



---

**Organizers**

---



Small and Medium Enterprises  
Development Authority,  
Government of Pakistan



School of Business and  
Economics (SBE), UMT

**Gold Partner**



**Partner**



# Why SMEs are reluctant to comply with tax laws in Pakistan?

**Moazzam Ali Tarar, AIOU, Islamabad.  
Author & Presenter**

**Muhammad Munir, AIOU, Islamabad.  
Co-Author**

# SMEs & Taxation

- The Small and Medium Sized Entities (SMEs) constitute 90% of economic establishment in Pakistan.
- SMEs share in GDP is 40% while their share in tax revenues is estimated below 10% of the total revenues receipts.
- Majority SMEs whether in the form of sole proprietorship or partnership form are not registered with the FBR.
- The tax compliance response among SMEs is low in-spite of introduction of many tax incentives schemes.
- A related problem is the absence of standardized record keeping practices in the SMEs that further complicates the assessment of tax liability.

# Key Concepts

## ❖ **Tax Morale:**

Tax morale represents the overall attitude and behavior of citizens in a country for voluntary compliance.

## ❖ **Fiscal Illusion:**

It refers to the systematic misperception about economic parameters that can alter the fiscal choices of the electorate.

## ❖ **Tax Illusion:**

Tax illusion, a term derived from the literature of fiscal illusion, shows the wrong understanding of people of tax system resulting in either underestimating the costs of public services provided to the people by Govt. or overestimation of revenue burden placed on them.

## ❖ **Tax Education:**

A term that denotes a set of systematic efforts by the Govt. to educate the taxpayers on their due share of taxes and the corresponding benefits.

# Literature Review

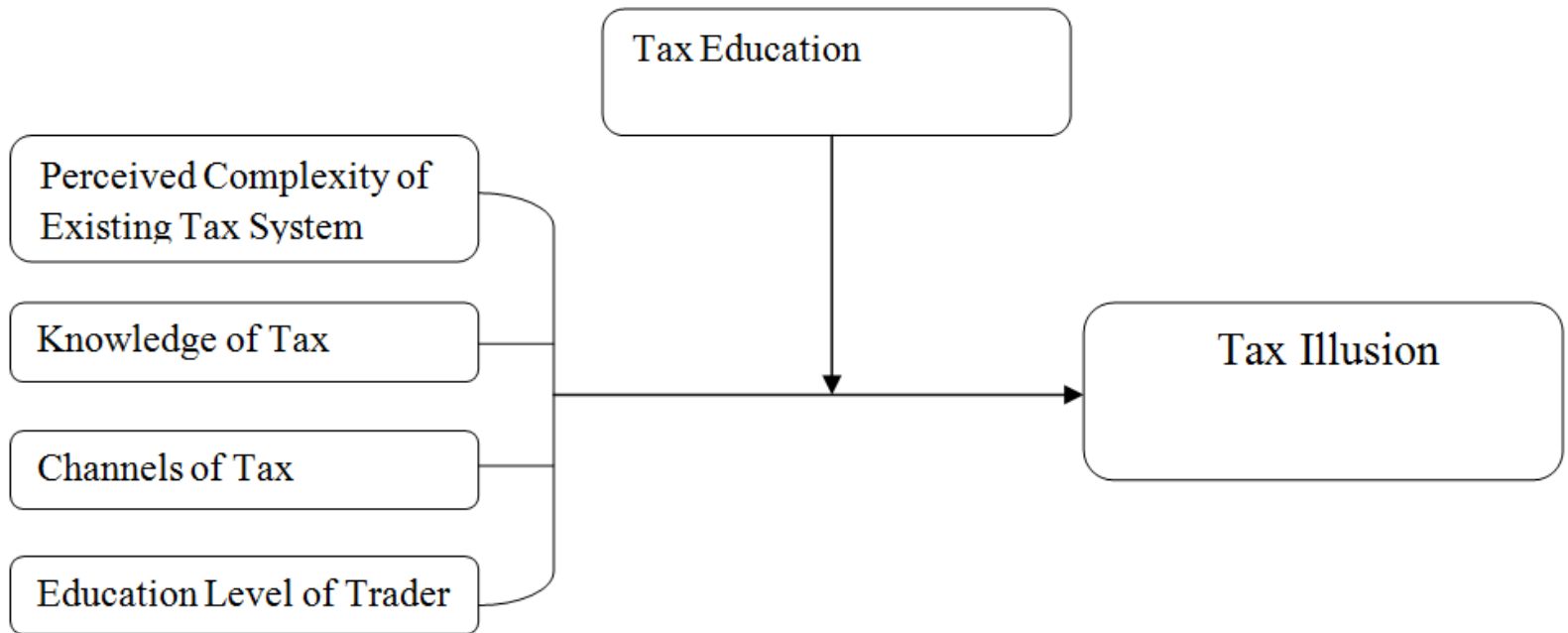
- ❖ Politicians tend to present the economic policies in an ill-transparent manner by creating illusions on both spending and revenues sides of the budget. This action results in presenting an unreal picture of the economy to the voters (Puviani, 1903)
- ❖ Mourao (2005) developed an index for measuring tax illusion by taking data from 68 countries since 1960 employing various dimensions. Pakistan ranked highest after Mali in fiscal illusion in this index making it a less transparent democracy.
- ❖ Tax payers are more aware of their income taxes if they have higher level of education (Gemmell, Morrisey & Pinor, 2004).
- ❖ Sanandaji & Wallace (2010) measured the level of tax illusion among the citizens of Sweden by making a nation-wide survey on knowing the public understanding of the taxes they pay to the Govt.

# Variables & Model

Independent Variables

Moderating Variable

Dependent Variable



# Methodology

## ❖ Subjects:

Population: Traders in Various Localities of Lahore

### • Procedure:

#### Stage I:

- Sample Size: 306 [Table for Determining Sample Size for a Finite Population by Krejcie & Morgan (1970)].
- Area sampling Technique
- Initial data collection through questionnaire and interviews

#### Stage II:

- Between-Groups Experimental Design
- Experimental Group: 10 subjects
- Control Group: 10 subjects
- Intervention of tax education: 4 weekly-sessions of 2 hours each
- SPSS 20.0
- Independent Sample T-Test for measuring effectiveness of intervention

# Results

## Survey Results:

No.	Variables	Mean	Standard Deviation
1	Tax illusion	4.23	0.20565
2	Perceived Complexity of Tax System	3.48	0.59947
3	Knowledge of Tax Utilization	2.53	0.50505
4	Institutional Channels of Tax Awareness	2.20	0.80607
5	Education Level of Traders	2.10	0.4123

# Independent Sample T-Test

To evaluate the difference between the means of two independent groups i.e. control group and experimental group.

Assumptions:

- i. Independence
- ii. Normality
- iii. Homogeneity of Variance of Two Groups

Shapiro–Wilk test of Normality:

	W	N	Sig.
Tax Illusion	No Tax Education	10	0.851
	Tax Education	10	0.890

The results of Shapiro–Wilk test show significance-value to be 0.851 & 0.890 which is higher than the chosen alpha level 0.05. Hence, the researchers found the evidence that the data tested were from a normally distributed population.



# Levene's Test for Equality of Variances

		Levene's Test for Equality of Variances		t-test for Equality of Means			
				df	Sig. (2-tailed)	Mean Difference	Std. Error Difference
		F	t				
Tax Illusion	Equal variances assumed	21.955	-1.024	18	.319	-.17445	.17034
	Equal variances not assumed		-.754	6.259	.478	-.17445	.23136

The variances in control group and experiment group were the same, Two-tailed significance value is more than (0.05) & significance level shows that the variability in two conditions i.e. provision of tax education and non-provision of tax education is not significantly different.

# Results of Independent Sample T-Test

		N	Mean	Std. Deviation	Std. Error Mean
Tax Illusion	No Tax Education	10	4.2321	.60565	.22892
	Tax Education	10	2.5177	.12093	.03354

Tax illusion was higher in control group where no education was provided to the group than that of experimental group where tax education was imparted. The difference between condition means shows that the subjects in experimental group have lower level of tax illusion after getting tax education

# Conclusion

- ❖ SMEs are largely unaware of their due share of taxes w.r.t. govt. budgetary requirements.
- ❖ The majority owners of SMEs have shown willingness to pay their share of taxes if transparency and honesty is established in the tax system.
- ❖ Tax education can play an effective role in decreasing the level of tax illusion in Pakistan.
- ❖ Specially designed tax education programs can significantly decrease level of tax illusion
- ❖ Effectively designed tax education can convince taxpayers to pay their due share.

# Recommendations

- ❖ Government should properly design tax education programs to increase the tax awareness among the taxpayers. These tax education programs can be in the form of seminars, television advertisement, radio programs, tax books etc.
- ❖ A localized tax structure should be developed where the tax collected from a particular market is to be spent on the welfare of the people surrounding that particular market.
- ❖ FBR should develop close partnership with the market players (SMEs owners) to develop a mutual relation of trust by bringing transparency in public spending.
- ❖ Private NGOs (Akhuwat, Edhi etc) can be involved in the tax collection system to assure the taxpayers of honest spending of their money.

# Interventions Introduced

## **Per Capita Reporting Card**

Federal Budget of Pakistan

- **Revenues:**

The per capita tax revenue in Pakistan is Rs. 1,200.

The per capita direct tax revenue in Pakistan is Rs. 400.

The per capita indirect tax revenue in Pakistan is Rs. 800.

- **Expenses:**

The per capita defense expenditure in Pakistan is Rs. 700.

The per capita interest expenditure in Pakistan is Rs. 400.

The per capita development expenditure in Pakistan is Rs. 600.

# Interventions Introduced

## Tax Spending Report Card

Name of Taxpayer: ABC

Tax Year:.....

NTN/CNIC.....

Area: .....

Taxes Paid		Tax Spending	
Income Tax		Defense	27,000
Advance Tax	10,000	Security	16,000
Withholding Tax	40,000	Education	5,000
With Return	5,000	Health	3,000
Sales Tax	25,000	Administration	14,000
Federal Excise Duty	5,000	Welfare	2,000
Customs Duty	15,000	Development	33,000
<b>Total</b>	<b>100,000</b>	<b>Total</b>	<b>100,000</b>