



Impact of socio-economic factors on tax compliance and collection in Quetta city Baluchistan Pakistan

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Abstract

The main purpose of the studies as to examine the socio-economic determinants of tax collection in Quetta city, Baluchistan. A region that struggled with low tax effort and compliance since past decades. Using exploit primary data, generated questionnaire through literature and conducted the survey through convenient sampling method and have analyzed data through statistical tool of descriptive analysis. A sample of 60 respondents were studied and the average response to factor that most influence tax collection is a tough system and meanwhile easing the tax system so that each citizen easily understands the law and operate the system conveniently. As the prevailing neoclassical view of tax behavior is that trust is good, but control is better, thus it emphasizes on both societal and economic aspects of tax collection. This study is based on model of slippery slope framework that integrates both psychological and economic perspectives on tax compliance, it assumes that tax payers are compliant and abide by law either they avoid fine and detection or are feeling obliged to compliance as fulfilling the duty of an honest citizen to contribute their shares. Tax automation and building trust between tax man and tax payer is of utmost consideration for better compliance.

Keywords: convenient sampling, slippery slope framework, tax automation, exploit survey

Introduction

Government role in regulating economy and bringing about reasonable economic growth and development has far remained a debatable concern, utilizing its economic stabilizing tools of monetary policy and fiscal policy. The government provision of public goods and services (infrastructure and education) are financed by taxes collected from citizen (although tax collection is not the only source but the largest). Citizen's compliance with tax is of immense concern for state in wealth redistribution and provision of public goods. Although citizens are found reluctant in contributing their tax share and cooperation in voluntary compliance, while suspected of being eager to benefit from public goods. As a result, tax administration must regulate tax payer's behavior by applying effective strategies. It is helpful at the beginning to be precise on some terms. People take a wide range of actions to cut back or decrease their tax liabilities. Some are legal "tax avoidance" activities, like financial gain/income rendering, postponement of taxes, and tax arbitrage across income that faces completely different tax treatment. The term "tax evasion" refers to unlawful and intentional actions taken by people to scale back and reduce their lawfully due tax obligations. People will evade financial gain taxes by underreporting incomes; by overstating deductions, exemptions, or credits; by failing to file applicable tax returns; or maybe by participating in barter. Most frequently these actions are viewed through the lens of the individual revenue enhancement, however these forms of action will clearly be taken in alternative taxes. For instance, within the company in- return tax companies will underreport financial gain, exaggerate deductions, or fail to file tax returns, even as people waste the individual taxation. Similarly, sales taxes gift various opportunities for evasion (Kirchler, 2007) ^[22].

According to Becker's seminal work (1968), evading taxes isn't any longer perceived as a criminal offense however a rational utility increasing strategy employed by tax payers, once the advantage of fortunate evasion values over the prices of being detected, audited and penalized. Based on a result foreseen by a model compliance might be raised everywhere the globe by simply increasing the likelihood of being audited and caught by tax authorities just in case of evasion and impose additional sever fine. Individuals will try to evade a jurisdiction's sales taxes on specific commodities by buying them in alternative neighboring areas and then overwhelming them within the relevant jurisdiction while not paying the specified use tax, and people will merely evade taxes on intangible services. A broad-based retail excise is definite to incorporate important exemptions (e.g., food, health, education, and services), thereby making individual and firm incentives for evasion. For an ad valorem tax, corporations will gift dishonest invoices that permit them to minimize their tax liabilities, or they will merely fail to register (especially if their added is high, like service providers); people could even obtain to register as corporations to disguise their own personal consumption as purchased inputs. Property taxes may be evaded by valuation of true property values. Non-remittance of lawfully due taxes during a timely approach is an apparent method of evasion for many any tax. The increasing globalization of economic activities presents a virtually infinite array of evasion opportunities each to people and to corporations (e.g., border searching, transfer valuation, smuggling). It is additionally necessary to stress the spatial relation of nonpayment to the foremost fundamental problems publicly economic science. Indeed, evasion is vital for several reasons. The foremost obvious

is that it reduces tax collections, thereby moving taxes that compliant taxpayers face and public services that voters receive. on the far side these revenue losses, evasion creates misallocations in resource use once people alter their behavior to cheat their taxes, like in their decisions of hours to figure, occupations to enter, and investments to undertake (Alm J., 2012)^[26]. According to the classical economic model of nonpayment assumes that there are four determinants that shapes tax payers' behavior: audit chance, fine, tax rate and financial gain (Larissa-Margareta *et al.*, 2012), as a result of tax payers are more probably to evade tax, therefore a harsh audit and fines can yield higher compliance and cut back nonpayment.

Baluchistan is the province of least developed in Pakistan and is considered the most backward region and similarly the tax collection is minimum at the region. Tax is the compensation or amount paid to finance the provision of public goods and services, since Baluchistan is not provided with much public security (goods or services) it results to least compliance with tax. This research study is undertaken to understand whether citizens in Baluchistan particularly Quetta

City do not compliance with tax due to doubt and miss trust on authorities (which is social psychological influencing tax compliance) or due to tough procedures in tax collection a payment process (which is the economic factor influencing tax behavior of citizens). The main objectives of the research studies are (i) To determine the impact of socio-economic factors of tax compliance and collection. (ii) To examine the effect of tax system automation on improvement of tax collection.

Literature review

Erich Kirchler, (2014) studied that citizens' tax compliance is of great importance for state to finance its provision of public good and services. While citizens are being reluctant in contributing their share for compensating the benefit they receive from public good, because they are concerned with maximizing their own profit and increasing their income share, they avoid when possible thus voluntary contribution is not providing positive result. They further urge that prevailing neoclassical economic view on tax-behavior states that trust is good, but control is better. Thus, to avoid tax evasion harsh fine and tough audit is necessary where citizens are not willing to participate in voluntary contribution, but also punishment has its unintended side effects for instance reactance, therefore psychological variables are receiving increased attention, where the psychological factors are attitude towards taxation, social norms, and perceived fairness. Slippery-slope framework is the integration of both psychological and economic factors of tax compliance, it assumes that taxpayers abide by law either due to risk of being audited and fear of being detected and fined or feeling the social obligation of honestly contributing their shares. The importance of trust is emphasized in the process of voluntary contribution of tax payment.

Philipp Doerrenberg, (2017) the decision to evade taxes are not only due to extrinsic pecuniary factors (audit, penalties and tax policies) but also due to some intrinsic non-pecuniary motives, these are termed as tax morale. Tax morale is shaped by many factors such as, guilt, preference for honesty, morale sentiment and cultural factors. Social norms and reciprocity are often at the center of explaining its determinants. Social norms of tax compliance behavior particularly depend on the perception about

the prevalence of tax evasion in society. Tax payers are more likely to evade if evasion is very common and might be more compliant if most other tax payers, pay their taxes honestly. The literature of social norms and reciprocity have been extensively studied on public good where contributing to the public good can be interrupted as the equivalent choice to paying taxes honestly. Margareta, *et al.*, (2012) the economic determinant of tax compliance discusses by neoclassical economic theory of smith, concept of homo-economicus, tax payers are selfish, rational utility maximizer, who following optimal strategy try to evade taxes as means of obtaining best outcome. Evading taxes not seem as criminal activity per se but a rational utility maximizing strategy; when benefit of successful evasion value more than cost of being audited. Classical economic model of tax evasion assumes there are four different determinants that shapes tax payers' behavior: audit probability, fine, tax rates and income; thus, an appropriate tax system must be formed to foster tax compliance.

Hallsworth *et al.* (2017)^[29] document in a randomized setting that telling taxpayers that '9 out of 10 people (in the UK) pay their taxes on time' increases punctual payment of tax debt. Reciprocity in this context means that the motivation to comply depends on the (perceived) services and quality of the state/government which citizens receive in return for their tax payments (this is also related to the concept of conditional cooperation; see Frey and Meier, 2004).

Fehr, and Gaechter (2000)^[40] argues that reciprocity has powerful implications for many economic domains. It is an important determinant in the enforcement of contracts and social norms and enhances the possibilities of collective action greatly. Reciprocity may render the provision of explicit incentive inefficient because the incentives may crowd out voluntary cooperation. It strongly limits the effects of competition in markets with incomplete contracts and gives rise to noncompetitive wage differences. Finally, reciprocity it is also a strong force contributing to the existence of incomplete contracts. Feld, and Frey, (2007)^[35] explored that a psychological tax contract goes beyond the traditional deterrence model and explains tax morale as a complicated interaction between taxpayers and the government. As a contractual relationship implies duties and rights for each contract party, tax compliance is increased by sticking to the fiscal exchange paradigm between citizens and the state. Citizens are willing to honestly declare income even if they do not receive a full public good equivalent to tax payments as long as the political process is perceived to be fair and legitimate. Moreover, friendly treatment of taxpayers by the tax office in auditing processes increases tax compliance.

Feld, Lars, and Frey, (2002)^[28]. Tax compliance has been studied in economics by analyzing the individual decision of a representative person between paying and evading taxes. A neglected aspect of tax compliance is the interaction of taxpayers and tax authorities. The relationship between the two actors can be understood as an implicit or "psychological" contract.

Dijke, and Verboon, (2010)^[41] explored the moderating role of trust in authorities in the positive effect of procedural fairness of tax office on voluntary compliance with tax authorities. Building on fairness heuristic theory, they predicted that particularly low trust I authorities make people carefully attend to the fairness with which the tax office enacts procedures. They documented that it must result in positive procedural fairness effect on

endorsement of norms prescribing tax paying and consequently, involuntary tax compliance, particularly among citizens with low trust in authorities they concluded that high trust in authorities forms an important boundary condition to the effectiveness of procedural fairness as a tool to enhance compliance with tax.

Fled and Frey (2007) ^[35] in their articles discussed that as a legally binding relationship infers obligations and rights for each agreement party, tax compliance is increased by sticking to the fiscal trade model among residents and state, residents are eager to sincerely proclaim income regardless of whether they don't get a same proportion of public benefit, as long as the political procedure is reasonable and reliable. A psychological tax contract model goes past the standard and clarifies tax morale as a complicated connection among tax payers and the government.

Alm and Vazquez (2003) in their study found that economics-of-crime approach gives the sensible and logical result that compliance on part depends upon enforcement. Nevertheless, it is important to recognize that the given approach of economics-of-crime also concludes that an individual pays taxes because - and only because - of the economic consequences of detection and punishment. Again, this is a plausible and productive insight, with the obvious implication that the government can encourage greater tax compliance by increasing the audit and the penalty rates. Individuals to avoid detection due to non-compliance will exclusively focus on financial incentives of evasion and see if the punishment and fine exceeds the reward from evasion, the individual will tend to comply with tax in order to minimize risk of being harmed in monetary term.

Basirat, *et al.*, (2014) ^[42] argued in their article that tax collection is of utmost importance as it is one of the strongest tool of fiscal policy that would help government to overcome its fiscal deficit and finance the expenses incurred in the provision of its public good and services, they further put an emphasis that revenue generated from tax collection must be incorporated in development of government organizations so that make them able to find opportunity of applying financial instrument.

Smith (1992) ^[44] in his study reviewed five prominent factors and theories that have been used to explain the behavior of compliance via economic deterrence, comparative treatment, fiscal exchange and political legitimacy and socio-psychology factors. He further added in his study that explaining tax compliance behavior is complex and it has multidimensional effect including both economic and noneconomic factors. As such, tax administrators as well as researchers on the subject matter should combine relevant models and incorporate these factors into developing effective tax systems.

Musharraf *et al.*, (2016) ^[45] argued that overall, more positive attitudes toward tax compliance were shown by group with lower labor force participation. Educated respondent's exhibit higher tax morale than the illiterate, but only for those with very low or very high educational attainment is tax morale higher than for those with bachelor's degrees. Tax morale is highest in major industrialized population centers that serve as seats of government. Females show generally higher tax morale than males, however, their attitudes tend to worsen with age to such an extent that elderly females have lower tax morale than elderly males. Our findings on gender suggest potential gains from increasing female labor force participation rates. More generally, addressing the current failures of tax administration and dealing with horizontal inequity arising from administrative weaknesses

may contribute materially to improving voluntary compliance. Rewarding whistle blowers would even encourage other citizens to add in power of authorities by informing them of illegal activities. A whistle blower received 104 million worth of USD in reward for whistle blowing, this is kept the largest reward yet (Saunders and Sidel, 2012).

Research methodology and theoretical framework

(1) Theoretical framework

According to prevailing neoclassical economics view on tax payer behavior, trust is good, but control is better, they perceive that a sincere control over the behavior of tax payer by mean of frequent audit and harsh fine may result in improving tax collection. Since the social psychological factors such as attitude towards taxation and tax morale have been receiving increased attention, the slippery-sloped framework, model of Kirchler, (2008) can best integrate both economic and psychological determinants of tax collection, and tax compliance. Over the years, various governments have simply tried to increase the level of tax compliance by adopting an intransigent attitude towards all taxpayers and by applying laws and regulations to sanction and fine evaders. These means of enforcement proved to be without a significant success. Towards the end of the 20th century, governments have realized that a change is needed in order to increase the amount of taxes collected. Thus, using adequate strategies based on understanding the reasons which drive compliance decisions is of greater help than strictly applying laws and regulations. According to view of Mr. Zaidi (chairman FBR), building trust between state and tax payer is top most challenge for base broadening, he further added that promoting voluntary compliance, tax automation and minimizing contact between tax man and tax payer would eventually lead to tax broadening (Mubarak, 2019).

This research is based on the neoclassical economic theory of homo-economicus---economic man is a rational person who pursue wealth for his own self-interest and would avoid any such activity that results in his wealth reduction---Individuals are rational utility maximizer and would intentionally evade tax payment where they find the value of evasion greater than benefit from taxation. This is why in contemporary system psychological factor is receiving increasing attention; thus, a model of slippery slope framework is used to present both social psychological and economic factor that influence individual tax behavior. It also presents the Economic Deterrence Theory that hold behavior of tax payers, influenced by various factors such as tax rate, that determine their behavior they react to tax burden as likelihood of being detected upon evasion, what penalties one may face).

(2) Conceptual framework

Starting with a basic conceptual framework for interpreting how various factors have influenced tax behavior of individuals in Quetta city. Given the neoclassical theory of homo-economicus, individual tax behavior is influenced by both economic factors and social psychological factors (from the data collected by questionnaire survey from individuals in Quetta, it is hence concluded that individuals are less intended towards tax morale but rather not compliance with tax due to corrupt and unmonitored tax system, individuals believe that by improving

tax system compliance with tax would increase substantially (Dijke and, Verboon, 2010) [41].

(3) Research methodology

The systematic plan for examines the socio-economic determinants of tax collection in Quetta city, Baluchistan through survey method, where subject responded to 18 closed-ended questions and one open-ended question and the study based on qualitative measures. Quetta is taken as sample frame and Quetta city is the sample. Convenient sampling method is used in this research study. Initially 20 samples were undertaken for piloting, and afterwards a sample of 60 respondents' views are incorporated in this study.

Dependent variable is taken is tax compliance, and impact of several social and economic factors which are independent variables of this study while independent variables are attitude towards taxation, law and regulation (which is basically behavior of tax system), power of authorities, whistle blowers, trust on authorities, consciousness about the state, subjective knowledge of tax law, social norms, perceived fairness of distribution of tax burden, government accountability, tax payers' education, tax system simplicity, tax automation and minimizing contact between tax man and tax payers are the factors that one way other way influence the degree of tax compliance and collection.

Data analysis and interpretation

Descriptive statistical analysis is applied in the process of data interpretation, this study is based on preferences of sixty respondents from Quetta city. Beginning this interpretation with the statistics of people in their shares in taxation. Followings are the descriptive analysis of each questions of questionnaire.

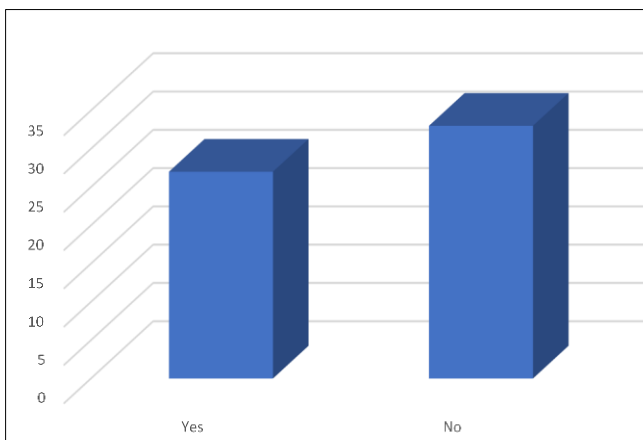


Fig 1: Are you a tax payer?

The Figure (1) explained that 45% of the respondents aged between 20-60 were tax payers (filer), while 55% were not formally compliant with taxation. Followings are the generalized justification of sample's behavior related to tax system and taxation as a whole. Each item of the scale (questionnaire) represents a specific socio-economic factor that influence level of tax compliance and consequently tax collection.

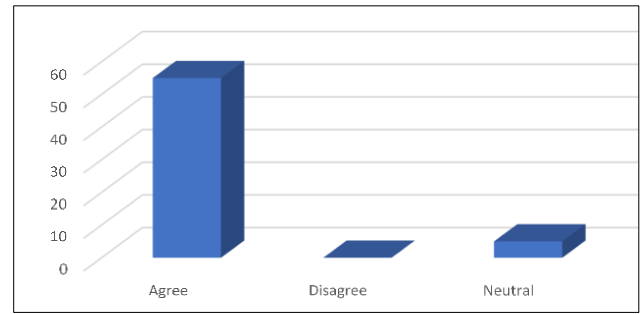


Fig 2: Adopting an inflexible attitude towards taxation would increase level of compliance

The figure (2) explained the social factor, linked with inflexible attitude towards taxation. The result implies that adapting an inflexible attitude towards taxation would positively affect level of tax collection and compliance. 75% of the respondents agreed on the positive relationship between tax collection or compliance level and having inflexible attitude towards taxation. Thus, it is recommended that social-psychological factor influence tax system, in terms of compliance and collection.

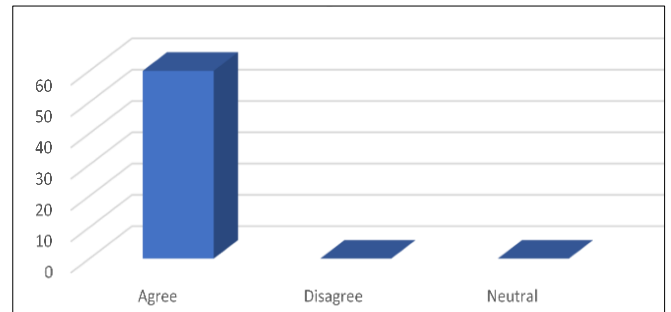


Fig 3: An increase in Govt. accountability with regard to Provision of public good and services result into higher compliance!

Allingham and Sandmo (1972) [1], in their article proposed the importance of government accountability in regard to provision of public good and services that directly influence level of tax compliance, thus improving the government accountability would consequently improve compliance. The result implies that 95% of sample respondents doubt accountability of government with regard to public good provision; in addition, they agree to the direct relationship of government accountability and tax compliance of citizens.

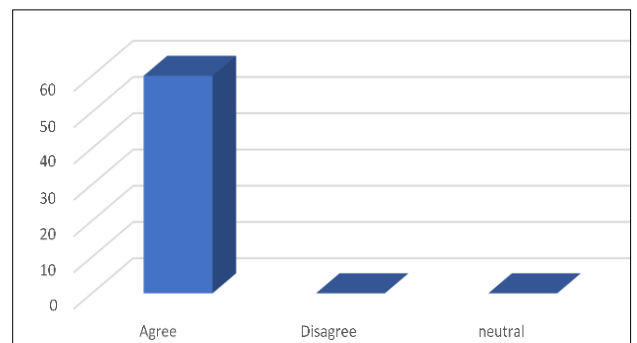


Fig 4: Simplicity of taxation system and understanding of tax Compliance will increase tax compliance!

The simpler the tax system the easier tax collection, this is discussed in Magiya's article on a comprehensive study in Nairobi. Almost 100% of the respondents in this study believed that simplicity of tax system would make people more inclined towards tax compliance (figure, 4).

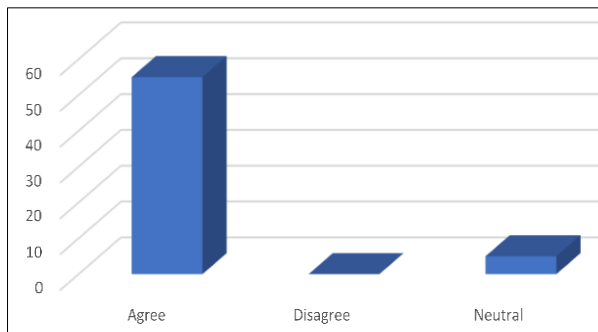


Fig 5: Tax authorities should promote cooperation rather than exclusively relying on effect of audits and fine!

Alm *et al.* (2012), argues that to improve tax collection tax authorities must not entirely rely on effect of tax audit and fine or penalties but rather promote cooperation simultaneously to attain even a better compliance level. 90% of respondents in this study also appreciate the cooperation from tax man despite of the presence of audit and fines.

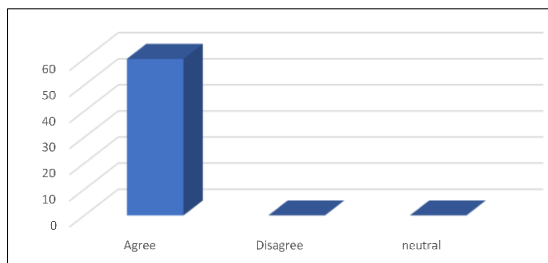


Fig 6: Due to high level of corruption citizens are not able to ascertain whether the taxes are used in financing Public goods and services or not!

Kirchler (2007) [22], induced the importance of fairness and minimization of uncertainty and corruption in tax system in order to ascertain citizens trust that taxes are used in financing public goods and services fairly among member of society. A majority of respondents have agreed to this proposition, thus reducing corruption, increases compliance (figure, 6).

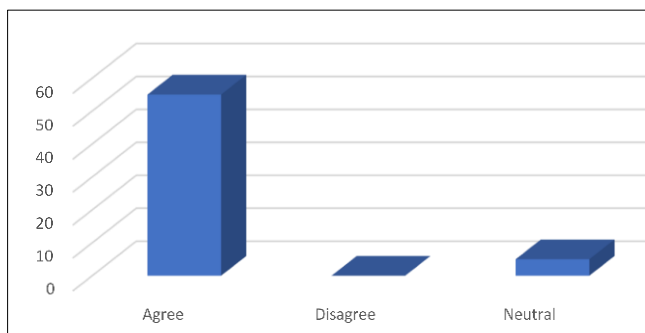


Fig 7: Tax automation and minimizing contact between tax man and tax payer would increase voluntary contribution

Figure (7) explained that the research questions is based on this item that, either tax automation and minimizing contact between tax man and tax payers would increase compliance or not. The results exclusively indicate that tax automation and reducing contact gap between authorities and citizens would result better compliance and hence higher tax collection is possible (Zaidi chairman FBR-DAWN).

Conclusion and Recommendation

The main objective of the studies to analyzing socio economic factors that alter the level of tax collection and compliance. Designing slippery slope framework with the help of economic deterrence theory and neoclassical theory of homo-economicus it is concluded that both social psychological and economic factors play an intimate role in encouraging tax compliance. A system will not collect taxes efficiently to finance the provision of public goods and services unless it improves its tax system and build trust of its citizens' civic and tax sentiments and to a fundamental attitude with regard to problems of their state. The findings of the study shows that tax system in Pakistan must focus on building trust between tax man and tax payer and ensure no corruption in tax burden distribution and assure that taxes are used for public betterment expenditures and projects. The most robust findings reported in empirical studies should be analyzed with the aim of developing a tax system which fosters compliance and reduces the distance between taxpayers and tax authorities. In the tax collection political stability is the main hurdle so government should need to focus on law and order situation, to incentivize the tax filer through varies incentives and tax polies should be easy for tax payers, to discourage tax evasion through check and balance on their bank account and other finical activities.

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