NAVIGATING THE TAX LANDSCAPE: ASSESSING THE IMPACT OF TAX POLICY ON BUSINESS ENVIRONMENT AND ECONOMIC DEVELOPMENT OF PAKISTAN

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Abstract

The tax system in Pakistan is dynamic and intricate, with a fine balance between tax collection and equality being of utmost importance. For sustained growth, a good business environment and an adequate tax-to-GDP ratio are linked. While a lower ratio might encourage investment, it will impede crucial income growth. On the other hand, placing too much emphasis on direct taxation may stifle innovation and foreign investment. Comprehensive tax reform that increases compliance reduces evasion, and broadens the revenue base is the answer. By supporting vital industries like infrastructure, healthcare, and education, this policy helps support a healthy economy. The long-term stability and prosperity of Pakistan depend critically on achieving the proper tax-policy balance.

Keywords: Business environment, Direct tax, Indirect tax, Tax-to-GDP ratio, Pakistan.

1. Introduction

The taxation of income, money, or assets taken directly from people or organizations is known as direct taxation (Balasoiu et al., 2023). Direct taxes place a direct financial burden on the taxpayer (Pințea, 2021). Income tax, corporation tax, property tax, and capital gains tax are examples of direct taxes. Based on their stated income or earnings, firms and individuals in Pakistan must pay direct taxes to the Federal Board of Revenue (FBR) (Shouzab et al., 2022).

On the other hand, taxes imposed on products and services are known as indirect taxes (Honcharenko et al., 2023). The government levies taxes on the sale, consumption, or manufacture of goods and services instead of directly taxing people; these taxes are ultimately passed on to the consumer (Mallick, 2021). Sales tax, value-added tax (VAT), customs charges, and excise duties are typical indirect taxes. The federal government collects these taxes (Jajja & Bhatti, 2022). The proportion of direct and indirect taxes in Pakistan is determined by many variables, such as the state of the economy, fiscal policies, and the need for more income (Khan et al., 2022).

In general, nations with greater levels of direct taxation have tax structures that are more progressive and aimed at reducing income disparity. In contrast, nations that rely more heavily on indirect taxes may place a larger priority on the simplicity and convenience of collection, but this might have a regressive effect on people with lower incomes (Bhattacharya & Stotsky, 2022). Indirect taxes may have several micro impacts on the economy and the cost of doing business. The cost of products and services rises due to indirect taxes like VAT and sales tax (Mgammal et al., 2023). Consumers' purchasing power may decline due to higher costs, affecting their spending patterns and the demand for particular items (Menyhert, 2022).

Additionally, it may cause people's consumption habits to change in favor of less expensive or untaxed items. Complying with intricate indirect tax requirements may be expensive for firms (Thottoli, 2022). For systems and procedures to effectively calculate, collect, and report taxes, businesses must invest (Honcharenko et al., 2023). The administrative load may be particularly difficult for smaller enterprises, harming their operational effectiveness and competitiveness (Bhalla et al., 2023). The cost of doing business may rise due to indirect taxes assessed at different points throughout the supply chain (Abd Hakim et al., 2022). This increases retail prices and less buying power since these expenses are frequently transferred to the ultimate consumers. While it is the responsibility of businesses to collect and remit indirect taxes, the true cost may be borne by consumers in the form of higher prices (Ochuka & Okafor, 2023). Tax incidence is the name given to this situation.

The price elasticity of the goods or services determines how much enterprises may transfer the tax burden to consumers. High indirect tax rates may entice companies to operate in the shadow economy to minimize tax obligations (Mpofu, 2022). As a result, government money may be lost, and enterprises that comply and those that do not may compete unfairly. The tax structure, rate levels, effectiveness of enforcement, and capacity of firms and consumers to alter behavior in response to these levies determine the micro impacts of indirect taxation on the economy and the cost of doing business. Achieving a balance between generating income and reducing distortions of economic activity is the goal of effective tax policy (Abata et al., 2023).

For a nation like Pakistan, choosing the right proportion of direct taxation necessitates thoroughly examining several economic and social factors (Naeem & Gulzar, 2021). In order to reduce income disparity and raise money for important public services and development initiatives, the government may need to use direct taxation, which includes income tax and corporate tax (Khan & haq Padda, 2021). The government should strive for a balanced and progressive tax structure to address Pakistan's imbalance. The appropriate level of direct taxation would depend on the particulars of the nation, including the GDP size, the degree of economic inequality, the tax base, and the effectiveness of tax collection (Sari & Qibthiyyah, 2022). A progressive tax system indicates that successful firms and people pay a larger percentage of their income in taxes. This can be accomplished by raising tax rates for higher income tax bands and addressing tax evasion loopholes. A progressive tax system can aid wealth redistribution and income equality, promoting a more just society (Abdullah et al., 2021).

Additionally, raising tax compliance and the tax base can boost revenue for the government without unduly burdening any group. This may entail improving tax administration, enforcement, and measures to bring the informal sector inside the boundaries of the official tax system. While developing and enacting tax reforms, policymakers should consider the possible effects of changes in direct taxes on economic growth, investment, consumption, and general welfare (Khan & Khalid, 2021). Determining the proper percentage of direct taxes for Pakistan's circumstances would require consulting with economic experts, researching global best practices, and performing extensive cost-benefit assessments. The government uses taxes for public expenditures, various necessary services, and national development initiatives (Abdu & Adem, 2023).

Governments levy taxes on the people under their control and the companies that do business there. These taxes are based on revenue, earnings, spending, or transactions inside the nation's boundaries. The international tax system does not allow for the export of taxes (Shafiq et al., 2021). Instead, each nation has its own tax rules determining how individuals and organizations are taxed when transacting internationally. To avoid double taxation and guarantee that income and earnings are duly taxed in one country or the other, nations might, nevertheless, enter into tax treaties or accords (Eyitayo-Oyesode, 2022). These agreements seek to further equitable tax treatment for organizations and people involved in global commerce and investment. In conclusion, Pakistan levies taxes on its residents and enterprises inside its geographical limits, just like every other sovereign nation, to raise money for internal purposes. Taxes are not exported to other nations (Zaheer et al., 2021).

There is no one-size-fits-all answer for figuring out the best tax rate and taxpayer base for Pakistan's economy since it is a complicated and multidimensional problem. There are benefits and drawbacks to low tax rates with a limited taxpayer base and higher tax rates with a larger one. A low tax rate may encourage spending, corporate growth, and investment, resulting in economic growth (Shabbir et al., 2021). It can lower tax avoidance by encouraging companies to function in the official economy and attracting international investment. In addition to lowering compliance costs for both firms and people, a streamlined tax system with lower rates can make it simpler for them to fulfill their tax duties (Sharipov, 2023). It may be difficult for the government to finance crucial public services and development initiatives if it depends too much on a small taxpayer base for income production. Because a tiny percentage of taxpayers are responsible for paying for public goods, it could also worsen income disparity (Evans et al., 2022).

By dispersing wealth, a higher tax rate, when implemented gradually, can reduce income inequality. Government revenue can rise by expanding the taxable base to encompass a bigger portion of the populace and enterprises (Malik, 2022). This would allow for social welfare, healthcare, and infrastructure investments. High tax rates may deter investment and impede economic expansion. If taxpayers can reduce their tax obligations, it may result in tax avoidance and evasion, which would be detrimental to total tax compliance (degl'Innocenti et al., 2022). It is vital to strike the ideal balance between tax rates and taxpayer base. The nation's economic climate, social goals, and administrative capabilities should all be considered in a comprehensive tax policy. Long-term benefits for Pakistan's economy may come from a combination of moderate tax rates and a large taxpayer base, as well as actions to improve tax compliance and lessen tax evasion (Jajja & Bhatti, 2022). A well-thought-out tax structure may encourage a healthy economy, social justice, and sustainable development (Singh, 2022).

The term "non-filers" refers to people not registered as taxes but are nonetheless permitted to engage in certain economic activities or transactions, such as buying expensive items like vehicles or real estate (Kassaw, 2023). Pakistan has discussed this clause because of its possible effects on tax compliance and revenue creation. The argument put up by supporters is that by facilitating faster access to assets and financial activities, the provision for non-filers can boost economic activity and promote investments (Malik, 2022). They think that enticing more individuals into the formal sector will increase the tax base, and there may be long-term revenue increases. However, detractors worry about how this clause may affect tax compliance negatively. By encouraging tax evasion and opening up loopholes, allowing non-filers to take part in large transactions might thwart attempts to increase the tax base and raise enough money. As individuals already paying taxes may be burdened with a disproportionate tax burden relative to non-filers, it may also worsen economic disparity. The government must undertake comprehensive tax changes that encourage tax compliance and economic growth to achieve a balance (Shafiq et al., 2021). Long-term effectiveness can be improved by addressing the root causes of certain people's continued non-filing, such as bettering tax administration, streamlining the tax code, and raising public understanding of tax duties (Jajja & Bhatti, 2022).

The country's tax system and how it affects different economic sectors and income groups may be done by looking at how much direct and indirect taxation is currently being levied (Zaheer et al., 2023). This information is essential for creating efficient tax laws that balance income distribution, revenue generation, and economic development. Examine the micro impacts of indirect taxes on the economy and the cost of doing business to ascertain the effects of tax policies on consumer behavior, corporate operations, and overall market dynamics (Balasoiu et al., 2023). Policymakers may use this data to create tax structures encouraging investment, entrepreneurship, and economic efficiency without burdening firms and consumers (Khan et al., 2022). Achieving the ideal mix of direct and indirect taxes can help decrease income disparity, improve tax compliance, and guarantee enough tax revenue for the government to provide basic services and development initiatives (Khan & haq Padda, 2021). In conclusion, understanding these tax-related issues in the context of Pakistan's economy is essential to developing fair, effective, and long-lasting tax policies that promote economic development, social welfare, and general prosperity for the nation and its people (Naeem & Gulzar, 2021). It allows decision-makers to make well-informed choices that influence the economic environment and advance the country's welfare (Naeem & Gulzar, 2021).

2. Methodology

Critical reviews aim to provide a critical evaluation and interpretive analysis of the body of literature on an area of interest in order to highlight any contradictions, issues, or other significant points regarding theories, hypotheses, research methods, or findings (Siegrist, 2021). Critical reviews make an effort to reflect on the research that has been conducted in a particular field of interest and assess its credibility utilizing critical interpretation methods or assessment tools (Abbasi, 2021). A critical literature review on Pakistan's taxation policy is being conducted in order to fully understand the present status of the study (Jadeja & Jain, 2022). The study conducted a critical review of the literatures from the years 2015 to 2023. Understanding how direct and indirect taxation relate to Pakistan's economic development is crucial. Direct taxes are a substantial source of revenue for the government, supporting public services and infrastructure initiatives that promote economic growth, whereas indirect taxes also contribute significantly to capital production for the government and improving the national economy (Kemal, 2010). Critical review is suitable for reviewing tax policy research because they shed important light on the subject by analyzing the results of developing a tax strategy that considers Pakistan's particular economic conditions while accommodating the tradeoff between direct and indirect taxes by collaborating with industry organizations, specialists, and officials.

3. Literature Review

3.1. Taxation policy of Pakistan

3.1.1. Current tax policy of Pakistan

The Income Tax Ordinance 1979 is the foundation for Pakistan's tax system (Mahmood, 2021). The statute has 245 sections and 11 parts (Khan et al., 2021). Pakistan's tax system is a complicated and dynamic structure. The Pakistani government is continually proposing revisions to the tax system to increase revenue collection and make the system more equal. The mainstay of Pakistan's taxation policy is a combination of direct and indirect taxes (Mahmood, 2021). While indirect taxes are charged on products and services, direct taxes are assessed on people and businesses based on income and profits. Income tax, sales tax, federal excise duty, customs duty, and wealth tax are the main pillars of Pakistan's taxation system. In Pakistan, those who make money are subject to income tax, with different tax rates based on their income levels. The income tax is progressive, meaning those with higher incomes pay a higher tax rate (Abshari et al., 2021). In addition, certain groups, including seniors and those with disabilities, are eligible for tax credits and deductions. The Pakistani government has been focusing on expanding the tax base and improving the effectiveness of tax collection in recent years (Hassan et al., 2021). Providing a more equitable allocation of the tax burden across the population entails enacting changes to lower tax evasion and enhance compliance. It is important to remember that taxation policies might vary due to various circumstances, including political agendas, economic situations, and legislative changes (Malik et al., 2021).

FBR's net revenue during the current fiscal year (July 21–June 22) was Rs. 6,126.1 billion, exceeding the objective of Rs. 6,100 billion by Rs. 25 billion. Over the same time last year, collections totalled Rs. 4,744 billion, a staggering increase of roughly 29.1%. The table mentioned below shows how much tax has been collected these past years.

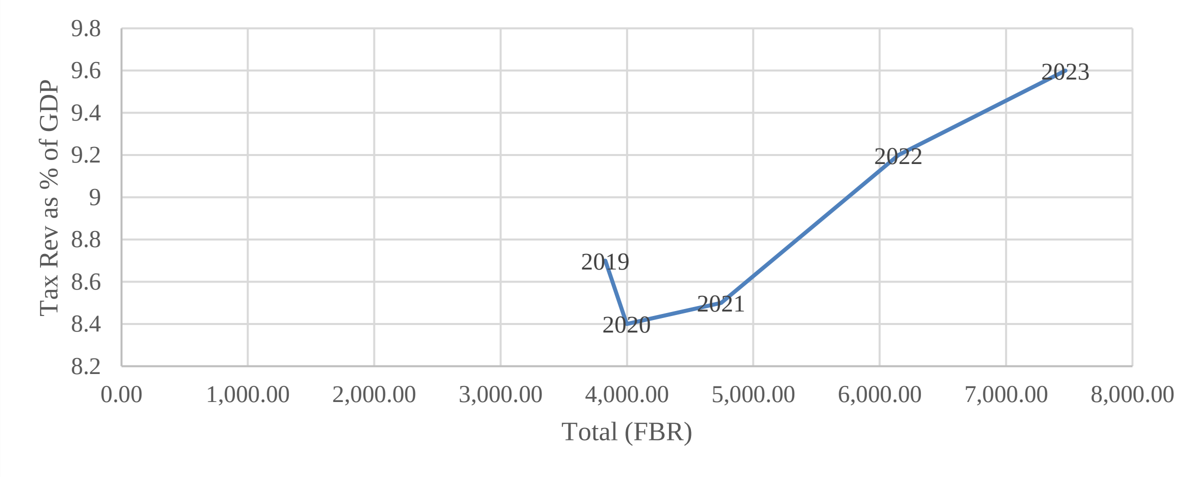

Figure 1: Tax Revenue (% of GDP) vs. Total Taxes

3.1.2. Direct tax policy of Pakistan

According to Pakistan's direct taxation policy, people and businesses are subject to taxation depending on their earnings (Jajja & Bhatti, 2022). In order to combat income inequality and finance public services, a progressive tax system needs to be promoted, and direct taxes are a key source of funding for the government. The Direct Taxation Policy for Individuals is governed by the Income Tax Ordinance 2001 (Yıldırım & Dibo, 2021). According to this legislation, people are divided into several income tax brackets and taxation rates depending on their taxable income. Corporations are also taxed on their income depending on their profitability and the nature of their operations. Depending on the sector, the size of the business, and other variables, different tax rates may apply to companies (Fernández-Rodríguez et al., 2021). Corporations may also be subject to minimum capital gains and income tax. The Federal Board of Revenue (FBR) oversees and executes Pakistan's direct taxation policy to simplify tax collection and increase compliance (Hasan et al., 2023). The FBR audits and investigations to find evidence of tax evasion while ensuring taxpayers comply with their tax responsibilities (Jajja & Bhatti, 2022).

3.1.3. Indirect tax policy of Pakistan

Indirect taxes are levied on products and services in Pakistan through various tools, including sales taxes, federal excise taxes, and customs duties (Khan & Khan, 2021). Indirect taxes are charged on the consumption of goods and services and are collected through mediators, such as service providers, merchants, and manufacturers, as opposed to directly from the people or entities who eventually pay the tax (Sherpa, 2022). One important element of Pakistan's indirect taxation strategy is the sales tax. It is used to provide products and services and is gathered at different points throughout the supply chain, from producers to retailers. The kind of goods or services might affect the tax rates. While luxury products could have higher tax rates, necessities like basic food items might be subject to reduced rates or even be completely free. Specific products and services produced or manufactured in Pakistan are subject to federal excise duty (Zaheer et al., 2023). Cigarettes, drinks, cement, and other commodities may be among these products and services. The FED is often added to customers' final price after producers or manufacturers have received their taxes (Sharma et al., 2022). Below mention table shows the direct and indirect tax.

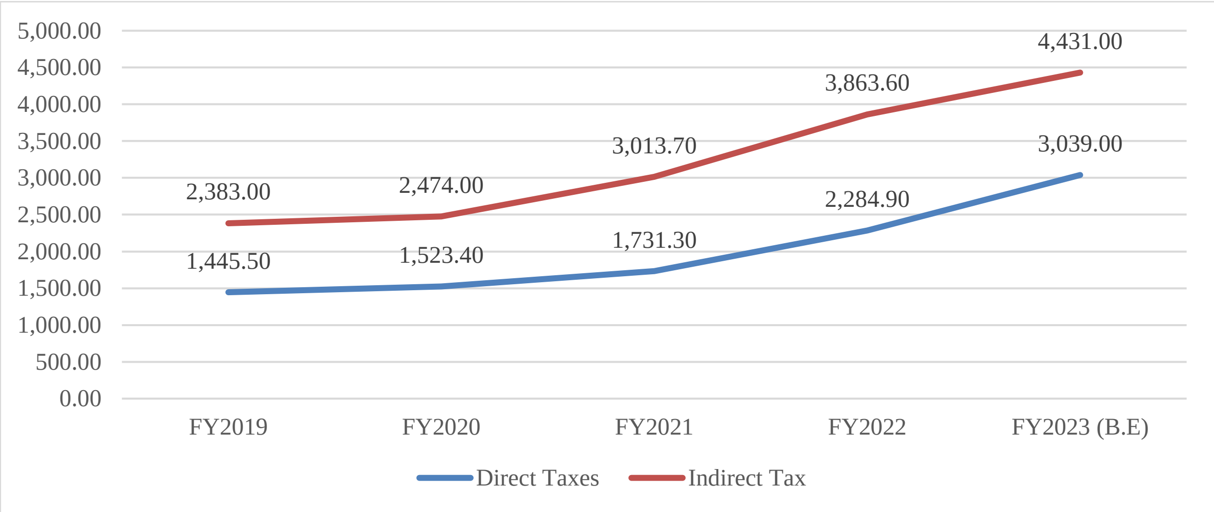

Figure 2: Direct and Indirect Tax Revenue (Year-to-Year)

3.2. Direct and indirect taxation in Pakistan

3.2.1. Direct tax in different industries of Pakistan

Direct tax is a type of tax imposed directly on individuals or entities, such as income tax and corporate tax (Sultan et al., 2023). According to study, direct taxes are paid on numerous industries in Pakistan in order to create revenue for the government and ensure socioeconomic growth. Income tax, corporate tax, and withholding tax are the three main types of direct taxes in the country. Rates and rules may differ based on the industry and the company (Amir & Siddiqui, 2023). Similarly, the manufacturing industry, which contributes significantly to the economy, is subject to corporate tax on net income, with rates ranging according to company size and type (Ahmad et al., 2023). Likewise, the banking and financial sector is subject to corporate taxation, as well as potential financial transaction taxes and capital gains taxes on certain transactions (Qadir & Ahmad, 2022).

Additionally, the services industry, which includes professional services, healthcare, education, and others, is subject to ordinary corporation tax rates. In the past, the IT industry, which is known for its growth potential, has benefited from tax breaks and exemptions to encourage development (Ahmad et al., 2023). Conversely, in spite of its importance to the economy, agriculture has generally been less taxed. The government has been looking into ways to bring this sector more effectively into the tax net (Qadir & Ahmad, 2022). In addition, Sultan et al. (2023) stated that industries in Pakistan must stay up to date on the newest tax policies and regulations in order to ensure compliance and make sound financial decisions. Consulting with tax professionals can assist industries optimize their tax payments while also contributing to the country's overall economic development (Evans et al., 2022).

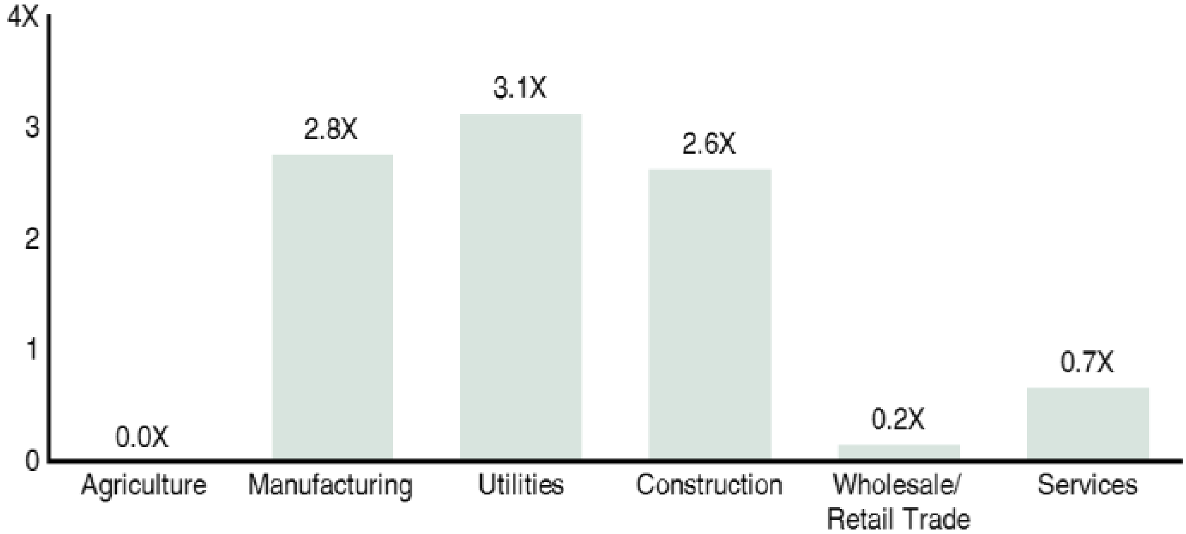

Figure 3: Sectoral Analysis of Share of Direct Taxes (Ahmed, 2020)

While manufacturing sector makes up 12.5% of GDP, it pays 34.5% of all direct taxes in the country. If we account for indirect taxes too, the number rises to over 50%. The petroleum industry alone pays 17% of all taxes in Pakistan. Along with utilities and construction, manufacturing is the hardest hit in terms of taxes, contributing almost three times as much to tax collection as to the economy itself (Ahmed, 2020).

3.2.2. Direct taxation and economic development in Pakistan

According to research, direct taxation is critical to Pakistan's economic development. It is an important source of money for the government, subsidizing public services and infrastructure initiatives that promote economic growth. The government can reduce income disparity and redistribute wealth by levying direct taxes on individual income and business profits, resulting in a more egalitarian society (Basit et al., 2022). Moreover, a well-designed direct tax system fosters investment, business management, and savings, ultimately promoting growth in the economy and job creation. Furthermore, direct taxes help to reduce tax evasion and promote a culture of tax compliance, which helps the government's fiscal situation (Abd Hakim et al., 2022). However, identifying the correct balance in tax rates and ensuring efficient tax administration are essential for preventing private sector growth and investment from being hampered. Governments must consider how direct taxes affect firm profitability and the entire economic environment (Qavami et al., 2023). Additionally, an effective and equitable direct taxation system can promote economic development in Pakistan by generating long-term revenue for the government and creating a favorable environment for firms and individuals to prosper (Abd Hakim et al., 2022).

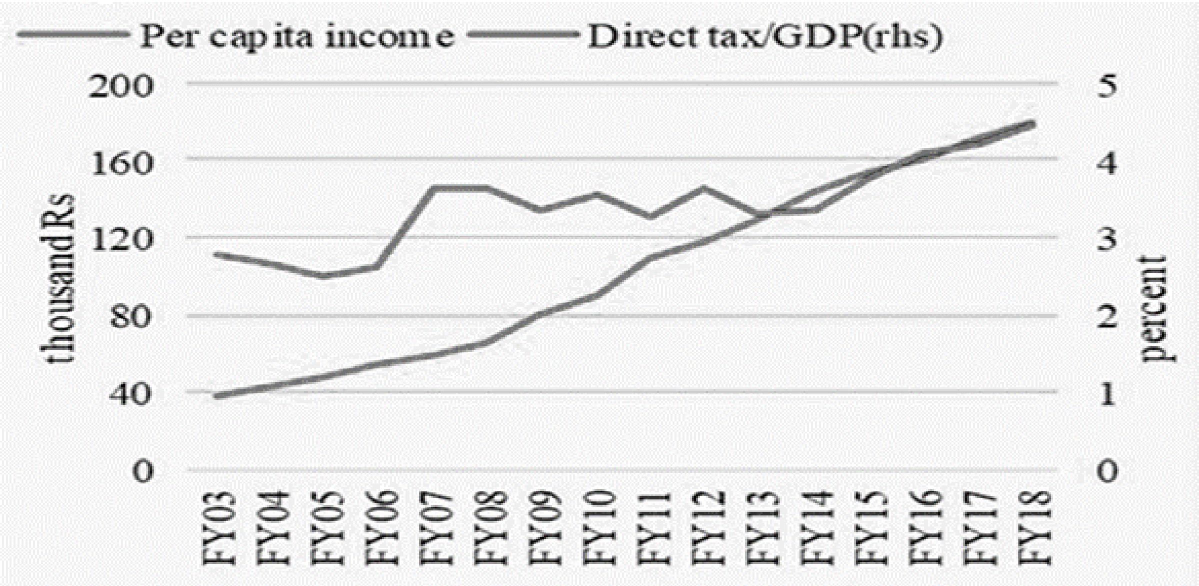

Figure 4: Income Tax Collection and viz-a-viz Per Capita Income (SBP, 2018)

According to the graph, direct tax income increased from an average of 2.9 percent between FY03 and FY17 to 4.3 percent in FY18 in terms of GDP. Tax collection growth was modest compared to rising income levels in the nation (SBP, 2018).

3.2.3. Indirect tax in different industries of Pakistan

In Pakistan, indirect taxes play an important part in producing capital for the government and contributing to the national economy. Different industries in the country are subject to various sorts of indirect taxes. The General Sales Tax (GST), which is collected on the supply of goods and services at each stage of production and distribution, is one of the most important indirect taxes (Imtiaz et al., 2023). While, textiles, autos, and electronics are all subject to GST on their sales and production activities in the manufacturing sector. Similarly, the services industry, which includes telecommunications, banking, and hospitality, is subject to GST on their services. The government may apply various tax rates to different sectors in order to support specific industries or protect domestic manufacturers (Mouneer et al., 2023).

Furthermore, indirect taxes on imported items, such as customs duties and tariffs, have a significant impact on the import sector. These tariffs are critical for safeguarding domestic businesses, limiting imports, and raising income for the government (Omolade et al., 2023). Although, special indirect taxes, such as the Petroleum Levy and the Gas Infrastructure Development Cess, are imposed on the petroleum and energy sectors to fund infrastructure development and energy security (Imtiaz et al., 2023). However, in Pakistan, indirect taxes are constantly shifting, with reforms and adjustments made to meet economic situations and fiscal requirements. While they represent a large revenue stream for the government, they can also have an impact on consumer pricing and the total cost of doing business in the country (Omolade et al., 2023).

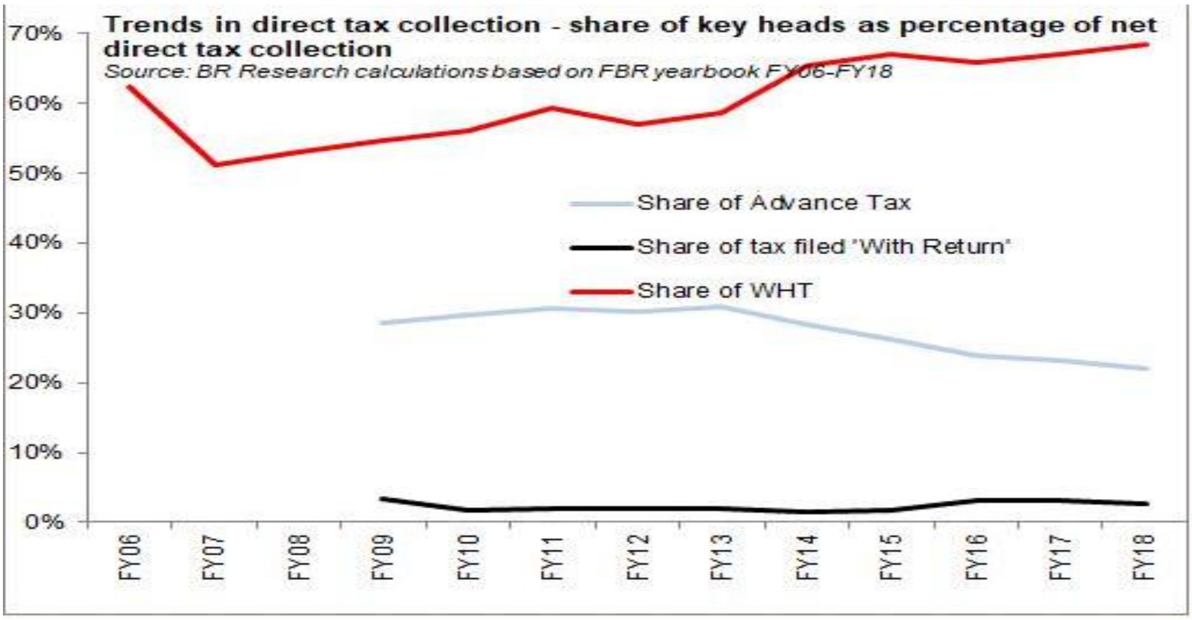

Figure 5: Trends in Direct Tax as % of Net Direct Tax (BR Research, 2018)

According to graph, FBR's recently released yearbook for FY18 shows that despite all hype about broadening the tax net, FBR's direct tax collection remains poor at about 40 percent of the total; the remaining being of course indirect taxes of various kinds such as sales tax, customs and the Federal Excise Duty (BR Research, 2018).

3.2.4. Indirect taxation and economic development in Pakistan

Abd Hakim et al. (2022) indicated that in Pakistan, indirect taxes are critical in driving economic development. Indirect taxes, as a key source of government revenue, help to fund critical public services and infrastructure projects. However, their impact on economic development can be uneven. On the plus side, a well-designed indirect tax system can help promote fiscal stability, ensure a consistent revenue stream, and support government spending on critical development initiatives (Kazemikhasragh & Buoni Pineda, 2023). Excessive or poorly targeted indirect taxes, on the other hand, can contribute to inflationary pressures, reduced consumer spending, and increased manufacturing costs, impacting corporate competitiveness. Furthermore, large indirect taxes may disproportionately affect low-income groups, thus aggravating income inequality (Manan et al., 2022). In addition, Pakistan's authorities must carefully examine the impact of indirect taxes on various businesses and income groups in order to strike the correct balance between revenue generation and economic development. Implementing progressive tax measures, encouraging tax compliance, and properly utilizing tax revenues are critical stages in fostering the country's long-term economic growth and development (Mouneer et al., 2023).

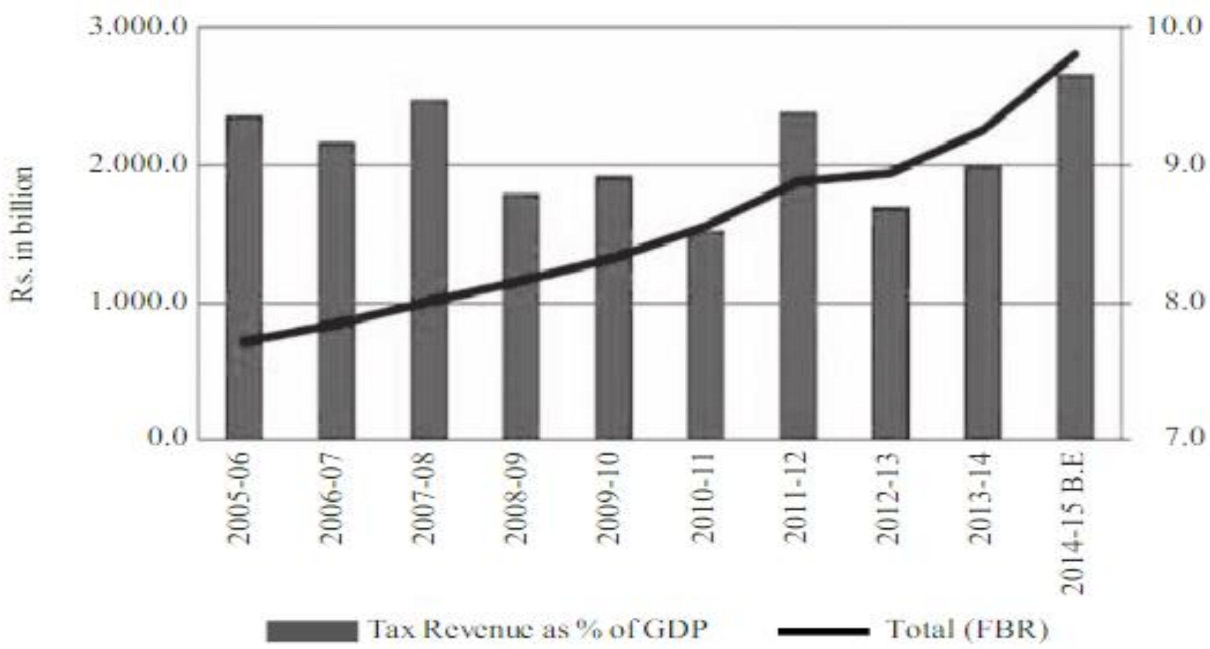

Figure 6: Tax Revenue vs. Total FBR (Ahmad et al., 2018)

According to graph, efforts to improve the tax system were made, but challenges persist with over-reliance on indirect taxes and trade-related levies. The tax-to-GDP ratio increased from 5% in the 1950s to 9% in the 1960s. Further reforms are needed to stimulate the economy. Graph shows Pakistan's tax-to-GDP ratio evolution from 2005–2006 to 2014–2015 (Ahmad et al., 2018).

3.2.5. Microeconomic effects of direct and indirect taxes in Pakistan

In Pakistan, the microeconomic consequences of direct and indirect taxes have a considerable impact on many economic operators. Individual behavior is influenced by direct taxes such as income and property taxes, which alter labor incentives and disposable money (Altaf, 2023). Higher direct tax rates may discourage labor supply while also reducing investment and entrepreneurial activity, so damaging total economic growth. Indirect taxes, such as the General Sales Tax (GST) and customs fees, on the other hand, influence consumer behavior through changing the prices of goods and services. They can cause changes in consumption patterns, especially for low-income households, which may incur a disproportionately higher burden as a result of spending a greater proportion of their income on taxed commodities (Abd Hakim et al., 2022). While, both types of taxes have an impact on corporate production costs and pricing decisions, potentially affecting profitability and investment decisions. Moreover, regulators in Pakistan must carefully balance the microeconomic consequences of direct and indirect taxes while taking measures to stimulate growth and support vulnerable parts of society in order to establish an effective tax system that fosters economic progress and income equality (Manan et al., 2022).

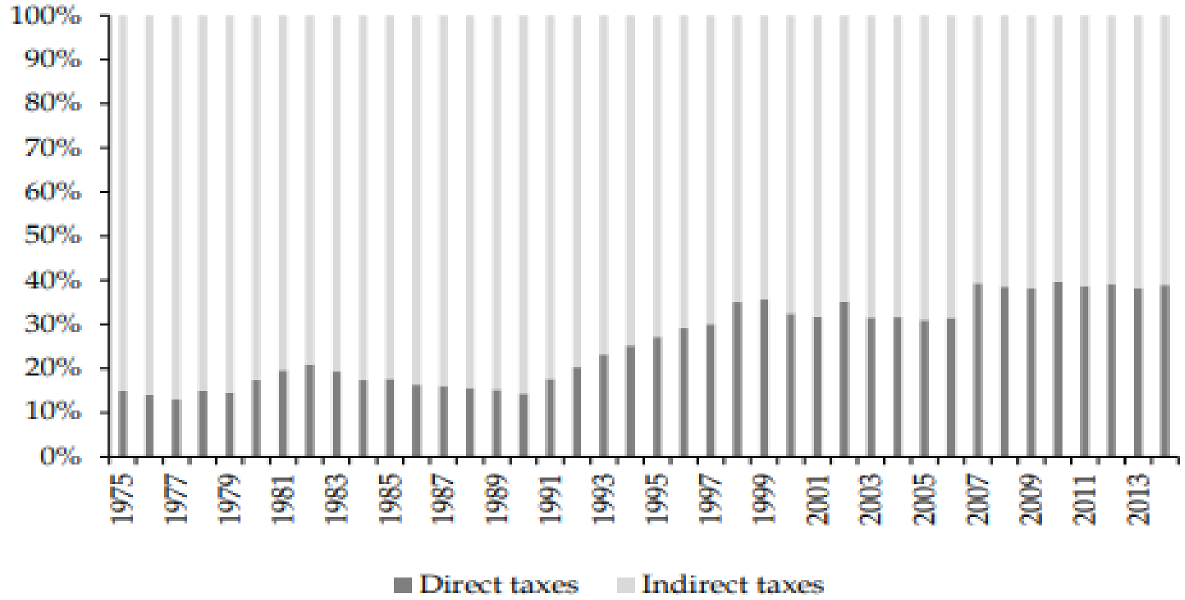

Figure 7: Direct and Indirect Taxes as % of Total Tax (Akram, 2016)

The breakdown of Pakistan's tax revenue is seen in this graph. Direct taxes now account for 40% of all taxes collected, up from 18% in 1975. This shows that there has been a significant policy shift over time from indirect to direct taxation and that the proportion of indirect taxes has decreased. Income tax, around 97 percent of all direct taxes, is essential to direct taxation (Akram, 2016).

3.2.6. Proportion of direct and indirect taxes in Pakistan

The proportion of direct and indirect taxes in Pakistan has shifted throughout time as the government strives to strike a balance between income generation and economic growth (Mouneer et al., 2023). Pakistan has historically depended more heavily on indirect taxes than direct taxes. The General Sales Tax (GST), which is classified as an indirect tax, has been a substantial source of revenue for the government. It is imposed at many phases of manufacturing and distribution, influencing the prices of goods and services (Khan et al., 2022). However, in recent years, there have been initiatives to raise the share of direct taxes in order to produce a more equitable tax structure. This includes steps to extend the tax base, improve tax compliance, and increase collection efficiency in the income tax and property tax domains. The goal is to minimize the burden on low-income people and encourage equitable taxes (Mouneer et al., 2023). Regardless of these efforts, the precise balance of direct and indirect taxes may alter as economic conditions and government policies change. Finding the correct balance between these two forms of taxation is critical for Pakistan's long-term economic development and wealth equality (Abd Hakim et al., 2022).

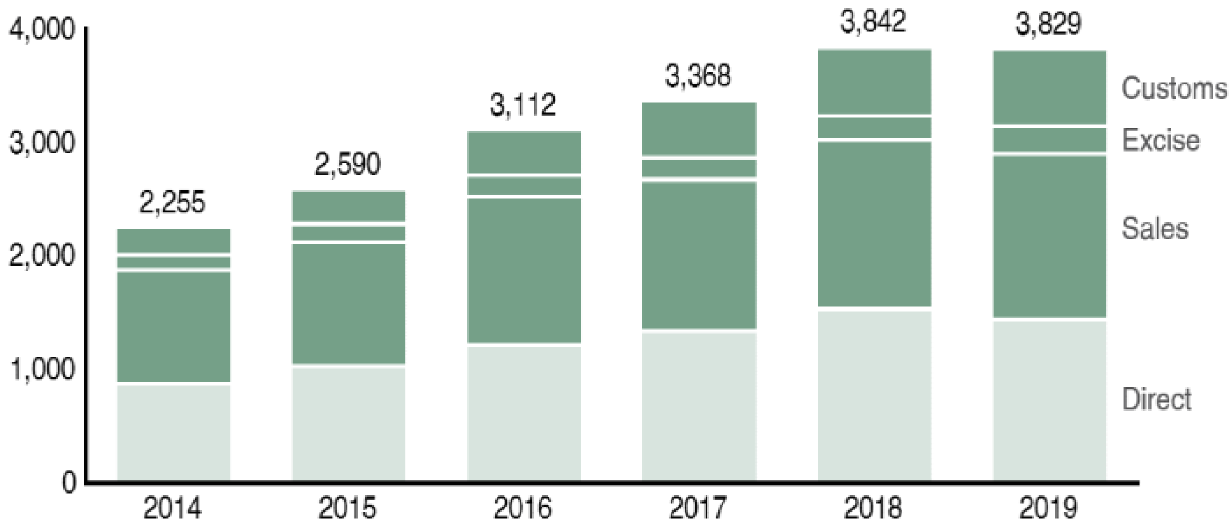

Figure 8: Total Federal Tax revenues by type (Ahmed, 2020)

According to graph, Pakistan's tax-to-GDP ratio rose from 10.2% in 2014 to 12.9% in 2018, then declined to 11.8% in 2019. Despite this, the government's tax collection potential is estimated at 26% of GDP, but only 50% of that value is collected due to low tax compliance (Ahmed, 2020).

3.3. Tax Policy and Economic Development

3.3.1. Direct tax and current imbalance

Pakistan has not been able to raise taxes. The tax-to-GDP ratio has remained constant at 10% of GDP despite various reform initiatives funded by donors. The federal government of Pakistan received between 36% and 39% of its tax income from direct taxes between 2008 and 2021, with the remainder coming from indirect taxes. The government is working hard to restore fiscal sustainability by decreasing the fiscal deficit in the medium to long term, despite major obstacles on the fiscal side (Kagan, 2021). However, this is only possible with efficient income mobilization and a careful spending plan. In this sense, increasing the tax to GDP ratio through different tax policy and administrative improvements and reducing needless spending through the implementation of austerity measures are significant aims. From 4.3 percent in FY2020 to 19.5% in FY2021, tax revenue grew. This enhancement was made possible by both the federal and provincial governments. Throughout FY2021, a recovery in domestic economic activity helped to increase tax revenue overall. Direct taxes make the system more progressive by reducing the inequality gap, making it a more equitable method of raising income. Over the past many years, FBR has taken a number of actions to boost the proportion of direct taxes to total tax collection (Ahmed, 2020). The ideal level of direct taxes will change over time, necessitating ongoing assessment and modification to reflect the nation's shifting economic objectives. To strike the correct balance and guarantee sustained economic growth, cooperation between policymakers, economists, and stakeholders is crucial.

3.3.2. Indirect taxation and business environment

The impact of indirect taxes on Pakistan's economy and company costs is extensive at the micro level. Individuals, businesses, and the general economic environment all experience these consequences. First off, indirect taxes like the Goods and Services Tax (GST) and excise taxes can make it more expensive to live for regular people. Consumers' buying power is diminished when these taxes result in increased costs for products and services. This can therefore result in less consumer spending and less of a desire for different items, which can hurt companies that depend on consumer sales. Indirect taxes also have a direct influence on the cost of conducting business in Pakistan. Because of the taxes that must be paid on raw materials, equipment, and services, businesses sometimes face higher input expenses. This may lower profit margins, making it more difficult for organizations to grow, make technological investments, or recruit more staff.

As a result, it can obstruct the expansion of the economy and the creation of jobs. Furthermore, market distortions may be brought on through indirect taxes. An uneven playing field might result from taxes that are levied at different rates or that are excluded from taxation on certain products and businesses. As a result, some enterprises may decide to operate illegally in order to avoid paying these taxes, which might promote tax evasion and informality in the economy. It can also discourage foreign investors from entering the sector and hinder healthy competition. Indirect taxes affect compliance and administrative expenses in addition to its financial effects. Businesses must commit resources to complying with complicated tax laws, submitting returns, and going through audits. This takes resources like time and money away from innovative and profitable endeavors. Last but not least, low-income people and small enterprises are disproportionately impacted by the indirect taxation's regressive character. While the rich may be able to endure price increases, the poor sometimes face a bigger cost since a larger portion of their income is spent on necessities like food and shelter. In order to encourage economic growth and guarantee justice and equality in the tax system, policymakers must carefully evaluate the effects of these levies.

3.3.3. Trade-off between higher and lower taxation

It is a complicated question that depends on a lot of variables and Pakistan's unique economic conditions whether a low tax rate with a big number of taxpayers or the opposite strategy is better for the nation's economy. The best tax policy should find a balance between these elements as both strategies have benefits and drawbacks (IGC, 2017).

3.3.4. More taxpayers and a low tax rate

Expanding the Tax Base: By encouraging more people to pay taxes, the tax base may be expanded, decreasing the reliance on a small group of people or companies to produce tax income. The tax system may become more resilient and stable as a result.

Reduced Tax Evasion: When the tax burden is acceptable and affordable, people and businesses are less likely to participate in tax avoidance. As a result, a low tax rate may disincentives tax evasion.

Economic Growth: Lower taxes may encourage investment, entrepreneurship, and other forms of economic activity that might result in increased economic growth and employment creation.

3.3.5. Fewer taxpayers and a higher tax rate

Sufficient Revenue: Raising taxes can bring in more money, which is needed to pay for public services, infrastructure improvements, and social initiatives. Pakistan confronts several development obstacles, and generating enough cash is essential to resolving these problems.

Progressivity: A higher tax rate can be made more progressive by requiring higher earners to pay a bigger percentage of their income in taxes. This might improve social justice and lessen wealth disparity.

Fiscal Sustainability: In the event that the government faces considerable debt or budgetary deficits, a higher tax rate may be required to maintain the government's long-term fiscal sustainability.

In actuality, Pakistan's ideal tax strategy should take into consideration the country's distinct economic and social circumstances. A well-rounded strategy may combine efforts to broaden the tax base by bringing more individuals and economic activities into the official tax system with a moderate tax rate that promotes compliance and economic progress. Additionally, every tax policy's effectiveness depends on measures to reduce tax evasion and enhance tax administration. The capacity to raise enough money for public services, stimulate economic growth, and guarantee justice and equality in the tax burden distribution ultimately determines whether Pakistan's tax policy is effective. To meet shifting economic conditions and the nation's development objectives, the government should periodically examine and modify its tax policy (Brockmeyer et al., 2015).

3.3.6. Non-filler and economic interest

In Pakistan's economic environment, there has been discussion over the provision for non-filers, which permits people and firms who do not submit income tax returns to acquire certain products and services. Even though it could appear advantageous to certain people in the short run, especially for those who would rather escape the difficulties and duties of the tax system, it poses serious issues for Pakistan's economy in the long run. Positively, the provision enables a larger proportion of the population to access a range of goods and services without having to file tax returns, which can boost consumption and economic activity. As a result, certain industries, notably those in the real estate and automotive industries, may expand quickly. The provision for non-filers, however, has a number of disadvantages over the long term.

First off, it undercuts initiatives to boost tax compliance and the tax base, which are crucial for Pakistan's budgetary sustainability. The government is losing out on potential tax income by enabling non-filers to engage in high-value transactions, which exacerbates the issue of tax evasion and economic informality. Additionally, it keeps the tax system unjust and fosters economic disparity. A disproportionate cost is placed on those who file their taxes on time compared to non-filers who take advantage of the provision. This disparity undermines public confidence in the tax system and limits the government's capacity to solve the problems facing the nation's growth. While the provision for non-filers may boost consumption and provide short-term economic advantages, it is not advantageous for Pakistan's economy as a whole. It weakens tax compliance, upholds inequality, and restricts the government's capacity to raise money for essential public services and infrastructure improvement. To achieve its economic development and growth objectives, Pakistan should give top priority to tax changes that foster a wider revenue base, improve compliance, and advance justice in the tax system (TheNews, 2023).

4. Conclusion and Recommendations

4.1. Conclusive Remarks

The tax system in Pakistan is a complex, dynamic system. To improve revenue collection and make the system more equitable, the Pakistani government is constantly recommending changes to the tax structure. Finding the ideal balance between these two criteria is essential for sustainable economic growth and development in Pakistan since the business climate and the tax-to-GDP ratio are inextricably intertwined. A climate that is favorable to business can be supported by a balanced tax structure that evenly distributes direct and indirect taxes at suitable rates. A lower tax-to-GDP ratio, like the present 10.3%, may promote investment and economic growth, but it might not bring in enough money for the government to meet urgent developmental requirements. On the other hand, a heavy emphasis on direct taxes would impede innovation and discourage foreign investment, which would have a detrimental effect on the business climate. The solution rests in overhauling the tax code to increase revenue, boost compliance, and combat tax evasion while maintaining justice. This strategy can improve the business climate by giving the government the funds it needs to spend in infrastructure, healthcare, and education, which in turn can promote a stronger economy. For Pakistan's economy to be stable and prosperous over the long term, it is crucial to strike the correct balance between taxes and business-friendly policies.

4.2. Recommendations

A number of critical reforms are necessary to raise Pakistan's economic competitiveness and bring its tax-to-GDP ratio in line with world norms. Implement initiatives to expand the number of people and companies paying taxes formally. Improved tax registration procedures, data-sharing agreements, and financial incentives for voluntary compliance are included in this. To guarantee that higher-income individuals and companies pay their fair amount, the tax system should be adjusted. Income disparity may be decreased and social fairness can be increased by progressive taxation. Increase the effectiveness of tax enforcement methods by, for example, modernizing tax administration, utilizing technology to better monitor compliance, and enforcing harsher sanctions for tax evasion. To guarantee that tax breaks and incentives support development objectives and economic agendas, examine and rationalize them. Aim to balance the direct and indirect taxes carefully. Indirect taxes can be regressive, although they are frequently required for generating income. Take steps to lessen the regressive effect on people with low incomes. Increased tax money should be used to fund necessary infrastructure, healthcare, and education projects. These expenditures have the potential to improve the business climate and promote economic expansion. Increased tax money should be used to fund necessary infrastructure, healthcare, and education projects. These expenditures have the potential to improve the business climate and promote economic expansion. Develop a tax strategy that takes Pakistan's particular economic conditions into account while accommodating the tradeoff between direct and indirect taxes by working with industry organizations, specialists, and officials. By putting these suggestions into practice, Pakistan may strive toward developing a balanced tax structure that fosters economic competitiveness, revenue sufficiency, and social equality, elevating the nation among its peers throughout the world.

4.3. Limitations and Future Research

The proposed tax reforms may have drawbacks such as vested interests' aversion to change, potential hiccups during the transition, and difficulties in precisely calculating taxable incomes. Furthermore, finding the ideal balance between direct and indirect taxes is still a difficult task. Future initiatives ought to put an emphasis on enhancing tax administration, funding digital infrastructure for effective data collecting, and growing financial literacy initiatives. To draw in international investment, policymakers must also concentrate on establishing a stable and predictable tax environment. For continued reform, it will be crucial to have regular discussions with stakeholders and evaluate how the tax system affects the business climate and economic competitiveness.

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