The Institute of
Chartered Accountants
of Pakistan

PROPOSALS FOR THE FEDERAL BUDGET
2012-13

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Dawn of a new Era

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PRESIDENT'S NOTE

The Institute of Chartered Accountants of Pakistan is pleased to submit this memorandum, containing ICAP's proposals to the Federal Board of Revenue (FBR) and the Government of Pakistan for their consideration while formulating Budget and the Finance Bill for the year 2012-13.

The Institute and its relevant committee have been constantly making efforts to identify areas where reforms are needed; to broaden the tax base, remove ambiguities in tax laws, and to simplify the process for tax payers. The suggestions contained in this document have been diligently formulated, with a view to augment tax collection without making any undue burden on the existing tax payers.

There is dire need to inculcate an atmosphere where the nation voluntarily complies with the tax laws. This can only happen once the complexity of the collection system is removed, and taxpayers' faith is restored in the administration. It is high time that we carry out our obligations to the society and to the nation. Tax base can only be increased when the tax payers have faith that government spending are for their benefit.

It should also be remembered that the amount of collection in tax revenue depends upon the general prosperity of the average population i.e. higher the economic activity higher will be the collection and vice versa. We, therefore, cannot only depend on changes in tax laws for increase in tax revenue - Government needs to take steps simultaneously to redress major reasons of the economic slowdown which besides the law and order situation include power shortages and fuel prices.

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The efforts of Mr. Saqib Masood, Chairman and the members of the Committee on Taxation, are highly appreciated for their hard work and invaluable input in developing these proposals.

Rashid Rahman Mir
President

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FOREWORD

The economic downturn and the resultant feeling of despondency have seized the whole nation. The overall sense of gloom is augmenting due to lack of vision and foresight by the decision makers.

I strongly feel that the first step to take for getting out of this vicious cycle is tax reforms. The economy needs infusion on immediate basis. The easy way out is to increase tax collections; not by increasing the tax rates, but through harmonization of existing rates, and by increasing the tax base. The need of the day is that all segments of society should contribute evenly in building the nation.

With this view in mind, the following proposals have been formulated by the committee to assist the Government of Pakistan. I must congratulate the Committee on Taxation members for their support and hard work in putting up these recommendations.

I am optimistic and trust that the Federal Board of Revenue will give due consideration to these proposals in developing the Finance Bill 2012-13.

Shaikh Saqib Masood
Chairman Committee on Taxation

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KEY RECOMMENDATIONS

BROADENING TAX BASE

- Amnesties, presumptive taxation, fixed tax and minimum tax regimes have proven to be counter-productive for documentation of economy.

  It is proposed that statutory restrictions be placed on announcement of such scheme and gradual withdrawal of existing schemes available under present tax laws.

Direct taxes

- Persons not enrolled in tax, maintain bank accounts and are engaged in sale and purchase of properties and vehicles, making air travels, paying utility bills, school fees, club memberships, and stay in hotels etc. for which they are required to produce their CNIC number.

  It is proposed that appropriate amendments be made in the relevant laws, including taxation laws, to make it mandatory to provide NTN / CNIC for specified transactions and such transactions be reported to the FBR to be matched with NTN data base to identify tax evaders. [2.2.2]

- The country is no doubt in dire need of foreign exchange. Accordingly, the tax laws were armed with section 111 providing immunity to the source of foreign remittances for tax purposes. However, it is generally believed that this facility has grossly been misused for whitening of untaxed income earned within Pakistan.

  It is proposed that appropriate checks and balances may be introduced, i.e. prescribing maximum immunity threshold, to discourage the trend of whitening of untaxed income under section 111. [2.1.12]

- Though agricultural income is exempt from income tax; trading in agricultural produce is not. The trading of agricultural produce is generally carried on by commission agents through various '*mandis*' managed through market committees, who grants / renew licenses of these agents.

  To bring this segment into the tax net, it is proposed that Market Commission Agent registered with Market Committees, dealing in agricultural produce, be subject to tax. As a first step, fixed tax may be introduced, payable at the time of renewal of their licenses. [2.2.9]

- There is a large size of black economy which gets its way into the real estate sector and does not contribute anything to the national exchequer. These real estate investors are involved in buying and selling of property on regular basis but escape taxation by taking advantage of vagueness in law.

  It is proposed that a deeming provision be added for defining a transaction of sale of immoveable property to be treated as an adventure in the nature of trade and any buying and selling thereof within a period of 4 years should be treated as income from business and charged as a separate block of income. [2.2.10]

Indirect taxes

- The menace of undocumented economy and *benami* business is the root cause of our economic ills. It is imperative to put a strong barrier against such trend.

  It is proposed that concept of withholding of sales tax be re-introduced, as was done earlier on trial basis in 2009, with appropriate precautions and corrective measures for difficulties faced earlier [3.1.1]

- Present rate of 16% General Sales Tax is a bottle-neck in inducing people to come within tax net at one hand, and is also contributing to inflation on the other hand.

  It is proposed that the general rate should be rationalised over a suitable period of time, keeping in view our peculiar business environment.

- Pakistan is faced with two fundamental menaces in relation to implementation of import duty structure; smuggling including abuse of Afghan Transit Trade and under invoicing.

  It is proposed that there should be quantitative ceiling for imports required for Afghanistan and there should be a mechanism to collect duty at import stage to be refunded on confirmation of passage from Pakistan. [3.5.3]

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POLICY MATTERS

Direct taxes

- The applicable corporate tax rate of 35% appears high in comparison to the rates of 25-28% applicable in the region. Prevalence of parallel final tax system distorts the comparative taxation of businesses which are organized and generally subject to normal tax. Further, lower tax rate applicable to individuals and association of persons is also an obstacle in corporatization.

  It is therefore proposed that the corporate tax rate be reduced gradually to a range between 25 – 28% to provide competitive edge in the region and to induce corporatization which would also help in broadening of a tax base. [2.1.1]

- Salaried individuals are taxed on their gross salary income without any deduction. It is generally noted that the salaries are not increased in line with inflation; hence, salaried persons are more affected due to reduction in purchasing power.

- To compensate, it is proposed that salaried persons be allowed tax credits for educational and utility expenses [2.1.3]

- Association of persons have been subject to progressive taxation since long. Through the Finance Act 2010, progressive taxation was abolished and uniform rate of 25% was prescribed without any threshold. This situation puts the association of persons in disadvantageous position.

  It is therefore proposed that tax rates for association of persons, which are statutorily barred from corporatizing be brought in line with individual's tax rates by re-introducing progressive taxation. [2.1.4]

- In 90's, minimum tax at 0.5% on turnover was introduced with an objective that primarily the corporate sector should pay at least 0.5% of their turnover in tax, despite the fact that this was against the basic principles of income tax. In 2008, minimum tax regime was abolished but re-introduced in 2009 with an increased rate of 1% which is burdensome for low margin businesses.

  It is therefore proposed that the rate prevailing over two decades i.e. 0.5% be restored. [2.1.6]

- Final tax regime has, in fact, proved to be counter-productive for documentation of economy.

  It is proposed that final tax regime may be gradually phased out. As a first step, presumptive taxation for corporate sector be substituted with minimum tax, allowing for unadjusted balance to be carried forward and adjusted against tax on taxable profits for subsequent years. [2.1.7]

- The net value of investments made through foreign currency gets diluted due to devaluation. This is generally considered as a major obstacle in attracting foreign investments.

  It is proposed that the foreign investments should be taxed after allowing indexation (for appreciation / depreciation) of Pakistan Rupee in line with best international practices. [2.1.9]

- Pakistan has great potential for export of services which is a source of foreign exchange earnings and providing employment within Pakistan.

  In order to attract setting up service centres in Pakistan, export of services be exempted from tax or alternately be equated with export of goods. [2.1.18]

- Withholding agents are obligated to deduct / collect tax from payments, deposit it in Government treasury, report such taxes to the FBR, and then get audited. To accomplish these responsibilities, withholding agents need to incur substantial time and cost, without any compensation.

  It is proposed that appropriate compensation be awarded to withholding agents performing state duties. [2.1.19]

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Indirect taxes

- Services rendered, initiated or consumed in the Province of Sindh are being taxed under the Provincial law. There are certain overlapping situations under the Federal and provincial laws e.g. admissibility of Sindh Sales tax on services for refund claim with FBR.

  It is proposed that FBR and Sindh Revenue Board should agree upon legal framework and thrash out the legal and procedural impediments. [3.2.2]

- Whitening Schemes announced from time to time have encouraged the trend of under / over invoicing issues and promoting remittances through *hundi / hawala*, depriving the exchequer with its due revenue. Also, immunity from audit to the commercial importer also encourages misdeclarations.

  It is proposed that value addition tax / minimum tax regime should be abolished and immunity from audits be withdrawn. [3.2.3]

- Input tax credit is not admissible to the registered person if the corresponding output tax is not paid by the supplier. In recent times, frivolous cases have been witnessed when the FBR web portal was unable to cross match the output tax in the returns of seller and corresponding input tax in the return of buyer.

  It is proposed that standard operating procedures be designed to cater for issues relating to cross verification of claims. [3.3.5]

- Under section 8A of Sales Tax Act, 1990, a registered person purchasing goods is jointly and severally liable if the sales tax is not paid by the seller of the goods. It is quite unjustified to punish a genuine buyer by disallowing genuine input tax for an offense committed by another person.

  The Institute believes that Section 8A is against the law of natural justice where a person is punished for an offense which he has not committed. Therefore, it is strongly recommended that the provision of Section 8A should be amended to provide protection to registered buyer, in case(s) where compliance of Section 73 of the Act has been duly made. [3.3.6]

- Under section 6 of Federal Excise Act, 2005, FED is adjustable only if the registered person holds a valid proof to the effect that he has paid the price of goods purchased by him including FED and received the price of goods sold by him including FED through banking channels. The condition of payment and receipt is creating problems for the taxpayers.

  It is, therefore, proposed that FED should be made adjustable on accrual / paid basis as per section 7 of Sales Tax Act 1990. Further the duty adjustment should not be made subject to receipt of sale proceeds and related duty.

- Present structure of customs duty supports promotion of trade in commodities rather than manufacturing the same in Pakistan, putting local manufacturers on disadvantageous pedestal.

  It is proposed that customs duty structure be reviewed afresh to facilitate promotion of local manufacturing industry. [3.5.1]

Others

- Appeals at Appellate Tribunal are generally adjudicated by a Division Bench comprising of Judicial Member and Accountant Member. An officer of FBR is appointed as an Accountant Member for specific period.

  In order to provide professional resources, it is proposed that Chartered Accountants with at least 10 years of experience in tax practice be appointed as Accountant Member of the Appellate Tribunal [2.3.3]

- Penalty provisions on delay / failure to file return of income etc. contained in section 182 on the basis of tax liability instead of tax payable (i.e. tax liability reduced by tax payments already made) is creating hardship and an impediment in inducing non-taxpayers. Further, levy of penalty for not filing of withholding statements with reference to tax liability of a person is contradictory to law

  It is proposed that penalty for non filing of tax return be imposed on the basis of net tax payable and the explanation inserted vide the Finance Act 2011 should be abolished . It is also recommended that penalty for non filing of withholding statements u/s 165 existed before the Finance Act 2011 be restored. [2.4.11]

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DIRECT TAXES

2.1 TAX POLICY

2.1.1 RATE OF CORPORATE TAX AND REGIONAL COMPARISON

As a measure of policy, the rate of Corporate Tax was substantially reduced over the decade. This is a correct policy. Rate of income tax for all corporate entities is now 35 percent, which requires reconsideration after taking into account the following factors:

2.1.1.1 Regional comparison with the economies having characteristics similar to Pakistan

The present Corporate Tax rate of 35 percent is the highest in the entire region. China, which provides reasonable opportunities for the establishment of manufacturing sector, operates with the rate of tax of around 15 to 20 percent. This is effectively a disincentive to multinational groups for locating their manufacturing base in Pakistan. India, Bangladesh, Malaysia and Thailand have also brought down their corporate rate of tax to around 30 percent.

There are, even, cases where the rate has been brought down to 25 to 28 percent. This level is by and large in line with almost all the OECD member countries where the rate of corporate tax is around 28 percent.

UAE presents another extreme where there is, effectively, nil corporate tax. The rate of corporate tax throughout the developed world has been brought down below 30 per cent.

Pakistan is a place where income is taxed at a substantially higher rate than the rate applicable to head office of a multinational group. This is considered a bad omen for tax planning.

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2.1.1.2 The effect of presumptive taxation system on the general corporate taxation

In Pakistan the concept of presumptive taxation is also in place. Prevalence of such system distorts the comparative taxation of such businesses which are organized and generally fall under the normal taxation system.

2.1.1.3 Effect of a lower tax rate for other entities

In Pakistan a reduced Corporate Tax rate of 25% is applicable for small companies and Association of Persons and for Individuals at slabs with maximum rate of 25%.This differential is discouraging expansion of companies and conversion of businesses from association of persons and individual to an organized and documented corporate structure.

2.1.1.4 Cost of doing business

Corporate sector being a withholding agent has to incur a huge cost to maintain and submit the details of the tax collected or deducted at source. Further the corporate sector also has to bear the extra burden of the amount of tax collected or deducted at source towards the cost of purchases and expenditures.

Recommendations:

The rate of corporate tax for Public and Private Companies in Pakistan should be gradually reduced to bring it at par with other competitive economies and to provide incentive for formation of organized and documented sector.

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2.1.2 NON-SALARIED INDIVIDUALS' TAX RATE

Discrimination of salaried and non-salaried persons by providing separate tax rates is against the norms of personal taxation. This clearly indicates that the law itself admits that non-salaried persons understate their income.

It is very odd that:

- A salaried person attracts the maximum tax rate of 20% where the income exceeds Rs. 4,550,000 as compared to a non-salaried person who attracts the maximum tax rate of 25% where the income exceeds Rs. 1,500,000;
- A salaried person is allowed a marginal relief where the income marginally exceeds from a particular slab of income and tax thereon whereas a non-salaried person is not allowed any such relief.

Recommendations:

- Huge gap in maximum tax rate should be narrowed by expanding the non-salaried tax bands so that the maximum tax rate of 25% starts at least for income above Rs. 3,000,000.
- Non-salaried individuals should also be allowed to claim marginal relief where the income marginally exceeds from a particular slab of income and thereon.

2.1.3 SALARY TAXATION - RATE AND BASIS OF CALCULATION

The general rate of personal taxation has been brought down over the years, however, on account of abolition of exemption for non-taxable perquisites the effective rate has remained almost the same. Even in the past there were very few cases where effective rate exceeded the maximum rate of 20 percent.

All the progressive tax regimes provide possibilities for tax planning for personal taxation if the same is in line with the overall economic priorities of the government. Such opportunities are provided by way of:

- availability of investment allowance for equity investment; and
- tax credit for interest on house mortgage, etc.

However, this needs to be rationalized by providing incentives for certain personal expenditure. In Pakistan, there is a need to incorporate planning mechanism that simultaneously encourages documentation and assist in bringing untaxed services sector into tax net. This requires introduction of 'tax credit' against personal taxation on submission of evidences of expenses incurred on education of children and Utilities.

Such a credit will provide incentive for the user of such services in obtaining evidences for payments. That will in turn induce the recipient to be within the documented sector. Like other measures, this system had also been introduced in the past. However, due to procedural difficulties and lack of will by the tax executives, positive results could not be achieved.

Recommendation:

Tax Credit for personal expenditure on education of children and utilities should be introduced with the only condition of submission of evidence of payment with full particulars of the payee.

2.1.4 ASSOCIATION OF PERSONS

Through Finance Act, 2010, tax at a flat rate of 25% without any "zero" tax rate threshold was introduced w.e.f. tax year 2010 for an association of persons as against the incremental slab rates with "zero" tax threshold for income of Rs.100,000 earlier applicable. This move is supposed to serve as an incentive to convert an association of persons to a corporate structure.

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In fact, the incentive to convert an association of persons to a corporate structure is further strengthened in terms of effective tax rate since a 'small company' is entitled to deduct Directors Remuneration/Salary in determining the taxable income and reducing effective tax rate on taxable income before such deduction, whereas an 'association of persons' is not entitled to deduct the Partners/Members Remuneration/Salary and will be subject to an effective tax rate of 25%.

However, small and medium sized association of persons which for many other reasons could not convert to a corporate structure and association of persons of professionals like engineers, architects, lawyers, chartered accountants, doctors, etc. which by their governing statute are not permitted to carry on the profession in a corporate structure are hard hit by this abrupt increase of flat rate of tax of 25% on taxable income as is evident from the following table:

Taxable income	Tax payable		Increase	
	Before amendment (Rupees)	After amendment (Rupees)	Amount	Percentage
100,000	Nil	25,000	25,000	Infinite
110,000	550	27,500	26,950	4,900%
125,000	1,250	31,250	30,000	2,400%
150,000	3,000	37,500	34,500	1,150%
175,000	5,250	43,750	38,500	733%
200,000	8,000	50,000	42,000	525%
300,000	15,000	75,000	60,000	400%
400,000	30,000	100,000	70,000	233%
500,000	50,000	125,000	75,000	150%
600,000	75,000	150,000	75,000	100%
800,000	120,000	200,000	80,000	67%
1,000,000	175,000	250,000	75,000	43%

Recommendations:

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Rationalizing of this abrupt increase in tax rate by introduction of incremental ax rates to cater for small and medium sized association of persons;

Re-introduction of the concept of no tax on the association of persons of professionals by restoring the amendments and omissions made in section 92 and 93 through Finance Act, 2007 to cater for the association of persons of professionals which by their governing statute are not permitted to carry on the profession in a corporate structure;

Alternatively, Salary paid to the members of association of persons of professionals should be made tax deductible expenditure by making suitable amendments in section 21(j).

2.1.5 SMALL COMPANY

The benefits of a small company are available to only those companies which are incorporated on or after July, 01, 2005. This has placed small companies formed earlier at a disadvantageous position to meet the tax differential of 10%.

The concept of 'Small Company' was introduced in 2005 with a reduced rate of tax and exemption from being a withholding agent under section 153 of the Income Tax Ordinance, 2001 as applicable to the non-corporate sector, in order to provide an incentive for businesses conducted in the status of 'individual' and 'association of persons' to convert themselves into corporate structure and be a part of organized and documented sector without any tax burden.

Later, the exemption from being a withholding agent in case of small company was withdrawn and associations of persons / individual with turnover exceeding fifty million rupees were also made a withholding agent under section 153.

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The incentive for converting an association of persons to a corporate structure has been further strengthened with the introduction of flat rate of tax of 25% on taxable income of an association of persons without any deduction on account of partners/members remuneration as against an effective lower tax rate available to a small company by way of deduction of directors' remuneration.

At present the only disadvantage for converting an association of persons to a corporate structure is the threshold of the turnover of 50 million available to an association of persons for the purposes of withholding tax under section 153.

Recommendations:

- The benefit of small company be extended to companies incorporated before July 01, 2005; and
- Small Company to be brought at par with an association of persons and individuals by providing the threshold of turnover of Rs. 50 million for the purposes of withholding agent under section 153.

2.1.6 MINIMUM TAX (TAX ON TURNOVER) - SECTION 113

Minimum tax on turnover was introduced in 1991 with an idea that certain persons should pay tax irrespective of their tax liability at half percent of their turnover. The minimum tax rate remained at half percent of the turnover until 2009. Through Finance Act, 2010 the rate of minimum tax under section 113, was raised from 0.50% to 1.00% and made applicable on certain individuals and association of persons in addition to a company.

The rate of 1.00% minimum tax is very high and results in financial hardships to the taxpayer especially in the current scenario where there are frequent power outages and deteriorating law and order situation in the country. As a result there businesses are struggling to operate even at break-even point. Further, the scheme of minimum tax incorrectly envisages that no business can sustain loss and there should always be a minimum taxable income margin of 2.85% to 4% of turnover in the case of companies and AOPs respectively.

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Recommendations:

- Minimum tax rate should be reduced to 0.5%.
- Please see our alternate proposal under Para 2.2.8

2.1.7 PRESUMPTIVE TAXATION

Presumptive Taxation Regime (PTR) introduced in 1990 is another dogma that needs a serious policy review for a sustainable growth in tax base.

There is unanimity of the view that policy framework for PTR was in principle, introduced to cater for certain negative aspects of Pakistani tax culture. These aspects were:

- Effectively no tax contribution by certain sectors which resulted in a view that at least a minimum presumptive sum be taxed; and
- Withholding taxation with normal taxation necessarily requires refund, if the tax liability determined on net income basis is less than tax withheld. There were serious abuses of refund provisions. Accordingly, checks to that effect were introduced by way of PTR.

Nevertheless, this was not a sustainable model. It was a 'stop-gap' arrangement. There was a need to incorporate and institute provisions which would check aforesaid abuses. Over a period of more than two decades concrete measures have not been adopted to curb the abuses that led to introduction of PTR. Accordingly, PTR has continued and in certain cases it is being promoted.

An effective tax system can only work where there are identical tax procedures and processes for the same kind or nature of business activities. Furthermore, there has to be no discrimination in incidence by one sector over the other. PTR disturbs both these aspects. There is a need to review PTR in that context.

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Recommendation:

As a transitional measure, for all corporate taxpayers current final tax regime should be converted into minimum tax, with facility to carry forward such minimum tax for immediate five succeeding tax years to adjust against tax liability determined on taxable income.

Alternatively, the corporate sector be given option to opt out from presumptive taxation.

2.1.8 TAXATION OF INCOME OF CERTAIN RETAILERS - SECTION 113B

Through Finance Act, 2010 the rate of tax on retailers being an individual or an association of persons having turnover upto Rs. 5 million was raised from 0.50% to 1.00% by amendment in Division IA of Part I of First Schedule.

However, under section 113B, the rate of tax on retailers having turnover of more than Rs. 5 million and registered under the special procedure for payment of sales tax continues to be 0.5% on turnover upto Rs. 10 million and 0.75% for the turnover in excess of Rs. 10 million.

Recommendation:

In Section 113B in the table in column 3 against serial number 1 the figure "0.5" should be substituted by "1.00" and against serial number 2 the figure "0.75" should be substituted by "1.25".

2.1.9 TAX ON CAPITAL GAINS (SECURITIES) - IN CASE OF NON-RESIDENT PERSONS

There is a need to rationalize the regime for taxability of capital gains in case of a non-resident person. Tax on capital gain should be calculated after allowing indexation for devaluation of Pakistani Rupee, if any. Similar treatment is also provided in section 48 'Mode of computation' of Indian Income Tax Act 1961, as follows:

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"The Income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely:

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto:

Provided that in the case of an assessee, who is a non-resident, capital gains arising from the Transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so however, that the aforesaid manner of computation of capital gains shall be application in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an India company…….."

Recommendation:

In case of a non-resident, tax on capital gain should be calculated after allowing indexation for devaluation of Pakistani Rupee, if any.

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2.1.10 PERQUISITES - SECTION 13(7) AND EXEMPTION OF PERQUISITES - CLAUSE (53A) OF PART I OF SECOND SCHEDULE

2.1.10.1 Taxation of Notional Income

Under sub-section (7) of section 13 of the Income Tax Ordinance, 2001 the difference between the benchmark rate and the actual rate of interest charged (where actual rate of interest is less than the benchmark rate) by the employers on concessionary loans provided to the employees is treated as perquisite chargeable to tax.

This is not a significant source of revenue for the Government on the one hand and very rigid piece of legislation on the salaried taxpayer on the other hand who are hard hit by the present economic situation. The taxation of this notional income is highly unjust since it taxes the notional income of the salaried person which is against the basic principle of taxation since this notional income will never ever be received by the taxpayer. Similar notional income in the hands of employees of airline, transport, educational institutions, restaurants, hospitals, clinics etc. is already exempt under clause (53A) of Part I of Second Schedule.

Recommendations:

- The taxation of marginal income on loans obtained from the employer below Benchmark rate should be exempted by making necessary amendments in clause (53A) of the Part I of the Second Schedule and by deleting sub-section (7) of Section 13; or
- Alternatively a minimum threshold of the loan amount should be specified on which the provisions of Section 13(7) would be attracted e.g. loans exceeding the limit of Rs. 2.5 million.

2.1.10.2 Exemption of mortgage loans (Alternate to above)

The rationale underlying this proposal is that:

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(a) Only mortgage loans will be exempted from the applicability of Section 13(7) of the Ordinance whereas all other concessionary loans like auto loans, personal loans will continue to be taxed on the difference between the actual and the benchmark rate;

(b) It will boast the housing industry since in today's economic situation and the presence of speculators in the property market it is next to impossible for a salaried employee to own a house on commercial mark up rates. Once this industry takes off there will be provision of cheap houses and there will be increase in tax revenue from housing and allied sector;

(c) it will contribute in enhancing the national economic activity by extending affordable loans and advances to middle class income group of society;

(d) It will remove detrimental financial ramifications due to incremental rate of interest on notional income for all other salaried persons, who are already facing a tough challenge to survive within their paltry resources- all legally declared and tax paid;

(e) The FBR is also cognizant of this fact by stating in Clause (53A) that "any other perquisite or benefit for which the employer does not have to bear any marginal cost; and the Circular Letter 4(8)IT-J/91 dated June 30, 1991 issued by then CBR opines that "…it is not desirable to tax such notional income…". The same principle should be applied in this situation.

Recommendation:

Alternatively at least the mortgage loans be exempted from the operation of section 13(7) of the Income Tax Ordinance, 2001.

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2.1.10.3 **Bench Mark Rate**

The Bench mark rate, in terms of sub-section (7) of Section 13 started from 5% in tax year 2003 and is presently 14% [will become 15% w.e.f July 1, 2012]. There is no logic behind such irrational / arbitrary increase in benchmark rate by 1% every year.

Recommendation:

The Benchmark rate should be fixed now at 10% for the year 2012-2013 and onward.

2.1.11 FOREIGN LOSSES - SECTION 104(2)

According to section 104(2) 'the foreign losses' are to be carried forward to the following tax year and set off against the foreign source of income chargeable to tax under that head in that year. As a result foreign loss sustained by resident taxpayer is not adjustable against the local income, which is un-realistic and against the concept of taxing global income.

In the repealed Income Tax Ordinance, 1979 there was no such restriction and foreign losses sustained by a resident could be set off against local income.

Recommendation:

The restriction of set off of foreign losses against subsequent foreign income needs to be removed.

2.1.12 INCENTIVES TO EVADE TAXES

Improvement of tax base essentially requires abolition of any discrimination between taxpayer with adequate penalties for the delinquents but in Pakistan the situation is on the contrary. There are two policy features favouring the delinquents:

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- **Whitening the untaxed money by abusing the various provisions of the law such as 'inward foreign remittance'**

  By virtue of clause (a) of sub-section (4) of Section 111 of the Income Tax Ordinance, 2001 a taxpayer does not have to offer explanation about the nature and source of any amount of foreign exchange remitted from outside Pakistan through normal banking channels.

  The above-mentioned sub-section though promotes inflow of foreign exchange remittances towards the country; however, the same provision is being largely misused to incorporate the untaxed income. Moreover, the provision is also refraining persons from being enrolled /included in the tax net and making true and fair declaration of income.

  It will be appreciated that why would someone like to pay tax at the rate of 20% to 25% when this permanent route of amnesty is available at a cost of around 2%.

- **Regular and persistent system of official whitening of money by way of 'Tax Amnesty Schemes'**

  Such schemes provide complete amnesty for all defaulted liabilities on payment of a very nominal sum. In the case of indirect taxes, there are almost regular amnesty schemes for delinquents. This places the taxpayer community in an embarrassing position.

  The existence of section 120A on the statute book, granting a perpetual power to the Federal Board of Revenue to make such schemes, is a best remedy available and temptation for delinquent taxpayers and discouragement for compliant taxpayers.

These policies encourage the unorganized sector to continue with the present setup. In this situation, the documented and organized sector suffers both in financial terms as well as culturally for the reason that such measures reflect a sign that system will continue to prevail and there is no need for a positive shift.

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Recommendations:

Section 111(4)(a) of the Income Tax Ordinance, 2001 should be abolished or alternatively a maximum threshold of immunity may be atleast be prescribed to stop unchecked whitening of funds;

Section 120A of the Income Tax Ordinance, 2001 should be deleted; and

Policy decision be taken that in future, no Tax Amnesty Schemes shall be offered.

2.1.13 PAYMENTS FOR GOODS AND SERVICES - SECTION 153(3)

Rendering of or providing of services subject to deduction of tax at source by the non-corporate sector has been excluded from the ambit of final tax and instead tax deducted at source has been made the minimum tax.

The initiative of restricting the presumptive tax/final tax regime is in line with the earlier recommendations of the Institute and is appreciated.

However, the concept of 'minimum tax' is against the norms of taxation of income and indirectly tantamount to the continuation of presumptive tax regime. This concept to secure the revenue, to start with, is understandable but also needs to be progressively phased out.

Professional service providers, who by their governing statutes are not allowed to get themselves incorporated, is a class of taxpayer for consideration for exclusion from the 'minimum tax' concept.

Recommendation:

Like corporate sector, professional service providers, who by their governing statutes are not allowed to get themselves incorporated, should also be excluded from the ambit of 'minimum tax' concept. Alternatively, such persons should be allowed to carry forward such minimum tax for next five tax years and adjust against their tax liability on taxable income.

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2.1.14 INCOME FROM PROPERTY - SECTION 15, 155 AND 169 AND CLAUSE (a) OF DIVISION VI OF PART I OF FIRST SCHEDULE

2.1.14.1 **Exclusion from fixed tax regime**

The Institute is of a firm view that presumptive/final/fixed tax regimes are distortion to our taxation system.

Income from property is another area for active consideration f bringing back to the normal tax regime (i.e., prior to the amendments made through Finance Act, 2006 & 2010) and to start with organized and documented corporate sector is a best fit.

Recommendation:

Income from property of the corporate sector should be excluded from the presumptive/final/fixed tax regimes.

2.1.14.2 **Exemption threshold - Section 15(7) and Division VI of Part I of First Schedule**

Income from property with a gross rent not exceeding Rs. 150,000 is not chargeable to tax under section 15(7) in the hands of an individual or an association of persons where such taxpayer does not derive taxable income under any other head. This threshold of Rs. 150,000 was fixed when the "zero" tax rate threshold for individuals and association of persons was Rs. 100,000 after giving 50% margin for expenses against the gross rent.

Through Finance Act, 2010 the "Zero" tax rate threshold for individuals was increased to Rs. 350,000 and for the associations of persons such threshold was abolished. However, in sub-section (7) of section 15 the corresponding change was not made which is an inadvertent anomaly.

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Recommendations:

- In clause (i) of sub-section (7) of section 15 the words "or association of persons" should be omitted;
- In clause (ii) of sub-section (7) of section 15 the figures "150,000" should be substituted with the figures "450,000";
- In clause (a) of Division VI of Part I of First Schedule the words "and association of persons" should be omitted; and
- In clause (b) of Division VI of Part I of First Schedule after the word "company" the words "and association of persons" should be inserted.

2.1.14.3 **"Zero" tax rate threshold - Division VI of Part I of First Schedule**

The existing rate card for Income from property under clause (a) of Division VI of Part I of First Schedule (applicable to an individual and association of persons) and section 15(7) are contradictory.

According to section 15(7), the exemption is available if the property income (gross rent) does not exceed Rs. 150,000 and the taxpayer has no other taxable income under any other head. Contrary to this under clause (a) of Division VI of Part I of First Schedule the exemption by way of "zero" tax rate is available even if the:

- property income exceeds Rs. 150,000; or
- taxpayer has taxable income under any other head and income from property (irrespective of the quantum of property income).

Recommendation:

The rate card under clause (a) of Division VI of Part I of First Schedule be substituted as under (subject to recommendation under the preceding Sub-Para):

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S. No.	Gross amount of rent	Rate of tax	
		where the taxpayer has no other taxable income under any other head	Where the taxpayer has taxable income under any other head
(1)	Where the gross amount of rent does not exceed Rs.150,000	Nil	5 per cent of the gross amount
(2)	Where the gross amount of rent exceeds Rs.150,000 but does not exceed Rs.400,000	5 per cent of the gross amount exceeding Rs.150,000	Rs.7,500 plus 5 per cent of the gross amount exceeding Rs.150,000
(3)	Where the gross amount of rent exceeds Rs.400,000 but does not exceed Rs.1,000,000	Rs.12,500 plus 7.5 per cent of the gross amount exceeding Rs.400,000	Rs.20,000 plus 7.5 per cent of the gross amount exceeding Rs.400,000
(4)	Where the gross amount of rent exceeds Rs.1,000,000	Rs.57,500 plus 10 per cent of the gross amount exceeding Rs.1,000,000	Rs.65,000 plus 10 per cent of the gross amount exceeding Rs.1,000,000

2.1.15 EXEMPTION TO MUTUAL FUNDS - CLAUSE 99 OF PART - I OF SECOND SCHEDULE

Clause 99 of Part I of Second Schedule exempts 'mutual funds' income provided 90% or more of its accounting income for the year is distributed. For this purpose, the accounting profit shall be reduced by capital gains, whether realized or unrealized.

This results in a situation where the unrealized income booked in the accounts on account of measurement of the investment on mark-to-market basis (in compliance with IAS 39 and IAS 40) and ultimately distributed to the unit holders.

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This provision has in fact restricted the growth of mutual funds and has resulted in decrease in dividend payout by mutual funds over the period. We believe that any accounting income which is not realized should not be considered for distribution.

To avail this exemption, the mutual funds resorted to short term investments in share market while other avenues of investment remained untapped.

Recommendation:

To amend clause 99 of Part - I of Second Schedule by adding the highlighted words as follows:

> *"Any income derived by a mutual fund or ……………………., if not less than ninety percent of its accounting income of that year, as reduced by realized capital gain* ***and adjustments made on account of application of International Accounting Standards 39 and 40****, is distributed amongst the unit or certificate holders or shareholders as the case may be:"*
>
> **Note:** The proposed amendment is in line with Clause (g) of Rule 1 of the Seventh Schedule

2.1.16 INTER-CORPORATE DIVIDENDS-CLAUSE (103A) OF PART-I OF SECOND SCHEDULE

Group taxation necessarily requires elimination of inter-corporate dividend taxation. This matter has been taken care of in the present law. However, it appears that like other positive measures this issue is not being properly implemented. Since the insertion of clause 103A in Part I of the Second Schedule virtually no group structure has practically evolved inspire of dire need and desire for the same by many existing and emerging business groups. This has happened on account of problems relating to inter-corporate dividend. In practical sense, no industrial group will endeavour to switch to holding company structure unless there is a clear position with regard to no taxation on inter-corporate dividend.

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In order to remove this anomaly in the taxation of dividend in the hands of the company, it has been recommended by the Institute in the past as well that dividend received by resident companies be exempted from tax as this is dual taxation in the hands of the holding company and then the ultimate shareholders.

Recommendation:

Exemption granted to inter-company dividends under clause 103A of Part I of the Second Schedule should be extended to inter-corporate dividends received by all resident companies instead of the present exemption to only group companies entitled to group taxation under section 59AA.

2.1.17 LIMIT OF EMPLOYER'S CONTRIBUTION TO PROVIDENT FUND - CLAUSE (3) PART I OF SIXTH SCHEDULE

Through Finance Act 2008, the employer's contribution in the recognized provident fund in excess of Rupees one hundred thousand (Rs.100,000) is deemed to be Income of the employee. This matter has importance since employer contribution, though a constructive receipt is not an actual receipt as the same is not at disposal of an employee and therefore tax incidence should not be levied at the time of contribution. Further, where such Fund is recognised under income tax laws, the payments from the fund to the employee (which include employer’s contribution) are exempt under clause 23 of Part I of Second Schedule to the Ordinance. Therefore, it is illogical that when an amount is ultimately exempt, it is taxed at the time of contribution. It is suggested that ceiling of rupees one hundred thousand may be withdrawn as in many case this is the only long term benefit.

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Further taxation of salary income is permitted by section 12 on receipt basis only, therefore in the event that there is an excess contribution to an employee above Rs. 100,000 how would that be taxed in the hands of an employee as he would not be receiving that contribution rather the contribution will be credited to the Fund who will pay to an employee when he retires or resigns from service. Further, the employer's contribution can be withheld by the employer in the case if employee is charged with misconduct. Due to such eventuality, it is only at the time of retirement or resignation that one can say with certainty that the employer's contribution would be received by the employee.

Recommendation:
Due to multiple complications, the ceiling of Rs. 100,000 should be withdrawn.

2.1.18 EXPORT OF SERVICES

Exports whether of goods or services are the back bone of any economy and particular of developing economies. Pakistan is no exception to this fact and our policy thrust is to enhance the exports to its optimum levels.

Export of goods and export of services are for all practical purposes more or less the same. In both cases all the related activities of producing the goods and generating of services originate from Pakistan and earn valuable foreign exchange for the country.

Currently, only Information Technology related services are recognized by providing exempt ion of income from export of such services. However, there are number of other services in particular professional services by Architects, Engineers, Chartered Accountants, etc. also needs to be recognized for promoting export of such services.

Recommendation:

To promote, encourage and incentivize export of services, it is proposed that this should be exempted like IT enabled services or alternately brought at par with taxation of income from export of goods.

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2.1.19 COMPENSATION TO WITHHOLDING AGENTS

Federal Board of Revenue has been availing the services of withholding agents free of charge for quite a long time. These withholding agents have been incurring heavy expenditure in the form of changes in their systems, hiring and training of their staff, storage for retention of withholding Tax records and similar operating expenses. They are also subject to tax audits of withholding taxes and then penalised for any default which at one hand puts thereon an additional cost.

Recommendation:

Withholding agents should be allowed to retain 10% of the amount of tax collected as service charges on the principle of natural justice.

2.1.20 EXEMPTION OF INCOME RECEIVED FROM ANNUITY OR ANNUITIES

Exemption of income received from annuity or annuities issued by a Life Insurance Companies registered under section 3 of the Insurance Ordinance were available through clause (21) of Part-I of second Schedule to the Income Tax Ordinance, 2001 which was withdrawn by Finance Act, 2008.

Pension received by an employee from its employer is exempt under clause (8), (9) and (12) of the Part-I of the Second Schedule to the Income Tax Ordinance, 2011. However, income received from an annuity, which is a kind of pension benefit remains chargeable to tax.

Logically, like pension, income received from an annuity should also be exempt from tax to safe guard the interest of senior citizens after reaching the retirement age.

Recommendation:
Income received from annuity upto Rs. 120,000 per annum after 60 years of age should be exempted from tax.

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2.2 DOCUMENTATION, RESOURCE MOBILIZATION AND BROADENING OF TAX BASE

2.2.1 GENERAL

Un-documented, cash and parallel economy is a menace to our entire taxation system. The major chunk of the state revenue is generated by few sectors of the businesses owned by National and Multi-National companies and corporations. The transport, wholesale, retail and professional services sector of the business has a very low contribution in the tax revenue as compared to their share in GDP.

Our direct tax laws need a major shift to curb his situation. Following are the examples of our existing laws that do not support documentation and resultantly the increase in tax base and resource mobilization:

- Final tax regime;
- Fixed tax or separate block of income;
- A very extensive withholding tax regime coupled with final tax, which has converted direct tax into indirect tax;

Another very significant area for major shift is facilitation of compliant taxpayers and penalization of non-compliant taxpayers. All our direct tax laws are day by day burdening the existing and compliant taxpayers. No measures are being taken to enforce the tax laws on the non-compliant taxpayers.

With this background following measures are recommended.

2.2.2 USE OF CNIC NUMBER

Generally, people who have not obtained National Tax Number and do not pay due taxes, participate in documented economy to meet their needs and comforts e.g. opening and maintaining bank accounts, placement of money in profit based securities, sale and purchase of properties and vehicles, air travels, utility bills, club memberships, credit cards, stay in hotels etc. For such needs, they are generally required to produce their CNIC Number. However, due to non-availability of data or lack of access to the available data, they could not be brought to the tax net. Accessing and developing data base on the basis of CNIC number can provide an opportunity to identify the non-tax payers to bring them into the tax net.

Recommendations

Appropriate amendments in the law should be made to make it mandatory to provide NTN on specified transactions e.g. transfer of property, transfer of vehicle, opening of bank account and to impose obligations on certain persons to provide periodical statements on the basis of CNIC Numbers e.g. air travel agents, hotels. Similarly, appropriate amendments could be made in banking laws to have access to the specified data of banks and financial institutions for the purpose of identifying non-taxpayers.

2.2.3 FINAL TAX, FIXED TAX AND SEPARATE BLOCK TAX REGIMES

In the last two years steps have been taken to reduce the scope of final tax, fixed tax and separate block tax regimes but a lot more needs to be done by abolishing and replacing the same with minimum tax concepts to start with. This will ensure documentation and payment of tax at the applicable rate on the consolidated taxable income instead of breaking in different regimes.

Income from property

The concept of taxing income from property as a separate block of taxable income should be done away. Deductions against the gross rent should be admissible only if actually incurred and that too subject to an overall threshold of 50% of the gross rent.

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Income from business - Commercial Imports

Commercial imports should be excluded from the final tax regime and the tax collected at import stage should be converted into a minimum tax to start with.

Income from business - Sale of goods and execution of contracts

Sale of goods and execution of contracts should be excluded from the final tax regime and the tax deducted at source should be converted into a minimum tax to start with, with entitlement to carry forward and adjust such minimum tax in future tax years against tax liability on taxable income.

2.2.4 TAX CREDIT TO REGISTERED PERSONS - SECTION 65A

To provide incentive for documentation of economy and increase in the tax base, in 2009 tax credit to those manufacturers registered under the Sales Tax Act, 1990, making 90% of their sales to persons registered under the Sales Tax Act, 1990 and also provide details of such sales to the department was introduced. This needs to be extended beyond the manufacturers in particular the entire wholesale chain.

Recommendation:

This tax credit should be extended to all persons registered under the Sales Tax Act, 1990.

Note: The proposed change will not affect the tax liability of incomes falling under the presumptive tax regime, as tax credits are not admissible to such persons under section 169.

2.2.5 CASH WITHDRAWAL FROM BANK - SECTION 231A; AND ADVANCE TAX ON TRANSACTIONS IN BANK - SECTION 231AA

Un-documented, cash and parallel economy is a menace to our tax revenues. In order to overcome this situation the cash transactions needs to be penalized with a pinch of tax. On the other side the existing taxpayers in respect of their declared bank accounts are facing unnecessary burden on one hand and delayed refunds, if any, on the other hand. However this burden may be lessen by increasing the exemption limit.

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Recommendations:

The exemption limit of Rs. 25,000 on the other hand should be increased to Rs. 50,000.

2.2.6 WITHHOLDING TAX ON INDUSTRIAL AND COMMERCIAL CONSUMERS OF GAS AND ELECTRCITY

The withholding tax regime has been very effective in increasing the tax base in the country. The existing scheme covers almost all the segments of the economy.

At present a very large number of taxpayers comprising of small and medium sized industries and the entire wholesale and retail chain are not contributing to the tax revenue in the ratio of their contribution to the GDP. This situation will be further deteriorated with the increased 'zero' tax rate threshold increased from Rs. 100,000 to Rs. 300,000, which needs to be taken care of by taking appropriate actions well in time i.e.:

2.2.6.1 Imposition of withholding tax on industrial and commercial consumers of natural gas

Currently, natural gas consumption by CNG Stations is subject to withholding tax only. A large number of industrial and commercial consumers of natural gas are not paying any tax or paying a very little amount as compared to the volume of business on the basis of their consumption of natural gas. It will be appropriate to bring this sector of economy to contribute to the national exchequer by way of a withholding tax.

Recommendation

Withholding tax at the rate of at least 5% and 10% on natural gas consumption by industrial and commercial consumers respectively should be introduced with a maximum capping of tax amount of Rs. 10,000 per month to take care of cash flow problems of large scale consumers.

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2.2.6.2 Increase in the rate of withholding tax on commercial consumers of electricity

The current rate of withholding tax on electricity consumption by commercial consumers with bill amount upto Rs. 20,000 per month ranges from 6% to 23% whereas for bill amount exceeding Rs. 20,000 it is 10%. This needs to be increased and rationalized for the reasons stated above.

Recommendation:

The rate of withholding tax on electricity consumption by commercial consumers should be fixed at a flat rate of 25% of electricity consumption with a maximum capping of tax amount of Rs. 10,000 per month to take care of cash flow problems of large scale consumers.

2.2.7 INCREASE IN THE RATE OF WITHHOLDING TAX ON PASSENGER TRANSPORT VEHICLES PLYING FOR HIRE AND OTHER PRIVATE MOTOR CARS - SECTION 234 AND PARA (2) AND PARA (3) OF DIVISION III OF PART IV OF FIRST SCHEDULE

The current rate of advance tax collected along with the motor vehicle tax does not commensurate with the current margin of profit in case of passenger transport vehicles plying for hire and other operating cost of private cars. Further the reason for non compliance of the provision of clause (vi) of sub-section (1) of Section 114 is also due to the fact that the current advance tax rates are very nominal. In our society in order to improve compliance with tax laws and increasing the tax base the rate of advance tax should have a pinching effect in proportion to the income or cost of operating.

Recommendation:

The current rate of advance tax under Para (2) and (3) of Division III of Part IV of First Schedule should atleast be doubled.

2.2.8 INCREASE OF TAX BASE BY WAY OF INCENTIVE TO THE COMPLIANT TAX PAYERS

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Currently there is nothing in the Income tax to promote tax culture and provide incentives to compliant tax payers. There is a need to introduce appropriate measures to reward compliant tax payers.

Recommendation:

It is proposed to introduce a concept of furnishing annual sales summary along with NTN or CNIC of the customers with an incentive of reduced rate of minimum tax of 0.50% instead of 1.00%.

2.2.9 DEALERS/AGENTS OF AGRICULTURAL PRODUCE

The Federal Board of Revenue introduced an amendment in SRO 363 whereby the exemption available to the supplier of agricultural produce from provision of section 153 has been withdrawn and limited to actual grower/producer of agricultural products. We welcome this step as it will bring into the ambit of taxation a very large segment of the economy which were taxable under the provisions of Income Tax Ordinance but were out of the net on excuse of agricultural income. Under the Income Tax Ordinance, the exemption to agricultural income is restricted to the actual producer and grower of the land and not to the intermediaries who make the real income in the process. However, we feel that this change will only bring into net all those intermediaries who are making supplies to withholding tax agents. The persons who do business through market (*mandis*) will remain outside the net.

All businesses of agricultural produces both cash crops, fruits and vegetables are conducted through various *mandis*' spread across the country which are managed through market committees. These market committees are governed under Provincial Act, e.g. Punjab Agricultural Marketing Ordinance 1978. Under this Act, in order to deal with the agricultural produces, they need to be registered as a working commission agent with the market committee under a formal licence which is renewed on annual basis. All Provincial Governments have reliable data available through market committees which can be used for taxation of their important segment and bring them into the tax net.

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However, since the entire system works on cash basis, therefore, it would be difficult to start with taxation of real income and it would be more advisable to tax them on some fixed tax regime.

Recommendation:

- The market commission agent registered with market committees may be subject to fixed tax (excluding income subject to collection of tax at source under section 153) depending upon their category; we suggest the following fixed rates for each category:

  - Category - A Rs. 10,000 per annum
  - Category - B Rs. 7,500 per annum
  - Category – C Rs. 5,000 per annum

- The marketing committee should be made the withholding tax agent for collection of the above tax along with the annual fees and be required to submit annual statement to the tax department.

2.2.10 CAPITAL GAIN TAX ON IMMOVEABLE PROPERTY

Capital gains on sale of immovable property is not subject to tax currently being a provincial subject and is also outside the ambit of taxation under the head capital gain under section 37 of the Income Tax Ordinance, 2001. However the purchase and sale transaction which is in the nature of business or trade is chargeable to tax under the head income from business under section 18 of the Income tax Ordinance, 2001.

There is a large size of black economy which gets its way into the real estate sector and does not contribute anything to the national exchequer. These real estate investors are involved in buying and selling of property on regular basis but escape taxation by taking advantage of vagueness in law as there are no clear define rules/parameters for determining the nature of transaction. There is a need to bring clarity in law which would enable the state to tax the business gains of the real estate sector.

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Different countries are taxing such income using various tools. In Sri Lanka any gain on disposal of property held for a period of less than two years is chargeable to tax at normal rates. Similarly in Malaysia the gain arising on disposal of properties is subjected to Real property gain tax on graduated scale.

Recommendation

It is proposed that a deeming provision may be added under section 18 for defining a transaction of sale of immoveable property to be treated as an adventure in the nature of trade. It is therefore proposed that any buying and selling of immovable property within a period of 4 years should be treated as income from business. The tax burden should also be based on the basis of holding period to avoid the charge of inflation or capital gain. Therefore it is proposed that tax may be charged on such business income as a separate block on the following rates:

- If sold within 2 years 10%

- If sold within 3-4 years 5%

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2.3 PROCEDURES AND MISCELLANEOUS

2.3.1 APPEAL TO COMMISSIONER (APPEALS) - SECTION 127

The Commissioner (Appeals) has the vested power to stay recovery of demand until decision of appeal as per the ratio decided by the honourable Supreme Court of Pakistan but this power has not been explicitly provided in the statute. Although this does not bar the Commissioner (Appeals) to grant stay but practical difficulties arise due to absence of explicit powers in this regard. Also sections 131 (5) & 133 (7) specifically deal with stay of recovery proceedings by the Appellate Tribunal and High Court.

Therefore there is a need to rationalize the powers of Commissioner (Appeals) in line with the findings of the Supreme Court in general, and powers of Appellate Tribunal and High Court in particular.

Recommendation:

A new sub section be introduced to enlarge the powers of the Commissioner (Appeals) to be able to stay recovery proceedings where appeal is filed before him on the same lines as provided in sections 131 (5) & 133 (7).

2.3.2 PROCEDURE IN APPEAL - SECTION 128(4)

The power to set aside the assessment order in an appeal before the Commissioner (Appeals) contained in section 129(1)(a) was withdrawn through Finance Act, 2005. With this change the powers vested in the Commissioner (Appeals), under section 128(4) to cause further inquiry before disposing of an appeal to be made by the Commissioner, has attained a significant importance, in order to enable the Commissioner (Appeals) to give clear cut findings on the matters arising in the appeal before him.

Restricting the further enquiry to be made by the Commissioner alone against whose order an appeal has been preferred by the taxpayer is not fair and judicious, because the results of such inquiry will naturally be biased and tilt to support the order, the Commissioner has originally made (order under appeal).

Recommendation:

The powers of the Commissioner (Appeals), under section 128(4) to cause further inquiry by the Commissioner should be enlarged enabling the Commissioner (Appeals) to cause further inquiry by an expert or seek an expert opinion.

Consequently, section 222 of the Income Tax Ordinance, 2001 should also be amended, enabling the Commissioner (Appeals) as well to appoint an expert.

2.3.3 APPOINTMENT OF THE APPELLATE TRIBUNAL

2.3.3.1 Section 130(4)

Chartered Accountants in Practice can be of great value as Accountant Member of the Appellate Tribunal. This was recognized in the repealed Income Tax Ordinance, 1979 whereby the Federal Government could appoint Chartered Accountants with at least ten years of experience in practice as Accountant Member of the Appellate Tribunal, till June 2001.

Recommendation:

Section 130(4) should be amended in order to provide for the appointment of Chartered Accountants with at least ten years of experience in tax practice, as Accountant Member of the Appellate Tribunal .

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2.3.4 ALTERNATIVE DISPUTE RESOLUTION - SECTION 134A(1)

Through Finance Act, 2009, the scope of cases which could be referred for Alternative Dispute Resolution (ADR) was restricted such that the cases where:

- prosecution proceedings have been initiated; or
- interpretation of question of law is involved having effect on other identical cases;

cannot be referred for Alternative Dispute Resolution.

The Rules regarding Alternative Dispute Resolution already provides that "Any such resolution shall not be used as precedent, except as provided in the agreement".

Accordingly restricting the scope of cases that could be referred for Alternative Dispute Resolution is not justified.

Recommendation:

The position prior to the amendment made through Finance Act, 2009 should be restored.

2.3.5 AUDIT - SECTION 177

Through Finance Act, 2010, section 177 has been amended by giving vast unconditional discretionary powers to the Commissioner at the field formation level without any restrictions to call for the records etc. and conduct audit of the income tax affairs of any person or class of persons.

The law in the present form:

- does not regulate the selection of any person or classes of person for audit; and

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- gives un-conditional wide discretionary powers to the field officer.

This is against the norms of taxation and subject to misuse and harassment of the taxpayers. It is imperative that such power needs to be regulated for its judicious use in a manner that reduces the discretion and at the same time facilitates the smooth operation of audit.

Recommendations:

- Specific rules be first introduced in the Income Tax Rules, 2002 to regulate the selection of any person or classes of person for tax audit;
- Section 177 should be then amended to provide for selection of any person or classes of person for conduct of tax audit under the prescribed rules (as suggested above) and only then call for the records etc.

2.3.6 REVAMPING OF INCOME TAX RULES

It has been observed that most of the Income Tax Rules are not aligned to Income Tax Ordinance, 2001.

Recommendation:

Income Tax Rules need to be re vamped to avoid confusions.

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2.4 REMOVAL OF HARDSHIPS

2.4.1 DEDUCTIONS NOT ALLOWED - SECTION 21(l)

Section 21(l) provides for deductions not allowed for transactions exceeding Rs. 10,000 paid otherwise than crossed cheque etc. Such provision is the need of the time o curb non-documentation and to increase the tax base. At the same time this section does not apply to certain transactions specified in second proviso.

The agro based industries are facing problem while making payments for purchase of agricultural produce directly from the growers/farmers, who either do not maintain any bank account or are not willing to accept crossed cheque etc.

Recommendation:

Exemption from payment through crossed cheque etc. should be provided in respect of transactions for purchase of agricultural produce directly from the growers/farmers.

2.4.2 GROUP TAXATION - SECTION 59B

Section 59B seeks to provide group relief in the form of adjustment of losses between holding and subsidiary or subsidiary to subsidiary if they fulfil the minimum holding criteria. The required holding is 55% if one of the companies in the group is a listed company and 75% if none of the companies in the group is listed company. The law further prescribes certain conditions that the group companies have to fulfill in case they avail the facility of group relief. The conditions are set out in sub section (2) of section 59(B). One of the conditions under sub-section 2(c) of section 59(B) is as follows:

> *"…..holding company, being a private limited company with seventy-five percent of ownership of share capital gets itself listed within three years from the year in which loss is claimed."*

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Recommendation:

The Institute is of the view that requiring holding company to get itself listed within three years from the year in which loss is claimed should be removed and instead there should be a condition that at least one company within the group should get itself listed. This would bring the condition in line with the other condition of minimum holding discussed above where a higher holding is only required if none of the companies in a group is a listed company. Further the requirement to list the holding company is against the principle of group formation and consolidation as a group may not like to keep its investments in a listed company due to the risk of hostile takeovers etc. as in such an event the group may lose control on its entire entities within the group.

It is therefore suggested that sub-section (2)(c) of section 59B be substituted as follows:

> *"At least one of the companies of the groups shall get itself listed within three years from the year in which loss is claimed if all companies of the groups including the holding companies are private limited companies."*

2.4.3 TAX CREDIT FOR NEW ESTABLISHED INDUSTRIAL UNDERTAKING UNDER SECTION 65D

Section 65D provides a tax holiday to newly established industrial undertaking, however, since in early years due to capital allowance, it is much likely that there will be not tax payable against which it may claim credit due to no tax payable, such industrial undertaking may be subject to minimum tax under section 113 at 1% of the turnover, which would in essence deprive the benefit of section 65D.

Recommendations:

A new sub-clause in clause 11A of Part IV of Second Schedule to be inserted to provide exemption from levy of minimum tax under section 113 on newly established industrial undertakings.

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2.4.4 TIMINGS FOR FILING OF RETURN OF INCOME – SECTION 114

The due date for filing of income tax returns by salaried individuals by 31 August is too short for compiling the required information and obtaining proof and evidences. Earlier, the deadline was 30 September.

Further, in cases, where a taxpayer, required to file return of income electronically, intends to file a return of income before the due date, there is no facilitation available to such taxpayer, as generally return forms are not made available on web portal until last days before the due date .

Recommendations

- Due date for salaried individuals for filing of income tax return be made 30 September.

- Where return forms are not available on web portal, and the taxpayers intending to file return of income before due date, their return of income should be accepted manually on the basis of return forms for last tax year.

2.4.5 COLLECTION OF TAX IN THE CASE OF PRIVATE COMPANIES AND ASSOCIATIONS OF PERSONS - SECTION 139

It is without any doubt that corporate sector is better regulated and documented as compared to an association of persons or individuals doing business. However, there are a number of provisions in the Income Tax Ordinance, 2001, that do not support the formation of corporate sector which in turns implies non-formation of regulated and documented sector.

One of such provision is section 139 of the Income Tax Ordinance, 2001 placing un-limited liability on the directors/shareholders of a Private Limited Company, which is against the basic concept of formation of limited liability business entity.

Recommendation:

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Section 139 should be suitably amended to exclude the directors and shareholders of a Private Limited Company from the discharge of tax liability of the Company.

It may be mentioned over here that in case of fraud by the director(s), the Companies Ordinance, 1984 does not protect them for discharge of any liability of the Company.

2.4.6 IMPORTS - SECTION 148

Manufacturers importing raw material for their own use are at present subject to collection of tax at source at the rate of 3% as against the standard rate of 5% applicable on imports. As a result, large scale manufacturers, whose major raw materials are imported goods, are facing cash flow problems due to abnormal delays in getting the refunds, if any.

Earlier, this problem was taken care by granting exemption certificates or substantially reducing rate of withholding tax. The menace of exemption certificates and its misuse has been controlled by removing sub-section 4A but on the other hand, the problems faced by large scale manufacturers were not taken care of.

Recommendation:

Substantially reduced rate of withholding tax, for large scale manufacturers not exceeding 25% of the standard rate of withholding tax on imports be introduced.

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2.4.7 DUE DATE FOR PAYMENT OF TAX - SECTION 137

Finance Act, 2008 had unreasonably decreased the numbers of days specified for making payment into Government treasury to 15 days.

This curtailment of time resulted into:

- Culture of creating unfair demands and unjustified liabilities by the assessing officers; and
- Short sighted approach adopted by field formations in meeting their tax collection targets, is hampering business confidence building measures adopted by the Pakistan Government during last decade.

Recommendation:

The original time of 30 days should be restored to remove the hardship faced by the business community and taxpayers.

2.4.8 PAYMENTS TO NON -RESIDENTS – SECTION 152

The law requires that where a payment is not likely to be chargeable to tax, then the payer is required to file a notice to the Commissioner. The Commissioner is required to make an order on such notice within 30 days. Since payments to non-residents are critical for business, therefore, 30 days appears to be higher side. Further, there is no mention in the law that if a Commissioner does not pass an order within 30 days, what should be the outcome.

Recommendations:

- It is suggested that the period of 30 days provided in section 152(5A) be curtailed to 15 days; and
- A proviso should be inserted that if the taxpayer does not served with an order on notice filed under section 152(5) within 15 days, the notice shall be taken as grant of exemption from withholding tax.

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2.4.9 PAYMENT FOR GOODS AND SERVICES - SECTION 153(1)(c)

The term 'execution of contract' is unique in Pakistan as this term does not exist in any regional or international fiscal laws. The term 'execution of contract' under section 153(1)(c) is open ended (except for specific exclusion of sale of goods and rendering or providing of services) as every transaction is an execution of a contract under the Contract Act e.g. sale and purchase of immoveable property, right to use an intangible, etc., which do not necessarily have any element of profit.

Recommendation:

The term 'execution of contract' for the purposes of section 153 be defined.

2.4.10 MONITORING OF WITHHOLDING TAXES WITHOUT SELECTION FOR AUDIT

It has generally been witnessed that the tax authorities are resorting on the provisions of section 176 of the Ordinance to conduct audit of withholding taxes, when the taxpayer has not been selected for audit under section 177 of the Ordinance. Further, it has also been witnessed that two different officers have simultaneously been conducting audit and monitoring of withholding taxes and the taxpayer is burdensome to comply with the notices of the both.

The Institute is of the view that monitoring of withholding taxes by exercising powers under section 176 of the Ordinance is against the scheme of the Ordinance in entirety, as section 177 is a complete scheme of audit wherein audit of withholding taxes is also covered, therefore, no monitoring of withholding tax should be carried out in isolation unless the taxpayer has been selected for audit

Recommendations:

Section 177 be amended to provide that only such cases shall be subject to monitoring of withholding taxes which have been selected for audit.

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2.4.11 OFFENCES AND PENALTIES – Section 182

Section 182 was substituted vide the Finance Act, 2010 to consolidate penalty provisions contained in the Ordinance in various sections. Entry No. 1 of the table provides penalty for failure to furnish return of income or a statement of final tax or wealth statement, or wealth reconciliation statement or statement under section 165 within the due date. Penalty for such failure was prescribed equal to 0.1% of the tax payable for each day of default subject to a minimum penalty of Rs. 5,000 and a maximum penalty of 35% of the tax payable in respect of that tax year.

Subsequently, vide Finance Act, 2011, an explanation has been inserted whereby for the purpose of this entry, it has been declared that the expression 'tax payable' means tax chargeable on the taxable income on the basis of assessment made or treated to have been made under sections 120, 121, 122 or 122C of the Ordinance.

At the outset, the prescription of above penalty for default in submission of withholding tax statement is not relevant as the same is not related to tax on taxable income.

Consequent to insertion of the said explanation, it has been noted that the tax authorities have invariably started levying penalty for a single day of default on the basis of tax payable in the return without taking into account the taxes already paid / deducted. Further, the tax authorities are now imposing this penalty for prior years / periods as well, which is against the established principle that any amendment putting additional burden can operate only prospectively. This situation is causing a serious hardship to the taxpayers, as now due to this explanation, the tax authorities are using the explanation as tax collection avenue instead of a deterrent.

Logically, imposition of penalty should have been restricted to the extent of short tax paid with the return, as was held by the appellate authorities before insertion of the said explanation, and if there was no tax payable then token amount of penalty should have been imposed, as was the case before substitution of section 182 of the Ordinance.

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Recommendations:

- Offence for failure to file statement under section 165 be specified separately from entry 1 and the penalty for such failure be restricted to base penalty of Rs. 5,000 per statement and even if after notice to file the statement the taxpayer commit defaults then further penalty of Rs. 200 per day of default be imposed; and
- The explanation inserted in column (3) of entry 1 be deleted, or alternatively, it should be clarified in the explanation that the same is applicable from tax year 2012 and onward.

2.4.12 COMPUTATION OF EXPORT PROFITS AND TAX ATTRIBUTABLE TO EXPORT SALES – RULE 231

Rule 231(1) of the Income Tax Rules, 2002 reads as under:

> *"Where a taxpayer exports any goods manufactured in Pakistan, the taxpayer's profits attributable to export sales of such goods shall be computed in the manner, namely:-*
>
> *(a) where a taxpayer maintains separate accounts of the business of export of goods manufactured in Pakistan, the profits of the export business shall be taken to be such amount as may be determined by the Commissioner in accordance with the provisions of Ordinance on the basis of such accounts; or ……."*

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The words 'separate accounts' (underlined above), are subject to different interpretations. One view is separate books of accounts in respect of business of export of goods manufactured in Pakistan and the second view is books of accounts of the taxpayer maintained in a manner from which the profits attributable to the business of export of goods manufactured in Pakistan can be separately determinable.

The Institute subscribes the second view as stated above.

Recommendation:

The rule 231(1)(a) be substituted as under:

> *"(a) where a taxpayer maintains books of account from which the profits of the business of export of goods manufactured in Pakistan are separately determinable, the profits of the export business shall be taken to be such amount as may be determined by the Commissioner in accordance with the provisions of Ordinance on the basis of such books of account; or……."*

2.4.13 DOUBLE TAXATION OF BESOS TRUSTS

With the aim of empowering public sector workers, the government introduced employees stock option scheme managed under trusts for Benazir Employees Stock Options Scheme. These BESOS trusts are conduit to provide benefit to the employees. However, when the dividends are paid to the BESOS trusts, the same is subject to withholding tax under section 150 by the dividend paying company. Later, when the trust transfer such dividend to the respective employee, the same again is liable to withholding tax under section 150. Consequently, same income is charged to tax twice.

Recommendations:

A new clause should be inserted in Part IV of Second Schedule to provide exemption from withholding tax under section 150 on dividends paid to a trust formed under BESOS Scheme.

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2.4.14 BANKS AND FINANCIAL INSTITUTIONS

2.4.14.1 **Restriction on claim of provision for Bad Debts**

The Seventh Schedule was introduced through the Finance Act 2007 and provided agreed, practical and convenient procedure for the allowability of charge for irrecoverable debts to the extent of provisions created by banks under the Prudential Regulation which are applicable to all banks under the Banking Companies Ordinance, 1962.

After intermittent amendments, through Finance Act 2009, a restriction on claim of provision for bad debts has been placed at a maximum of 1% of total advances, whereas Finance Act 2010 introduced allowability of provision at 5% of total advances for consumers and SMEs.

The restriction on claim of provision for bad debt at 1% is too low in view of the Banking industry's NPL position, whereas especially in the case of consumer NPL, while carrying over of provision for consumer financing need to be allowed.

This measure of introducing changes in piecemeal has effectively withdrawn the very essence of Seventh Schedule which was primarily purported to brought in to address the issue of allow ability of bad debts.

Recommendation:

The position of Seventh Schedule on bad debts before as enacted vide Finance Act, 2007 may be revived. However, if the above is not acceptable, than the threshold should be relaxed to at least 2% of total advances as suggested by Pakistan Banks' Association.

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2.4.14.2 **Allowability of 1% or 5% of advances as charge against Bad & Doubtful Debts**

The Taxation Officers are interpreting total advances as 'Advances' shown on the face of the balance sheet which are net of provision for bad debts (non-performing debts) specifically created by the banks. This means an illogical calculation of admissible provision for bad debts on the net advances (gross advances minus provision made in the accounts) as shown on the face of the balance sheet instead of the gross advances. In other words, to exclude the provisions from the gross advances would be to disallow the actual provisions twice which cannot otherwise be claimed under any provisions of the Seventh Schedule.

Recommendation:

An explanation should be inserted in Rule 1(c) of the Seventh Schedule that total advances means 'Gross Advances' before the accounting provisions for Bad & Doubtful Debts.

2.4.14.3 **Transitional provisions - Rule 8A**

- Through the Finance Act, 2010, the Seventh Schedule was amended to include that amounts provided for in or prior to the tax year 2008 which were neither claimed nor allowed as a tax deductible in any tax year, will be allowed in the tax year in which such advances are actually written off against such provisions, in accordance with the provisions of sections 29 and 29A.

  All such debts that have been written off are legally admissible deductions. In case they have not yet been allowed, all such claims should be allowed as a deduction. It is hard to comprehend a situation whereby a Bank can demonstrate that a write off of bad debts was neither claimed by the tax payer nor disallowed by the tax authorities.

  Recommendation:

  Rule (8A) of the Seventh Schedule requires suitable amendment in order to avoid misinterpretation and removal of the ambiguity. It is the suggested that existing Rule 8A (1) be replaced with the following text:

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  “Amounts provided for in the tax year 2008 and prior to the said tax year for or against irrevocable or doubtful advances which were not allowed as tax deductible in any tax year, shall be allowed as a deduction in the tax year, when there are reasonable ground for believing that the debt is irrecoverable.”

- Reference to section 29A in Rule (8A) of the Seventh Schedule is misplaced as the same is no more applicable to Banking Companies vide amendments made through Finance Act, 2009.

  Recommendation:

  Reference to section 29A in Rule 8A should be removed from the transitional provisions.

2.4.14.4 **IAS 39 & 40 whilst arriving at Taxable income**

The banking companies have not adopted and applied the requirements of IAS 39 and 40 in the preparation of their annual accounts, in view of the instructions issued by the SBP under BSD circulars. However, the taxation officer tends to amend the assessment on this account by invoking clause (g) of Rule (1) of Seventh Schedule and subjecting to tax the Mark-to-Market (MTM) adjustment by taxing the unrealized losses.

Since the applicability of IASs 39 and 40 have specifically been deferred by the SBP, the financial assets and liabilities of the banks are classified, measured and reported under the SBP's BSD circulars. Accordingly, additions made by the tax department on the plea that unrealized losses due to Mark-to-Market are in accordance with IAS 39 and 40 are both factually and legally incorrect. It would be completely absurd to presume that the requirements of these are in line with the measurement criteria of IAS 39 and 40.

Recommendation:

Explanation should be added under Rule (1)(g) of the Seventh Schedule in order to avoid misinterpretation and removal of the ambiguity.

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2.4.14.5 **Auditor's Certification under Clause (c) of Rule (1) of Seventh Schedule**

The charge for provision of bad debts in the financial statements is subject to verification by the external auditors', who also examine the adherence to the Prudential Regulations.

In the presence of an overall auditor's report (which also covers adherence to Prudential Regulations), the requirement of furnishing a separate auditors' certificate for the claim of bad debts is superfluous and duplication.

Recommendation:

The requirements of furnishing a separate auditor's certificate should be dispensed with by making appropriate amendment in Rule 1(c) of the Seventh Schedule.

2.4.15 INSURANCE COMPANIES

2.4.15.1 **Deduction of tax at source (as recipient)**

In the case of banking companies subject to Seventh Schedule under Rule 5 (2), an exemption has been provided to banks from withholding tax as 'recipient' as such entities are all in organized sector and are subject to advance payment of tax.

Recommendation:

It is recommended that same principle be adopted for the insurance companies.

2.4.15.2 **Capital gains on securities**

Consequent to withdrawal of exemption of capital gains contained in Rule (6A) and introduction of tax on securities by insertion of section 37A, new Rule (6B) was inserted in Fourth Schedule to provide tax rate on capital gains on securities in the case of insurance companies. The proviso of this rule states as under:

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> *"Provided that this rule shall not apply to the securities held for a period of more than twelve months".*

Unlike the rates provided for the purpose of section 37A of the Ordinance, the rate card provided in rule (6B) does not provide zero rate for capital gains on securities held for a period of more than twelve months.

The very intention of the above proviso is akin to provisions of section 37A whereby capital gains on securities held for a period of more than twelve months should not be chargeable to tax, but the wordings of the proviso does not reflect such intention in clear terms.

Recommendation:

Proviso to Rule (6B) should be amended in the manner that capital gains on disposal of specified securities held for a period of more than twelve months will be exempt from tax.

2.4.15.3 **Withholding tax on Maturity proceeds of Life Insurance Policies**

Benefits paid out under life insurance contracts have always been exempt from income tax. In the recent past, however, the Income Tax Department have sought to pressurize life insurers to deduct withholding tax under Section 151(1)(d) of the Income Tax Ordinance 2001 from maturity values paid out on life insurance policies under the grab of section 151 of the Income Tax Ordinance, 2001. The relevant section is as follows:

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"151. Profit on debt:- Where

(d) a banking company, a financial institution, a company referred to in sub clauses (i) and (ii) of clause (b) of sub-section (2) of section 80, or a finance society pays any profit on any bond, certificate or debenture or instrument of any kind (other than a loan agreement between a borrower and a banking company or development finance institution) to any person other than financial institution.

the payer of the profit shall specify tax at the rate specified in Division I of Part III of the First Schedule from the gross amount of the yield or profit paid as reduced by the amount of Zakat, if any, paid by the recipient under the Zakat and Ushr Ordinance, 1980 (XVII of 1980), at the time the profit is paid to the recipient."

The sub-section reproduced above clearly is meant to apply to financial instruments and not to policies of life insurance.

In order to remove any ambiguity it is suggested that a provision be included in the Income Tax Ordinance clearly stating that section 151 does not apply to any amounts paid out under a contract of life insurance.

Recommendation

A new sub-section - 151 (2A) should be introduced as under:

"This section shall not apply to any amount paid out under a contract of life insurance as defined in Section 2(xxvii) of the Insurance Ordinance, 2000 (XXXIX of 2000)."

2.4.16 TRANSFER PRICING

Throughout the world, fiscal regulations prescribe provisions relating to non-arm's length consideration and taxing the sum falling outside this purview. This is termed as taxation of 'Transfer Pricing'.

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Through the Income Tax Ordinance, 2001 special provisions were introduced for that purpose (Section 108). These provisions are almost in line with the international best practices as laid down in the principles laid down by the Organization for Economic Cooperation Development (OECD).

Almost all the entities engaged in manufacturing sector, especially those in pharmaceutical group, were subjected to arbitrary additions to income on that account under the repealed Act. These additions were contested in appeals and some companies are engaged in protracted litigation. That experience has revealed that there is no deficiency or shortcoming in the law. The problems arose in implementation and arbitrary attitude of tax officials. Provisions relating to non-arm's length consideration were streamlined in the Income Tax Ordinance, 2001. Furthermore, it has been specifically provided that such laws will be implemented in line with the guidelines laid down by OECD.

Since the introduction of the Income Tax Ordinance, 2001 there are very few cases where tax proceedings have been finalized under the new provisions of the Ordinance. All the cases from Tax Year 2004 to Tax Year 2008 are effectively exposed to action by the tax officers on that matter. It is considered that unless well laid down processes and procedures are agreed upon between tax officials and the taxpayers in accordance with the principles laid down by the OECD, it is expected that problems which arose under the repealed Act are expected to be repeated notwithstanding the improved and well laid down laws. That eventuality has to be avoided.

Recommendation:

The institute can undertake an effective role in the implementation of revised and improved provisions relating to non-arm's length consideration. It has been experienced throughout the world that fiscal issues relating to non-arm's length consideration are matter of determination of fact rather than application and interpretation of any law. OECD model also supports the same principle.

It is suggested that an exercise and then agreed upon processes be undertaken to prescribe the procedures for implementation of fiscal measure for taxing non-arm's length transactions.

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2.5 TECHNICAL AND EDITORIAL

2.5.1 CAPITAL GAINS (SECURITIES)

Capital Gains arising on the disposal of "Securities" (shares of a public company, vouchers of Pakistan Telecommunication Corporation, Modaraba Certificates or instruments of redeemable capital and derivative products) have been brought in the ambit of chargeable capital gains under the Income Tax Ordinance, 2001 and for this purpose section 37 was amended, Section 37A and Division VII in Part-I of the 1st Schedule was inserted and clause (110) of Part-I of 2nd Schedule was omitted through Finance Act, 2010.

A cumulative reading of the aforesaid amendment, insertion and omission has resulted into the following anomalies:

2.5.1.1 Chargeability of capital gains arising from disposal of securities u/s 37 & 37A

Sub-section (1) of Section 37 does not exclude the capital gains dealt separately under section 37A. Resultantly, capital gains arising on disposal of shares of public companies etc. held for less than twelve months are inadvertently chargeable to tax both under section 37 and 37A.

2.5.1.2 Taxability of capital gains arising on disposal of securities held for a period of exactly twelve (12) months and six (6) months

Sub-section (1) of section 37A reads as under:

> "The capital gain arising on or after the first day of July 2010, from the disposal of securities held for a period of less than a year, shall be chargeable to tax at the rates specified in Division VII of Part I of the First Schedule;
>
> Provided that this sub-section shall not apply if the securities are held for a period of more than a year:"

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Division VII of Part-I of the 1st Schedule reads as under:

"The rate of tax to be paid under section 37A shall be as follows:

S. No.	Period	Rate of Tax
1.	Where holding period of a security is less than six months.	10.00
2.	Where holding period of a security is more than six months but less than twelve months.	7.50%
3.	Where holding period of a security is more than one year	0.00%

From the above it will be observed that the capital gains arising on the disposal of the"Securities" held for the period of exactly twelve (12) months is not covered under section 37A as well as Division VII of Part-I of the 1st Schedule.

Similarly, no rate of tax has been prescribed in Division VII of Part-I of the 1st Schedule for capital gains arising on the disposal of the "Securities" held for the period of exactly six (6) months.

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2.5.1.3 Determination and computation of capital gains arising on disposal of securities held for a period of less than a year

Section 37A is silent as to how the capital gains arising on disposal of "Securities" held for a period of less than a year shall be determined and computed.

Provisions similar to Sub-section (2), (4) and (4A) of Section 37 are missing in Section 37A and nor these sub-sections have been crossed referenced in Sections 37A for determination and computation of capital gains arising on the disposal of "Securities" held for a period of less than a year.

2.5.1.4 Taxability of capital gains arising on disposal of securities held for a period of exactly twelve months and more than a year

Section 37 applies to all capital gains arising on disposal of "Capital Assets" which includes the "Securities" as well. However, the capital gains arising on disposal of "Securities" held for a period of less than a year stands presumably excluded from Section 37 by virtue of specific provisions under Section 37A.

Accordingly, capital gains arising on disposal of "Securities" held for a period of one year or more being not covered under Section 37A, in the absence of any exclusion from Section 37 continue to be chargeable under Section 37 (earlier this was covered by exemption granted under clause (110) of Part-I of 2nd Schedule).

It appears that instead of granting exemption to the capital gains arising on disposal of "Securities" held for a period of one year or more by making a specific provision in the Part-I of 2nd Schedule an alternate route has been adopted through First Proviso to Sub-Section (1) of Section 37A and S. No. (3) of the Table in Division VII of Part-I of the 1st Schedule.

However, this alternate route adopted is of not a valid legislation and the capital gains arising on disposal of "Securities" held for a period of one year or more are chargeable to tax under Section 37 for the following reasons:

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- Sub-Section (1) of Section 37A applies to capital gain arising from the disposal of securities held for a period of less than a year and therefore the First Proviso to Section 37A providing for that Sub-Section (1) of Section 37A shall not apply if the securities are held for a period of more than a year is a self contradiction, redundant and irrelevant.
- Similarly, the "Zero" rate of tax provided at S. No. 3 of Table in Division VII of Part-I of the 1st Schedule for capital gains arising on disposal of "Securities" held for a period of more than a year, is also a self contradiction, redundant and irrelevant since this Division is subservient to Sub-Section (1) of Section 37A which does not apply to "Securities" held for a period of more than a year.

The manner in which the long term capital gains have been ousted from sub-section (1) of section 37A and from sub-section (3) of section 37 suggests that these gains are not totally ousted from taxation instead the Capital Gain arising from the disposal of shares of public companies, etc. held for twelve months or more are chargeable to tax at the standard rate (35%for company, 25% for an association of persons and 7.5% to 25% for an individual), where as short term gains have been made chargeable to tax at the rate of 8% to 10%.

2.5.1.5 Set-off of capital losses against capital gains arising on disposal of securities held for a period of less than twelve months

Sub-Section (5) of Section 37A reads as under:

> *"Notwithstanding anything contained in his Ordinance, where a person sustains a loss on disposal of securities in a tax year, the loss shall be set off only against the gain of the person from any other securities chargeable to tax under this section and no loss shall be carried forward to the subsequent tax year."*

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A plain reading of the Sub-Section reveals that loss on disposal of "Securities" in a tax year, irrespective of the disposal period (i.e., held for less than six months, six months, more than six months and less than twelve months, twelve months or more than twelve months) can be adjusted against the capital gains on disposal of any other "Securities" chargeable to tax under section 37A (i.e. gains arising on disposal of "Securities" held for a period of less than twelve months).

The capital gains arising on disposal of "Securities" for the purposes of taxability is divided into following categories:

Disposal after holding for	Basis of Taxation	Rate of Tax
Less than six months	U/S 37A Separate Block	10.00%
Six months	U/S 37A Separate Block	Not provided*
More than six months but Less than twelve months	U/S 37A Separate Block	07.50%
Twelve months	U/S 37 Taxable Income*	Not provided**
More than twelve months	U/S 37 Taxable Income*	
	U/S 37A Separate Block**	00.00%

* In view of anomalies stated above

** FBR's view based on first proviso to section 37A(1) and S. No. 3 of Table in Division VII of Part-I of the 1st Schedule

The mode of taxation and the rate of tax of each of the above five categories of capital gains is different. However, this sub-section is silent as to the whether capital loss on disposal of "Securities" under each of the categories stated above can be adjusted against the capital gains of that category alone, or capital loss under one category can be adjusted against the other category.

2.5.1.6 Capital gains arising on disposal of securities by taxpayers engaged in Insurance Business

The foregoing anomalies pointed out in respect of taxation of capital gains arising on disposal of securities chargeable under section 37 and 37A are also attracted in case of taxpayers engaged in Insurance Business under Rule (6B) and (6C) of the fourth schedule.

2.5.1.7 Rate of tax on capital gains arising on disposal of securities by taxpayers engaged in Insurance Business

The existing rates of tax on capital gains arising on disposal of securities as per Rule 6B of the Fourth Schedule to the Income Tax Ordinance, 2001 are higher than the rates of tax prescribed under Division VII of Part I of the First Schedule for taxpayers other than those engaged in the Insurance Business as under:

	Tax Year	Under Division VII of Part I of 1st Schedule	Under Rule 6B of the 4th Schedule
Where the holding period of a security is less than six months	2012	**10.00%**	**12.50%**
	2013	**12.50%**	**15.00%**
	2014	**15.00%**	**17.50%**
	2015	**17.50%**	**17.50%**
Where the holding period of a security is more than six months but less than twelve months	2012	**8.00%**	**8.50%**
	2013	**8.50%**	**9.00%**
	2014	**9.00%**	**9.50%**
	2015	**9.50%**	**10.00%**

There appears to be no reason for this discrimination for the taxpayers engaged in the Insurance Business.

Recommendation:

Removal of the foregoing anomalies by making appropriate amendments in the law.

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2.5.2 EXEMPTION OF INCOME OF INTERNATIONAL DONOR/DEVELOPMENT AGENCIES

All the aid agreements entered into with the international donor/development agencies such as the United Nations (UNO, UNICEF, UNCTAD, WFP, UNCHCR, UNDP) US AID, Japan International Cooperation Agency (JICA), Department for International Development (DFID UK), Asian Development Bank etc. contains a covenant whereby the amounts given under the grant or aid would not be utilized for the purposes of paying direct taxes in the recipient (donee) countries.

In the absence of any specific provision in the Income Tax Ordinance, 2001 there is always an ambiguity and doubt on the taxability of income, if any, of such donor agencies and in particular with reference to withholding taxes.

Recommendation:

Appropriate amendments should be made in the Ordinance to specifically exempt such international donor/development agencies from the application of income tax laws.

2.5.3 LIMITATION ON SET OFF AND CARRY FORWARD OF LOSSES - Section 59A

In subsections (1), (2) and (3) of section 59A, there is reference of sub-section (2) & (3) of section 92 and section 93 where as the above sub-sections and section 93 had been omitted by Finance Act, 2007.

Recommendation:

The provisions of section 59A should be amended in light with change brought by Finance Act, 2007.

2.5.4 GEOGRAPHICAL SOURCE OF INCOME - AFTER-TAX PROFIT OF A BRANCH OF A FOREIGN COMPANY - SECTION 101

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By virtue of insertion and amendment of section 2(19)(f) through Finance Act 2008 and 2009, the remittance of after-tax profits of a branch of a foreign company operating in Pakistan has been included in the definition of dividend. However, the corresponding amendment in section 101 has not been made accordingly.

Recommendation:

The corresponding amendment be made in section 101(6) to remove this anomaly.

2.5.5 MINIMUM TAX - SECTIONS 113(3)(a) and 113(3)(c)

In clause (a) the amount of Sales Tax and Federal Excise Duty has been specifically excluded from the turnover being the collection of tax on behalf of the Government. However, in case of petroleum products, a major chunk of the turnover comprising of "Petroleum Levies" is not excluded from the turnover for the purposes of section 113 which is an anomaly and unnecessary burden on taxpayers dealing in such products.

Recommendation:

The words and comma "Petroleum Levies," should be inserted before the words "Sales Tax" in clause (a) of section 113(3).

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2.5.6 FILING OF WEALTH STATEMENT - SECTION 116(4)

Filing of wealth statement along with its reconciliation is obligatory on every person (other than a company) who is required to file the statement of final tax, where the final tax amounts to Rs. 35,000 or more.

Inadvertently, the obligation of filing wealth statement has also been placed on an Association of Persons. Wealth statement is only in respect of an individual and therefore placing this obligation on an Association of Persons is not appropriate.

Recommendation:

The words 'Every person (other than a company)' should be substituted by 'An individual'. Alternatively, if the intention is filing of wealth statement of members of an association of persons than the entire section needs to be suitably re-drafted.

2.5.7 APPEAL TO THE COMMISSIONER (APPEALS) - SECTION 127

Section 127 (1) of the Income Tax Ordinance, 2001, provides for orders against which an appeal lies with the Commissioner (Appeals). For this purpose, specific sections have been referred to in this section.

As a result dispute arises as to whether an appeal lies before the Commissioner (Appeals) against orders under the sections that are not specifically mentioned in section 127(1) e.g. orders under section 123, 124 etc.

Originally, this section provided for all orders of the Commissioner under the Ordinance against which an appeal lies with the Commissioner (Appeals), just like the existing section 131(1) [orders against which an appeal lies before the Income Tax Appellate Tribunal].

Recommendation: www.imranghazi.com

In order to remove, the ambiguity in section 127(1) of the Income Tax Ordinance 2001, it should be substituted as under:

> *"Any person dissatisfied with any order passed by a Commissioner (other than the Commissioner (Appeals)) or an Officer of Inland Revenue under the Ordinance other than an order against which a specific remedy is provided under the Ordinance, may prefer an appeal to the Commissioner (Appeals) against such order".*

2.5.8 DECISION IN APPEAL BY THE COMMISSIONER (APPEALS) -SECTION 129

Through Finance Act, 2009 a time limit of 120 days from the date of filing of appeal has been specified for the Commissioner (Appeals) for disposal of appeals. However, this period of 120 days can be extended by another 60 days, for reasons to be recorded in writing by the Commissioner (Appeals).

On the other hand, the provisions regarding notice by a taxpayer to the Commissioner (Appeals) for disposal of an appeal remains unchanged to 4 months from the date of filing of appeal, which does not cater for the extended 60 days time limit available with the Commissioner (Appeals). Further, in section 129(4) the time limit has been stated in days, whereas in the corresponding sections 129(5) to 129(7), these are stated in months.

Recommendation:

- The ambiguity needs to be appropriately redressed.
- In order to bring uniformity, in section 129(5) to 129(7) the time limits be stated in days instead of months.

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2.5.9 ADVANCE INCOME TAX - SECTION 147(6A)(b)

2.5.9.1 Advance tax on taxable income - Section 147(1)

Two types of advance tax payment are now envisaged, i.e., advance tax against taxable income (Section 147(1)) and advance tax against certain capital gains (Section 147(5B)). Sections 147(1) does not operate to the exclusion of section 147(5B), which is erroneous.

Recommendation:

Appropriate amendment of section 147(1) to exclude certain capital gains against, which advance tax is payable under section 147(5B).

2.5.9.2 Advance tax on taxable income - Section 147(4B)

Section 147(4B) provides for the formula of calculating the amount of quarterly advance tax payable by an individual.

Under section 147(1)(c), salary income subject to deduction of tax at source under section 149 is excluded for the purposes of payment of advance tax and similarly in the component "B" of the formula given in section 147(4B) tax deducted under section 149 cannot be deducted from the each quarterly instalment.

Accordingly, the advance tax payable should have been the proportionate tax attributable on taxable income as reduced by income from salary. Contrary to this the component "A" of the formula given in section 147(4B) requires to pay advance tax equal to the tax assessed for the latest tax year which is inclusive of tax on income from salary as well.

Recommendation:

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In component "A" of the formula given under section 147(4B), the words "tax assessed" should be substituted by the words "proportionate tax attributable on taxable income excluding income from salary assessed".

2.5.9.3 Advance tax on taxable income - Section 147(6A)(b)

Under clause (b) of section 147(6A), a company is entitled to 'make adjustment for the amount (if any) already paid'. The words 'make adjustment for the amount (if any) already paid' are ambiguous.

Recommendation:

The words "make adjustment for the amount (if any) already paid" should be substituted with the words "make adjustment of tax already paid for which a tax credit is allowed under section 168".

2.5.10 IMPORTS (COLLECTION OF TAX AT SOURCE) - SECTION 148(8)

Through Finance Act, 2009, tax collected at source on import of 'packing material' has been made minimum tax. A plain reading of the amended section reveals that 'packing material' imported by any one is subject to minimum tax. However, contrary to the provisions of the law, Para 32.2 of Circular No. 3 of 2009 states that by virtue of this amendment the import of packing material by manufacturers of edible oil, will be subject to minimum tax. The amendment made last year is against the intent as explained in Para 32.2 of Circular No. 3 of 2009. Accordingly, section 148(8) of the Ordinance needs to be suitably amended to reflect the true intent to avoid any misconception.

Recommendation:

In section 148(8) after the word 'oil' a semicolon should be inserted and after the word 'material' the words 'imported by the manufacturers of cooking oil or vegetable ghee or both' be inserted.

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2.5.11 PAYMENTS TO NON -RESIDENTS - SECTION 152(3)(a)

This clause excludes payments to non-residents from the operation of section 152(2), which are otherwise covered under other provisions of the Income Tax Ordinance, 2001. Specific provision also exists for payment to non-resident media persons under section 153A of the Income Ordinance. However, the same is not mentioned in this sub-section.

Recommendation:

In section 152(3)(a) after the figure and comma '153,' the figure, alphabet and comma '153A,' be inserted.

2.5.12 EXPORTS (DEDUCTION/COLLECTION OF TAX AT SOURCE) - SECTION 154(3C) AND FIRST SCHEDULE - PART III - DIVISION IV

The Collector of Customs has been empowered to collect tax at source from the gross value of goods at the time of clearing of goods exported [section 154(3C)] in addition to an authorized dealer in foreign exchange at the time of realization of foreign exchange proceeds on account of export of goods by an exporter [section 154(1)].

A plain reading of the section 154(1) and 154(3C) reveals that the tax on export of goods will be collected twice, once at the time of clearing of goods and again at the time of realization of export proceeds of such goods. Although, this is not the intent of law as explained in Para 36 of Circular No. 3 of 2009 that sub-section 154(3C) applies only on clearing goods for export made without form "E". However, the sub-section inserted is silent as to what has been explained in Circular No. 3 of 2009.

Recommendation:

In section 154(3C), after the word 'exported' the words "without Form 'E'" or the words 'through land routes' be inserted.

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2.5.13 CERTIFICATE OF COLLECTION OR DEDUCTION OF TAX AT SOURCE

2.5.13.1 Section 164(1)

A withholding agent collecting or deducting tax at source is also required to provide the copies of tax deposit form (challan) of the tax duly deposited on behalf of the person from whom it is collected or deducted or "any other equivalent document".

The Ordinance and the Rules are silent as to what is meant by 'any other equivalent document'. This will be open to different interpretations and continuity of the problem of allowing credit of tax or refund of tax collected or deducted at source, particularly in case of utility bills, book transfers by government departments / banks in respect of profit on debt and cash withdrawal, etc.

Recommendation:

The term "any other equivalent document" should be defined in section 164(1).

2.5.13.2 Section 164(2)

The sub-section on one hand requires submission of the tax deposit form (challan) in respect of tax collected or deducted at source along with the return and on the other hand states that the certificate of tax collected or deducted in the prescribed form shall be treated as sufficient evidence thereof, which is a contradiction.

Recommendation:

The contradiction in section 164(2) needs to be removed.

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2.5.14 PROSECUTION FOR NON-COMPLIANCE WITH CERTAIN STATUTORY OBLIGATIONS -SECTION 191

Under sub-section (1) non-compliance of statutory obligations results in prosecution proceedings which may result into a fine or imprisonment for one year or both and under sub-section (2) a further fine or imprisonment for two years or both if the compliance is not made within the time allowed by the court.

Sub-section (2) dealing with a further fine or imprisonment or both, after the amendment made through Finance Act, 2009, provides for a maximum limit of fine of Rs.50,000 while sub-section (1) continues to remain open ended as to the quantum of fine.

Recommendation:

In section 191(1) after the word 'fine' the words 'not exceeding fifty thousand rupees' be added.

2.5.15 POWER TO COMPOUND OFFENCES - SECTION 202 AND CONDONATION OF TIME LIMIT - SECTION 214A

In these sections the word 'Director General' has been used but there is no authority known as 'Director General' under the Ordinance.

Recommendation:

The words 'Director General' should be replaced by the words 'Chief Commissioner' in the above sections.

2.5.16 DEFAULT SURCHARGE - SECTION 205

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The rate of default surcharge in sub-section 1, 1A, 1B and 3 of section 205 is given at KIBOR plus three percent per quarter.

KIBOR rate is an annual rate to which adding 3% per quarter is superfluous. It may be noted that in the corresponding provisions of the Sales Tax Act the correct words i.e. "KIBOR plus three percent per annum" have been used.

Further, there is some confusion in the interpretation of the period for calculation of default surcharge under sub-section (1B). Currently the calculation of default surcharge starts from 1st day of April, which is not correct as the last date of instalment would be different in case of special income year.

Recommendations:

In sub-section 1, 1A, 1B and 3 of section 205 the words "per quarter" should be substituted by "per annum"

In sub-section (1B) the period of default should start from the due date of the last instalment to the due date of filing of return.

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2.5.17 ELECTRICITY CONSUMPTION (COLLECTION OF TAX AT SOURCE) - SECTION 235(4)

In case of non-company taxpayer, tax collected along with electricity bills is a minimum tax where the monthly bill amount does not exceed Rs. 30,000 and adjustable tax where the monthly bill amount exceeds Rs. 30,000. As a result such tax collected during the year is partly minimum tax and partly adjustable tax depending upon the each month bill amount. Accordingly, each and every bill or a month has to be seen to establish which is the 'minimum tax" and which is the 'adjustable tax'. It is not a simple job, both for the taxpayer and the department, and it becomes more difficult where more than one electricity connection is involved.

Recommendation:

In section 235(4) instead of threshold of Rs. 30,000 of each electricity bill amount an annual threshold of Rs. 360,000 on total expenditure of electricity should be prescribed for the purposes of determining whether the annual tax collected is minimum tax or adjustable tax.

2.5.18 EXEMPTION OF INCOME OF WORKERS' PROFIT PARTICIPATION FUND - CLAUSE (66) OF PART - I OF SECOND SCHEDULE

Income of the WPP Fund is exempt under the WPP Fund Act which was accepted under the Ordinance by virtue of Proviso to section 54 of the Ordinance as it stood before an amendment brought in through the Finance Act, 2008.

However, through the Finance Act, 2008 the proviso to section 54 of the Ordinance was omitted. As a result exemption provided to the income of the WPP Fund under the WPP Act lost its applicability, which appears contrary to the entire Scheme.

The WPP Fund itself is not an entity engaged in any profit earning activity for the reason that the sums available to it are either to be paid to the workers or deposited with the Government. It is for this reason that the relevant Act provided exemption to a WPP Fund and such exemption was also protected under the Income tax law.

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The amendment in section 54 of the Ordinance as discussed above jeopardized a number of entities which were exempt from Income-tax under various statutes other than the Income tax law. Accordingly, certain sub-clauses were inserted in Clause (66) of Part I of the Second Schedule to the Ordinance granting exemption from Income Tax to entities which were enjoying such exemption under respective statutes after the proviso to section 54 of the Ordinance was withdrawn. However, due to an oversight the exemption of income of WPP Fund could not find its place in Clause (66) of Part – I of the Second Schedule.

Recommendation:

In view of the above it is imperative that a corresponding amendment should be made giving exemption to the income of WPP Fund established under the WPPF Act. Accordingly, it is proposed that the following sub-clause be reinserted in Clause (66) above after sub-clause (xxiii) - *"(xxvi) Workers Participation Fund established under the Companies Profits (Workers Participation) Act, 1968."*

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2.5.19 MINIMUM TAX - SECTIONS 148(8), 153(3) AND 235(4)

The above sections read as under:

Section 148(8) - "The tax collected from a person under this section on the import of edible oil and packing material for a tax year shall be minimum tax".

Section 153(3)(b) - "tax deducted shall be a minimum tax on transactions referred in clause (b) of sub-section(1)".

Section 235(4) - "in the case of a taxpayer other than a company, tax collected upto bill amount of thirty thousand rupees per month shall be treated as minimum tax on the income of such persons and no refund shall be allowed".

The first two sections do not clearly indicate whether this minimum tax is on the overall income [i.e. taxable income (normal income), income subject to final taxation and income subject to fixed tax as a separate block of income] or the proportionate tax attributable on such incomes.

On the other hand in section 235(4) the words used are 'minimum tax on the income of such persons', which read with the definition of income in section 2(63), clearly means that this is the minimum tax on the overall income [i.e. taxable income (normal income), income subject to final taxation and income subject to fixed tax as a separate block of income].

Recommendation:

For the sake of simplicity and uniformity, the aforesaid minimum taxes should be on the overall taxable income excluding income subject to final tax and fixed tax and in order to remove the ambiguity, sections 148(8) and 153(6) needs to be appropriately amended.

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2.5.20 RULE FOR TAXABILITY OF FEE FOR TECHNICAL SERVICES OF NON - RESIDENTS - RULE 19

Rule 19 is in contradiction to scheme of taxation laid down in section 6. Proviso to Rule 19(1)(c) provides option to non-resident person to elect for presumptive tax regime, whereas it is not permissible under section 6. Thus, this Rule overrides the sanctity of the Ordinance. A similar proviso in Rule 18 already stands deleted by SRO 590(1)/2004.

Recommendation:

The option should be withdrawn. Alternatively, option should be provided in section 6 with a time limit of 90 days for filing of option.

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2.6 LABOUR LEVIES

2.6.1 GENERAL

During the first tenure of the present government in 70's, labour levies were introduced to let the labourers share the benefit in the profits of the companies. Nevertheless, over the last three decades, such levies have been abused in such a manner that this social benefit has become a tool for exploitation in the form of high tax rate. In Pakistan, the effective corporate tax rate is 35 percent plus 2 percent Workers' Welfare Fund (WWF) and 5 percent Workers' Profit Participation Fund (WPPF). This effectively makes the rate equal to 42 percent which may be one of the highest corporate tax rates in the world. There is a need to immediately review the same.

Recommendation:

Consolidation of all labour levies with a rate of 2 to 3 percent in line with regional standards.

2.6.2 WORKERS' WELFARE FUND [WWF]

Every business establishment is required to pay a 2 percent WWF at higher of returned income or accounting profit. This is a straight levy. The amount is collected along with the income tax.

This levy effectively places the profitable organized sector at serious disadvantage viz-à-viz unorganized sectors which are prone to under declaration of income.

The amount collected is apparently handed over to the Ministry of Labour to be utilized for the welfare of the workers. We are not aware of any instance where labourers employed have directly or indirectly been benefited by any scheme undertaken out of such funds. This places serious question on the continuity of this levy. For effective use of WWF it is advised that the employers be allowed to retain certain portion of the contribution enabling them to make investments for welfare of workers.

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Workers Welfare Fund is levied under Workers Welfare Ordinance 1971 on all industrial establishments operating in Pakistan. Upto 30th June 2008 it was levied as 2% of the total income as determined under the Income Tax Ordinance 2001. Certain changes were introduced in the Finance Act 2006 to amend the concept of total income. In order to implement the above change, further amendments were made in Section 4 of the above Ordinance by Finance Act 2008. The above amendments have changed the total scheme of Workers Welfare Fund and the burden of Industrial Establishment on account of Workers Welfare Fund has increased manifold.

Further, the scope of this levy has been extended to almost all entities by inclusion of establishments covered under the Shops and Establishment Act, 1969 in the definition of Industrial Establishment in the Workers Welfare Ordinance, 1971. Historically, this levy was restricted to 'Establishments' where industrial labour/workers were involved. The amendment made has extended this levy to almost all establishments and has substantially increased the quantum of such levy as well.

Effect of Changes:

The concept of total income was changed and the same was defined to mean as under:

"(i) " total income" means:

(i) where Return of Income is required to be filed under this Ordinance, the profit (before taxation or provision for taxation) as per accounts or the declared income as per the return of income whichever is higher; and

(ii) where return of Income is not required to be filed, the profit (before taxation or provision for taxation) as per accounts or four per cent of the receipt as per the statement filed under section 115 of the Ordinance, whichever is higher."

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The effects of above change in the definition of 'total income' under the Workers Welfare Ordinance, 1971 are discussed as under:

Taxpayers filing Return of Income

In case of income liable to tax under normal law the return of Income is required to be filed. In such circumstances, the Workers Welfare Fund is payable at 2% of the income as per the accounts or income as per the Income Tax Ordinance whichever is higher.

It is to be noted that main difference between accounting income and taxable income arise on account of timing difference in claiming of depreciation allowances. In taxation law, initial depreciation is allowed on all new assets purchased by the taxpayer in addition to normal depreciation. Moreover, the rate of depreciation may also differ in accounting and tax laws. Therefore, the taxing higher of the both income would mean that the taxpayer will be denied the genuine expense of depreciation. In other words, the Workers Welfare Fund would be charged without allowing deduction of major expense in shape of investment made in the project. Therefore, the Workers Welfare Fund would be payable on income which is not real income of the industrial undertaking. The above treatment is not legally tenable and is also against the spirit of Workers Welfare Fund which allows the workers to participate in genuine profits of the industrial undertaking.

Moreover, under the International Financial Reporting Standard, the income of the subsidiary/associated company is also clubbed in the accounting income of the holding company under equity method. Therefore, in these circumstances, accounting income and holding company may include income of subsidiary, which has either itself paid the Workers Welfare Fund on its income or is not an industrial undertaking at all. Under the new scheme, the company will be burdened to pay Workers Welfare Fund on income of subsidiary which is totally unreasonable and not legally tenable.

Taxpayers filing Statement of Final Tax (PTR cases)

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This scheme is for all those cases which fall in the presumptive tax regime and are not required to file the return of income. Under the above regime the tax payer will be required to pay the Workers Welfare Fund on higher of profit as per accounts or 4% of the receipt.

It practically means that even a loss making unit has to pay Workers Welfare Fund at 2% of 4% of receipt as the same will be higher in case the company is making loss as per accounts.

As discussed in (a) above, this treatment is against the basic concept of Workers Welfare Fund scheme and put extra burden on industrial undertaking.

Recommendations:

The Workers Welfare Fund may be charged on a consistent basis based on taxable profit as under the old scheme;

Employers should be allowed to retain certain portion of the contribution enabling them to make investments for welfare of workers;

The pre-amended position be restored for restricting the levy to establishments where industrial labour/workers are involved for whose benefit the fund was originally established i.e. establishments covered under the Shops and Establishment Act, 1969 should be excluded.

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2.6.3 WORKERS' PROFIT PARTICIPATION FUND [WPPF]

The Income Tax Ordinance, 2001 ("Ordinance") provides exemption in the hands of workers receiving sums out of the WPP Fund vide Clause (26) of Part I of the Second Schedule and allows deduction of the sum allocated to the WPP Fund by the Company vide section 60B of the Ordinance.

Under the law all business establishments are required to contribute a sum equal to 5 percent of the profit as WPPF. This amount is in principle required to be distributed amongst the workers of that establishment. However, due to constant and intentional bureaucratic mismanagement this share of labour in profit has been converted into a direct levy for such establishment.

This intentional mismanagement has been undertaken by placing unnatural and unreasonable restrictions on the distribution of such amount. Under the law only the workers getting salary of a very low level are entitled to receive any sum out of such fund. Any excess not so distributed amongst the workers is transferred to the Fund that effectively ends up with the Government. Thus for all practical purposes it is Government levy.

In the case of organized sector, the salary and wages of the workers are such that in almost all the cases workers do not get any sum out of WPPF. This is definitely not the objective of WPPF.

Recommendations:

- Allow the establishments to utilize the contribution of WPPF for the welfare of labour in the form of providing health, education and housing for the labour. This was exactly the intention of the law when it was introduced.
- Enhance the threshold of worker's salary in line with current prevailing structure.

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INDIRECT TAXES

3.1 BROADENING THE TAX BASE

3.1.1 WITHHOLDING SALES TAX

The menace of undocumented and *benami* business is the root cause of our economic ills. Undoubtedly, we need to put a strong barrier against such trend. However, keeping in view the peculiar business and tax culture prevailing in the country, measures akin to recently issued SRO 821(I)/2011 and SRO 191(I)/2012 may not yield the desired results for the Government. As an alternate, it is recommended that the Government should re-introduce the concept of withholding sales tax, as was introduced on a trial basis, during the Year 2009. The tool of withholding tax may prove to be an effective instrument for broadening the tax base in the indirect tax regime. To make it acceptable to every segment of taxpayers, following modifications are also suggested in such scheme.

Through amendments in Sales Tax Special Procedure (Withholding) Rules 2007 (the rules), the Government may make all registered persons, conducting business with an annual turnover of Rs. 10 million and above, liable to deduct withholding tax, say @ 1/5th, of the total tax passed onto them by their customers. In case of purchases of taxable goods from unregistered persons, the withholding of sales tax may be made compulsory at the applicable tax rate, e.g., 5%, 16%, 19.5%, 18.5%, 21%, 25% out of the total purchase bill. After deduction, the balance sum may be paid to the concerned seller. To promote such scheme and as a reward of such compliance work, the withholding agent should also be offered the claim tax credit of an equivalent sum as has been deducted by him from payment made to unregistered persons.

The corresponding exemption available in 6th Schedule of the Sales Tax Act 1990 (the Act) upto Rs. 5 million to manufacturer and retailer should be restricted to those manufacturers and retailers who sell to businesses making turnover below Rs. 10 million annually. Withholding of sales tax on purchases may also be made applicable upon taxpayers whose supplies are otherwise exempt or zero rated under the Act, e.g., pharmaceuticals, textiles, etc. This will help document the economy at a faster rate.

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Sales tax so deducted may be deposited by the withholding agent in the bank under the relevant head of account by 15th of the month following the tax period during which payment has been made to the supplier. If the withholding agent is also registered under the Act or the Federal Excise Act 2005, he shall file the return and deposit the withheld amount of sales tax in the manner as provided under Chapter II of the Sales Tax Rules 2006 along with other tax liability. However, if the withholding agent is not registered for sales tax or federal excise duty purposes but holds a National Tax Number assigned under the Income Tax Ordinance 2001, he shall file the return electronically as set out in the Annexure to the SRO and deposit the amount deducted at source in the manner as provided for persons filing returns electronically under Rule 18 of the Sales Tax Rules 2006.

3.1.2 RATE OF SALES TAX

Although the tax rate has been reduced to 16%; yet it is still high, which is adding fuel to inflation. Thus, it is vital that a strategic review of sales tax rate may be made and the same may be rationalised over a suitable period of time keeping in view our peculiar business environment.

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3.2 POLICY FRAMEWORK

3.2.1 TAXATION OF INDUSTRIAL SECTOR VS TRADING

Unlike all the developing countries of the world, Pakistan does not offer any substantial protection to its manufacturing / industrial sector. Consequently, businesses prefer to operate as traders and enjoy associated tax / duty benefits. To address the growing inflation, unemployment and shrinking business environment, not only the rate of indirect taxes needs to be reviewed but policies should be geared to make indigenously manufactured goods competitive against imported goods.

3.2.2 SALES TAX ON SERVICES

Effective 01 July 2011, Services rendered, initiated or consumed in the Province of Sindh are being taxed under the provisions of Sindh Sales Tax on Services Act 2011 (SSTSA) and administered by Sindh Revenue Board (SRB).

The provision of SSTSA and allied rules are more or less akin to that of the Sales Tax Act 1990. However, at various places, the provisions of the Act and SSTSA are not only overlapping but also lack clarity especially with reference to the kitting, i.e., provincial or national, where sales tax needs to be deposited by the taxpayer. Further, position is still uncertain regarding mechanism and procedure of sales tax on restaurants, franchise services and advertisement services. On the other hand, FBR authorities still dispute admissibility of Sindh sales tax as tax refund.

It is, therefore, suggested that FBR and SRB should agree upon a legal framework and thrash out the various legal and procedural matters which remain unsettled todate. Besides, the Institute also recommends that specific provisions need to be simultaneously incorporated in both the tax statutes i.e., SSTSA and Federal Excise Act 2005 whereby taxpayer would not be called upon to pay the tax twice, in case FBR or SRB is satisfied that the tax payer had rightly discharged his tax liability but inadvertently deposited such tax it into a wrong account head of either FBR or SRB.

3.2.3 IMPORT PRICE / MINIMUM VALUE ADDITION / IMPLIED WHITENING OF INCOME

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Pakistan is effectively the only country in the world where whitening of black money is possible with a minimal cost equal to the presumptive tax. The negative effect of this system is a major handicap in development of tax base and documentation. This has been explained as under:

- Under and over invoicing has become a very serious issue which is badly affecting the collection of taxes at import stage. Under invoicing also promotes outflow of differential proceeds via *Hundi / Hawala*, which is detrimental to the economy.
- In view of value addition tax scheme offered to commercial imports coupled with immunity from audit, there is effectively a ceiling on the genuine value addition as very few businesses declare actual value addition which leads to serious distortion.
- Implied whitening of income by way of paying 6% Income Tax & 19% Sales Tax and declaring any sale price which is final liability for Income Tax purposes is another aspect which needs to be addressed on war footings.

Recommendations:

Value Addition tax @ 3% was levied to en sure Government revenue which otherwise is leaked on supply chain dealing in imported goods. However, in view of the above factors, a substantial part of manufacturing sector is presently induced to operate [in the absence of conducive environment] in the unorganized sector to avoid standard tax regimes.

This mechanism is not correct in principle, however, unless there is an overhaul or introduction of sales tax on the whole supply chain, this seems to be the only measure to collect tax from such sectors.

In line with VAT International Best Practices, Value Addition Tax / Minimum Value Addition Regimes should be abolished forthwith. Besides, associated audit immunity should also be withdrawn.

3.2.4 INTEGRATION OF DATA BASE

There is a need to integrate the data base of SECP and FBR in order to identify and ensure the corporate entities registered with the SECP are also registered with FBR without any exception.

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3.3 AMENDMENTS IN SALES TAX ACT 1990

3.3.1 RATE OF TAX

The general rate of sales tax is 16%, however higher rates of 19.5% and 22% are also applicable on specific taxable goods. Further, there is an additional 3% value addition sales tax on commercial imports.

Originally the rate of sales tax was 12.5% which was enhanced to 15%, then 16% on account of merger of octroi on its abolition.

From an economic context, especially in relation to the present state of affairs there is a need to review the present rate of VAT in Pakistan.

This matter will be more clearly appreciated on the review of the composition of total collection and sectors contributing to the same. There is no general consensus on the rate of VAT around the world. However, it has to be appreciated that in the region being China, India, Thailand, Malaysia and UAE, there is no or much lesser incidence of VAT in the form of sales tax. For example, in India it is provincial subject with a straight tax rate of around 5% to 10%. In China, there is effectively no VAT. The only country in the region with a full fledged VAT is Bangladesh where the incidence is closer to Pakistan.

3.3.2 DEFINITIONS

3.3.2.1 Section 2(33) - Supply

The amended definition of the term 'supply' does not include "Other Disposition" as part of supply. "Other Disposition" was discussed in Para 1(E) of Sales Tax General Order (STGO) No. 2/2004 dated 12 June 2004 wherein the FBR had opined that return of goods by the vendor back to the principal tantamount to "Other Disposition" and accordingly liable to sales tax. It appears that Toll Manufacturing is now out of the tax ambit.

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Besides our contention as above, the Sindh High Court, in case reported as 2006 PTD 1459 has also declared that no sales tax is payable by the vendor either on the value of goods returned to its principal or on the charges received for the conversion of goods made by him.

Recommendation:

Since now Toll manufacturing is out of the ambit of term 'supply', it is suggested that Part I (E) of above STGO may also be withdrawn to avoid potential problems for the taxpayers during audit.

3.3.2.2 Section 2(37) -Tax Fraud

There is a need to review the definition of Tax Fraud. Currently supply of taxable goods without getting registration with the department is treated as 'tax fraud' on the part of the supplier. Therefore a genuine businessman is facing problems to commence his business till the time he is awarded his sales tax registration number. On the contrary, supply of taxable goods without getting actually registered could penalize him with the most serious offence of 'tax fraud' under the Act.

Moreover, this is inconsistent with the exemption available to businesses having turnover lower than Rs. 5 million during the last 12 months.

Recommendation:

It would be more business friendly to encourage a new entity to start the commercial activity immediately without requiring for procedural compliance at the starting stage provided a bank guarantee for a requisite amount is provided and a registration is acquired within a stipulated time. Moreover, FBR may also consider allotting provisional Sales Tax Registration number.

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3.3.2.3 Section 2(44) - Time of Supply

There is a need to clarify tax incidence on 'hire purchase' transaction. As it involves periodical instalments received/earned over a period of time, charging tax on full amount at the signing of hire purchase agreement is not justified and is in conflict with the definition of value of supply that is the consideration which the supplier receives from the recipient for the supply.

Recommendation:

It is suggested to bring the chargeability of hire purchase transactions in accordance with the international practice and coherence (timing and the amount on which the sales tax is payable) i.e. tax should be levied at the time of payment of the instalments.

3.3.3 REGULATION OF SALES TAX ON VAT PRINCIPLES - SECTION 7A

In an attempt to broaden the tax base, the Government has introduced minimum value addition schemes for different sectors i.e. importers, steel re-rollers and melters etc. The sales tax collected at import or local procurement stage is treated as full and final liability of such specified registered persons. Charging sales tax in presumptive mode is a deviation from core VAT principles.

Recommendation:

For the sake of simplification and compatibility with the core principles of VAT, it is proposed that the sales tax laws may suitably be amended by abolishing all fixed tax schemes.

3.3.4 TAX CREDIT NOT ALLOWED - SECTION 8

Input Tax Credit on Electricity and Gas consumed in Residential Colony of Independent Power Producers (IPPS)

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The tax auditors have been objecting adjustment of input tax paid by the taxpayer on electricity and gas consumed in residential blocks of the factory where its production facilities are located. The tax department is of the view that this area falls under the mischief of section 8(1)(a) and thus such claims of input tax are inadmissible.

For IPPs, the in-house consumption of electricity is also included in the overall cost of production, which is charged to sales tax when billed to WAPDA. Such in-house consumption justifies to be considered for sales tax exemption.

It is pertinent to note that the Customs Tribunal has already allowed input tax credit related to electricity and gas consumed in residential blocks of the taxpayer's factory. Even otherwise such input tax very much becomes refundable to the taxpayer's since it is paid on workforce without which the factory operations cannot function. Consequently, the input tax paid on electricity and gas consumed within residential colony was disallowed vide SRO.490(I)/2004 dated 12 June 2004, as amendment in June-2007. This disallowance is contrary to the principles of VAT regime. It is, therefore, suggested that suitable amendments may be made to allow input tax on electricity and gas consumption within residential colonies of the registered person, particularly where the round the clock supervision of production activities is indispensible and plants are based at remote locations.

3.3.5 CROSS VERIFICATION OF TAX - SECTION 8(1)(CA)

The provision of section 8(1)(ca) prescribes that input tax credit is not admissible to the registered buyer if the corresponding output tax was not paid by the supplier. In recent times, frivolous cases have been made when the FBR Web Portal failed to cross match the output tax in the tax return of seller and corresponding input tax in the tax return of the buyer.

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Recommendation:

Keeping in view the mechanism of e-filing recently introduced in sales tax laws, we understand cross matching of tax returns may not be possible due to:

- Timing differences envisaged in Section 7(1) of the Act
- Erroneous reporting in tax return by Seller by treating the registered buyer as unregistered
- Different due dates for filing of sales tax returns as prescribed for specific sectors like utility companies, etc
- Lack of communication between buyer and sellers

In view of the above and to avoid frivolous litigation between the tax department and taxpayers, it is suggested that a Standard Operating Procedure (SOP) may be issued by FBR to cater all the foregoing factors and possible resolution in case FBR Web Portal fails to recognize payment of output tax paid by supplier.

3.3.6 JOINT & SEVERAL LIABILITY OF REGISTERED PERSONS IN SUPPLY CHAIN WHERE TAX IS UNPAID – SECTION 8A

This section requires that a registered person shall be made jointly and severally liable if the sales tax is not paid by the seller of the goods from whom the seller had purchased goods. In numerous cases, show cause notices have been issued and adverse orders passed under Section 8A against genuine businesses where the corresponding output tax was not paid by respective sellers. Based on such an anomaly, legitimate input tax was disallowed to such taxpayers without establishing collusion between the parties, which is the essence of section 8A.

Recommendation:

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The Institute believes that Section 8A is against the law of natural justice where a person is punished for an offense which he has not committed. Therefore, it is strongly recommended that the provision of Section 8A should be amended to provide protection to registered buyer, in case(s) where compliance of Section 73 of the Act was duly made.

3.3.7 ADJUSTABLE INPUT TAX - SECTION 8B

The concept of minimum value addition across the board was first introduced in the statute vide Section 8B which primarily was inserted in the law to guarantee certain monthly cash flows to the exchequer in the form of sales tax.

Any provision requiring mandatory payment from taxpayers and deferring their legitimate refunds is not justified in any fiscal law. Even otherwise, with new tax measures recently announced by the Government, the tax incidence has gone up to a significant extent and Government revenues budgeted accordingly. Therefore, it is imperative that the sword of Section 8B may be removed from the statute.

3.3.8 DEBIT / CREDIT NOTES - SECTION 9

In the present era where technology checks can be placed, as long as the registered person is able to prove the genuineness of original and revised transaction, no time limits may be imposed upon him under the rules for issuing credit and debit note or enjoying related tax credit / adjustment. At least, the minimum time period should be extended to 365 days.

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3.3.9 REFUNDS - SECTION 10

3.3.9.1 Production of records, returns, accounts etc. for refunds

Apart from the list of supportive documents prescribed in Rule 38 of Sales Tax Rules 2006, the department requires the refund claimant to furnish records, returns, accounts, statements and summaries pertaining to his suppliers to cross match the payment of output tax. Such departmental requirements are not backed by the statute or the rules. Further, under the law, the supplier is not bound to furnish his returns, summaries and other statutory declarations to his buyer. In certain reported and unreported judgments, the Appellate Tribunal Inland Revenue (ATIR) have held verification of transactions through STARR as not sufficient and have directed the tax officers to make human efforts for desired verifications.

Recommendation:

To streamline the entire refund verification and sanctioning process particularly in the light of dictum of ATIR, the FBR should device necessary mechanism for the whole country in the light of the Section 10 and Sales Tax Rules 2006 thus ending practical hassles, liquidity problems for refund claimants and frivolous litigation pertaining to refunds.

3.3.9.2 Apportionment of input between exports and local supplies

Tax attributed to exports and zero rated supplies is refundable to the registered person. However, the law does not prescribe any formula / method of proration of input tax between exports and local supplies.

Recommendation:

It is suggested that a formula / mechanism identical to the 'Apportionment of Input Tax Rules' should be introduced in the statute. Else the exporter may be allowed to carry forward entire excess input tax to the next tax period without any exception.

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3.3.9.3 Manual over-ruling

STARR system of FBR defers some of sales tax refund claims on ground of discrepancies in filing of sales tax returns on the part of suppliers of taxpayers. There was a procedure in place whereby sales tax officials used to overrule these objections on the basis of documentary evidences provided by taxpayers. FBR has now ceased accepting documents from taxpayers and system of manual overruling has been abolished. The department is planning to institute a new mechanism in which sales tax officials will update STARR system on their own by rechecking documents / returns submitted by taxpayers.

Recommendation:

The new system is likely to be introduced after sometime. Till then, deferred sales tax refunds will remain stuck-up with the Government. Therefore, it is suggested that manual over ruling of STARR's objections should be reintroduced.

3.3.9.4 Restriction of refund claims

Allowable refund claim for a particular month has been restricted to 1% of total sales in case of textile companies. There is no provision in the law to that effect. Due to this a significant amounts of refund claims are denied every month.

Recommendation:

The above practice, being ultra vires to the law, should be discontinued.

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3.3.9.5 Deferred claims

Some of deferred claims are released on the basis of replication of STARR system upon which some of the discrepancies in suppliers returns previously observed are removed. Further, taxpayers need updated status of their deferred refunds so that they can arrange documents from the suppliers to remove objections. Obtaining this status from departments is a herculean task and cause unnecessary delays.

Recommendation:

To streamline the process, we suggest that such process can be expedited, or even automated, if view-only access to STARR system is granted to taxpayers on FBR portal.

3.3.10 ASSESSMENT OF TAX - SECTION 11(5)

The provision provides for a presumptive assessment in case the taxpayer fails to file the return. The parameters of presumptive assessment are defined in Para (I) of Part II of Sales Tax General Order 3 of 2004.

However, in numerous cases, the superior courts have held that any assessment on the basis of assumptions is not legal and permissible under the law.

Recommendations:

It is suggested that this section and the related Para I of Sales Tax General Order 3 of 2004 may be deleted altogether. Section 11(5) is also not consistent with the provisions of section 36 of the Act.

FBR may also consider merging provisions of section 11 into section 36 to make it a more comprehensive section dealing with the assessment of tax under various circumstances.

3.3.11 DELISTING, BLACK LISTING & SUSPENSION OF REGISTRATION - SECTION 21

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There should be proviso that before declaring any person as Blacklisted, the charge for issuing fake invoice or committing tax fraud should also be established in the Order-in-Original rather than only in the show cause notice.

Further, input tax on account of purchases by a genuine buyer (from a subsequently declared Blacklisted person) should be allowable to the extent of purchase until Blacklisted declaration date, as the genuine buyer would have bought the goods in the good faith and no such, declaration was appearing on the FBR website at the time of purchases. There are numerous reported and unreported judgments by ATIR where the Tribunal has held that blacklisting may only operate prospectively and no retrospective effect may be given to deprive the buyer from his legitimate right of input tax.

3.3.12 RECORDS - SECTION 22

While conducting audit under Section 25, the tax officers usually demand records / information which is not specified under Section 22 of the Act or the Sales Tax Rules 2006. For instance, apart from prescribed sales tax records, auditors usually demand income tax returns, cost audit report, etc. which is not permissible in any fiscal statue. Consequently, tax demands have been created on the basis of such extra records submitted by the taxpayers before tax auditors.

In is notable that the ATIR has already held that sales tax liability created on the basis of income tax returns, not specified in Section 22, is not legal and permissible.

Recommendations:

- In sub- section 2(a) the word 'fiscal' be removed.
- The FBR and Federation of Pakistan Chamber of Commerce & Industry (FPCCI) have already agreed upon records which may be sought by the tax administration during tax audit. This agreement was also made public vide FBR's letter dated 17 November 2001. It is suggested that the suitable amendments be made in section 22 of the Act by incorporating the above FBR letter as part of the statute.

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3.3.13 REVISED RETURN - SECTION 26

It is suggested that necessary amendments may be made and reference of section 27 may also be incorporated in section 26(3) of the Act so as to enable the taxpayer to rectify any omission in the special return.

3.3.14 ADDITIONAL TAX / DEFAULT SUR CHARGE - SECTION 34(1)

It should be clarified that in case of past cases (cases related to all preceding years) additional tax will be levied at the rate presently applicable as default surcharge subject to a maximum of principal tax liability.

Simultaneous levy or penalty and additional Tax under the Act may need to be removed, being unjustified, since both the provisions are of punitive nature. There should be only one penalty on a single default. Moreover, default surcharge should not be charged on an inadvertent error as was the case of additional tax.

3.3.15 RECOVERY OF TAX NOT LEVIED OR SHORT LEVIED OR ERRONEOUSLY REFUNDED – SECTION 36(1)

It should be clarified that section 36(1) is applicable in case of 'tax fraud' only.

3.3.16 POWER TO ARREST - SECTION 37(A)

This section should only be applicable where the case of tax fraud has already been established at the stage of Order-in-Appeal.

3.3.17 APPEALS TO TRIBUNAL - SECTION 46

It is suggested that the condition of expiry of stay after six months be removed (by administrative instructions).

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Further, in the larger interest of justice and fair play, the criteria for appointment of "Accountant Member" in the Appellate Tribunal may be modified. Accordingly, 'Accountant Member' may be the individual who is:

- a 'Chartered Accountant' within the meaning of Chartered Accountants' Ordinance 1961 with at least 10 years of experience at Tribunal level
- a serving FBR Officer not below the rank of Grade 21.

Likewise, a 'Judicial member' may be a person who has been an advocate for the last 10 years with 5 years experience in tax practice.

3.3.18 APPEALS TO HIGH COURT - SECTION 47(8)

It is proposed that section 47(8), which allows stay to the extent of 6 months only, may be deleted.

3.3.19 LIABILITY FOR PAYMENT OF TAX - SECTION 58

The Section 58 dealing with the "Liability for payment of tax in the case of private companies or business enterprises" is not happily worded. Under the existing law a person who was a shareholder representing even one share can be held responsible for the liability of the company. Similarly a person who is a nominee director or employee director can be held responsible for the liability of the company.

In the Income Ordinance 2001 such matters are covered under section 139 which comprehensively deals with the liability both in case of company and association of persons. The section 139 needs to be replicated in the Sales Tax Act on the similar lines.

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3.3.20 VERIFICATION OF TRANSACTIONS - SECTION 73

As per section 73 of the Sales Tax Act, 1990, buyer will not be entitled to claim input tax credit, adjustment etc. if the amount of related Sales Tax Invoice is not paid within 180 days.

The aforesaid provision is similar to a provision in Income tax Ordinance, 2001 which lays that if a liability is not paid within three years of accrual than its expense will be disallowed. The said Income Tax provision, however, allows the company to claim this expense when actual payment is made.

Recommendation:

We understand that even in Sales Tax law when an expense is disallowed due to non-payment within aforesaid period it would be subsequently allowed when payment is actually made however; such a provision is not expressly included in law. Accordingly, it is suggested that a provision should be expressly included to the effect that any disallowed input on account of non compliance of section 73 be allowed to be claimed once sales tax liability is actually paid through prescribed banking channels.

3.3.21 SUPPLY TO EXPORT PROCESSING ZONES - FIFTH SCHEDULE

Sales tax at the rate of zero percent is applicable on supply of raw materials, components and goods for further manufacture of goods in the Export Processing Zone vide serial number 5 of Fifth Schedule to the Sales Tax Act, 1990. This means, supply of goods which are not used in manufacturing of goods in EPZ are not entitled to zero rating of sales tax.

The intention behind not allowing zero rating sales tax on goods used otherwise than in manufacturing/ production was in the context of SRO 578 (I)/98 dated June 12, 1998 which interalia had disallowed input sales tax on building materials. Since now under the existing provisions of the Sales Tax Act, 1990 input sales tax is allowed on building material, it is proposed that zero rated sales tax supply may be allowed on building material to EPZ as well.

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3.3.22 APPEAL EFFECTS

It is suggested that a new section be introduced to the effect that any issue decided by the Commissioner (Appeals), Appellate Tribunal Inland Revenue, High Court or the Supreme Court will be given effect in the returns / orders for the subsequent period. If that order or decision is reversed by a superior forum then such assessment / returns shall be revised to that effect. This section should in principle be in line with section 124A of the Income Tax Ordinance 2001. It may be noted that absence of similar provision leads to unwarranted litigation.

3.3.23 THIRD SCHEDULE

Third Schedule should be deleted. On items included in this schedule, sales tax is recovered from the manufacturer at the retail price which is against the concept of VAT. In 1996 amendments had been made to reduce number of items to three. In the recent past a regressive approach has been adopted for the same that needs to be changed and items from the Third Schedule provisions be gradually deleted.

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3.3.24 ACTIVE TAXPAYERS LIST - SALES TAX GENERAL ORDER 34/2010

The aforesaid Sales Tax General Order 34/2010 (STGO) has been issued in terms of section 55 of the Act and introduces a wider definition of 'non active taxpayers'. Besides, various serious repercussions have been listed therein when either such non active taxpayers carry out businesses or when business transactions are made with them.

We understand the STGO suffers from fundamental legal infirmity since, on one hand, the Act does not contain any specific definition or criteria whereby a taxpayer may be classified as 'non active', on the other hand, the STGO does not only lists down a self contradictory definition of 'non active taxpayers' but also specifies the repercussions if business is conducted by / with such taxpayers.

In short, the FBR has attempted to legislate an entirely new mechanism which obviously cannot be made under Section 55 through a General Order. In short, following are the various stipulations of STGO and legal defects thereof which, in our view, should be considered by the Government in the upcoming budget:

Stipulations of STGO	Legal Defects / Comments
Every person who fails to file the return under section 26 of the Act within the prescribed period for two consecutive months has been classified as a Non Active Taxpayer.	Usually FBR Web Portal suffers from system problems near the filing date which delays timely filing by the taxpayer. Nonetheless, the STGO does not has provision to condone the where the delay in filing is beyond the control of businesses. Secondly, this requirement is in direct conflict with Rule 11(4) of Sales Tax Rules 2006 (the rules) whereby non filing of tax returns for consecutive 6 months may lead to deregistration of concerned taxpayer. A person who fails to file any missing return within 15 days of notice issued to him can also be classified as non active. However, it has not been specified whether this reference is made towards missing return in the departmental data base or otherwise.
Anyone who fails to file any due Income Tax return under section 114 or who fails to file the monthly withholding tax statement under section 165 of the income Tax Ordinance 2001 for two consecutive quarters will also stand disqualified as Non Active Taxpayer.	The term 'non active' has also not been defined in the Ordinance. Also, in the absence of any inter-tax / contra penal action prescribed in both Act and the Ordinance, the proposed action under STGO lacks due legal backing. In two identical judgments pronounced by the Appellate Tribunal Inland Revenue, it was held that the department is not authorized to use the data or information and figures, supplied by the businessmen in their Income Tax Returns, as basis for assessment of sales tax liability.

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Stipulations of STGO	Legal Defects / Comments
Whosoever fails to respond to the "discrepancy notice" or any other notice issued by tax authorities within 15 days of the issuance of such notice will also be treated as non active. The term" discrepancy" has been defined in STGO to mean "mismatching of invoice summary statements between registered buyers and sellers, mismatching of import goods declaration in the sales tax return by the registered person vis.a.vis data furnished by the Customs or any other discrepancy intimated by the tax administration to the taxpayer".	The condition of filing invoice summary statements in no longer prescribed in the statute since it was done away with 2 years back. Moreover, the clause regarding mismatching of invoices in taxpayers' tax return is also legally defective since such mismatching is duly protected under section 7(1) of the Act which empowers the buyer to claim his input tax credit in any of the 6 succeeding tax periods to which the purchase relates.
Mismatching of Goods Declaration between taxpayer's records and that furnished by customs may result in penal action against the taxpayer.	Such mismatching could also be when a particular import was not recorded / uploaded by Customs' in its own database.
The discrepancy, sent to taxpayer's email address or placed in his e-folder at e.fbr portal, will need to be removed by taxpayer getting himself 'audited' by tax authorities or explaining his position.	Under Section 56, a notice shall only be treated as having served to the taxpayer if it is personally delivered to him or his representative, sent by registered post or courier or served as prescribed under Code of Civil Procedure 1908. Even otherwise, the service of notices through email is also likely to incite other questions such as proof of service to the taxpayer, date of email, etc.
In clause 2(vi) of STGO, the taxpayer is required to furnish reply against discrepancy notice within 15 days of issuance.	Interestingly, on other hand, clause 3(ii) requires him to furnish his reply within 15 days of the receipt of discrepancy notice. Thus, STGO appears to be carrying serious self contradiction.
The taxpayer may be declared as 'non active' without service of any formal show cause notice and associated appealable order being served upon him.	The absence of such a mandatory procedure is against all norms of natural justice and fair play and negates the fundamental principle of equity which is the basis of every taxation system.
The buyer procuring goods from Non Active Taxpayer would be deprived of related input tax credit in case he purchases goods from a non active supplier. In such a case, the FBR's web portal would blink such message whenever he tries to feed his purchases over his tax return.	No mention of the law under which the department seeks to disallow the sales tax credit of a person if he fails to file his income tax return.
Taxpayers have been advised not to have any transaction with non-active taxpayers unless they are restored on active taxpayers list on the recommendation of their respective tax office or appellate forum. The 'advice' has also placed upon another restriction of settlement of transaction with non active taxpayers through banking channels even if the value of goods is below the limit of Rs. 500,000 prescribed in section 73 of the Act.	The STGO has crossed the ambit of statute which categorically prescribes settlement of business transactions through banking channel only when the value of supply exceeds Rs. 50,000.

3.3.25 INITIATION OF RECOVERY ACTION - RULE 71

By virtue of Section 45B of Sales Tax Act 1990 , the registered person aggrieved by any decision, may file an appeal within 30 days from the date of receipt of such order. However, on the contrary, under Rule 71 of Sales Tax Rules 2006, the proceedings for recovery of impugned tax may be initiated after 30 days from the date of order. This anomaly results in initiation of recovery proceedings where the registered person receives order after sometime from the date of order and he still enjoys right of appeal under section 45B of the Act.

Therefore, to keep harmony and in the spirit of natural justice, Rule 71 may be amended to provide commencement of recovery proceedings after 30 days from the receipt of order.

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3.4 FEDERAL EXCISE ACT 2005

3.4.1 GENERAL

Excise duties are, in principle, levied to curb consumption of luxury and unwarranted products. Nevertheless, that general principle is being seriously violated in Pakistan. There are excises on many essential items. There is a need to determine the equitable basis for commodities and services which should be subject to the levy of Federal Excise. At present, Federal Excise is effectively an additional indirect tax on major manufacturing sectors. This high incidence of indirect taxation encourages evasion. It is due to this reasons that there is very high evasion of taxes in those sectors where both excise duty and sales tax is leviable. This also promotes manufacturing in unorganized sector e.g. paints, beverages, etc.

There is a need to review the issue of overall incidence of indirect taxes so that possibilities and comparative advantages for evasion are reduced or minimized.

3.4.2 ADJUSTMENT OF DUTY - SECTION 6

Under section 6, Federal Excise Duty is adjustable only if the registered person holds a valid proof to the effect that he has paid the price of goods purchased by him including FED and received the price of goods sold by him including FED through banking channels. The condition of payment and receipt is creating lot of problems for the taxpayers.

It is, therefore, suggested that FED should be made adjustable on accrual / paid basis as per section 7 of Sales Tax Act 1990. Further the duty adjustment should not be made subject to receipt of sale proceeds and related duty.

Secondly, FED paid on excisable goods, which are used directly as input goods for the manufacture of dutiable goods, is adjustable against the final liability. It is suggested that adjustment should be linked to the purpose or actual consumption of excisable goods, in line with Section 7 of Sales Tax Act 1990.

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3.4.3 DEBIT / CREDIT NOTE - RULE 14A

Identical to section 9 of Sales Tax Act 1990, Rule 14A of Federal Excise Rules, 2005 also allows adjustment(s) in tax invoice or return for dutiable goods. However, the benefit of such Rule has not been extended to dutiable services.

It is suggested that necessary amendments may be made in Rule 14A to include reference of dutiable goods and dutiable services.

3.4.4 MANDATORY PAYMENT BEFORE FILING APPEAL - SECTION 37

Before preferring appeal before Office of Commissioner (Appeals) or Appellate Tribunal, a taxpayer is required to deposit the impugned duty demanded or penalty imposed in the appealable order. This mandatory compulsion is considered as a hindrance in the dispensation of justice.

The identical provisions in Income Tax and Sales Tax have already been repealed. Therefore, it is suggested that the same should also be removed from the excise law.

3.4.5 SPECIFIC ISSUES

3.4.5.1 INPUT TAX ADJUSTMENT UNDER SALES TAX & FEDERAL EXCISE DUTY

An effective VAT system requires taxing the whole supply chain and credits for all taxes borne at input stage. In Pakistan, on account of the weaknesses, as briefly identified in the earlier paragraphs, distortions have been created in that system. As a result in many cases credit for input taxes are treated

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as inadmissible, whilst determining the overall tax liability. This results in effective higher rate for sales tax and federal excises.

This problem, like many others in our system, emanates on account of improper implementation rather than any provision of law. It is required that implementation issues in the admissibility of input tax in sales tax be resolved and proper guidance on that matter be obtained from other countries where such systems are effectively in operation. The best examples are UK in the developed world and Bangladesh in our region.

The status in case of Federal Excise duty is different. In that case in many sectors the input tax is effectively not allowable under the law. This places the said tax outside the ambit of VAT regime. In that situation as a measure of policy it needs to be decided by the Government whether such a levy is to be operated as VAT or a straight indirect tax. If the second option is to be implemented, that rate of tax will have to be reduced.

The Institute considers that implementation of full fledged VAT with same rate, is a better option. One of the examples of adverse application is availability of input excise in the case of beverage industry on the purchase or import of concentrate. There are many other such examples. This matter needs to be settled in principle.

3.4.5.2 ROYALTY PAYMENTS

'Royalty' payments have been subject to Federal Excise Duty. The term used in the law is 'Franchise fee' which at times distinguishable with royalties in strict commercial and practical sense. This has lead to serious issues of interpretation and misapplication in many entities. Taxpayers are more seriously affected for the reason that in such cases on account of use of technology etc. and their nature of operation, such entities engaged in various activities, necessarily require such payments.

It is recommended that FED procedures for franchise fee be streamlined and the same be brought in line with the State Bank's regulation. Such measures will resolve the issue correctly as most of the organized entities remit such fees through SBP and there are well laid down procedures for the same.

3.4.5.3 COLLECTION OF FED ON LUBRICATING OIL

According to the serial No. 22 & 23 of the First Schedule of the Federal Excise Act 2005, FED is being charged on Lubricating Oil on the basis of Retail Price @10%, while FED on reclaimed oil has been reduced from Rs.5 to Rs.2 per litre.

This has given rise to the following problems.

- Smuggling and adulteration is encouraged, due to widening in the gap between virgin and reclaimed oil.
- Difficulty in calculation of FED, if one claims, that the product is formulated with more percentage of reclaimed oil.
- Difficulty in monitoring of volume of lubricants sold containing reclaimed oil.

Uniform duty structure will discourage smuggling of base oil that is misdeclared as reclaimed oil for evasion of excise duty by the unorganized sector.

Recommendation:

There are approximately 100 different grades of lubricants having different Retail Prices. Therefore, preparation of monthly Federal Excise return on the basis of varying retail price is time consuming exercise.

It is therefore, suggested that there should be a fixed rate of FED on the basis of quantity produced as per the previous practice otherwise FED may be allowed on the value of supplies instead of Retail Price.

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3.4.5.4 ADJUSTMENT OF PETROLEUM DEVELOPMENT LEVY (PDL)

Under Federal Excise General Order # 1 of 2005 (FEGO), the POL products supplied to Pakistan Navy, outgoing vessels or international flights are entitled to exemption from Excise Duty. This exemption of Excise Duty shall be reflected by the concerned Oil Refinery in their invoices issued to the Oil Marketing Companies mentioning that the products covered therein are meant exclusively for the said users.

The problem arises that only adjustment of Federal Excise duty is allowed in the said FEGO, however, the adjustment of Petroleum Development Levy (PDL) already paid on products exported, supplies to out going vessels or international flights is not allowed. Further the said FEGO does not allow adjustment in case of export. The refund of PDL against exports & supplies of POL products to outgoing vessels or international flights are pending with the Large Tax Payers Unit, Karachi since long.

Recommendation:

The said FEGO should be amended to allow such adjustment in case of other exports. The adjustment of PDL may be allowed by the concerned refinery in a manner prevalent for adjustment of FED under the said FEGO.

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3.5 CUSTOMS DUTY

3.5.1 CASCADING OF RATE OF DUTY ON LOCAL INDUSTRY

Over the last two decades custom duty rates on raw materials, intermediaries and finished products have been substantially reduced. The objective is to reduce possibilities of evasion and avoidance on account of high rates of duties. There are two primary reasons for the same viz:

- The whole world has changed on account of financial turmoil in the USA and there is a consensual view that ultimate stability in economics will require concentration on manufacturing sectors; and
- in the wake of reduction of custom duty 'cascading' with the duty structures were not appropriately taken care of due to which local manufacturing sector has been seriously hampered.

There is a need to review the custom duty structure afresh to facilitate the promotion of local manufacturing industry. In the absence of proper cascading in the duty structure such opportunity cannot be effectively availed. Present structure supports the promotion of trade in commodities rather than manufacturing the same in Pakistan. This results in unemployment and poverty.

3.5.2 COMPOSITION OF MAJOR COLLECTION

The present collection is being made from very few sectors. Major contributories are:

a) crude oil imports;
b) import of commodities like edible oils etc;
c) import of consumables; and
d) minimum import duties on plant and machinery items

This analysis of collection reveals that there is a need to align the objective of overall economic policy with the fiscal measures. Pakistan's annual import bill is around US $ 40 billion requires a substantial reduction to meet the constant pressures on foreign reserves. Rationalization of custom duties will ensure facilitation of the local manufacturing sector. This requires a comprehensive tariff review. Furthermore, it should be ensured that custom duty is taken as a measure to manage the trade policy rather than tax collection.

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3.5.3 AFGHAN TRANSIT TRADE AND UNDER INVOICING

Pakistan is faced with two fundamental menaces in relation to implementation of import duty structure and abolition of smuggling. These are:

- Abuse of Afghan Transit Trade (ATT); and
- Under invoicing at import stage.

Both of these issues are directly affecting the organized sectors. No meaningful improvement can occur unless such abuses are either abolished or substantially reduced in the short run. This in itself is a complete subject of fiscal policy. However, at the outset following suggestions may lead to constructive framework:

(i) In case of ATT, like all other land locked countries, the agreement [treaty] for facilitation of imports with Afghanistan be revised. There has to be 'quantitative ceiling' for imports required for Afghanistan; and an effective mechanism should be implemented to collect duty on ATT at import stage to be refunded on confirmation of passage from Pakistan to the Afghan border should also be subject to quantitative restrictions.

(ii) Exchange control mechanism be streamlined so that economic barriers are placed for financing of under invoiced goods. At present, liberation of exchange controls are being abused to finance such under invoiced imports.

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