

WITHHOLDINGIZATION OF TAXATION SYSTEM: BENEFICIAL OR NOT?

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ABSTRACT

Tax collection has always been a challenge for the governments all over the world. Pakistan has relatively low tax to GDP ratio which creates budgetary pressure and affects the development of the country. The withholding taxation system is considered an easy and convenient way for the collection of income tax. The tax collected through this system comprises a major portion of the income tax in Pakistan but the problems in the withholding taxation system have adverse effects on the economy and federal tax collections.

In this research report, we present the current state of withholding taxation system and identified the problems in this system. Suggestions are also given to overcome these problems and to make improvements. The results are based on data collected from different reports published by Federal Board of Revenue, Finance Division, research institutions and other departments regarding the withholding taxation system. Besides this, discussions are made with tax professionals, taxpayers and businessmen to identify the effects of this system.

One of the major findings of this report shows that 65%-70% of the total income tax is collected through withholding taxation system and if we include other voluntary payments this reaches to 96%. Only 3%-4% tax is collected through the direct efforts of the FBR. This shows Pakistan's over reliance on withholding taxes. This research also finds that comparatively low-income tax has been collected from the services and trade sector. Data analysis at individual level shows that salaried persons are paying almost half of the amount of the withholding income tax collected from individuals, which indicates that the current withholding taxation system is not covering a significant number of the non-salaried individuals.

This report explains some important implications for different stakeholders. First, reliance on the withholding income taxes should be reduced because income tax is a direct tax and it should be collected in a direct tax mode. Second, if over-reliance seems unavoidable, there is a need to introduce new withholding income tax provisions for under-paying sectors such as services and trade. Last, there is a need to transform the cash economy to a documented economy to bring more individuals and businesses under the tax net.

PREFACE

Low tax-to-GDP ratio is one of the reasons for poor economic development in Pakistan. There has always been a need for some in depth analysis of the withholdingization of taxation system in Pakistan. This report elaborates benefits and criticism related to withholding taxation system and some improvements are suggested. This study will help the policy makers in understanding the role of the withholding tax regime in our current taxation system. The analysis of withholding tax data is arranged and presented in such a manner that there remains only occasional need for reference to other wider and multi-volumes publications related to withholding tax data.

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LIST OF ABBREVIATIONS

| | |
|------|--|
| AGP | Auditor General of Pakistan |
| AoP | Association of Persons |
| FBR | Federal Board of Revenue |
| GoP | Government of Pakistan |
| OECD | The Organization for Economic Co-operation and Development |
| PRAL | Pakistan Revenue Automation Limited |
| WHTs | Withholding Income Taxes |
| WHAs | Withholding Agents |

INTRODUCTION

Tax is a compulsory payment by the people to the government which is ultimately used for the common interest and welfare of the public of the country and running the expenses to carry out the government functions (Ahmed, 2016). It is imposed on a taxpayer either individual or legal entity, by the government in order to fund the various public expenditures, government spending and development work.

The first known taxation took place in Ancient Egypt around 3000–2800 BC. Tax is considered as the largest financial source for developments work like public service, poverty relief and to establish physical and social infrastructure that leads towards long term growth of a country. However, since long time, many developing countries like Pakistan have been facing a great challenge in generating revenues from taxes (Khan & Ahmad, 2014). A failure to pay the taxes or in timely manner, is punishable by the law.

Tax system is a set of policies for the individuals and organizations to pay taxes on their taxable incomes (Górecki & Letki, 2021). The structure of taxation affects the pattern of economic development in developing countries. They use their taxation system as a principal policy instrument to provide incentives for the development of the different sectors.

Withholding tax (WHT), also called a retention tax, is an act of deduction or collection of tax at source, which has generally been in the nature of an advance tax payment. Withholding tax is a tax system in which the payer withholds a portion of a payment and remitted directly to the government. Its common example is tax deducted from the salary of employee by the employer. After the deduction, employer will deposit this tax into the national treasury in the name of the employee. This tax system is used by many countries around the world, including developing countries, to ensure that individuals, companies and other legal entities who derive income should pay their due share of taxes (Mella, 2023). It is an important and timely source of revenue for the governments. WHT creates several advantages and disadvantages to the governments and tax payers (Shi, Yao & Luo, 2023). WHT system allows governments to reduce collection tax costs by using administrative powers of withholding agents. Another advantageous feature of WHT is that the remitter, called withholding agent, is not the statutory bearer of the tax. This decreases the incentive of tax avoidance since the remitter does not directly benefit from evasion. Though, the use of WHT shifts the risk of non-compliance to the remitter, and it may happen that taxes are not withheld or not remitted to the tax authorities (Buettner et al., 2020). Overall, the WHT system has the benefit of reducing the cost of tax collection and enhancing the government's cash flow and budgetary management because of the advance collection of taxes.

1.1 Scope of the Study

Low tax-to-GDP ratios are one of the reasons for poor economic development in developing countries. These countries use mix instruments for collection of taxes (Dahal, 2020). Like other developing countries Pakistan is also facing tax evasion and noncompliance behaviour of the taxpayers (Akitoby et. al., 2020).

Governments always try to find the ways and methods to minimize the time lag between the point when amount of tax becomes due, and the point when Government actually receive this amount form tax payer. The most famous and effective way to achieve this objective is the WHT system. Origins of WHT can be found back in the history in 15th century, it became most famous form of direct tax collection during the 16th, 17th and 18th centuries and in the modern world its use is increasing (Ahmed, 2020).

The government often collects this tax to ensure taxpayers comply with their tax obligations (Dalziel, Saunders, & Saunders, 2018). Withholding tax has become increasingly common in recent years, and many countries have adopted it to collect revenue (Pavlovich, 2022). There are many problems in the implementation of the WHT regime in Pakistan. In the current study, the scope of the WHT regime will be discussed. Through data analysis, problems and difficulties of the different stakeholders will be identified and solutions will be recommended.

1.2 Literature Review on Withholding Taxation

WHT system helps to ensure the tax compliance and performing tax obligations. Through this system government receives its revenue timely basis and throughout the year (Wang, 2023). Like employers deduct the required tax from the employees' salaries and deposit in the government treasury which makes it a simple process of the payment of tax on salary income. Persons earning from other type of income sources need to maintain all records of the tax withheld by other parties on the payments made to them. This creates an administrative burden for them which also attracts more expenses on administration (Thomas, 2019). But on the other side it becomes a burden on the low-income taxpayers (Khan & Siddiqui, 2023). WHT tax system is used in many developing and developed countries all over the world (Mella, 2023). Rates of the WHT are different as per the

taxation laws of the different countries (Altawyan, 2023). There are few studies on the cost and benefit of the WHT system and this area should be explored by researchers and professionals (Mpofu, 2022). There are different studies by many researchers in which impact of WHT on the trade and investment was analyzed. (Zharov et al., 2022; Deng, You & Wang, 2022). Major motive of implementing more WHT on transactions is to increase the collection of income tax in easy way. It is considered as the most convenient way to collect income tax but there are also its demerits (Dušek & Bagchi, 2018). Literature also identified some possible benefits of withholding tax. In presence of withholding tax, the compliance rate of tax is higher and it also reduces the administration and compliance costs when implemented because its collection is assigned to third parties called withholding agents (Thomas, 2019). On the other hand, it increases the risk of non-compliance on the side of third parties involved in the collection of withholding tax (Advani, 2022).

There is a need to study the WHT system and its effects, problems in its administration, criticism on this system and suggested solutions in developing countries like Pakistan. Because in Pakistan it consists of on average 70% of the total income tax collected. There are almost eighty plus types of different transactions covered under this regime and it is one of the highest number of transactions in developed and developing countries.

1.3 Research Problem

WHT is the most effective way of tax collection in Pakistan. The contribution of WHT to total income tax collected is almost 69% (FBR, 2021). It is operated through withholding agents (WHAs) who collect these taxes and deposit them in national treasury. There are detail provisions regarding the WHT in Income Tax Ordinance 2001. These legal provisions are related to the scope, rates and taxability of WHT. They also elaborate the scope and responsibility of WHAs. Increasing tax to GDP ratio is a bigger challenge in developing countries. In Pakistan, FBR and Government are striving to make it better. WHT system has its costs and benefits and there are also many limitations of this system. These things need to be identified, discussed and solutions should be recommended.

1.4 Research Questions

This study tries to find the answers of the following research questions:

- Are withholding taxes helping in the collection of income tax?
- What are the disadvantages of WHT system?
- What is the role of WHAs and are they performing their role in a better way?
- What is the solution for time delay in tax receipts by WHA, onward transfer to FBR, and stuck-up of funds?
- What are the suggestions to make WHT system simpler and easier to handle?
- Are current human and other resources of FBR are enough for the administration of withholding taxation system?
- Is there any form of irregularities exist in WHT system?
- How can we control irregularities in WHT system?
- How can we make tax audit more transparent and effective?
- Are withholding taxes are affecting business environment?
- Is there any substitute of withholding taxes?

1.5 Objectives of the Study

Following are the main and sub objectives of this research project:

- With respect to the economy, business environment and different groups of tax payers:
 - i. To identify the effects of withholding taxes on business environment.
 - ii. To explore the related benefits and costs of withholding taxes in Pakistan.
 - iii. To identify the problems being faced by tax payers due to withholding taxation system and their solution.
- With respect to the withholding tax laws:
 - i. To make outline of the withholding taxes in Pakistan.
 - ii. To compare withholding taxes with the regional and other countries.
 - iii. To analyze the reasonableness of rates of WHTs and to recommend changes in them.
 - iv. To analyze the taxability and treatment of withholding taxes and to make recommendations for changes in these treatments.

- v. To identify the substitute of withholding taxes.
- With respect to the WHAs:
 - i. To identify the reasons for the time delay in tax receipts by WHAs, onward transfer to FBR, and stuck-up funds and its solution.
 - ii. To analyze the current nature and size of the WHAs and FBR control over them and suggested changes in them.
 - iii. To identify the different problems being faced by WHAs in tax deduction/collection and compliance with related provisions of Income Tax Ordinance 2001.
- With respect to FBR:
 - i. To identify the administrative problems being faced by FBR in the administration of withholding taxes and their solution.
 - ii. To identify problems in tax audit and recommended solutions.

1.6 Relevance and Significance of the Study

This study is aimed at adding value by making relevant recommendations and conclusions with the intent to make withholding tax system more effective and useful.

Findings of this research project are helpful for:

- Designing new rules and making current rules more effective for better tax collection.
- Making new regulations that protect tax payers.
- Broadening tax net and adding new people in active taxpayer's list.
- Minimizing the time delay in tax receipts by WHAs, onward transfer to FBR, and stuck-up funds.
- Making better administration of withholding taxation system.
- Making rules for timely receipts of WHT from WHAs, which will help to manage cash flow of the Government.
- Making business environment friendlier and more favorable.
- Making tax audit more effective.

2. RESEARCH METHODOLOGY

In the first phase of this research project, we collected the required data from different reports published by FBR, finance division, research institutions and other departments regarding the WHT. For the collection of additional data which is not publicly available, a direct request was made to the FBR and in response to that FBR provided us most of the requested data officially. Credibility of the data was ensured and all the required data were taken from official reports of FBR. Discussions were also made with tax professionals, taxpayers and businessmen to identify the effects of WHT system. Then this data was analyzed and interpreted to answer the questions of the study.

3. TAXATION IN PAKISTAN

Federal government of Pakistan collects four types of direct taxes income tax, worker's welfare fund and worker's profit participation fund. Indirect taxes include sales tax on goods, federal excise duty and custom duty. Major provincial taxes include sales tax on services and property tax. The biggest source of federal taxes is sales tax on goods. Income tax is the second biggest source of tax income of the federal government. Both income tax and sales tax consist of the almost 80% of the total tax revenue of the federal government (FBR, 2022). Income tax consists of more than 97% of the direct taxes collected by the federal government (FBR, 2022). Direct taxes consist of 38%-40% of the total tax collected by federal government and remaining portion is collected through indirect taxes (FBR, 2022). In the Table 1, we can see the amount of tax collected through these taxes from 2008 to 2022.

Table 1: Tax Collection of FBR (Amount in Million Rupees)

| Tax Year | Sales Tax | FED | Custom Duty | Total Indirect Taxes | Total Direct Taxes | Income Tax | Other Direct Taxes | Total Taxes | Indirect Taxes % | Direct Taxes % |
|----------|-----------|-----|-------------|----------------------|--------------------|------------|--------------------|-------------|------------------|----------------|
| 2008 | 377 | 92 | 151 | 620 | 388 | 368 | 20 | 1,008 | 62% | 38% |
| 2009 | 452 | 118 | 148 | 718 | 444 | 422 | 22 | 1,162 | 62% | 38% |
| 2010 | 517 | 121 | 162 | 800 | 529 | 505 | 24 | 1,329 | 60% | 40% |
| 2011 | 634 | 137 | 185 | 956 | 602 | 582 | 20 | 1,558 | 61% | 39% |
| 2012 | 805 | 122 | 217 | 1,144 | 738 | 720 | 18 | 1,882 | 61% | 39% |
| 2013 | 843 | 121 | 239 | 1,203 | 743 | 723 | 20 | 1,946 | 62% | 38% |
| 2014 | 1,002 | 139 | 241 | 1,382 | 884 | 855 | 29 | 2,266 | 61% | 39% |
| 2015 | 1,088 | 162 | 306 | 1,556 | 1,034 | 1,007 | 27 | 2,590 | 60% | 40% |
| 2016 | 1,302 | 188 | 405 | 1,895 | 1,217 | 1,192 | 25 | 3,112 | 61% | 39% |
| 2017 | 1,329 | 198 | 497 | 2,024 | 1,344 | 1,324 | 20 | 3,368 | 60% | 40% |
| 2018 | 1,485 | 214 | 608 | 2,307 | 1,537 | 1,515 | 22 | 3,844 | 60% | 40% |
| 2019 | 1,459 | 238 | 686 | 2,383 | 1,445 | 1,426 | 19 | 3,828 | 62% | 38% |
| 2020 | 1,597 | 250 | 627 | 2,474 | 1,523 | 1,502 | 21 | 3,997 | 62% | 38% |
| 2021 | 1,988 | 277 | 748 | 3,013 | 1,731 | 1,711 | 20 | 4,744 | 64% | 36% |
| 2022 | 2,532 | 320 | 1,011 | 3,863 | 2,285 | 2,216 | 69 | 6,148 | 63% | 37% |

Source: FBR, Year Book 2008-2022.

There is 6 times increase in the total tax collected from 2008 to 2022. Ratios of direct and indirect taxes were almost consistent during this period.

3.1 Income Tax in Pakistan

First income tax law in Indo Pak region was Income Tax Act 1860 which was subsequently repealed by the Income Tax Act 1886. Later on, Income Tax Act 1918 and then Income Tax Act 1922 were introduced. This law remained in force after the independence and replaced by the Income Tax Ordinance 1979. The current Income Tax Ordinance 2001 (ITO 2001) was promulgated on September 13, 2001. This law specifically deals with income tax and there are other relevant laws for other types of taxes. For the administration of the federal taxes, an institution called Federal Board of Revenue (FBR), previously called Central Board of Revenue, was established. FBR is responsible to implement these taxation laws in Pakistan. FBR, being a regulatory body, manages the affairs of federal taxes in Pakistan. To explain the procedural matters of the implementation of income tax law, FBR under the authority of section 237 of ITO 2001, developed the Income Tax Rules 2002. Both of these laws, Income Tax Ordinance 2001 and Income Tax Rules 2002, deal with the affairs of income tax in Pakistan.

Income tax law classifies the income under following five heads as per ITO 2001:

- Income from salary
- Income from property
- Income from business
- Capital gain
- Income from other sources

All types of income must fall under any one of the above-mentioned heads and income tax law describes the rules and regulations for the calculation of taxable income under each head. Income tax will be calculated as per the specified rates on the total taxable income from all heads.

3.2 Payment of Income Tax

Income tax is calculated as per rules and regulations given by the ITO 2001. The following ways of the payment of income tax to the government are also explained in this law:

3.2.1 Deduction/Collection of Income Tax at Source/Withholding Tax

It is the first and the biggest source of the collection of income tax from tax payers. Income tax law has specified some transactions, when these transactions are generated then the person making/receiving payments is required to deduct/collect income tax at source. Generally, it is called withholding tax. It consists of 69% of the total income tax collected during the year 2022 (FBR, 2022).

3.2.2 Quarterly Advance Payment of Tax

Income tax law has specified some persons which are required to calculate their income tax as per the rules and pay that amount at the end of each quarter of the financial year. This tax will be adjusted from the tax liability of these persons at the end of the financial year. It consists of 26% of the total income tax collected during the year 2022 (FBR, 2022).

3.2.3 Payment of Tax with Annual Income Tax Return

At the end of each of the financial year, the persons who are required to file income tax return under section 114(1) of ITO 2001 and pay income tax liability. An income tax return cannot be filed until a tax payer pays the income tax liability. It consists of 3% of the total income tax collected during the year 2022 (FBR, 2022).

Income tax paid under above three heads are collectively called income tax paid voluntarily by the tax payers. They are collected without the direct efforts of FBR.

3.2.4 Payment of Tax on Demand by Tax Authorities

Upon the detection of undeclared expenses or assets or after the audit of the tax payers by FBR, a tax demand is generated and the tax payer pays this amount in the national treasury. This is the only income tax collection which involves the direct efforts of FBR. It consists of 4% of the total income tax collected during the year 2022 (FBR, 2022).

4. WITHHOLDING TAX REGIME IN PAKISTAN

Because WHTs are collected/deducted at source, therefore, it is considered as the most quick and convenient way of collecting the income tax. This method is widely in most of the economies for the purpose of tax collection (Pavlovich, 2022). It provides a reliable stream of income for the government throughout the year. In Pakistan, it increases from Rs. 5 billion in 1991 to over Rs 1,534 billion in 2022 (FBR, 2022), indicating exponential growth and Pakistan's strong reliance on WHTs. It contributes 69% to total income tax collected and 25% to the total tax collected in the year 2022 (FBR, 2022). Due to its significant contribution in the total tax collected, it has become extremely important to study the relevant problems and challenges related to WHT regime.

Variations in WHT rates depend on the country's tax laws and regulations (Mahpudin, Reminta & Fadilah, 2022). In Pakistan, all these rates are prescribed in the first schedule of the ITO 2001. At the time of the final computation of income tax, WHTs are treated either adjustable against tax liability of that year or considered as full and final discharge of income tax liability on those relevant transactions. These tax treatments are given in income tax law and they are changed from time to time in budgets through finance act. Transactions covered under the WHT regime started from three items (i.e., Salary, Interest-on-Securities and Dividend) under Income Tax Act 1922. Under ITO 2001, there are 24 sections/sub sections mentioning more than eighty types of different transactions on which tax is collected or deducted at source. There is a drastic increase in WHT provisions during the previous twenty years (Ahmed, 2020).

Here is summary of withholding tax provisions of ITO 2001 (Updated as per tax year 2024):

Table 2: Summary of Withholding Tax Provisions

| Sr.# | Transactions/Items | Sections | Average Rates |
|------|--|----------|--------------------------|
| 1- | Imports | 148 | 1%- 5.5 % |
| 2- | Salaries | 149 | Avg. rate |
| 3- | Dividend | 150 | 15% |
| 4- | Profit on Debt | 151 | 15% |
| 5- | Payment to non-residents | 152 | 5% - 20% |
| 6- | Payment for goods, service and contracts | 153 | 4%-10% |
| 7- | Exports of goods and services | 154 | 1% |
| 9- | Rent of immovable property | 155 | Slab rates |
| 10- | Prizes and winnings | 156 | 15%-20% |
| 11- | Sale of petroleum products | 156A | 12% |
| 12- | Motor Vehicles | 231B | Based on Engine Capacity |
| 13- | Cash Withdrawal from bank | 231AB | 0.6% |

| | | | |
|-----|--|-------|-----------------|
| 14- | Brokerage and commission | 233 | 8%-12% |
| 15- | Tax on motor vehicles | 234 | Different rates |
| 16- | Electricity consumption | 235 | Different rates |
| 17- | Telephone and Internet | 236 | 10%-15% |
| 18- | Sale by public auction | 236A | 5%-10% |
| 19- | Sale or transfer of immovable property | 236C | 2% |
| 20- | Advance tax on foreign TV serials and advertisements | 236CA | Different rates |
| 21- | Advance tax on sales to distributor, retailer and wholesaler | 236G | 0.1% - 0.25% |
| 22- | Advance tax on sales to retailers | 236H | 0.5% |
| 23- | Advance tax on purchase of immovable property | 236K | 2% |
| 24- | Advance tax on amount remitted abroad credit, debit or prepaid cards | 236Y | 1% |

Source: FBR, Year Book 2008-2022.

4.1 Contribution of WHTs and other Voluntary Payments in Total Income Tax Collected

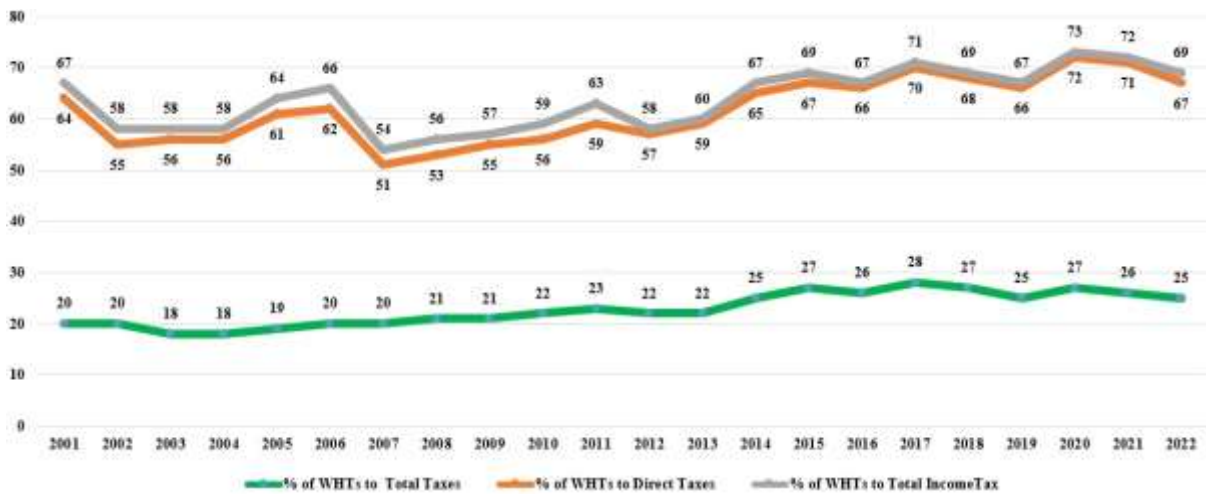
Table 3 shows the total income tax collected, income tax collected through WHT system, income tax paid by the taxpayers with the income tax return, quarterly advance tax (collectively they are called voluntary payments) and income tax paid on demands generated by the FBR officials through assessments and audit.

Table 3: Amount of Voluntary Tax Payments and Payment on Demand (Amount in Million)

| Years | Gross Income Tax Collected (A) | Withholding Income Tax (B) | Income Tax Paid with Annual Return (C) | Quarterly Advance Income Tax (D) | Total Voluntary Payments (B+C+D) | Income Tax Paid on Demand by FBR |
|-------|--------------------------------|----------------------------|--|----------------------------------|----------------------------------|----------------------------------|
| 2006 | 243,736 | 139,274 | 24,011 | 63,349 | 226,634 | 16,799 |
| 2007 | 346,900 | 169,191 | 48,553 | 117,182 | 334,926 | 11,173 |
| 2008 | 393,782 | 205,144 | 9,199 | 136,417 | 350,760 | 42,779 |
| 2009 | 461,239 | 242,137 | 14,484 | 127,196 | 383,817 | 77,167 |
| 2010 | 559,698 | 295,249 | 9,500 | 156,301 | 461,050 | 98,529 |
| 2011 | 629,102 | 357,836 | 11,852 | 184,213 | 553,902 | 72,182 |
| 2012 | 811,893 | 420,457 | 14,968 | 222,398 | 657,823 | 130,054 |
| 2013 | 776,009 | 436,088 | 14,770 | 230,150 | 681,008 | 89,427 |
| 2014 | 918,863 | 571,667 | 13,761 | 248,837 | 834,265 | 80,582 |
| 2015 | 1,084,472 | 691,181 | 17,915 | 269,693 | 978,789 | 115,495 |
| 2016 | 1,242,195 | 803,116 | 38,462 | 302,358 | 1,143,936 | 87,884 |
| 2017 | 1,373,697 | 944,068 | 45,394 | 325,112 | 1,314,574 | 92,819 |
| 2018 | 1,577,441 | 1,046,917 | 131,216 | 335,791 | 1,513,924 | 102,905 |
| 2019 | 1,509,788 | 960,239 | 117,830 | 344,334 | 1,422,403 | 102,648 |
| 2020 | 1,570,820 | 1,091,737 | 60,674 | 350,664 | 1,503,135 | 60,807 |
| 2021 | 1,802,417 | 1,237,338 | 54,091 | 413,664 | 1,705,092 | 80,143 |
| 2022 | 2,269,800 | 1,534,400 | 78,534 | 586,880 | 2,199,814 | 101,095 |

Income tax collected through WHT system represents the major portion of total income tax. WHT is the most effective and convenient way to collect income tax in Pakistan. We can see its contribution in total income tax collected in the Figure 2.

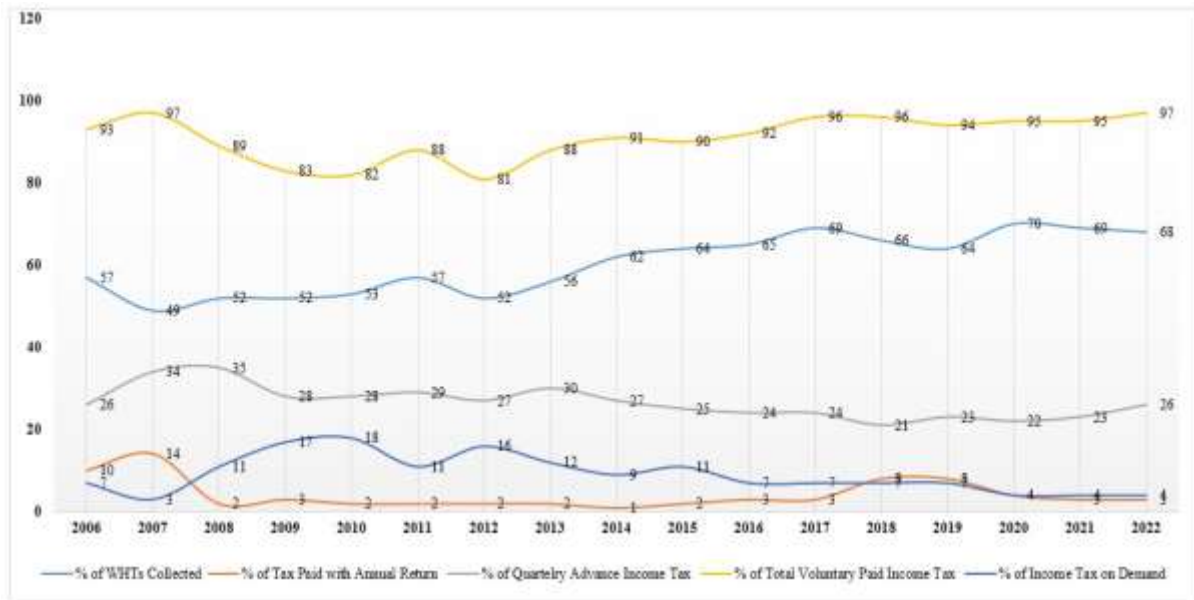
Figure 1: Comparison of WHTs Collection with Total Taxes, Direct Taxes and Income Tax Collection



Source: FBR Year Books

In addition to the WHTs, other voluntary payments (VP) include income tax paid at the time of filing of return and quarterly advance tax. Figure 3 shows the contribution of these three voluntary payments (withholding tax, income tax with return and quarterly advance tax). Figure 3 also highlights the lowest contribution of the income tax collected on demands generated by the tax officials after the assessment procedures or audit.

Figure 2: Comparison of WHTs, Voluntary Payments and Income Tax on Demand

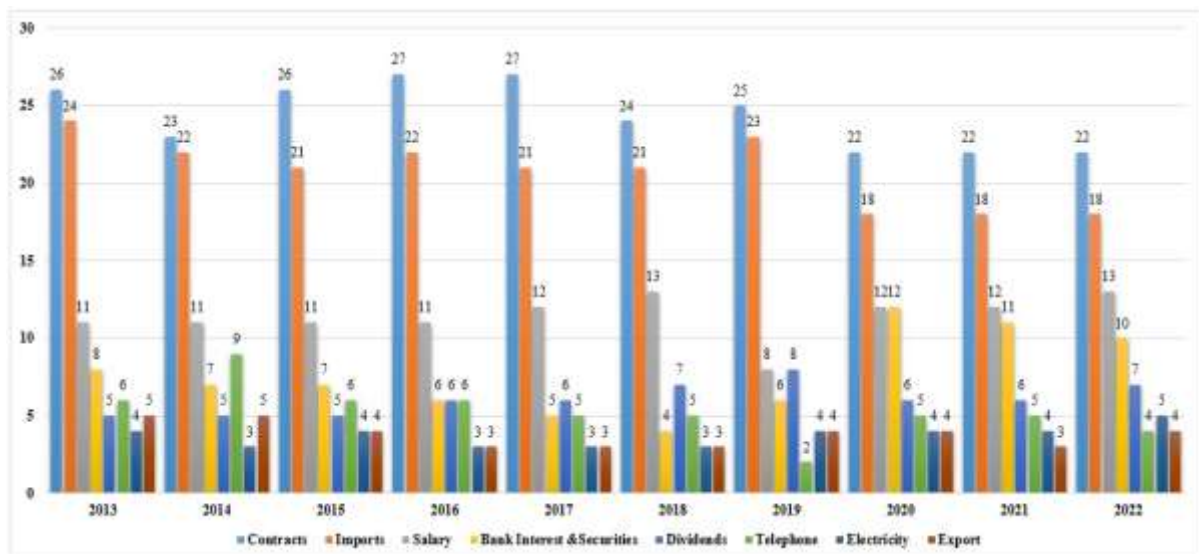


Source: FBR Year Books

4.2 Major Heads of Withholding Taxes

There are eighty plus transactions/heads from which WHT is required to be collected/deducted. Out of these, top eight transactions contribute 80%-85% to the total WHT collection. These heads include contracts, imports, salary, bank interest, dividend, telephone, electricity and exports. The summary of last ten years' contribution of these eight major WHT heads is given in Annexure 3. In Figure 1, we can see the contribution of these top eight heads in the total collection of WHT.

Figure 3: Comparison of Major Heads of Withholding Taxes (In Percentage)



Source: FBR Year Books

There are many challenges to economy because of the heavy dependence on the WHTs. For example, when the WHT collected from any of the above-mentioned heads is affected due to economic factors or government policies, it leads to a significant change in the total income tax collected.

4.3 Tax Treatments of Withholding Taxes

As per law, there are three types of tax treatments of the WHTs collected/deducted at source:

- In some cases, WHT collected/deducted at source will be treated as full and final discharge of tax liability. It is called Final Tax Regime (FTR). It means that there is no further income tax liability on that particular transaction on which WHT was collected/deducted. WHT deducted on the payment of dividend to individual taxpayers is a common example of this treatment.
- In other cases, WHT will be adjustable against the income tax liability at the end of the year. It is called Normal Tax Regime (NTR). The tax payers will compute their income tax in a normal manner and will adjust WHT collected/deducted on specific transactions from income tax liability. Its examples include the WHT collected on sale or purchase of the property and WHT deducted from the payment of salary.
- And, in some other cases, the WHT will be considered as the minimum tax liability of the tax payer. It is called Minimum Tax Regime (MTR). It means if income tax calculated in normal manner is less than the WHT collected/deducted on specified transactions then this WHT will be considered as the tax liability. Its example is the WHT collected from commercial importers on their imports.

4.4 Filing of Income Tax Returns

Filing of income tax return is mandatory for persons specified by ITO 2001. It is required from a filer to show his/her total income from all heads of income and tax payable on taxable income. At the time of filing of return, a tax payer enters all WHTs paid in the respective sections of the return. Table 4 shows the eight years detail of income tax returns filed with WHTs adjustments.

Table 4: Total Income Tax Return and Return Filed with WHTs Adjustments

| Tax Year | Total Returns Filed | WH Income Tax Returns |
|----------|---------------------|-----------------------|
| 2014 | 1,193,057 | 164,262 |
| 2015 | 1,448,933 | 788,069 |
| 2016 | 1,725,636 | 991,331 |
| 2017 | 2,079,367 | 1,210,517 |
| 2018 | 2,986,699 | 1,829,410 |
| 2019 | 3,339,616 | 2,155,762 |
| 2020 | 3,617,621 | 2,124,800 |
| 2021 | 4,274,618 | 2,305,534 |

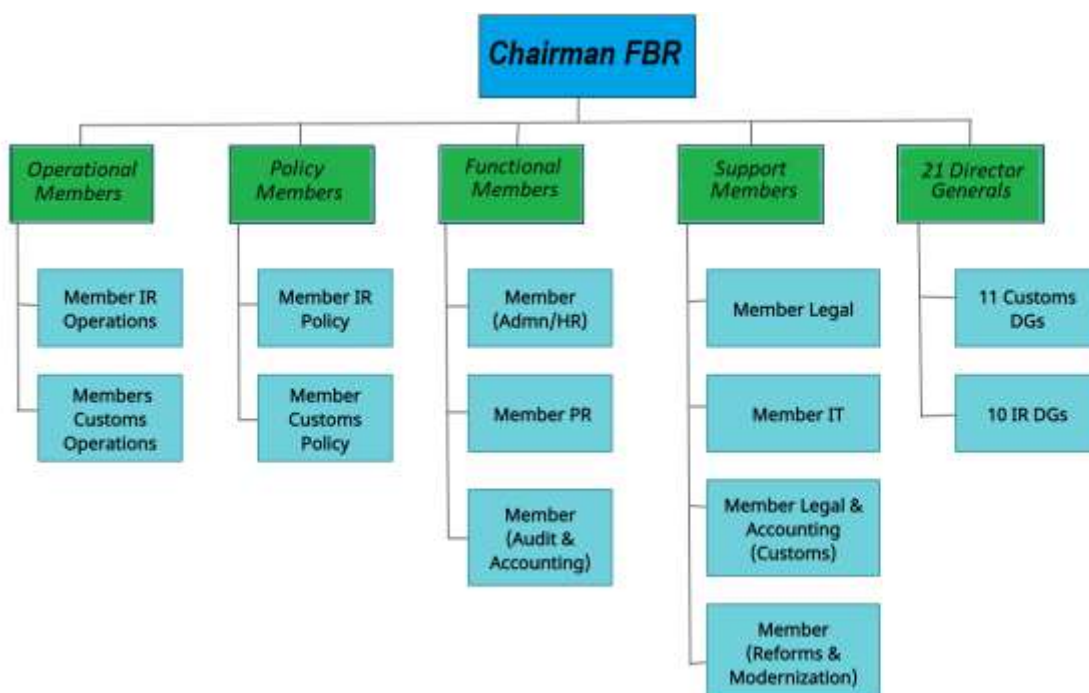
Source: FBR

From the above data, it is evident that almost 55% of the returns filed in the tax year 2021 include the adjustment of WHTs. Auditor General of Pakistan (AGP) found irregularities in the adjustments of WHTs in the income tax returns filed by the tax payers. As per its report for the year 2019-20, the excess claim of WHTs was found amounting to Rs. 10,780 million. AGP found similar irregularities in other years as well which resulted in a significant loss of income tax. There is a need to establish a mechanism for desk audit of income tax returns filed by the taxpayers to control this irregularity which will result an increase in income tax collection.

5. FEDERAL BOARD OF REVENUE

FBR is the institution which is responsible for the collection of federal direct and indirect taxes. Previously it was called Central Board of Revenue (CBR) but through the FBR Act 2007, it became Federal Board of Revenue. FBR is responsible for the collection of income tax, sales tax, excise duty, custom duty, workers' welfare fund and workers' profit participation fund etc. Figure 4 shows the organogram of the FBR.

Figure 4: FBR Management



FBR has nine wings and Inland Revenue wing is responsible for the collection of income tax, sales tax and federal excise duty. Currently, FBR has almost 32,000 personnel.

There is a consistent decline in the portion of income tax on demand by FBR. We can see only an immaterial portion of income tax is collected with the efforts of FBR officials. In many years cost of administration of different regions of FBR is more than the income tax collection by the efforts (AGP, 2018). This shows the poor performance of the FBR officials in the collection of income tax. In Table 5, there is a comparison of the tax on demand and cost of tax administration for the last 9 years.

Table 5: Comparison of Tax Collected on Demand and FBR Expenditures (Amounts in Million)

| Year | FBR's expenses | Inland Revenue Division' expenses | Total expenses | Total I.Tax on Demand | % of Total Exp. to I.Tax on Demand |
|------|----------------|-----------------------------------|----------------|-----------------------|------------------------------------|
| 2012 | 2,082 | 6,804 | 8,886 | 130,054 | 7% |
| 2013 | 2,433 | 8,404 | 10,837 | 89,427 | 12% |
| 2014 | 2,938 | 9,307 | 12,245 | 80,582 | 15% |
| 2015 | 3,294 | 9,489 | 12,783 | 115,495 | 11% |
| 2016 | 3,284 | 10,165 | 13,452 | 87,884 | 15% |
| 2017 | 4,324 | 11,594 | 15,918 | 92,819 | 17% |
| 2018 | 3,967 | 12,816 | 16,783 | 102,905 | 16% |
| 2019 | 4,368 | 13,741 | 13,741 | 102,648 | 13% |
| 2020 | 3,404 | 13,396 | 16,800 | 60,807 | 28% |

Source: Audit Report on the Accounts of Federal Board of Revenue, Audit Year 201-2012 to 2020-2021 by Auditor General of Pakistan.

There are many studies on the structural reforms in the tax collection system of Pakistan¹. Here is the summary of some valuable suggestions:

1. There is a need to establish National Tax Authority (NTA) comprising specialists, not bureaucrats to deal all national, provincial and local tax matters.
2. The recruitment, training, remuneration, progression and incentive structure of tax administration should be completely revamped.
3. Performance evaluation systems with real KPIs should be introduced to turn the FBR into a result oriented, highly professional and performance-based organization.
4. At present, there are too many unqualified and redundant staff occupying non-technical positions. Due to large proportion of salaries and wages paid to them, FBR is unable to recruit high level professionals.

¹ For example, see Bukhari & Haq, 2020.

5. A special wing/division should be established in FBR, which will be responsible to expand the tax net. Government should give time-based targets to this division to bring all the taxable persons in the tax net.
6. Currently assessing officers of FBR are overworked and unable to perform quality assessments of the taxpayers' cases. Additional professional human resources should be hired to solve this problem.
7. There is a need to revise key performance indicators used to measure the annual performance of FBR regarding the collection of income tax.

5.1 Administration of Withholding Taxation System- Directorate General of Withholding Taxes

For the purpose of the administration of WHT system, FBR has a special office to manage its affairs called Directorate General of Withholding Taxes. This directorate was established through Finance Act 2008 under section 230A of the ITO 2001.

Following are some major functions performed by this directorate:

- To deal with the matters relating to WHAs.
- To give recommendations regarding the WHTs in Pakistan.
- To ensure the enforcement of WHT provisions of ITO 2001 in Pakistan.
- To maintain the record of WHTs and WHAs.
- To investigate the cases of non-deduction/short-deduction of WHTs by WHAs.
- To verify and cross check the record of the WHT collected with the statements and other documents filed by WHAs and taxpayers.

Unfortunately, there are many inefficiencies and irregularities in the functions performed by the directorate. Many of them have been identified by the AGP in its different reports. These include non-deduction of WHT by WHAs, wrong treatment and claim of WHTs etc. These inefficiencies cause billions of tax losses to the government. In the following section, these inefficiencies are discussed in detail.

6. PROBLEMS IN THE APPLICATION OF WITHHODLING TAX REGIME

Following are some important issues being faced by WHT system.

6.1 Treatment of WHTs

Significant losses emerged due to the wrong application of the tax treatments given by ITO 2001 regarding the WHTs. AGP often reports the cases of wrong treatments which cause loss of billions of rupees in the income tax collection. Table 5 reports the figures of losses for the years 2017 to 2020. FBR and DG Withholding should strictly monitor these wrong treatments to control this loss of revenue.

Table 6: Loss of Income Tax Due to Wrong Treatments of WHTs

| Tax Year | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|-------------------|----------------|----------------|----------------|----------------|
| Amount in Million | 2,933.52 | 539.82 | 6,337.95 | 6,337.95 |

Source: Audit Report on the Accounts of Federal board of Revenue, Audit Year 2016-2017 to 2020-2021 by Auditor General of Pakistan.

6.2 Sector Wise Collection of WHT

Table 6 represents the sector wise collection of WHTs. There is comparatively low-income tax collection from the services and trade sector. There is a need to introduce new WHT provisions like income tax in the electricity bills or fixed income tax scheme for small traders etc. to cover these sectors for maximizing their contribution in the income tax.

Table 7: Comparison of Share in GDP and Share in WHTs

| Sector | Share in GDP (%) | Share in WHTs (%) |
|-------------------|-------------------------|--------------------------|
| Manufacturing | 12.52% | 12.90% |
| Services | 37.43% | 11.20% |
| Traders/retailers | 18.75% | 3.90% |
| Others | 31.30% | 71.60% |

*Source: FBR *Data is related to the year 2020-21.*

6.3 WHT Paid by Individuals

Table 7 reports the percentage of WHT collection by companies, association of persons (AoPs) and individuals. On average 50% of the WHT paid by individual tax payers is collected from salaried individuals. It shows that a significant number of non-salaried individuals who are doing businesses and other economic activities are still out of the WHT net. Its basic reason is cash-based economy. To include more individuals in the tax net, there is a need to transform the cash-based economy to a documented economy.

Table 8: Person Wise Collection of WHTs (In %)

| Tax Year | Companies | AOP | Individual | Salaried | Non-Salaried |
|----------|-----------|-----|------------|----------|--------------|
| 2014 | 41% | 8% | 50% | 54% | 46% |
| 2015 | 38% | 8% | 54% | 51% | 49% |
| 2016 | 38% | 8% | 54% | 50% | 50% |
| 2017 | 38% | 9% | 53% | 50% | 50% |
| 2018 | 37% | 9% | 53% | 51% | 49% |
| 2019 | 42% | 9% | 48% | 34% | 66% |
| 2020 | 41% | 8% | 51% | 50% | 50% |
| 2021 | 38% | 8% | 54% | 46% | 54% |

Source: FBR

6.4 Problems in Collection/Deduction of Tax at Source

All WHAs dealing in the specified transactions are required to deduct/collect WHT at source from these transactions and in case of failure to comply with this requirement, there are certain penalties which will be imposed on the WHAs. Sometimes these WHAs failed to comply with this requirement. This practice can be eliminated by enforcing the prescribed penalty provisions and taking the strict action against defaulter WHAs. AGP in its audit reports showed the following short/non deduction of WHT by WHAs.

Table 9: Transaction Wise Non/Short Deduction of WHTs

| Sr.# | Type of Transactions (Only Major Heads) | Amount (Rs. in million) | | | |
|--|--|-------------------------|-----------------|------------------|------------------|
| | | 2017-18 | 2018-19 | 2019-20 | 2020-21 |
| 1- | Payments to suppliers and | 29,785 | 5,320 | 11,340 | 12,568.30 |
| 2- | Payment of Dividend | 599 | 199 | 1,569 | 1,946.18 |
| 3- | Payment of brokerage and | 123 | 103 | 166 | 1,725.35 |
| 4- | Payment of rent from immovable | 982 | 138 | 113 | 476.49 |
| TOTAL (Above mentioned and other items) | | 33,111.76 | 8,258.34 | 17,326.07 | 31,424.14 |

Source: Audit Report on the Accounts of Federal Board of Revenue, Audit Year 2017-2018, 2018-2019, 2019-20 & 2020-2021 by Auditor General of Pakistan.

6.5 Timely Deposit of Tax

WHAs are required to deposit the tax deducted at source into the national treasury within the stipulated time, otherwise they are charged with default surcharge.

AGP identified in its report the amount of default surcharge for the late payment of income tax liability, which is not levied on tax payer by FBR. We can imagine the total amount of default surcharge from the figures given in Table 9. There is a need to impose prescribed default surcharge on the WHAs on this irregularity and FBR should also ensure its receipt from the WHAs. This will reduce the practice of late payments of WHTs collected by the WHAs.

Table 10: Default Surcharge on Late Payment

| Tax Year | 2017-18 | 2016-17 | 2018-19 |
|-------------------|----------|-----------|----------|
| Amount in Million | 1,103.01 | 10,201.42 | 2,367.32 |

Source: Audit Report on the Accounts of Federal Board of Revenue, Audit Year 2017-2018, 2018-2019, 2019-20 & 2020-2021 by Auditor General of Pakistan.

7. IMPLEMENTATION STRATEGY OF WITHHOLDING TAXATION REGIME

Income tax law described the applicable rates for WHTs and also specified some persons who will deduct/collect WHT on specified transactions. These WHT related operations are performed by WHAs and law also has explained the role and responsibilities of the WHAs.

7.1 Withholding Agents

There are certain provisions in ITO 2001 regarding the eligibility criteria for WHAs. Table 10 shows the number of WHAs, persons and province wise, from 2014 to 2022. FBR should make continuous efforts to grow the number of WHAs to maximize the collection of WHTs.

Table 11: Person/Province Wise Number of Withholding Agents

| Years | Persons | | | Provinces | | | | |
|-------|---------|---------|---------|-------------|-----------|--------|---------|---------|
| | AOPs | COYs | INDs | Balochistan | Islamabad | KPK | Punjab | Sindh |
| 2014 | 164,133 | 58,804 | 334,143 | 7,170 | 38,823 | 25,941 | 344,519 | 140,627 |
| 2015 | 172,570 | 62,670 | 348,756 | 7,643 | 41,296 | 27,293 | 361,670 | 146,094 |
| 2016 | 181,008 | 69,219 | 367,992 | 8,712 | 44,776 | 29,276 | 381,344 | 154,111 |
| 2017 | 190,611 | 76,388 | 390,703 | 9,668 | 48,685 | 31,600 | 405,513 | 162,236 |
| 2018 | 201,227 | 87,318 | 423,114 | 10,477 | 55,098 | 34,589 | 438,936 | 172,559 |
| 2019 | 212,785 | 104,462 | 455,107 | 11,264 | 63,921 | 38,162 | 474,173 | 184,834 |
| 2020 | 225,523 | 123,967 | 494,929 | 12,159 | 73,114 | 42,316 | 518,579 | 198,251 |
| 2021 | 242,595 | 150,911 | 521,857 | 13,096 | 84,557 | 46,726 | 560,953 | 210,031 |
| 2022 | 262,974 | 179,201 | 538,738 | 14,127 | 94,386 | 50,866 | 599,819 | 221,715 |

Source: FBR

The ITO 2001 has defined some reporting and record keeping responsibilities of WHAs. The ITO 2001 has also described penalty provisions on defaults made by WHAs in the collection/deduction of WHT, its timely payment, recording keeping and reporting. The directorate of WHT within the FBR oversees the matters of WHTs and WHAs.

According to the ITO 2001, WHAs are required to strictly comply with the following responsibilities.

7.2 Collection/Deduction of Tax at Source

All WHAs are required to collect/deduct income at source from the specified transactions generated by them. But AGP found many cases involving billions of rupees transactions on which WHAs are failed to collect/deduct WHT at source (AGP, 2021). For details refer to Table 8.

7.3 Deposit of Tax into Treasury

Tax withheld by the WHAs will be deposited in national treasury within a specified time period. But as reported in Table 9, a big amount is not deposited or deposited with a delay in the government treasury by WHAs and FBR has been failed in imposing penalties on this irregularity (AGP, 2021).

7.4 Maintaining of Tax Record

In addition to reporting requirements, ITO 2001 also required from WHAs to keep the records regarding WHTs which will be produced to the income tax authorities at the time of the audit of WHTs. However, a significant number of WHAs do not comply with this requirement.

7.5 Filing of Periodic Statements

As per ITO 2001 certain reporting obligations should be complied by the WHAs. Every agent is required to furnish a quarterly/annual statement showing the details mentioned in section 165 of the ITO 2001. In the performance audit report prepared by AGP, it has been identified that a significant number of WHAs do not file the required statements on timely basis and FBR has failed to enforce its compliance (AGP, 2019).

7.6 Synchronized Withholding Administration and Payment System Agent

To resolve issue of non-payment/late payment of tax withheld by the WHAs, FBR has introduced new system. This system was introduced through Finance Act 2022, section 164A of ITO 2001 explains this system. It deals with the real time deposit of WHTs collected by selected WHAs. FBR can notify any person or class of persons to collect or deduct WHT through Synchronized Withholding Administration and Payment System Agent (SWAPS). Such agents remit WHT collected/ deducted to FBR through digital mode and in this regard, a SWAPS Payment Receipt (SPR) shall replace Computerized Payment Receipts. The notified SWAPS agent will be integrated with FBR and WHT will be deposited in government treasury on real-time basis simultaneously at the time of making third party payment processed through SWAPS by the SWAPS agent. Penalties were introduced for

non-compliance this system. It will also result in auto generated withholding statements, thereby saving time and reducing cost of compliance for the businesses. The SPR will be generated upon deposit of tax in this manner which can be used as a valid document for the purpose of claiming credit against tax payable.

8. WITHHOLDING TAX AUDIT

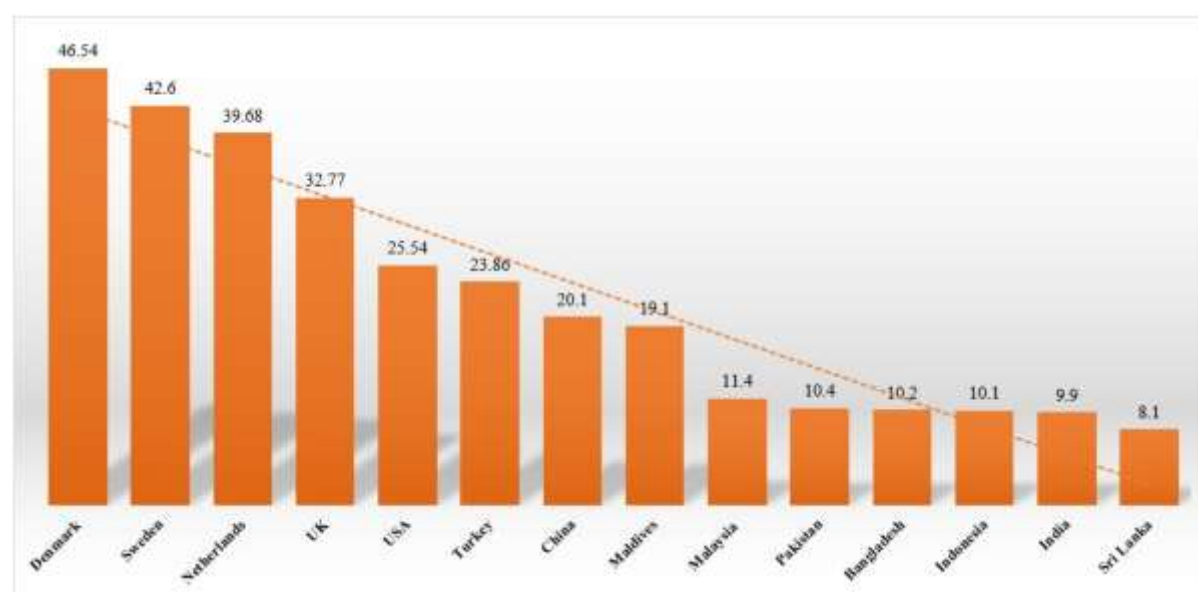
Whole system of the income tax is based on self-assessment and declaration. All declarations are made by the taxpayers on self-assessment basis but ITO 2001 empowers commissioner inland revenue to audit the tax record of the selected tax payers. During this audit, compliance of all legal requirements is verified including the legal responsibilities of WHAs regarding WHT deduction, reporting, record keeping, etc.

FBR with the help of risk-based audit management system selects the taxpayers through balloting by applying risk-based parameters. The parameters of selecting taxpayers for audit purpose are highly confidential, therefore, not disclosed by the FBR. However, different classes of tax payers like salaried individuals, persons whose entire income fall under final tax regime, and some other persons are excluded from the process of selecting taxpayers for audit. In the audit policy for the tax year 2019, 10,441 persons were selected by the FBR for income tax audit. During the audit, FBR checked all the relevant financial and other records and also verify the responsibilities of persons as WHAs. However, FBR did not meet the targets of tax collection through audit and inspection (AGP, 2021). There is a need to improve the system of taxpayers' audit and FBR should endeavor to make it more result oriented.

9. PRACTICES IN OTHER COUNTRIES

Collecting income tax is always a challenge particularly in developing countries. Figure 5 shows the tax to GDP ratios of the year 2020 of some developed and developing economies including Pakistan. Pakistan's tax to GDP ratio is quite low (10.40) as compared to other countries. It is below than the Asia and Pacific countries' average of 19.10% by 8.70 percentage points. It was also below than the OECD average (33.5%) by 23.10 percentage points. The highest tax-to-GDP ratio was 11.4% in 2017, and the lowest 9.0% in 2012. In developed countries it ranges from 25% to 45%. Improving the tax to GDP ratio has been a big challenge for Pakistan. Due to low tax to GDP ratio, our country relies on local and international loans to meet its expenses.

Figure 5: Comparison of Tax to GDP Ratio of Pakistan with Other Countries (Year 2020)



Source: OECD

WHT is a common procedure in the most of the countries. In many countries it is known as pay-as-you-earn (PAYE), and tax deduction at source (TDS) system. WHT rates vary across countries, depending on the country's tax laws and regulations (Mahpudin, Reminta & Fadilah, 2022). WHT itself is not a problem but the real problem is over reliance on this system. In Pakistan, almost eighty plus different kinds of transactions are covered under WHT regime. In the year 2022, 69% of the total income tax was collected through WHT system. In India this figure ranges 38%-40%. In most of the countries, WHT regime include few transactions for example Dividend, interest, salary, royalty etc. In most of the countries it ranges from 15%-25% of the income tax collected (OECD, 2023). But in

our country, there are excessive WHT provisions which indicates the failure of the system to collect the income tax through normal assessment procedures.

10. PROBLEMS OF STAKEHOLDERS

There are three stakeholders of the withholding tax regime which includes tax payers, WHAs and the FBR. Following are the major problems being faced by these stakeholders.

10.1 Tax Payers' Problems

Majority of our small and medium entrepreneurs and general tax payers do not have sufficient knowledge of WHT rates and other matters. They face problem in the adjustments of WHTs due to non or late payment of WHTs, non-availability of payment receipts and their non verification by FBR data base. Taxflation is also a burden on the taxpayers due to WHTs. There are also problems in the receipt of refund generated due to the excessive payment of WHTs during the year.

There are many types of WHTs which are expenses in nature. For example, taxpayers are required to pay WHT on cellular and internet services even they do not have any income or income below than the taxable income threshold.

10.2 Withholding Agents' Problems

In small and medium enterprises some time supplier of goods and services are not willing to pay WHT on their supplies. As a result of this, taxes are paid by the recipient of these goods or services instead of supplier which is completely against the objective of this system. WHT management responsibilities have some administrative costs for the WHAs. Therefore, in many budget proposals by the professional accounting bodies, it is suggested that a percentage in WHT collected should be given to the WHAs as service charges to cover these costs.

10.3 FBR's Problems

FBR is also facing problems in the implementation of WHT regime because there are number of cases of non-deduction or short deduction of the WHTs by WHAs. Wrong treatment of WHTs at the time of the filing of annual income tax return also causes loss of billions of rupees but due to human resource and technical constraints FBR is unable to do desk audit of these returns. There are also many problems in the audit and assessment processes of the taxpayers and WHAs. To make current WHT regime more effective, there is a need to overcome these problems.

11. BENEFITS OF WITHHOLDING TAXATION SYSTEM

WHT is an easy and convenient way to collect tax from tax payers. It involves zero cost and minimum time required for the collection of tax. Tax is withheld by WHAs and deposited within few days after the collection/deduction. Following are some major benefits associated with the WHT system.

11.1 Convenience in Tax Collection

It is easy to collect income tax through this system because it is collected and deposited in treasury when transactions are generated. In a country like Pakistan which has limited resources, it is difficult to cover every type of income and to assess it and impose required income tax on it. Through this system, a payer simultaneously becomes the agent of the revenue authorities and collect income on behalf of them.

11.2 Ease for Tax Payers

For taxpayers, it is easy to pay required tax conveniently. For example, salaried persons pay total tax due on their salary through deduction at source from the monthly salary payment. Through this system income tax burden of the tax payer spread over the year in easy small instalments, it results in saving him from the burden of income tax accumulated at the end of the year (Ahmed, 2020).

11.3 Low Cost of Collection

WHTs reduce the cost of collection of income tax because its collection totally depends on the WHAs. They collect the tax while doing specified transactions and deposit in the national treasury. No direct collection cost of FBR involved in this procedure.

11.4 Better Cash Flow Management for the Government

Government gets the money promptly and throughout the year through this system. Because the major portion of the income tax is collected through this system, therefore, the government has no

need to wait for the payment of the income tax by the taxpayers at the time of the filing annual income tax return. In this way, WHTs improve the cash flow management of the government (Ahmed, 2020).

11.5 Reduction in Tax Avoidance and Evasion

Tax avoidance and evasion is not possible for those transactions covered under WHT system. WHAs are responsible for the collection/deduction of this tax and they cannot avoid it because of the penalties imposed by the ITO 2001.

12. CRITICISM ON WITHHOLDING TAXATION SYSTEM

There is a strong criticism on the scope and application on the WHT system. Over reliance on this system always creates problems in the collection of income tax. Here is the summary of some critics on this system.

12.1 Mismatch with Progressive Taxation

Our income tax system is based on progressive tax rates for individuals and AoPs but through this system the tax is collected/deducted with the same rate irrespective of taxable income of the taxpayers. For example, WHT rate for dividend income and profit on debt is 15% irrespective of the relevant income tax rate slab of the taxpayer. This rate will be equally applied on taxpayers earning either 2 million or 20 million. This is against the spirit of the progressive tax rates approach.

12.2 Over Reliance on WHT

In Pakistan, WHT is considered an easy mechanism of the collection of tax. For the increase in the figure of income tax collection, our policy makers have adopted a practice of increasing WHT rates. We can observe this practice in finance bills of previous years. This leads to the withholdingization of the whole income tax system.

12.3 Undocumented Economy

Sometime WHT becomes a reason for undocumented transactions. People prefer to do transactions in cash to avoid the WHT imposed on these transactions. Besides, WHT system is unable to cover the undocumented economy, therefore a substantial number of persons are still out of the tax net.

12.4 Tax on Transactions, Not on Income

There are many types of WHTs which are applied on the taxpayers' expenses rather than incomes. For example, WHT collected on purchase and sale of property, tax on cellular and internet services etc. If you are selling the property even on loss, you have to pay WHT on that transaction. In the case of purchase of property, it is completely unjustified.

12.5 Taxflation- A type of Indirect Tax

It increases taxflation in the country, for example, someone imports an item and pays WHT on it then he will add all types of taxes paid on these imports in the price of the items and shifts its burden to the end consumer (Ahmed, 2020).

12.6 Undeposited WHTs

WHTs are deducted/collected from the payments but not deposited in the national treasury by WHAs is a common practice in our country (AGP, 2020). Therefore, some times, it becomes the additional source of income for the WHAs.

12.7 Double Taxation of Income

In some cases, it leads to double implementation of the income tax on an amount. For example, if you earn income from dividend or salary etc., income tax will be deducted from these payments. Afterwards you buy a car from a company, again you are required to pay income tax on this transaction. If you calculate effective tax rate paid on all these transactions, it will be more than normal income tax rate.

12.8 Taxation in Cases of Losses

WHTs collection/deduction in case of loss is also a problem for taxpayers. For example, the tax deducted from the payment for execution of contracts, you are required to pay this tax even you are suffering from a loss in that contract, which is completely unjust and unfair.

12.9 Problems in Widening of Tax Base

Over reliance on the withholdingization is a major cause of narrow tax base. As long as our country will achieve targets for revenue by simply changing WHTs provisions, no sincere efforts will be made by the tax authorities for broadening the tax base and inclusion of those persons in the tax net which are still out of it.

12.10 Inefficiency of FBR

Tax administration hide their inefficiency by collecting major portion of income tax through WHTs. As discussed earlier, they have no direct role in the tax collection through this mode. However, FBR uses WHTs collection in measuring their performance against tax targets (FBR, 2016).

12.11 Burden on Current Tax Payers

Due to continuous increase in WHT rates, existing tax payers suffered from extra tax burden. It has become the practice of the government to increase the rates of indirect taxes and WHTs to attain the tax targets.

13. RECOMMENDATIONS FOR IMPROVEMENT IN THE WITHHOLDING TAXATION SYSTEM

As mentioned earlier that WHT system is the backbone of the income tax collection system in Pakistan. Major portion of income tax is collected through this system, therefore, there is a need to improve and upgrade this system.

In the light of the analysis made by using available data on WHT system, we present the following recommendations to make it convenient and suitable for economy and business environment.

13.1 Reduction of Reliance on WHT System

Reliance on the WHTs should be reduced, because it is partially an indirect tax in the form of direct tax. Over reliance on WHTs affects the collection of income tax. In almost every budget government change the tax rates of WHTs and indirect taxes to meet the target of tax collection. Income tax is a direct tax and it should be collected in direct tax mode.

13.2 Reduction in Number of Transactions

Currently almost more than eighty types of transactions are included in the WHT regime. This number should be reduced to top 15 items which contribute almost 95% of the total WHT collection. Out of total items, 45 items of WHT contribute only 2%, these marginal items should be eliminated from WHT regime (Nasir & Anwar, 2020).

13.3 Correction in the System to Claim Adjustable Taxes

Claiming of the adjustments of WHTs should be based on system generated figures. For example, income tax deducted from salary is written in the IRIS manually, it should be automatically inserted by the FBR system in the annual tax return of the individual. Hence, it will not be possible to claim unpaid amount by the taxpayers. It will eliminate the figures of WHTs claimed for adjustments but not paid in the national treasury by the WHAs. This will also reduce the wrong treatment of WHTs in annual income tax return.

13.4 Replacement of Withholding Income Tax System with The Monthly Advance Tax System

Because of many problems of the adjustments of WHTs, it is recommended by the tax professionals' bodies that this system should be replaced with the monthly advance tax system for the listed companies. It will reduce the unnecessary documentation and problems in the verification and eliminate the chances of committing frauds by WHAs. It will also improve the cash flow of the companies and minimize the exposure of tax refunds.

13.5 Widening the Tax Net

There are no sincere efforts have been made by FBR to include more persons in tax net. Figures of the collection of income tax through the efforts of FBR can be seen in the Figure 3. FBR should aggressively work to minimize tax evasion in the Pakistan and inclusion of more persons in tax net instead of just changing the tax rates in WHT regime. New taxpayers should be brought in the net through the use of NADRA databases, data analytics and digitalization. Present taxation regime is highly complex, narrow, mostly skewed towards the urban, industry and formal sectors. It has low compliance and enforcement and inefficient administrative structure.

In Pakistan, according to different estimates, tax gap is about 70% of the actual tax receipt. Its basic reason is reliance on the indirect taxes and WHTs, and absence of fruitful efforts to broadening the tax net (Bukhari & Haq, 2020).

13.6 Rationalization of the Items included in the WHT List

There are many items which are actually expenses of the consumers not incomes like purchase of motor vehicles, cash withdrawals from bank, cellular and internet services etc. It is irrational and unjust to collect WHT on these items. From the list of WHT all these items should be eliminated.

13.7 Non-Filers' Data

Through this system FBR has obtained huge data regarding the persons who are non-filer but spending money on valuable purchases like property, motor vehicles, international air tickets etc. But still FBR is ineffective in the inclusion of these persons in tax net. By using this data tax collection can be increased and disease of tax evasion can be minimized. FBR should use this data effectively for this purpose.

13.8 Real Time Availability of WHT Data

A taxpayer can view WHTs on limited transactions made by him online from the FBR system. Its scope should be expanded to the entire WHT regime, for example, WHT paid on utility bills, banking transactions, etc. This will help the taxpayers to reconcile position of income tax paid on real time basis. Therefore, any lapse on the part of the WHAs can also be pursued by the taxpayers.

14. DIGITALIZATION OF WITHHOLDING TAXATION SYSTEM

On December 16, 2008, FBR signed a contract with Pakistan Revenue Automation Ltd (PRAL), a fully owned subsidiary and information technology (IT) wing of FBR. PRAL was initially required to help FBR in business process re-engineering, automation and managing information communication technology (ICT) infrastructure.

14.1 Journey and Current Structure of Digitalization

With the help of PRAL, FBR is continuously striving to increase the tax base and revenue collection, facilitate tax payers, and minimize incidence of leakages with the help of digital tools. The World Bank Data shows that FBR's digitalization initiatives helped in reducing the time involved in paying taxes (Bukhari & Haq, 2020). The indicator "Time to prepare and pay taxes" specifically measures the improvement regarding the online filing and tax payments. The lower the magnitude of this indicator, the higher the digital procedures implemented in the tax system. For example, between 2016 and 2017, Pakistani tax payers had spent about 312 hours per year in preparing, filing, and paying taxes such as Corporate Income Tax and General Sales Tax. According to the World Bank's Raises Revenue Project for Pakistan, the time to prepare and pay taxes indicator had been reduced by almost 22 percent, to 243 hours from 312 hours in 2017.

For the purpose of digitalization of taxation system in Pakistan, following major steps have been taken in previous years:

- Computers introduced for office work & data processing in FBR
- Pakistan Revenue Automation Limited (PRAL) was formed
- E-Filing of Income Tax & Sales Tax Returns started
- Launch of "IRIS" Portal for Filing of Income Tax Returns
- Payments through E-Banking "Alternate Delivery Channels (ADC)" for all commercial banks
- Online submission of withholding statements
- Issuance of system-generated notices and assessment orders
- Online filing of refund application
- Application and issuance of exemption certificates
- Online filing of appeals to commissioner appeal
- Online issuance of order by commissioner appeal

FBR has created a new inland revenue field formation namely Directorate General of Digital Invoicing and Analysis (DGDIA) in April 2022 and launched a digital directory for withholding agents by the name Synchronized Withholding Administration and Payment System (SWAPS) in May 2022. Withholding agents are also required to integrate with the SWAPS and collect withholding taxes and deposit the same in the government treasury through the new automated system. The availability of withholding transactions' data in the digital mode has been benefiting FBR in the following several ways.

- Making informed decisions through real-time monitoring
- Analysis of the WHTs data,
- Auto generating withholding statements thereby saving time and reducing compliance cost for WHAs
- Generating agent, section, or sector wise WHTs collection reports

- Tracking past performance and improve efficiency and curtailing tax evasion

FBR is also planning to establish a high-capacity data warehouse to support big data analysis and the integration of databases of taxpayers. Taxpayers can get the information about their assets online.

14.2 Effect of Digitalization on Efficiency of the Tax System

Recent advancements in the tax collecting machinery in terms of digitalization has facilitated tax payers and enhanced revenue collection. FBR helped more taxpayers than ever to pay their taxes quickly and easily online. For example, 2.19 million people filed income tax returns till the end of December 2020 reflecting a growth of 10.6% when compared with 1.98 million returns filed till same date of financial year 2019 and they were 2.46 million up to year ended 2021. On February 24, 2023, 4.15 million persons are appearing on Active Taxpayers List (ATL) of income tax. This becomes possible by the use of information technology.

The share of e-payments of income tax, sales tax and federal excise duty has increased from 6.26% of total payments during July to December 2019 to 40.5% during the same period of 2020 (FBR, 2021), indicating a massive growth in taxpayers' confidence and interest in digital payments.

14.3 Technological Problems in the Current Tax System and Recommended Solutions

1. The time a Pakistani tax payer takes to prepare and pay tax is highest relative to other developing countries with a lower or comparable Tax-to-GDP ratio.
2. According to media reports, PRAL data center does not have any international standard certification. Its last certification has already expired since December 2020. The data center has a systematic flaw and is not equipped with any intrusion detection system. By automating all tax collection and payment processes. PRAL should restore its repute affected by recent legal allegations (J Sigamony, 2021).
3. FBR lacks IT-based tracking system or database of different valuable initiatives and ventures made by FBR.
4. End-to-end automation, computerization and digitization through cloud computing, blockchain, machine learning, expanding functionality of websites and e-filing and epayment systems should be accelerated. Still total time spent in the organizations for complying taxation laws is more than double from time spent in different countries (World Bank, 2019).
5. Digital security and confidentiality of data of the tax payers should be ensured. This is still a challenge for the FBR. It may cause severe adverse legal consequences for FBR.

15. CONCLUSION

Collection of taxes always remain a challenge for the government in Pakistan. WHT system helps in the collection of income tax but its effects on the taxpayers are similar as indirect taxes which result in the taxflation. Measures should be taken to control these harmful effects. Higher dependence on the WHT depicts the failure of tax collection system. Our study suggests that we should reduce the dependence on the WHT system for the collection of income tax. There are many other problems associated with WHT regime which cause short collection and deposit of WHTs. In this project these problems are analyzed and suitable solutions are recommended.

We cannot eliminate WHT regime from our current taxation system. It will create problems in tax collection because still major portion of our economy is undocumented and out of tax net. Surprisingly, our government is not striving to expand the tax net. In every budget, only changes are announced in WHTs and normal tax rates to increase the income tax collection. Now this practice should be avoided and strict steps should be taken to add more people in the tax net. Similar to the practices of many other countries, few items like salaries, profit on debt, dividend and royalty etc. should only be included in the list of WHT regime.

It is not possible to implement reforms in WHT regime and in overall taxation system without the strong institutional reforms in FBR. According to professionals, its only solution is to establish a National Tax Authority (NTA) to deal with all types of taxes in Pakistan (Bukhari & Haq, 2020). Sooner or later our government will realize that the structural reforms in tax authorities, laws and collection system are the only solutions of the revenue problems of Pakistan and moving towards a just and equitable taxation system.

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ANNEXURES

Annexure 01: Break up of Income Tax under Each Collection Head (Amount in Million Rupees)

| | Total Tax Collected | Direct Taxes Collected | Gross Income Tax Collected | Refunds | Net Income Tax Collected | Withholding Tax Collected | Voluntary Payments of Income Tax | % of WHTs to Total Taxes | % of WHTs to Total Income Tax | % of WHTs to Direct Taxes |
|---------|----------------------------|-------------------------------|-----------------------------------|----------------|---------------------------------|----------------------------------|---|---------------------------------|--------------------------------------|----------------------------------|
| 2000-01 | 392,277 | 124,585 | 130,574 | 13,112 | 117,462 | 79,155 | 34,993 | 20% | 67% | 64% |
| 2001-02 | 404,070 | 142,505 | 152,986 | 16,444 | 136,542 | 78,884 | 50,855 | 20% | 58% | 55% |
| 2002-03 | 460,627 | 151,898 | 164,407 | 19,141 | 145,366 | 84,973 | 53,895 | 18% | 58% | 56% |
| 2003-04 | 520,843 | 165,079 | 178,207 | 20,759 | 157,448 | 91,782 | 66,543 | 18% | 58% | 56% |
| 2004-05 | 590,387 | 183,372 | 202,801 | 29,033 | 173,768 | 111,499 | 73,803 | 19% | 64% | 61% |
| 2005-06 | 713,442 | 224,988 | 243,736 | 34,001 | 209,735 | 139,274 | 87,360 | 20% | 66% | 62% |
| 2006-07 | 847,236 | 333,737 | 346,900 | 32,200 | 315,152 | 169,191 | 165,736 | 20% | 54% | 51% |
| 2007-08 | 1,008,091 | 387,861 | 393,782 | 25,822 | 367,959 | 205,144 | 145,616 | 20% | 56% | 53% |
| 2008-09 | 1,161,150 | 443,548 | 461,239 | 38,798 | 422,441 | 242,137 | 141,680 | 21% | 57% | 55% |
| 2009-10 | 1,327,382 | 525,977 | 559,698 | 54,204 | 505,494 | 295,249 | 165,801 | 22% | 58% | 56% |
| 2010-11 | 1,558,014 | 602,451 | 629,102 | 46,678 | 582,424 | 357,836 | 196,066 | 23% | 61% | 59% |
| 2011-12 | 1,882,693 | 738,424 | 811,893 | 91,561 | 720,332 | 420,457 | 237,366 | 22% | 58% | 57% |
| 2012-13 | 1,946,360 | 743,409 | 776,009 | 53,397 | 722,612 | 436,088 | 244,920 | 22% | 60% | 59% |
| 2013-14 | 2,254,531 | 877,255 | 918,863 | 63,711 | 855,269 | 571,667 | 262,598 | 25% | 67% | 65% |
| 2014-15 | 2,589,978 | 1,033,720 | 1,084,472 | 77,649 | 1,006,835 | 691,181 | 287,608 | 27% | 69% | 67% |
| 2015-16 | 3,112,472 | 1,217,474 | 1,242,195 | 47,523 | 1,192,247 | 803,116 | 340,820 | 26% | 67% | 66% |
| 2016-17 | 3,367,874 | 1,344,226 | 1,373,697 | 49,975 | 1,323,722 | 944,068 | 370,506 | 28% | 71% | 70% |
| 2017-18 | 3,843,755 | 1,536,583 | 1,577,441 | 69,461 | 1,515,086 | 1,046,917 | 467,007 | 27% | 69% | 68% |
| 2018-19 | 3,828,482 | 1,445,508 | 1,509,788 | 83,897 | 1,425,891 | 960,239 | 462,164 | 25% | 67% | 66% |
| 2019-20 | 3,997,408 | 1,523,445 | 1,570,820 | 68,604 | 1,502,216 | 1,091,737 | 407,170 | 27% | 73% | 72% |
| 2020-21 | 4,744,997 | 1,731,253 | 1,802,417 | 91,278 | 1,711,139 | 1,237,338 | 467,754 | 26% | 72% | 71% |
| 2022-22 | 6,148,500 | 2,284,900 | 2,269,800 | 54,221 | 2,215,579 | 1,534,400 | 676,408 | 25% | 69% | 67% |

Annexure 2: Withholding Tax Payers-Sector Wise (Amount in Million Rupees)

| Tax Year | FTNs | Manufacturers | NGOs/NPOs | Others | Services | Traders/Retailers |
|-----------------|-------------|----------------------|------------------|---------------|-----------------|--------------------------|
| 2014 | 1,424 | 66,387 | 77 | 320,454 | 37,071 | 13,228 |
| 2015 | 2,159 | 75,179 | 166 | 382,115 | 45,236 | 17,924 |

| | | | | | | |
|------|-------|---------|-----|---------|---------|--------|
| 2016 | 1,942 | 71,460 | 266 | 442,858 | 57,708 | 20,899 |
| 2017 | 2,010 | 76,316 | 291 | 518,650 | 71,841 | 24,166 |
| 2018 | 3,156 | 86,434 | 309 | 568,429 | 93,125 | 29,149 |
| 2019 | 2,421 | 95,144 | 289 | 480,249 | 94,745 | 30,822 |
| 2020 | 2,896 | 99,596 | 329 | 634,359 | 93,590 | 30,260 |
| 2021 | 3,587 | 128,118 | 436 | 710,623 | 111,141 | 38,694 |

Annexure 3: Item Wise Collection of Withholding Income Tax (Amount in Million Rupees)

| Sr.# | Items | 2013 | % | 2014 | % | 2015 | % | 2016 | % | 2017 | % | 2018 | % | 2019 | % | 2020 | % | 2021 | % | 2022 | % |
|------|----------------------------|----------------|------------|----------------|------------|----------------|------------|----------------|------------|----------------|------------|------------------|------------|----------------|------------|------------------|------------|------------------|------------|------------------|------------|
| 1 | Contracts | 111,516 | 26% | 129,901 | 23% | 176,783 | 26% | 220,062 | 27% | 259,539 | 27% | 249,889 | 24% | 235,476 | 25% | 237,479 | 22% | 271,991 | 22% | 341,419 | 22% |
| 2 | Imports | 103,235 | 24% | 123,808 | 22% | 147,352 | 21% | 179,728 | 22% | 197,041 | 21% | 218,691 | 21% | 221,835 | 23% | 199,691 | 18% | 218,499 | 18% | 281,607 | 18% |
| 3 | Salary | 50,056 | 11% | 64,552 | 11% | 79,460 | 11% | 92,253 | 11% | 111,188 | 12% | 133,362 | 13% | 76,441 | 8% | 129,423 | 12% | 151,838 | 12% | 196,249 | 13% |
| 4 | Bank Interest & Securities | 35,339 | 8% | 40,675 | 7% | 49,785 | 7% | 48,200 | 6% | 42,595 | 5% | 45,646 | 4% | 58,134 | 6% | 128,107 | 12% | 134,927 | 11% | 154,962 | 10% |
| 5 | Dividends | 19,191 | 5% | 24,182 | 5% | 29,399 | 5% | 42,042 | 6% | 49,489 | 6% | 57,847 | 7% | 57,056 | 8% | 55,046 | 6% | 63,781 | 6% | 83,328 | 7% |
| 6 | Telephone | 27,102 | 6% | 51,974 | 9% | 44,676 | 6% | 47,653 | 6% | 51,773 | 5% | 47,382 | 5% | 17,187 | 2% | 54,635 | 5% | 63,167 | 5% | 67,889 | 4% |
| 7 | Electricity | 16,026 | 4% | 19,758 | 3% | 27,541 | 4% | 25,526 | 3% | 25,840 | 3% | 33,832 | 3% | 35,558 | 4% | 45,427 | 4% | 51,264 | 4% | 71,412 | 5% |
| 8 | Export | 23,201 | 5% | 26,371 | 5% | 26,231 | 4% | 24,898 | 3% | 24,252 | 3% | 28,279 | 3% | 34,448 | 4% | 38,443 | 4% | 42,249 | 3% | 64,972 | 4% |
| | TOTAL | 385,666 | 89% | 481,221 | 85% | 581,227 | 85% | 680,362 | 86% | 761,717 | 82% | 814,928 | 79% | 736,135 | 78% | 888,251 | 83% | 997,716 | 82% | 1,261,838 | 83% |
| | Total WHT | 436,087 | | 571,716 | | 691,185 | | 803,116 | | 944,068 | | 1,046,917 | | 960,239 | | 1,091,737 | | 1,237,338 | | 1,534,365 | |

Annexure 4: Ratio of Voluntary Tax Payments and Payment on Demand

| Years | Total Income Tax collected | % of WHTs to Income Tax collected | % of Tax paid with annual return to Total income tax | % of quarterly Advance Income Tax to Total income tax | % of voluntary paid Income Tax to Total income tax | % of Income Tax on demand to Income Tax collected |
|-------|----------------------------|-----------------------------------|--|---|--|---|
|-------|----------------------------|-----------------------------------|--|---|--|---|

| | | | | | | |
|------|-----------|-----|-----|-----|-----|-----|
| 2006 | 243,736 | 57% | 10% | 26% | 93% | 7% |
| 2007 | 346,900 | 49% | 14% | 34% | 48% | 3% |
| 2008 | 393,782 | 52% | 2% | 35% | 37% | 11% |
| 2009 | 461,239 | 52% | 3% | 28% | 31% | 17% |
| 2010 | 559,698 | 53% | 2% | 28% | 30% | 18% |
| 2011 | 629,102 | 57% | 2% | 29% | 31% | 11% |
| 2012 | 811,893 | 52% | 2% | 27% | 29% | 16% |
| 2013 | 776,009 | 56% | 2% | 30% | 32% | 12% |
| 2014 | 918,863 | 62% | 1% | 27% | 29% | 9% |
| 2015 | 1,084,472 | 64% | 2% | 25% | 27% | 11% |
| 2016 | 1,242,195 | 65% | 3% | 24% | 27% | 7% |
| 2017 | 1,373,697 | 69% | 3% | 24% | 27% | 7% |
| 2018 | 1,577,441 | 66% | 8% | 21% | 30% | 7% |
| 2019 | 1,509,788 | 64% | 8% | 23% | 31% | 7% |
| 2020 | 1,570,820 | 70% | 4% | 22% | 26% | 4% |
| 2021 | 1,802,417 | 69% | 3% | 23% | 26% | 4% |
| 2022 | 2,269,800 | 68% | 3% | 26% | 29% | 3% |