigned values from one to five (strongly disagree to strongly agree) and (never to always).

*Table 6: Level of Agreement to Different Statements*

* Tax Complexity	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1. Tax rules and procedures are too complicated for ordinary people to understand.	23	64	19	137	144
2. I find it difficult to calculate my tax liability accurately.	22	73	15	132	145
3. Filing tax returns is too complicated for a trader.	22	63	22	143	137
* Tax Fairness					
4. The tax system in Pakistan is fair and unbiased for all taxpayers.	135	105	53	78	16

<b>* Perceived Tax Benefits</b>					
5. I believe tax revenues are used for public welfare and national development (e.g., roads, schools, healthcare)?	120	111	39	96	21
6. I see visible improvements in services due to tax collection.	116	102	54	96	19
7. I can get the same share of services from the government by paying taxes.	114	115	72	78	8
<b>* Institutional Trust</b>					
8. The tax authorities are trustworthy and free from corruption.	159	117	28	75	8
9. I trust in the judiciary.	153	81	36	93	24
<b>* Quality of Tax Information</b>					
10. Tax guidelines are clear and easy to understand.	81	114	22	128	42
11. Tax-related information is easily accessible.	58	108	21	152	48
12. Tax authorities provide timely updates and guidance.	40	86	29	186	46
<b>* Tax Knowledge</b>					
13. I am aware of important tax deadlines.	29	67	27	209	55
14. I regularly listen to the news for any changes in taxes.	154	90	25	109	9
15. I am familiar with tax laws.	139	92	27	119	10
<b>* Tax Morale</b>					
16. Tax evasion is unethical.	14	22	12	184	155
17. Tax avoidance is unethical.	17	38	10	147	175
18. Paying taxes reflects good citizenship.	9	15	7	161	195
<b>* Laffer Effect Perception</b>					
19. "In a progressive tax system, businesses that earn higher profits are subject to higher tax rates." To what extent do you agree with the statement: 'A Progressive tax system discourages business expansion'?	11	43	60	130	143
<b>* Tax Rate Perception</b>					
20. Tax rates are increasing every year.	3	4	15	181	184
21. Tax rates for small and medium enterprises are high	2	23	32	181	149
22. I consider the tax rate when deciding how much income to report.	55	98	41	131	62
23. Decreasing the tax rate will increase tax compliance?	18	14	9	206	140
<b>* Cognitive Ability</b>					
24. I quickly learn any skill	10	25	34	231	87
25. I feel confident in understanding simple financial documents.	7	43	45	227	65
<b>* Conduct Disorder</b>					
26. I keep myself calm in stressful situations.	8	35	25	217	102
<b>* Locus of Control</b>					
27. Success comes with hard work, not by luck.	7	48	44	149	139

*Note: Scales: 1. Strongly Disagree 2. Disagree 3. Neutral 4. Agree 5. Strongly Agree.*

*Source: Authors' computations.*

Overall, respondents perceive the tax system as highly complex in terms of tax laws, tax filing procedure and determination of tax liability. This was also evident in the discussions with the experts. Tax morale is generally high among traders provided that the traders are facilitated with simplification of the tax system and incentivized with lower tax rates, institutional quality and direct benefits to the traders. Majority of the traders and the experts believe that the trust on the

government institutions is very low and the traders doubt on the efficient use of the tax revenue as evident by the perceived benefits question. Most traders believe that they do not receive benefits by paying taxes. Similarly, they also doubt on the fairness and impartiality of the tax system. Most respondents believe in the Laffer effect, underscoring the preference of regressive tax system over the progressive system as a motivating factor to expand the businesses. A large majority think that tax rates are quite high and strongly believe that tax compliance can be improved by lowering the tax rate. This high tax rate misperception was also manifest in our discussion with the experts as they believed that the high tax rates were the source of resentment among the traders leading to tax non-compliance. In addition, several respondents also believe in an internal locus of control, based on their views about the primary factor behind success, whether it is hard work or luck.

Table 7: Frequency Distribution of Different Responses

<b>* Heuristic Behavior</b>	<b>Never</b>	<b>Rarely</b>	<b>Seldom</b>	<b>Often</b>	<b>Always</b>
28. How often do you use mental shortcuts?	74	111	120	78	4
<b>* Behavioral Bias</b>					
29. How often do you mis predict situations in the market?	114	107	120	38	8
<b>* Banking Channel</b>					
30. How often do you make your business transactions via bank?	35	67	121	82	82
<b>* Tax Salience</b>					
31. I take taxes into consideration when making business decisions such as setting price or investment.	144	50	79	56	58
<b>* Subjective Norms</b>					
32. Most people around me pay taxes	55	143	66	77	46

Note: Scales: 1. Never 2. Rarely 3. Seldom 4. Often 5. Always.

Source: Authors' computations.

The congestion of responses related to heuristic behavior and behavioral bias was concentrated on the left side of the mean, indicating a relatively low level of agreement with these statements. In contrast, responses regarding payment via bank were quite symmetrical. A substantial proportion of respondents believe that most people in their social environment do not comply with tax laws, reflecting strong perceptions of widespread non-compliance and weak social norms in favor of tax compliance.

#### 4.4. Logistic Regression Analysis

Model 1 includes the determinants of tax compliance that are directly relevant to the business. In the Logistic regression analysis, four dependent variables have been taken for four different equations. Being tax filer or not is the dependent variable for the First equation. All the respondents in this survey were obligated to register for sales tax. Therefore, registering the business for the sales tax or not was taken as the dependent variable for the second equation. Willingness to pay the turnover tax under section 113 of income tax ordinance was taken as the dependent variable for the third equation. Willingness to accept the presumptive tax regime has been taken as the dependent variable for the fourth equation.

Table 8: Model 1 Logistic Regression Results

<b>Variables</b>		<b>DV;Filer</b>	<b>DV;STRN</b>	<b>DV:WTOT</b>	<b>DV:WPTR</b>
<b>Spatial lag</b>	Odd ratio	17.846	35.508	3.105	2.359

	Standard error	0.499	0.487	0.501	0.448
	Significance	***	***	**	*
<b>Employees</b>	Odd ratio	1.097	1.085	1.008	1.023
	Standard error	0.076	0.074	0.058	0.049
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Elementary or less</b>	Odd ratio	Reference category	Reference category	Reference category	Reference category
<b>Secondary or higher secondary</b>	Odd ratio	1.687	1.886	1.136	1.341
	Standard error	0.324	0.33	0.319	0.276
	Significance	Insignificant	*	Insignificant	Insignificant
<b>University education</b>	Odd ratio	1.776	2.144	0.777	0.851
	Standard error	0.412	0.406	0.383	0.323
	Significance	Insignificant	*	Insignificant	Insignificant
<b>Lower income</b>	Odd ratio	Reference category	Reference category	Reference category	Reference category
<b>Middle income</b>	Odd ratio	0.708	0.64	0.65	1.207
	Standard error	0.342	0.35	0.329	0.284
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Upper middle income</b>	Odd ratio	1.204	1.075	0.909	1.181
	Standard error	0.439	0.427	0.391	0.338
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Experience in present business</b>	Odd ratio	1.012	1.041	1.018	1.047
	Standard error	0.014	0.015	0.013	0.013
	Significance	Insignificant	***	Insignificant	***
<b>Demand</b>	Odd ratio	1.036	0.906	1.747	1.097
	Standard error	0.153	0.152	0.14	0.12
	Significance	Insignificant	Insignificant	***	Insignificant
<b>Business Type</b>	Odd ratio	1.828	1.937	1.496	0.616
	Standard error	0.311	0.316	0.298	0.267
	Significance	*	**	Insignificant	*
<b>Tax misperception</b>	Odd ratio	0.42	0.694	0.297	0.748
	Standard error	0.243	0.213	0.209	0.178
	Significance	***	*	***	Insignificant
<b>Tax complexity</b>	Odd ratio	0.814	0.698	0.85	1.311
	Standard error	0.162	0.167	0.145	0.128
	Significance	Insignificant	**	Insignificant	**
<b>Bank transactions</b>	Odd ratio	1.417	1.36	0.884	1.006
	Standard error	0.131	0.131	0.124	0.101
	Significance	***	**	Insignificant	Insignificant
<b>Branded</b>	Odd ratio	0.581	0.883	0.76	0.931
	Standard error	0.429	0.426	0.418	0.348
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Investment</b>	Odd ratio	0.723	1.18	0.981	0.766
	Standard error	0.451	0.468	0.416	0.356
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Homogeneous Environment</b>	Odd ratio	2.075	1.409	0.978	1.272
	Standard error	0.429	0.379	0.341	0.295
	Significance	*	Insignificant	Insignificant	Insignificant
<b>Trader's Union</b>	Odd ratio	0.47	0.735	0.909	0.736

	Standard error	0.409	0.389	0.347	0.304
	Significance	*	Insignificant	Insignificant	Insignificant
<b>Constant</b>	Odd ratio	0.052	0.021	0.132	0.455
	Standard error	0.7	0.723	0.618	0.555
	Significance	***	***	***	Insignificant
<b>Pseudo squared</b>	<b>r-</b>	0.337	0.398	0.311	0.099
<b>Chi-square</b>		165.776	210.801	166.438	50.614
<b>Prob&gt; chi2</b>		0.000	0.000	0.000	0.000

*Source: Authors' computations.*

The logistic regression results show that spatial lag is strongly related to the likelihood of being a filer/registered for sales tax, as well as with the willingness to be part of turnover-based or fixed tax-based regimes. This finding highlights the importance of social norms and tax culture. Trader's decision to comply with tax obligations is largely influenced by the behavior of their neighbors. Greater experience in the present business is strongly associated with a higher probability of sales tax registration and with a willingness to accept the presumptive tax regime. Secondary or higher secondary and University education both have positive and significant effects on the likelihood of being a tax filer. Education enhances awareness of tax obligations and compliance benefits. This shows that traders with higher education levels are more likely to file taxes and be sales tax registered. The variable type of business (type) is highly significant and positive, suggesting that wholesalers or traders with more formal business setups are substantially more likely to be tax filers and registered for sales tax than retailers. Misunderstanding about the tax system discourages compliance, as reflected by the significantly negative coefficient for tax misperception (misp), indicating that traders with higher levels of tax misperception are less likely to be tax filers or registered for sales tax. tax misperception (misp) has a strong negative effect, indicating that misunderstandings about the tax system significantly reduce traders' willingness to pay turnover tax and their preference for the presumptive tax regime. It reflects that accurate tax knowledge and awareness play a crucial role in shaping attitudes toward simplified tax schemes. Although tax complexity (tc) shows a negative relationship with filing behavior, the effect is statistically insignificant, implying that a more complex tax system may discourage filing. On the other hand, tax complexity exhibits a negative and significant relationship, suggesting that a more complex tax system discourages traders from registering for sales tax. Both findings emphasize the importance of simplifying tax procedures and improving taxpayer understanding to enhance registration rates. In contrast, tax complexity (tc) shows a positive and significant relationship with the preference for the presumptive tax regime. This suggests that traders are more likely to favor a fixed or simplified tax regime, as such systems reduce administrative burdens and uncertainty. Banking transaction shows a positive and significant effect, meaning that traders for whom, it is essential to conduct transactions through banking channels are more likely to be tax filers. This finding vindicates government/FBR decision to discriminate between the filer and the non-filer to perform bank transactions. Financial transactions promote compliance and reduce opportunities for tax evasion. But it does not significantly influence the decision to register for sales tax.

Traders operating in homogeneous markets or clusters are more likely to be income tax filers. However, this homogenous environment does not encourage voluntary compliance. Homogenous

environment results in price competition among traders and low profit margins that do not encourage voluntary compliance. Nevertheless, they become filer in a competitive environment to enjoy the benefits such as lower tariffs on utility bills under section 235 and lower advance tax under section 236 G/H for the filers. While operating within cohesive market environments or being part of trade associations significantly reduce the likelihood of being income tax filer showing the defiant culture of the unions. Though these effects are not strong enough to significantly influence sales tax registration.

In contrast, traders who made investment in any other business show no significant effect, implying no meaningful impact on tax filing likelihood, and business performance factors do not strongly determine sales tax registration behavior. The logistic model identifies the factors influencing traders' willingness to pay turnover tax. Traders experiencing increasing demand for their products are more willing to pay turnover tax, as shown by the strong positive effect of the demand variable. This indicates that better business performance, profitability and economic upturn encourage tax compliance attitudes. This finding further underscores the importance of phase of economic expansion and boom for the voluntary tax compliance. The type of business (type) also has a positive and significant relationship, suggesting that traders or wholesalers are more inclined to pay turnover tax.

Overall, the findings suggest that enhancing tax knowledge, promoting formal business structures, simplifying the tax system, and encouraging financial transparency can substantially improve tax compliance and increase the number of registered filers among small traders. Furthermore, the results suggest that economic performance (demand) and tax misperception are the most critical determinants influencing traders' willingness to pay turnover tax.

Model 2 includes the determinants of tax compliance that are related to the behaviors of the traders. In the Logistic regression analysis, four dependent variables have been taken for four different equations. Dependent variable in each equation is the same as in model 1.

*Table 9: Model 2 Logistic Regression Results*

<b>Variables</b>		<b>DV: Filer</b>	<b>DV : STRN</b>	<b>DV:WTOT</b>	<b>DV:WPTR</b>
<b>Age</b>	Odd ratio	1.032	1.012	1.023	1.012
	Standard error	.015	.015	0.013	0.011
	Significance	**	Insignificant	*	Insignificant
<b>Employees</b>	Odd ratio	1.285	1.26	1.074	1.071
	Standard error	.081	0.073	0.051	0.047
	Significance	***	***	Insignificant	Insignificant
<b>Tax morale</b>	Odd ratio	1.687	1.321	1.32	1.187
	Standard error	0.181	0.193	0.168	0.139
	Significance	***	Insignificant	*	Insignificant
<b>Tax fairness</b>	Odd ratio	0.802	0.877	0.838	0.954
	Standard error	0.143	0.15	0.128	0.11
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Perceived benefits</b>	Odd ratio	0.833	0.879	1.109	0.592
	Standard error	0.206	0.213	0.187	0.169
	Significance	Insignificant	Insignificant	Insignificant	***
<b>Institutional Trust</b>	Odd ratio	0.778	1.097	1.859	2.15
	Standard error	0.294	0.286	0.236	0.222

	Significance	Insignificant	Insignificant	***	***
<b>Quality of tax information</b>	Odd ratio	1.76	101	0.521	0.952
	Standard error	0.21	0.216	0.2	0.171
	Significance	***	Insignificant	***	Insignificant
<b>Tax knowledge</b>	Odd ratio	3.685	6.607	2.604	1.037
	Standard error	0.325	0.329	0.266	0.24
	Significance	***	***	***	Insignificant
<b>Laffer effect perception</b>	Odd ratio	0.902	0.943	0.961	1.177
	Standard error	0.136	0.138	0.123	0.109
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Tax rate perception</b>	Odd ratio	0.807	0.669	1.426	1.148
	Standard error	0.241	0.245	0.228	0.19
	Significance	Insignificant	*	Insignificant	Insignificant
<b>Cognitive ability</b>	Odd ratio	1.279	1.32	0.919	0.743
	Standard error	0.164	0.176	0.154	0.143
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Conduct disorder</b>	Odd ratio	1.203	1.57	0.889	0.791
	Standard error	0.166	0.169	0.151	0.128
	Significance	Insignificant	***	Insignificant	*
<b>Locus of control</b>	Odd ratio	0.938	0.831	0.993	0.92
	Standard error	0.133	0.135	0.125	0.111
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Heuristic behavior</b>	Odd ratio	1.254	1.139	1.105	0.986
	Standard error	0.153	0.151	0.134	0.116
	Significance	Insignificant	Insignificant	Insignificant	Insignificant
<b>Behavioral bias</b>	Odd ratio	1.005	0.63	1.018	0.871
	Standard error	0.154	0.175	0.142	0.123
	Significance	Insignificant	***	Insignificant	Insignificant
<b>Tax salience</b>					
	Standard error	0.117	0.112	0.101	0.093
	Significance	***	***	***	*
<b>Social norms</b>	Odd ratio	0.998	1.18	1.49	0.952
	Standard error	0.133	0.139	0.122	0.105
	Significance	Insignificant	Insignificant	***	Insignificant
<b>Risk attitude</b>	Odd ratio	2.706	1.96	2.059	1.186
	Standard error	0.341	0.342	0.311	0.272
	Significance	***	**	**	insignificant
<b>Constant</b>	Odd ratio	0.032	0.071	0.063	3.319
	Standard error	1.446	1.47	1.302	1.157
	Significance	**	*	**	insignificant
<b>Pseudo r-squared</b>		0.360	0.420	0.276	0.072
<b>Chi-square</b>		177.070	2222.082	147.723	36.839
<b>Prob&gt; chi2</b>		0.000	0.000	0.000	0.005

*Source: Authors' computations.*

The results show that age has a positive and significant effect, indicating that older traders are more likely to be tax filers and inclined to comply with turnover tax obligations, possibly due to greater experience and awareness of formal business practices. Similarly, business size (employees) shows a strong positive and significant relationship, suggesting that larger businesses, with more

structured operations have a higher probability of filing taxes, showing willingness to comply with registration requirements compared to smaller traders. Furthermore, tax morale (tm) is positively and significantly associated with tax filing behavior. This signifies the importance of motivation and ethical commitment to paying taxes as a driving factor behind compliance. Likewise, quality of tax information (qt) has a significant positive effect, implying that traders who have access to clear, reliable, and timely tax information are more likely to register and file taxes. The variable tax knowledge (tk) has a positive coefficient, indicating that a higher level of understanding of tax rules and procedures significantly increases the likelihood of being registered, enhances compliance, and strengthens traders' willingness to pay turnover tax. Moreover, tax salience (ts) is also positive and significant, suggesting that when traders take into consideration the taxes while making business decisions they demonstrate a greater willingness to comply and register for taxation. Furthermore, risk-taking behavior shows a significant positive effect, suggesting that traders who are more open to taking business risks are also more likely to engage with formal systems, including tax filing. Risk lovers are more likely to be filers, sales tax registered and willing to accept the turnover tax regime, reflecting a proactive approach toward voluntary compliance. This further means that incentives are more important rather than imposing penalties to boost tax compliance.

Among the cognitive and behavioral determinants, cognitive ability also demonstrates a positive and significant relationship, suggesting that traders with better cognitive capacity are more capable of understanding and managing tax obligations. In contrast, behavioral bias shows a negative and significant effect, indicating that traders who more often miss-predict situations are less likely to register for sales tax or comply with formal tax requirements. The results further reveal that cognitive ability negatively and significantly influences preference for the presumptive regime. The variable tax rate perception (trp) also exhibits a negative and significant relationship, suggesting that traders who perceive tax rates as too high are less likely to register. Trust in government institutions (institutional trust) exerts a positive and significant influence, indicating that trust in government and judiciary increases the willingness to be the part of turnover based and presumptive tax regimes. In contrast, quality of tax information (qt) has a negative and significant coefficient, suggesting that access to clear, transparent, and user-friendly tax information discourages the participation in presumptive tax regime. Results indicate that public welfare perception (pf) has a negative and statistically significant relationship with traders' preference for the presumptive tax regime. This suggests that when traders believe tax revenues are effectively used for public welfare are less likely to prefer simplified or fixed tax systems.

#### 4.5. Mediation Analysis

Indices for tax complexity (TC) and tax knowledge (TK) were constructed using factor analysis. Meanwhile, indices for tax misperception (misp) and tax compliance were also developed through factor analysis following a Tetrachoric correlation analysis, due to the dichotomous nature of these variables.

*Table 10: Determinants of Tax Misperception*

Variable	Coef.	Std.Err.	z	P>z
DV: Tax Misperception				
Experience	-0.025	0.003	-7.910	0.000

employees	-0.048	0.014	-3.460	0.001
Cognitive Ability	-0.109	0.041	-2.670	0.008
Tax Complexity	0.168	0.039	4.270	0.000
Heuristic Behavior	0.019	0.036	0.530	0.594
Behavioral Bias	-0.007	0.036	-0.190	0.850
Homogenous environment	-0.192	0.087	-2.210	0.027
union	-0.484	0.082	-5.910	0.000
_cons	1.167	0.191	6.120	0.000

Source: Authors' computations.

The results show that experience has a significant negative effect on tax misperception, suggesting that traders with more experience tend to have fewer tax misperceptions. Similarly, business size (number of employees) also has a significant relationship, meaning that larger traders are less likely to misperceive the tax system compared to smaller ones. The variable confidence in understanding financial documents (cognitive ability) also shows a negative and significant effect, suggesting that financially literate traders have a better understanding and less misperception about taxes. In contrast, the complexity of the tax system (tc) has a positive and significant relationship, implying that a more complex tax structure increases tax misperception among traders. While homogeneity among surrounding traders is significant, it indicates that traders operating in more homogenous environments tend to share accurate information and thus exhibit fewer misperceptions. Finally, membership in trade unions (unions) has a strong negative and significant relationship, showing that traders associated with unions are better informed and less likely to misperceive the tax system.

Table 11: Mediation Analysis

Variable	Direct Effect			Indirect Effect			Total Effect		
	Coef.	Std.Err.	z	Coef.	Std.Err.	Z	Coef.	Std.Err.	Z
Tax Misperception	-.1969	.0484	-4.07	No path	No path	No path	-.1969	.0484	-4.07
Experience	.0045	.0033	1.36	.0050	.0013	3.62	.0095	.0032	2.95
Employees	.0188	.0135	1.40	.0093	.0035	2.63	.0282	.0135	2.08
Cognitive Ability	No path	No path	No path	.0215	.0096	2.23	.0215	.0096	2.23
Tax Complexity	-.0789	.0384	-2.05	-.0331	.0112	-2.94	-.1120	.0384	-2.92
Heuristic Behavior	No path	No path	No path	-.0038	.0072	-0.53	-.0038	.0072	-0.53
Behavioral Bias	No path	No path	No path	.0013	.0070	0.19	.0013	.0070	0.19
Homogenous Environment	.0672	.0859	0.78	.0377	.0194	1.94	.1049	.0874	1.20
Union	-.0578	.0828	-0.70	.0953	.0284	3.35	.0751	.0815	0.46
Demand	-.0251	.0358	-0.70	No path	No path	No path	-.0251	.0358	-0.70
Business Type	.1529	.0790	1.94	No path	No path	No path	.1529	.0790	1.94
Tax Rate Perception	-.0956	.0430	-2.22	No path	No path	No path	-.0956	.0430	-2.22
Locus of Control	-.0326	.0324	-1.01	No path	No path	No path	-.0326	.0324	-1.01
Laffer Effect Perception	-.0010	.0321	-0.03	No path	No path	No path	-.0010	.0321	-0.03
Risk behavior	.2809	.0772	3.64	No path	No path	No path	.2809	.0772	3.64

Bank Transactions	.1306	.0299	4.36	No path	No path	No path	.1306	.0299	4.36
Spatial Lag	.4915	.0642	7.65	No path	No path	No path	.4915	.0642	7.65

*Source: Authors' computations.*

The above table shows the factors influencing tax compliance, with tax misperception acting as a mediating variable. The variable tax misperception (misp) has a strong and direct effect on tax compliance, indicating that traders with a higher level of tax misperception are significantly less likely to comply with tax regulations. The experience in the present business shows no direct impact on compliance but demonstrates a small, positive indirect effect, suggesting that traders with more experience tend to comply more due to lower levels of misperception. Similarly, business size (number of employees) has both direct and indirect positive effects, showing that larger businesses are more likely to comply with tax obligations both directly and through the mediation of tax misperception. Cognitive ability also shows a positive relationship with compliance through the mediation of tax misperception. Conversely, tax complexity (tc) shows a significant negative direct and indirect effect on tax compliance. This means that a more complex tax system reduces compliance both directly and by increasing misperceptions among traders. Social factors also play a crucial role in influencing tax compliance behavior. Traders operating within homogeneous trading environments show higher compliance levels indirectly through reduction in tax misperceptions. However, the direct effect is insignificant possibly due to higher competition in the presence of similar businesses. Similarly, membership in trade unions has a strong positive indirect effect, reflecting the role of collective support and awareness in reducing tax misperceptions. However, the direct effect is insignificant underscoring the defiant role of trader's unions. Other significant determinants include business type, where wholesalers are more likely to comply with the tax obligations than retailers. Risk-taking behavior suggests that traders who are more open to taking risks tend to comply more, possibly due to the system offering greater incentives for compliance. Traders using banking channels also show a significant positive effect, indicating that financial transparency and dependency on the banking channels encourage compliance. Spatial lag is strongly and positively associated with compliance to the tax obligations, indicating that peer influence the decision-making of the traders. This further determines that the tax culture needs to be promoted. Variables such as changes in demand, locus of control based on luck perception, and Laffer effect perception (lep), were found to have no significant effect on tax compliance.

## RESULTS AND DISCUSSION: QUALITATIVE DATA ANALYSIS

In the previous section, we explored the determinants of tax compliance using regression analysis. In this section, we will discuss the factors behind tax non-compliance using qualitative data, and we will also present solutions for each factor.

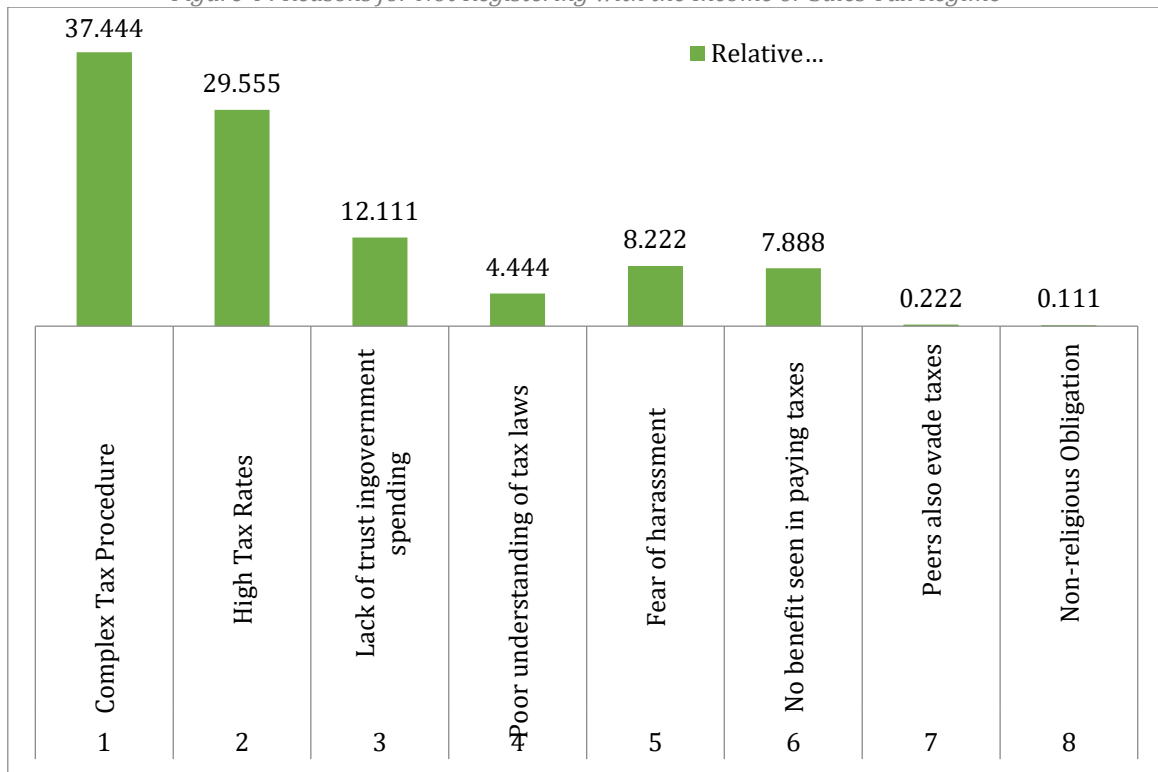
### 5.1. Reasons for Tax Non-Compliance

Table 12: Reasons for Not Registering with the Income or Sales Tax Regime

No.	Reasons	Top 1 Rank	Top 2 Rank	Top 3 Rank	Relative Scores
1	Complex Tax Procedure	105	9	4	37.444
2	High Tax Rates	41	67	9	29.555
3	Lack of trust in government spending	2	37	29	12.111
4	Poor understanding of tax laws	1	16	5	4.444
5	Fear of harassment	1	16	39	8.222
6	No benefit seen in paying taxes		5	61	7.888
7	Peers also evade taxes			2	0.222
8	Non-religious Obligation			1	0.111

Source: Authors' computations.

Figure 4: Reasons for Not Registering with the Income or Sales Tax Regime



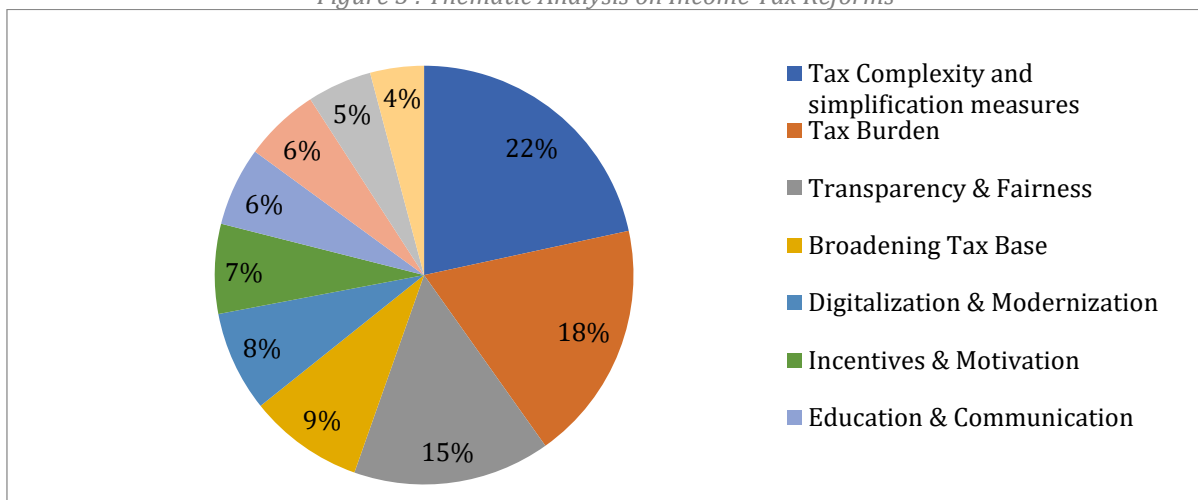
Source: Authors' computations.

It is important to first highlight the major factors that the non-tax-compliant traders mentioned in the survey. As the figure shows, the complex tax procedure emerges as the most significant reason traders mentioned for not registering for tax. The second most prominent factor is high tax rates, which discourage small traders from formal registration. A lack of trust in the government and fear of harassment, including audits and notices, also contribute to low tax compliance. Moreover, some traders have a poor understanding of tax laws and see no direct benefit in paying taxes. Only a small number cited peer influence and non-religious obligation as reasons for not registering, suggesting that social and moral considerations play a relatively minor role in shaping tax compliance behavior.

Another reason the experts (tax lawyers/consultants, tax officials, and traders’ representatives) mentioned was the low profit margins despite very high trading volumes, with no protection against credit sales, deferred payments, or trade credit. This particularly encourages traders to report income as a commission agent to avoid the implementation of Section 113 of the Income Tax Ordinance, which relates to turnover tax. The experts also highlighted the absence of a tax culture. Traders in the tax net receive frequent notices from FBR and are burdened more than they should be, which discourages those not in the tax net from registering for income/sales tax. Low institutional trust among traders, the absence of benefits or incentives for paying taxes, and fear of FBR further discourage traders from complying with tax laws. Traders and traders’ bodies can be encouraged and incentivized by offering lower tax rates and providing benefits such as VIP treatment at government offices. Furthermore, the tax net needs to be expanded to reduce the cynical attitude among current taxpayers. Traders’ unions and tax bar representatives must be taken into confidence before the implementation of any new SROs, with proper prior planning.

Another important point emphasized by the experts was the lack of education and awareness among traders regarding tax laws and procedures. The number of traders also highlighted, as indicated by the above table and the figure 5, which presents the content analysis of responses related to income tax reforms.

Figure 5 : Thematic Analysis on Income Tax Reforms



Source: Authors’ computations.

In response to the question on income tax reforms, traders suggested several points which are categorized by different themes, as shown in the above pie chart after performing thematic and content analysis. The most emphasized suggestion was the simplification of the tax system. The second most highlighted point was to reduce tax burden, followed by transparency and reduction in corruption. A significant number of traders advised the government to broaden the tax base rather than putting additional burden on the existing tax payers. Adoption of modern technology was another important point raised by the traders. About 25 traders stressed the need for incentives and the provision of benefits for the traders. Educating the traders and creating awareness among traders was the next most important concern. About 21 traders emphasized improving the enforcement mechanism. A few traders raised sector-specific concerns. Whereas a small number of traders underscore the importance of bringing administrative reforms.

By performing sentiment analysis on the question related to income tax reforms, we find out that about 12 traders were satisfied with the present system. Whereas eight respondents were quite cynical and hopeless with the present system. A large percentage of responses were neutral, about 102 traders who gave no clear opinion. The majority of traders were dissatisfied with the current system. Suggestions of the traders are discussed in the later sections of this paper.

### **Thematic Analysis**

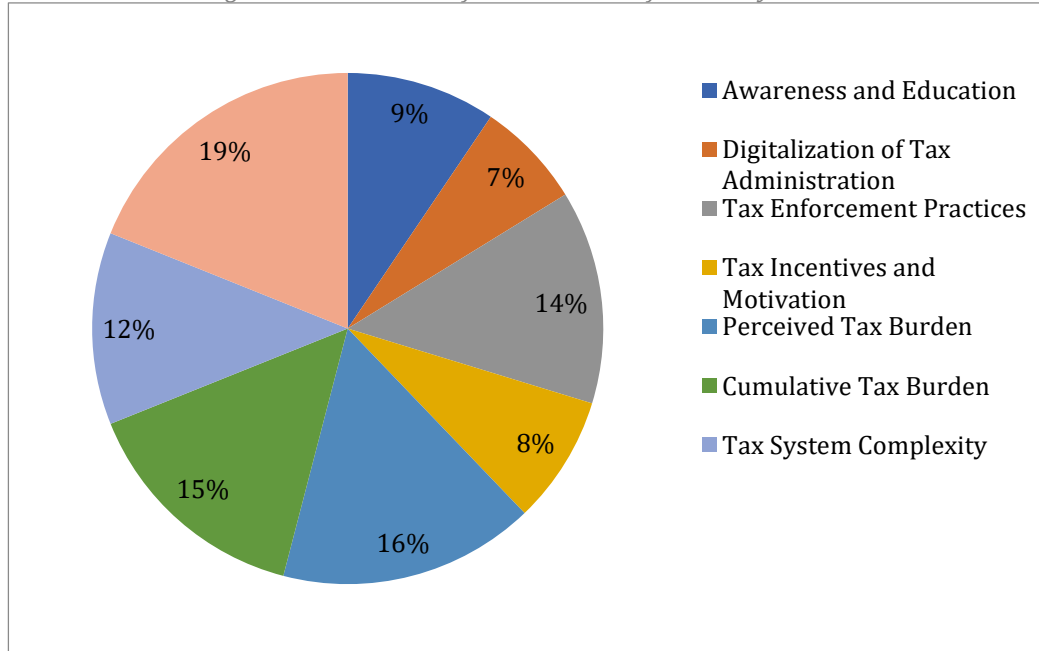
*Table 13: Key Themes identified in Focus Group Discussion (NVivo-Based)*

<b>Theme</b>	<b>Core Focus</b>	<b>No. of References</b>	<b>No. of Sources</b>	<b>Summary</b>
Awareness and Education	Knowledge of tax rules, procedures, and benefits	7	1 (FGD)	Repeated references show a widespread lack of tax awareness among traders
Digitalization of Tax Administration	Use of digital invoicing, banking, and online systems	5	1	Consistent discussion of partial digital adoption and dominance of cash transactions
Tax Enforcement Practices	Notices, audits, and enforcement pressure	10	1	Enforcement experiences were repeatedly cited across participants
Tax Incentives and Motivation	Facilities, incentives, and motivation to comply	6	1	Strong convergence on incentive-based compliance logic
Perceived Tax Burden	High tax rates relative to low profit margins	12	1	High salience theme reflecting trader capacity constraints
Cumulative Tax Burden	Overlapping taxes (advance, turnover, withholding)	11	1	Consistent concern over layered taxation effects
Tax System Complexity	Multiple accounts, NTN, STN, procedural confusion	9	1	Complexity is identified as systemic rather than individual
Trust and Transparency in	Trust deficit and perceived misuse	14	1	Recurrent trust concerns are directly linked to

Tax Governance	of tax revenue			compliance behavior
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Source: Authors' computations.

Figure 6: Distribution of Nvivo-coded References by Theme



Source: Authors' computations.

Table 9 summarizes the distribution of sub-themes that emerged during content analysis, showing the number of times specific issues were mentioned in the context of larger thematic groups. The most important point raised by the members of the focus group discussion was the lack of institutional trust and lower perceived benefits among the traders. The next most important point raised was the perceived tax burden and the cumulative tax burden. Members of FGD underlined the importance of the provision of incentives and benefits to the traders, creating awareness among traders, adoption of modern and digital technologies, simplification of tax procedures, and improvements in enforcement mechanisms.

## 5.2. Methods of Tax Evasion and Avoidance

Before we proceed with detail discussion and solutions on key areas identified by thematic and content analysis, it is important to discuss the methods of tax evasion and avoidance. Almost all the tax consultants were in consensus that traders avoid taxes by working on cash, underreporting income, and suppressing sales. Moreover, producing fake invoices is another common method of tax evasion that was highlighted by the majority of the respondents. Respondent 8 highlighted that traders show their business is involved in international trade to avoid sales tax. He further pointed out that traders evade income tax by showing bogus loans that were actually never taken. Another method that respondent number 8 highlighted was to use non-business cash, such as from agriculture or from remittances, or by selling the previous year's assets that are exempted from income tax, to underreport income. Respondent number 6 also mentioned the use of agricultural

income to underreport business income. Respondent 23 mentioned that he advised his clients to pay 25% more tax than the previous year's tax liability to avoid automatic selection for audits. He was referring to Section 214D of the income tax ordinance. Respondent 14 and respondent 26 mentioned the use of exemptions to avoid taxes. Several respondents highlighted some common methods of tax avoidance employed by traders. Respondents 6, 8, and 26 noted that business fragmentation among family members is frequently used to benefit from lower income tax rates. Respondents 14, 24, and 25 expressed concerns that traders often inflate expenditures to reduce taxable income, while respondent 30 added that allowable deductions, such as other operating costs or depreciation, are frequently overstated. Respondent 28 pointed to the exploitation of tax-free zones, including the former FATA region and export processing zones, as another avenue of avoidance. According to respondents 29 and 37, fake input credits are claimed, and respondent 21 mentioned that some traders create fake double-bookkeeping to mislead tax officials.

Most tax officials reported that traders frequently challenge tax notices and assessments by filing appeals before appellate tribunals and the High Courts against decisions made by the Commissioner or other authorized officers. According to a tax official respondent 39, most of the traders get relief from the court. According to official respondent 40, weak prosecution by the FBR outsourced prosecutors is a source of this relief. He further criticized the Supreme Court's decision in the Taj International case, which, according to him, restricts FBR powers. Another important avenue of tax avoidance that was highlighted by respondent 38 involves misreporting sales as commission-based trading. This method is used by traders, particularly to avoid the application of Section 113 of the Income Tax Ordinance, which imposes a minimum tax on a business's turnover.

### **5.3. Tajir-Dost Scheme: Deficiencies and Lessons**

As discussed in the introduction section, the TajirDost Scheme was introduced to attract traders to register themselves for income tax. However, this scheme failed to achieve its intended targets. Its failure is evident from the fact that only 16 traders in the present survey out of 387 traders were aware of this scheme. Most tax consultants and lawyers believed that the major reason for the failure of the TajirDost Scheme was the imposition of a high fixed tax rate uniformly applied across the market, regardless of variations in traders' earnings. Respondent 13 and a trader's representative highlighted that even less profitable traders were required to pay the same fixed tax, rendering the scheme inequitable and financially burdensome for small and low-margin businesses. For example, shopkeepers located away from main fronts or individuals selling unrelated items like hot beverages in the gold market were compelled to pay the same fixed amount of tax. The trader representative further mentioned that this fixed tax was not adjustable in their annual tax liability. Almost all the tax lawyers, consultants, and traders' representatives stressed the view that the business community is rarely taken into confidence during the formulation of new tax policies. They stressed the importance of prior consultation with traders to ensure that policies are practical, context-specific, and more likely to gain acceptance within the business community. Most tax lawyers believe that such schemes are amnesties for traders who are not in the tax net to make the black money white. It discourages those traders who are already in the tax net.

Although most tax consultants and traders' representatives believe that the scheme offered high fixed rates, the opinion of the tax officials gave a contradictory view. Respondents 38 and 40 believe that the scheme offered substantially lower tax rates than the actual tax liabilities of the traders. They praised the scheme and were of the view that it was implemented after consultation with all the stakeholders. Respondent 39 mentioned the lack of interest, commitment, and motivation of all the stakeholders in the implementation of the scheme. However, Respondent 37 highlighted some technical issues, such as the determination of the market value of the business premises and the correct assessment of moveable businesses.

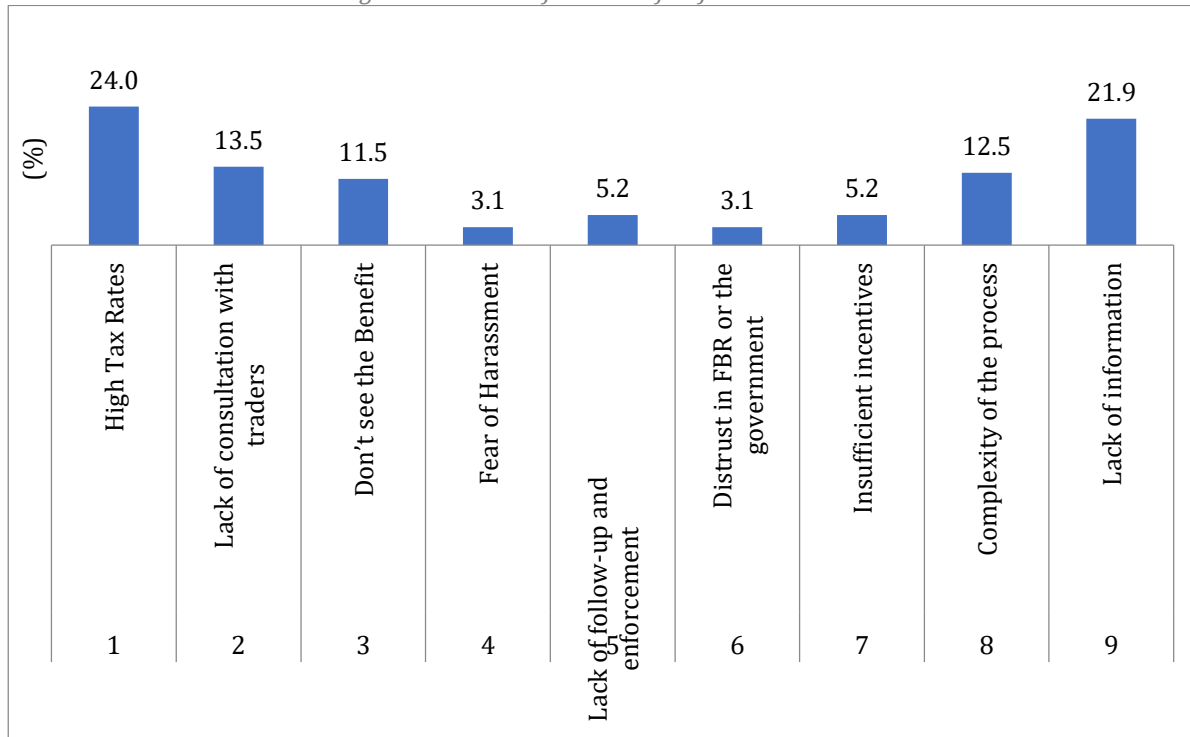
Table 14: Failure of Tajir Dost Scheme

No.	Reasons	Top 1 Rank	Top 2 Rank	Top 3 Rank	Relative Scores*
1	High Tax Rates	4	5	1	23.958
2	Lack of consultation with traders	1	4	2	13.541
3	Don't see the Benefit		3	5	11.458
4	Fear of Harassment	1			3.125
5	Lack of follow-up and enforcement	1		2	5.208
6	Distrust in FBR or the government		1	1	3.125
7	Insufficient incentives			5	5.208
8	Complexity of the process	2	3		12.5
9	Lack of information	7			21.875

Note: \*: Relative scores have been calculated by assigning 3 to rank 1, 2 to rank 2 and 1 to rank 3.

Source: Authors' computations.

Figure 7: Reason of Failure of Tajir Dost Scheme



Source: Authors' computations.

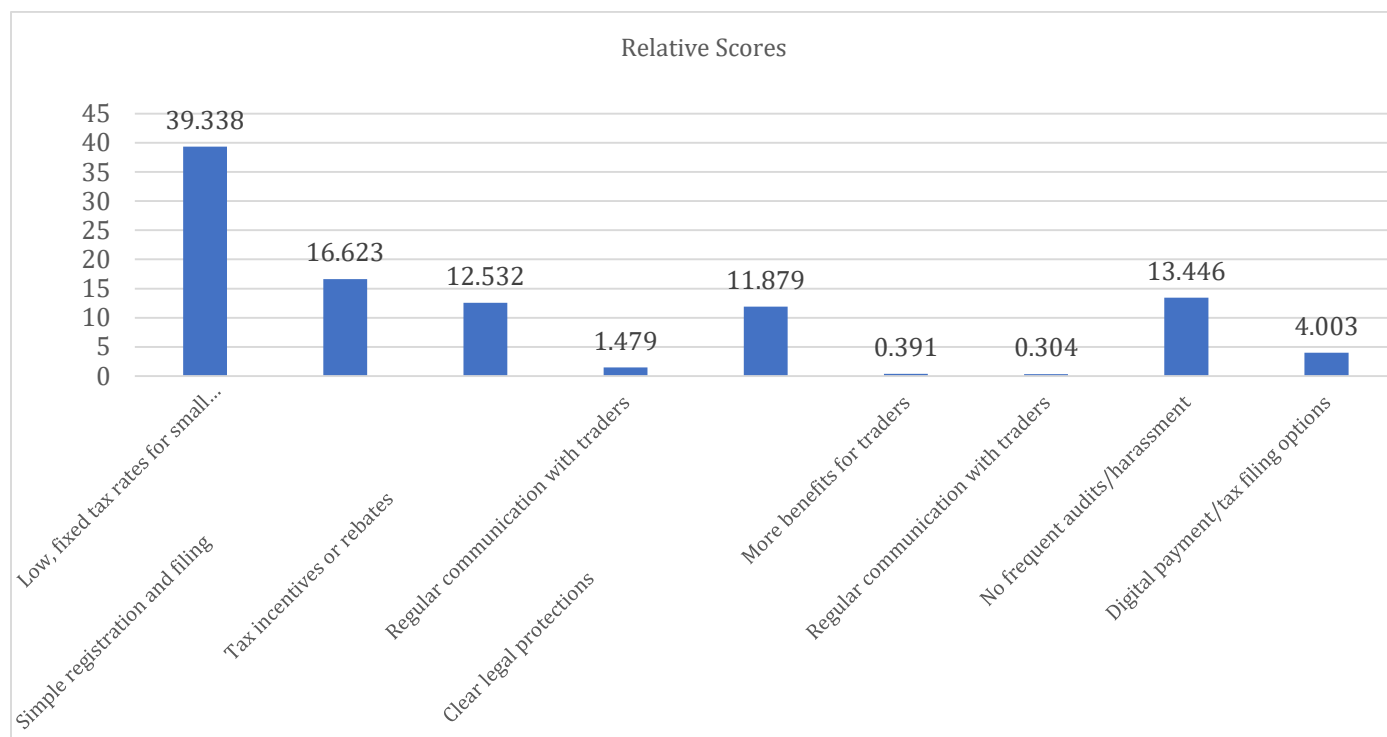
In the survey, only 16 traders were aware of the TajirDost Scheme. The high fixed tax rate proposed by the government was a major reason for the scheme’s failure. Traders felt that the current tax rates were already too high, which lessened their motivation to register. Many traders were also unaware of the scheme’s details, benefits, and procedures because of weak communication and limited outreach by the FBR. Additionally, traders believed they were not properly consulted before the scheme was launched. The registration and compliance process was seen as too complicated, and without clear benefits or simplified procedures, participation remained low. Furthermore, the lack of enforcement, insufficient incentives, and ongoing distrust in the FBR further weaken traders’ confidence in the scheme.

*Table 15: Features of Traders' Friendly Scheme*

<b>No.</b>	<b>Features</b>	<b>Top 1 Rank</b>	<b>Top 2 Rank</b>	<b>Top 3 Rank</b>	<b>Relative Scores</b>
1	Low, fixed tax rates for small businesses	292	9	10	39.338
2	Simple registration and filing	31	139	11	16.623
3	Tax incentives or rebates	6	107	56	12.532
4	Regular communication with traders	2	3	22	1.479
5	Clear legal protections	2	32	203	11.879
6	More benefits for traders	2	1	1	0.391
7	Regular communication with traders			7	0.304
8	No frequent audits/harassment	46	82	7	13.446
9	Digital payment/tax filing options	2	10	66	4.003

*Source: Authors' computations.*

*Figure 8: Features of the Traders' Friendly Scheme*



*Source: Authors' computations.*

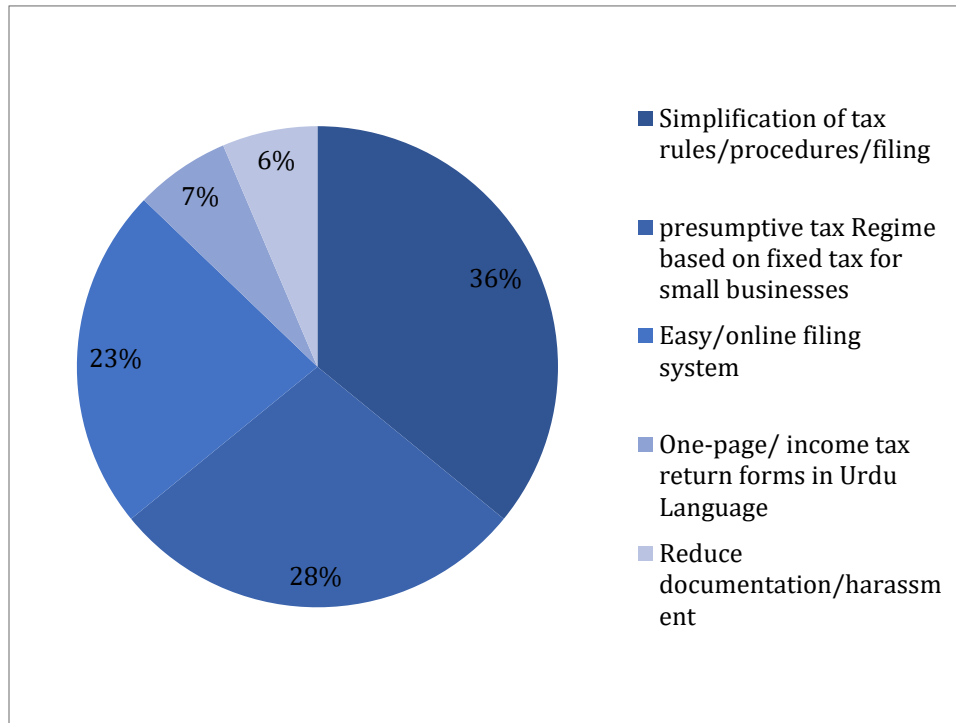
The most preferred feature demanded by the traders is low, fixed tax rates for small businesses, as traders want affordable tax obligations that do not vary with income fluctuations. The second most valued feature is simple registration and filing, reflecting traders' desire for an easier and more efficient tax process. Tax incentives or rebates and clear legal protections were also rated highly, showing that traders search for both financial relief and fair treatment. On the other hand, digital payment and filing options, and regular communication with traders received lower scores, suggesting either less awareness or lower priority among traders

Most tax officials stressed the need to educate business communities through targeted seminars, workshops, and social media campaigns. Respondent 32 suggested offering a 2 to 3-year tax exemption to encourage initial registration under the income tax system. Respondent 40 further argued that any reform scheme should be implemented for a minimum duration of five years to ensure credibility and stability. Additionally, Respondent 38 recommended that tax rates should be kept low during the initial years, while Respondent 40 proposed a regressive or graduated tax structure for the first five years of business operations. Experts collectively highlighted that policy consistency and the provision of meaningful incentives to the trading community are essential for the long-term success of any tax reform scheme.

#### **5.4. Tax Simplification Measures**

As discussed above, tax complexity is a major reason for non-compliance. Moreover, regression results also support the notion that complex tax procedures create misperceptions and discourage tax compliance. Therefore, it is essential to simplify the tax system.

*Figure 9: Tax Complexity and Simplification Measures*



*Source: Authors' computations.*

In response to the question regarding income tax reforms, the most conspicuous measure demanded by the traders was the tax simplification measure, as indicated by the figure 5. Content analysis on this issue given in the above figure suggested that twenty-eight respondents demanded to simplify the tax filing procedures and tax rules. Approximately 22 respondents emphasized the importance of introducing a presumptive tax regime based on a fixed tax. It is pertinent to mention here that regression findings also suggested that the traders who perceive greater tax complexity are more likely to favor a presumptive tax regime. A number of traders cited to introduce an easier online filing system. A Few traders pleaded for a 1-page income tax form in the Urdu language. Moreover, some traders asked to reduce documentation requirements and to reduce harassment by FBR officials.

Among experts, respondents 9 and 26 suggested introducing a 1-page tax filing in the Urdu language so that every trader could understand and submit the tax returns themselves. Respondent 26 criticized the tax imposed at source, such as withholding tax or the advance tax. According to him, tax deducted at source is later adjusted in the price by the trader. Respondent 14 highlighted that the imposition of multiple taxes is the source of complexity in the tax system. Most tax consultants believe that those who do not file their income tax returns and those who do not register for sales tax are encouraged to stay away from the tax net by those who are tax filers or sales tax registered. When they share their experiences with the tax administration and the notices they receive, they discourage the non-filers from entering into the tax net.

Respondents 1 and 2 suggested expanding the number of items listed in the Third Schedule under Section 3(2) of the Sales Tax Act, 1990, as a means to simplify the sales tax regime. In addition, most consultants recommended removing the mandatory QR code and OTP requirements for filing sales

tax and income tax returns, arguing that these measures complicate rather than facilitate compliance.

### **5.5. Tax Rate and Tax Rate Regime**

All respondents in this survey, including traders, tax lawyers/consultants, and tax officials were in consensus that the present tax rates are very high. As discussed above, traders rated the present tax rate as a major reason for tax non-compliance. This finding is also evident in the regression analysis. Moreover, tax rate downward adjustment is the second most required income tax reform that the traders stated, as revealed by the thematic analysis given in Figure 5. Experts and traders' representatives also gave different suggestions in this regard. Respondent 21 suggested that tax rates of 2022-23 should be restored. Respondent 8 suggested reducing by 1 quarter. Respondent 22 suggested eliminating tax rate discrimination between the salary class and business class. According to him, this discrimination discourages the business community from paying taxes. Respondent 27 and the trader representative believed that the tax rate for the highest income slab should not be more than 35%. A tax official emphasized removing the difference between the FMCG (rate and the standard rate to determine the minimum turnover tax under section 113. Presently standard rate is 1.25%, and the FMCG rate is 0.25%. According to him standard rate should be brought down to 0.25%. On the other hand, the trader representative was of the view that some wholesalers earn profit with a margin of less than 0.25% despite high turnover. In our survey of the traders, average value addition ranged from 0.3% to 45%, with the mean of 10.41%, which clearly makes a case for different rates of turnover tax for different sectors. However, traders of such sectors where the profit margins are very low, generally in the case of wholesalers of FMCG, need to be consulted to determine the turnover tax rate.

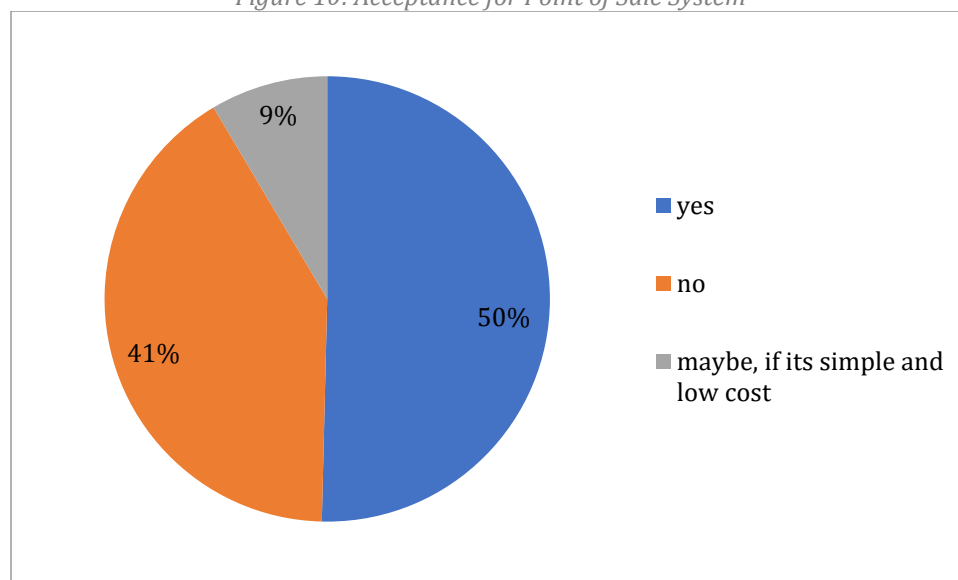
Regarding the tax rate regime, experts were divided in their opinions. A few favored a regressive system, arguing that it could encourage business expansion and improve compliance by reducing the incentive to underreport sales to stay in lower tax brackets. In contrast, the majority supported a progressive system, emphasizing that marginal tax rates should be adjusted downward across income slabs to ensure fairness while maintaining compliance incentives. One trader representative suggested offering tax incentives to traders who expand their businesses, noting that such measures could promote overall economic growth.

### **5.6. Role of Technology**

In this era when every person holds smart phone, it is important to educate the business community to use the technology. Most of the respondents stressed the need to adopt new technology to boost tax compliance. However, respondents 15 and 17 emphasized the importance of first educating the business community before adopting any new technology. In this regard, they referred to the recent introduction of QR code registration for the filing of sales tax returns and an OTP based verification for filing income tax. According to them, while intended to streamline processes, such technology-related measures may actually complicate the tax filing process and discourage the business community. Almost 28 responses were related to the adoption of modern technology and online systems against the question related to income tax reforms, as shown in Figure 5. They stressed the need of introducing user friendly apps and digital payment.

Moreover, nearly half of the tax consultants stressed the need to expand the Point of Sale System (POS) as a vital step toward increasing tax compliance. A trade union president also expressed support for expanding the POS system to ensure greater transparency and accountability in business transactions. A tax official respondent, 36, advised introducing a prize scheme for customers with POS receipts to ensure that traders make full use of the POS network.

Figure 10: Acceptance for Point of Sale System



Source: Authors' computations.

The majority of the respondents are willing to accept a Point of Sale system, provided it is available at no cost.

### 5.7. Cash-based Transactions v/s Transactions via Bank

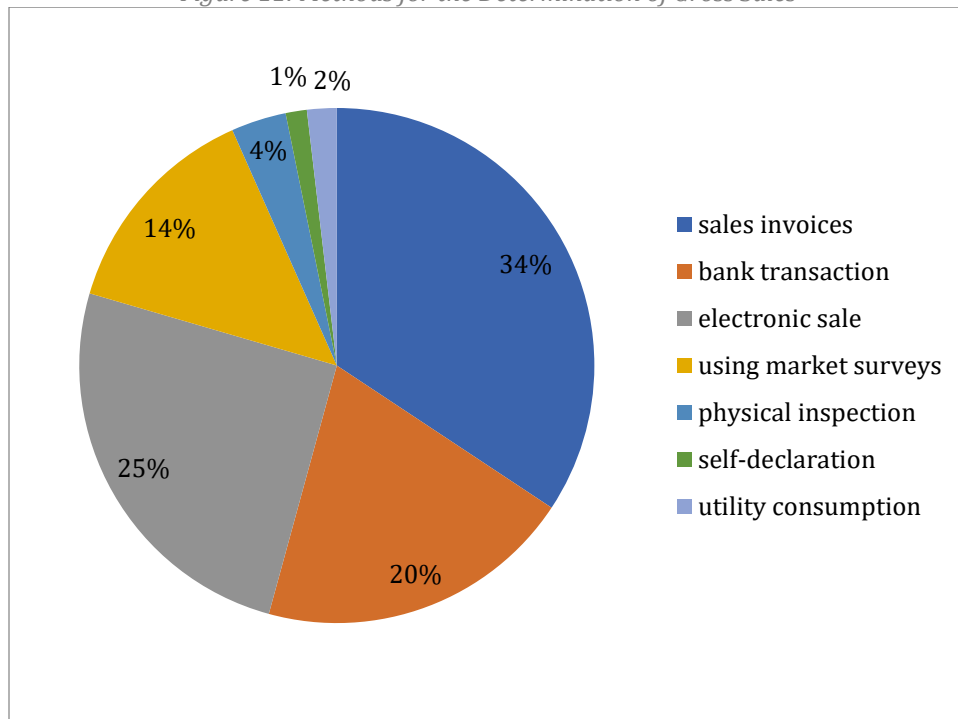
The use of a banking channel is essential to bring the business transactions on record. But in Pakistan, the use of banking channels for sale and purchase is still at a beginning level. Respondents 14, 17, and 18 thought that the 5000 currency note should be banned to increase bank transactions. Respondent 14 was further in favor of banning the 1,000 currency note. Respondents 59 and 60 from the State Bank of Pakistan advised that banning the 5000 currency note is not the best option in the near future. However, new designed 5000 currency note will only be available via bank transaction. Moreover, respondent 60 thought that the recent decision to culminate bonds worth more than 1500 has contributed significantly and positively to tax compliance. Though black money is now moved to the gold market. Respondents 1 to 5 believed that bank transactions can be increased by providing incentives, such as by reducing withholding tax on payments by credit card. Respondents 11, 12, and 40 believed that incentives should be given to customers to switch to payment via bank. Respondents 15 and 8 were of the view that it should be obligatory for the traders to keep a bank transaction machine at their shops. Respondent 11 argued that the recent amendment to Section 21 of the Income Tax Ordinance, disallowing 50% of expenditures claimed on cash transactions of rupees 200,000 or above, will not encourage bank transactions, as traders are likely to split payments into multiple invoices below the threshold. In contrast, respondents 15

and 26 believed that the amendment would promote greater reliance on banking channels and help in formalizing transactions.

### 5.8. Determination of Gross Sales and Value Addition

In this regard, respondents expressed diverse opinions. Some consultants, lawyers, and traders proposed that sales should be self-declared to reduce administrative hurdles. In contrast, respondents 14, 21, and 26 recommended adopting a fixed percentage of value addition based on market surveys to ensure consistency. However, the majority supported the introduction of modern mechanisms like track-and-trace systems or Point of Sale (POS) machines to provide a more accurate method for assessing sales.

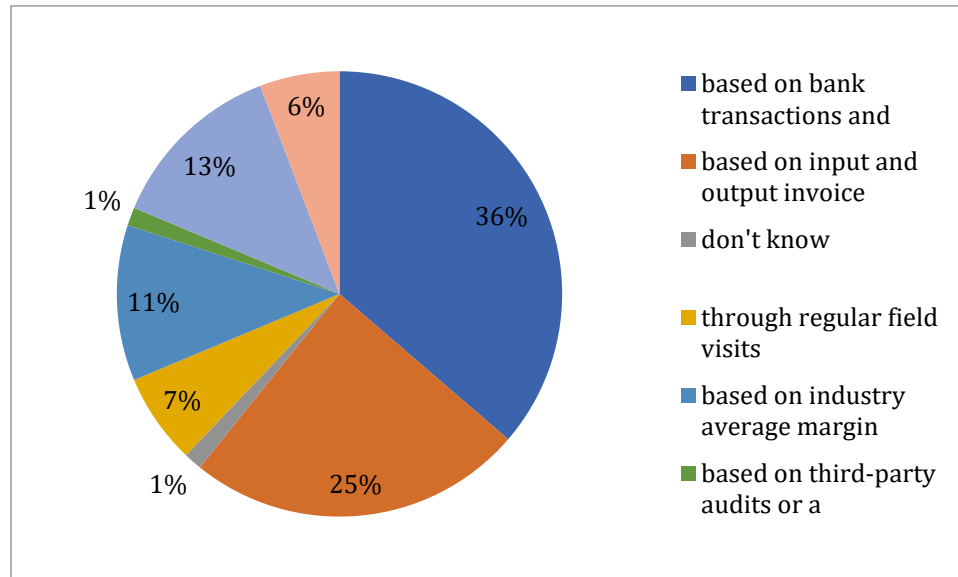
Figure 11: Methods for the Determination of Gross Sales



Source: Authors' computations.

The most common and preferred method for determining traders' turnover is based on sales invoices. This shows that most traders rely on recorded sales transactions as the main source of income verification. Another preferred method is electronic sales reporting systems, indicating growing acceptance of digital tools for accuracy. Bank transaction records and market surveys or industry benchmarks are also seen as a reliable basis for turnover estimation. In contrast, methods such as physical inspections and stock verification by FBR officials, self-declaration with random audits, and utility consumption analysis received very few responses.

Figure 12: Determination of Value Addition



Source: Authors' computations.

One method for determining value addition is based on bank transactions and financial records. This suggests that traders consider financial documentation as the most accurate and transparent method for assessing value addition. The second most preferred method is based on input and output invoices, showing traders' dependence on documented trade flows. Self-declaration by the trader and industry average margins are also recognized, but to a lesser extent. On the other hand, methods such as regular field visits and inspections, fixed value addition rates set by FBR for specific sectors, and third-party audits or assessments received relatively low responses.

### 5.9. Loopholes in Tax Laws and Effectiveness of Audits

Respondent 22 pointed out that Section 153 of the Income Tax Ordinance contradicts Section 113, as the former is treated as a final tax while the latter serves as a minimum tax. According to him, this creates a situation of double taxation, since tax withheld at source under Section 153 is accompanied by turnover-based minimum tax at the time of filing returns. Respondent 27 noted that under recent changes, tax deducted at source under Section 235 from electricity bills is no longer adjustable in the income tax returns of AOPs, thereby adding to the tax burden.

Audits are rather effective in improving tax compliance. However, the majority of the tax lawyers and consultants highlighted the corruption of FBR officials in the audit process. Tax officials 39 and 40 believe that the present tax laws are best. However, prosecution from the FBR is poor. Respondents noted concerns regarding outsourced FBR prosecutors, who are paid relatively low official salaries but may receive substantial payments from defendant parties in exchange for presenting weak arguments. They recommended that prosecutors be appointed internally within FBR and that their performance be evaluated periodically. However, another tax official believed that even the prosecutors outsourced are also evaluated periodically, and prosecutors with bad performances are excluded from the list. A tax lawyer and official in the FGD discussion mentioned that the FBR has not done the balloting since 2018 to facilitate the traders. Moreover, traders have several forums, both in FBR and in the judiciary, to present their case against the notices they

received. On the other hand, if the case is genuine but the trader offers bribery to the tax officials can be controlled by the digital footprint of the notices that FBR officers issue. Both FBR and Tax Bar representatives believed that FBR staff are heavily burdened with the workload.

### 5.10. Miscellaneous Suggestions

All the representatives of the tax bar, traders, and FBR were in consensus that the tax net should be expanded. Those who are not in the tax net should be forced and encouraged to bring in the tax net. Whereas those who are already in the tax net should not be burdened more. A tax official suggested addressing the jurisdictional issues. A trader representative advised that only the sale tax registered traders should be allowed to buy from the manufacturers. The adjustment of advance/withholding tax in the price of the product is another important issue highlighted by several traders. A few traders and tax consultants advised the policymakers to devise a strategy against the misuse of exemptions offered to different sectors or regions. Moreover, after taking action in the foreign exchange market and the bonds market, the government should now take action in the gold market to discourage the black money, as advised by an SBP official.

### 5.11. Benefits Demanded by the Traders

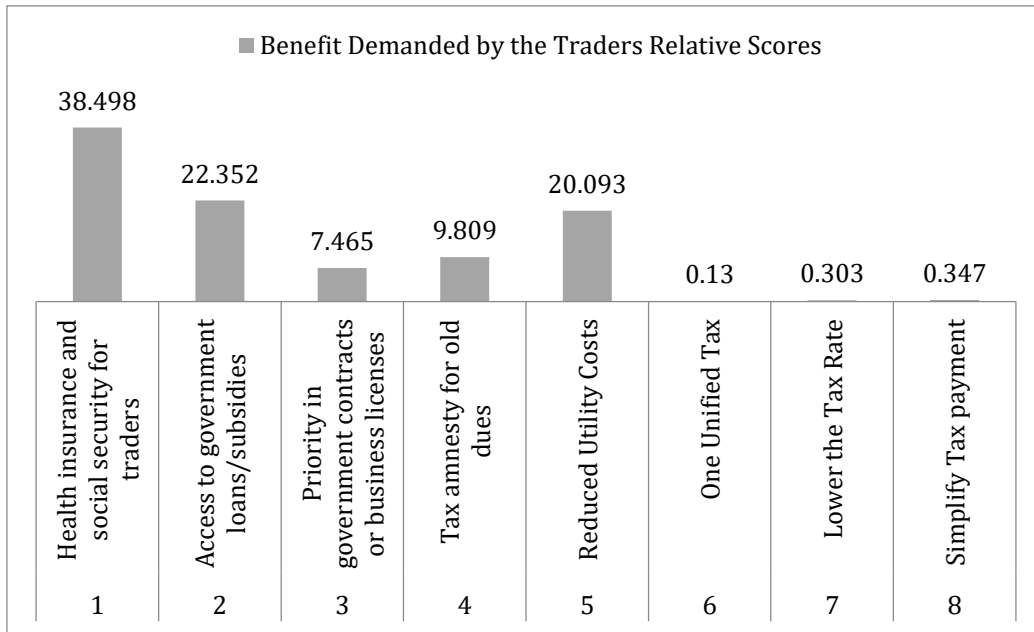
It can be concluded from the above discussion that the traders can be encouraged to comply with tax laws by offering lower tax rates and a simpler tax filing system, accompanied by direct benefits such as those given in the following table.

*Table 16: Benefit Demanded by the Traders*

No.	Benefits	Top 1 Rank	Top 2 Rank	Top 3 Rank	Relative Scores
1	Health insurance and social security for traders	281	14	16	38.498
2	Access to government loans/subsidies	54	165	23	22.352
3	Priority in government contracts or business licenses	8	62	24	7.465
4	Tax amnesty for old dues	6	63	82	9.809
5	Reduced Utility Costs	35	80	221	20.093
6	One Unified Tax			3	0.130
7	Lower the Tax Rate			7	0.303
8	Simplify Tax payment			8	0.347

*Source: Authors' computations.*

*Figure 13: Preferred Benefits by the Traders*



Source: Authors' computations.

This bar chart shows that health insurance, access to government loans, and reduced utility costs are the most valued benefits among traders. Meanwhile, options such as a unified tax, simplified tax payment, and lowering the tax rate scored much lower and have minimal preference (option 6 to 8 were initially not the part of this question and emerged from traders' responses provided under "any other" category).

## CONCLUSION

The trading sector (wholesale and retail) contribute trivial to the tax revenue of Pakistan despite having a significant share in the GDP of Pakistan. The present study investigates not only the determinants behind non-compliance of tax obligations among traders, but it also discusses the possible solutions to the challenges in tax compliance. This study uses both quantitative as well as qualitative data. Quantitative data have been analyzed by logistic regression and Structural Equation Modeling (SEM). Whereas, qualitative data has been analyzed by thematic/content analysis and the triangulation method.

Study finds that tax complexity is a major hurdle in tax compliance, both directly and indirectly through the mediation of tax misperception. However, the study finds that traders perceived greater tax complexity are more likely to accept a presumptive/fixed tax regime. Spatial lag is another important determinant of tax compliance, underscoring the importance of social norms and promoting tax culture. High tax rate perception among the traders is another central barrier to tax compliance. The need of using banking channel compels the traders to comply with the tax laws. Risk lovers are more likely to register for income/sales tax and accept turnover tax, underlining the significance of tax incentives in the tax system. Institutional trust is another major determinant of willingness to be part of turnover-based and presumptive tax regimes. Tax salience is another important determinant of tax compliance, highlighting the importance of tax rates and tax policy in the decision-making of the traders. A growing environment for businessmen also exhibits greater acceptance for the payment of turnover tax. Tax misperceptions contribute significantly to tax non-compliance. Traders working in a homogeneous environment and working under the umbrella of traders' unions possess a lower level of tax misperceptions. Tax knowledge, cognitive ability, and education have a significant role in the tax system, both directly and indirectly, by reducing tax misperceptions.

Qualitative data analysis vindicates the above findings as the traders, tax lawyers/consultants, and tax officials emphasized simplifying the tax system, reducing tax burden/cumulative tax burden, provision of tax incentives/benefits, creating awareness among the traders, and enhancing institutional trust to boost the tax compliance environment. Moreover, they stressed the need of expanding the tax net and to provide tax incentives and benefits to the present taxpayers to promote the tax culture.

## **POLICY IMPLICATIONS**

This study provides critical insights for public policy by identifying key factors that contribute to non-tax compliance among traders. It supports evidence-based reforms to expand the tax base, improve voluntary compliance, and to enhance the effectiveness of schemes like the TajarDost Scheme (TDS). This study has also focused on challenges in implementation procedures in different tax regimes, such as general sales tax, advance tax, or presumptive/fixed tax. This research broadly studies barriers to achieving tax compliance at the micro level with the help of both qualitative and quantitative data. Making the tax system simpler and more transparent can reduce unintentional evasion and foster greater compliance in Pakistan. This study provides policymakers with valuable insights into tax simplification procedures, legal and illegal tax evasion, optimum tax rate, targeted audits, and the role of digitization to formulate effective policies against tax evasion.

There is a vicious circle going on between the traders and state institutions, as the traders who lack institutional trust are not willing to comply with their tax obligations. On the other hand, a low tax-to-GDP ratio is a big hurdle in the provision of publicly provided goods and improving institutional quality. Therefore, there is a need for the traders who fully comply with the tax laws to be incentivized with the provision of direct benefits, such as health insurance, relief on utility bills and reduction in tax rates. In this regard, traders' unions and tax bar associations should be taken into confidence.

Tax filing procedure should be simplified by introducing 1/2 pages Performa in the Urdu language, particularly for the small traders. Moreover, notices should be accompanied with Urdu translation in simple words. For the traders who are not yet income tax filer may be offered fixed/presumptive tax regime. Where the fixed tax rate may be determined by devising a formula based on rent, utility bills, and sales, based on a market survey. But such formulas should be determined by taking the traders and tax bar representatives into confidence.

Prosecution needs to be improved, and it needs to be ensured that only the sale tax registered traders purchase from the manufacturers. Since the findings of both quantitative and qualitative data support the notion that incentives encourage compliance. Therefore, our policymakers should focus more on providing incentives rather than creating an environment of fear.

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