



The American Business Council
of Pakistan



American Business Council suggestions for Federal Budget 2011/12





EXECUTIVE SUMMARY

Attached are the proposals for the upcoming Federal Budget 2010/2011 which comprise of 8 taxation related proposals and 4 procedural improvement/modification proposals. All these proposals will positively impact the ability for US companies to operate efficiently in Pakistan. The procedural suggestions are designed to help streamline and improve tax collection and appeal processes..

ABC vision remains to have a robust, understandable and transparent taxation environment which includes:

- **EVERY EARNING MEMBER OF SOCIETY SHOULD BE PAYING TAXES:**
 - ✓ We have one of the lowest “Tax to GDP” ratio in the world at less than 9%.
 - ✓ Major sectors of the economy are not appropriately taxed, such as agriculture, real estate & stock market.
 - ✓ Industry, which makes up 20% of GDP, is disproportionately taxed.
 - ✓ Currently less than 2% of the population pays personal taxes.

- **HAVE A SIMPLE TAXATION STRUCTURE:**
 - ✓ Taxes should be easy to levy and easy to file for tax payers.
 - ✓ Focus should be on only 3 sources of taxation, i.e.
 1. General Sale Tax (GST);
 2. Customs Duty;
 3. Corporate and Personal Income Tax.

- **SHOULD BE COMPETITIVE VIS-À-VIS OTHER COUNTRIES:**
 - ✓ Make Pakistan attractive for foreign investment by making its taxation competitive.
 - ✓ This in turn will help reverse the unfortunate brain drain taking place.

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cc: ABC Executive Committee

SUMMARY OF ABC SUGGESTION FOR FEDERAL BUDGET 2011/12

The ABC Suggestions for the Federal Budget 2011/12 can be divided into 8 taxation related proposals impacting US companies operating in Pakistan, as follows:

CORPORATE TAXES

This encompasses lowering the high Corporate Income Tax, revamping WPPF & WWF, rationalizing Minimum Turnover Tax for all Companies, Simplifying Advance Taxes for Manufacturers and addressing the high rate of Advance Income Tax at the import stage.

EXPANSION OF GENERAL SALES TAX (GST)

This focuses on the expansion of the current tax net through communication and incentives. Issues and concerns within the gambit of GST that need to be addressed involve the proposed Value Added Tax to replace the current GST, Toll Manufacturing ambiguity, suspension without notification, withholding of Sales Tax and blacklisted suppliers.

EXCISE DUTY ELIMINATION

The proposal calls for the elimination of Excise Duty, with the introduction of Consumption Tax if needed, and a further call to eliminate Special Excise Duty altogether.

PERSONAL INCOME TAX

The section encompasses Tax Relief for the lower salaried class, the introduction of a "Tax Payers Card", the elimination of a cap on the exemption of Interest on house loans, the simplification of Income tax returns & Wealth Statement Bracket Increases, Tax on employers' contribution to a recognized Provident Fund, withholding tax on banking transactions, and small payments for prizes and winnings.

FINAL TAX REGIME (FTR)

Aside from encouraging investment, this point also suggests a simplification of the tax regime leading to greater transparency.

TAX CREDIT ON BAD DEBTS

This proposal addresses the issues of prior years bad debts being disallowed by the Tax Authorities and the allowance of bad debts expense post the calendar year that ended Dec 31, 2007

ELIMINATE SALES TAX ON PHARMACEUTICAL INPUTS

The suggestion is to make pharmaceutical raw materials zero rated for Sales Tax, and look into Custom Duties on pharmaceutical raw materials as well as the high Duties on basic hospital supplies.

INCONSISTENCY IN COMPUTING VALUE OF IMPORTS

Attending to this issue will result in clarity and fairness in the application of the law, along with avoiding unnecessary time delays.

PROCEDURAL ISSUES AND PROPOSALS:

On the procedural front, we have 4 proposals to help streamline processes & improve taxation collection systems; which are General Sales Tax related, and involve the amendment of Assessment - Section 122, the appeal process - Section 124/127/129/131/132, as well as streamlining ideas for the collection of taxes.

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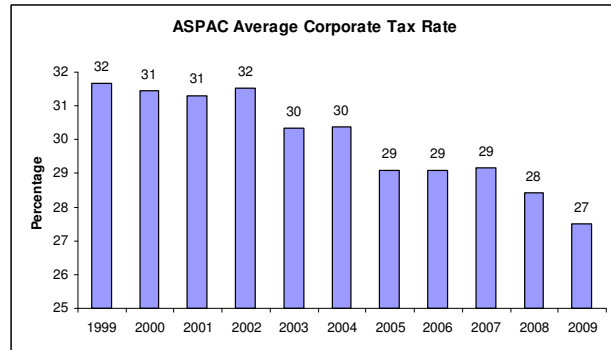
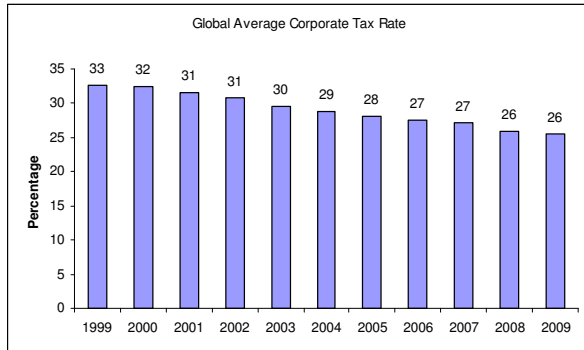
TAXATION PROPOSALS FOR FEDERAL BUDGET 2011-12

1. HIGH CORPORATE TAXES

1 A) High Corporate Income Tax

Issue

With global shift towards indirect taxes, average corporate tax rates are coming down, e.g. among 116 countries tax rate has fallen from a high of 32.7% in 1999 to 25.5% in 2009.



Source: KPMG 2009 Corporate Tax survey

In line with the continuous downward trend in world direct taxes, average corporate tax rates among Asia Pacific countries has also fallen from 31.8% in 1999 to 27.5% in 2009 (0.94% below 2008) while Pakistan Corporate Tax Rate remains at 35% (effective is 42% including WPPF and WWF), which is far above in the region.

Looking ahead, if we want to remain competitive in attracting foreign investment, we will have to be competitive on corporate taxes among our region and neighbors. This is all the more important and urgent with the current global reduction in economic activity. Also the limited supply of capital investment will go to those countries which have most attractive overall package of which corporate tax rate is a key factor.

Country	Corporate Tax Rate	Pakistan Higher by
Pakistan	35.0%	-
India	33.6%	1.4%
Indonesia	25.0%	10.0%
Hong Kong	16.5%	18.5%
Singapore	17.0%	18.0%

Proposal

In order to remain internationally competitive, Pakistan needs to reduce its corporate tax rate to a maximum of 30% in line with regional standards.

Benefit

Lower corporate tax will promote investment in Pakistan, make private sector more vibrant and will enable Pakistan to be internationally competitive.

1 B) Workers' Welfare Fund (WWF) and Workers' Profit Participation Fund (WPPF)

Issue

In addition to this higher corporate tax, companies in Pakistan are also responsible for taxes on account of WWF and WPPF intended to benefit low-income workers. However, in reality workers who contributed to generate this fund are being deprived of from this benefit.

Also worth noting that welfare taxes are also among the highest in the region.

Country	Pakistan ⁽¹⁾	India ⁽²⁾	Korea ⁽³⁾	Singapore ⁽⁴⁾	Indonesia ⁽³⁾
Tax rate	7%	2%	3-4%	Various %	3.7%
Levied on	Corporate Profits	Basic Salary of Labors	Employee Salary	Employee Salary	Employee Salary

- 1. This includes both WPPF and WWF calculated on the taxable income and profits of the Company.**
- 2. In India 2 employee welfare schemes exist, i.e. a) Employee State Insurance (ESI), for medical care of employees with salary of less than 10% (something like EOBI); b) Employee Welfare Fund, for all employees, levied at (less than) 2% of basic salary.**
- 3. Calculated on employee salary**
- 4. 6% above 60 days, 9% between 55-59 years, 13% up to 54 years (all calculated on base salary)**

Proposal

- a) Ever-rising demand for spending on the social sector specially health and education, we suggest utilization of WPPF by the company itself through a fund for the interest of their own workers who contributed towards generation of the profit. Companies are willing to incur this expense as part of their cost of doing business in Pakistan but would like this investment to help their workers.

Company manages it through a fund, following the same legal requirements associated with the Provident Fund, to benefit its workers to help build schools and hospitals near their operation and plants.

- b) Elimination of frivolous clause of interest % on dividends declared (which goes to a maximum of 75% of the dividend rate) and keep it only linked to bank rate + 2.5%.

Benefit

This proposal would clearly enhance investment in the much needed social sector across Pakistan and will clearly have a major impact on improvement of health and education facilities across Pakistan.

It will positively impact poverty alleviation through availability of much needed funds for facilities like schools, hospitals, etc. and in turn enhance the motivation and moral of workers and ultimately government revenues

1 C) Rationalize Minimum Turnover Tax for all Companies

Issue

The Board has vide its SRO 1086 (1) / 2010 dated November 30th, 2010 given relaxation in minimum tax to distributors of pharmaceutical products, fertilizers, consumer goods including fast moving consumer goods where after the minimum tax has been reduced by 80% from the 1.0% to 0.2%.

In cases of Oil marketing companies, Oil refineries, Sui Southern Gas Company Limited and Sui Northern Gas Pipelines Limited the rate of minimum tax shall be reduced to 0.5% in cases their annual turnover exceeds Rupees 1.0 billion.

We strongly feel that the minimum tax is unfair to companies that are in a start-up phase and have made initial capital investments / marketing investments and are making resultant losses in their first years of trial production or trial operations.

Proposal

It is recommended that to create a level playing field to the new entrants in the market the minimum tax should be reduced to 0.2% in the first 3 Tax Years of the company. For existing companies who have made investments exceeding US\$ 0.5 Million, the same should be applicable for the year of investment to encourage investment in existing facilities.

Benefit

1. Companies willing to enter Pakistan, as well as those already functioning in the country, which are planning on investing in capital or marketing, will be encouraged to make further investments.
2. A rationalized levy of minimum tax and will not act as a show stopper for companies in difficult financial situations.

1 D) Simplify Advance Tax for Manufacturers

Issue

1. Section 147 of the Ordinance requires companies to pay advance tax on the quarter's turnover in the same proportion as the tax assessed for the latest tax year bears to the total turnover for that year.

Further, if any taxpayer fails to pay advance tax or the tax so paid is less than 90% of the tax chargeable for the relevant tax year, he shall be liable to pay additional tax @ KIBOR plus three per cent per quarter on the amount of tax so chargeable or the amount by which the tax paid by him falls short of the 90%, as the case may be.

This requirement is very harsh, as it requires companies to make huge amounts of advance tax at an early stage thus causing cash flow issues. If refunds are expected at finalization of assessment order stage, the tax office may resort to making arbitrary disallowances negating the refund situation.

2. Presently the manufacturers are required to pay advance taxes in multiple forms e.g. withholding taxes u/s 153 (deducted by customers), tax at import stage u/s 148 paid to Customs authorities and quarterly advance taxes u/s 147 paid on the basis of estimated tax liability for the current fiscal year. Pertinent to note that all the withholding taxes paid during the quarter are adjustable against the quarterly tax liability.

Proposal

1. It is recommended that preferably the law be changed to the one, which was in force before the 2006 Finance Act amendment whereby a company was required to pay advance tax equal to one fourth of the tax liability finalized for the latest tax year or at least the benchmark of 90% should be reduced to 75%.
2. Manufacturers should be given exemption from withholding taxes u/s 153 and u/s 148. They should only be required to pay advance tax u/s 147. This way the manufacturers will pay the same amount of advance tax but through a much simpler way. Reduce complexity at both ends, i.e. payer and government.

Benefit

Help simplify and streamline tax process for good corporate citizens and will ease cash position of the company

Further, it will eliminate the imposition of additional tax due to estimation variance. As due to uncertainty of economic and political condition of Pakistan it is very difficult to estimate the taxable income with 90 % accuracy especially in a case very a company's business income is very volatile like income from investment in listed securities.

1 E) High Rate of Advance Income Tax at Import Stage

Issue

Withholding tax at import stage has been increased from 4% to 5% of value of goods inclusive of custom duty and sales tax from July 2010. This has badly affected industries importing raw material for manufacturing purposes. Huge working capital is stuck in tax paid at import stage.

Proposal

Rate of withholding tax at import stage should be reduced to 2% to 3%. Exemption should be allowed to those industries which are importing raw material for their own manufacturing purposes.

Benefit

This will improve cash flow and make companies more efficient

2. EXPANSTION OF GENERAL SALES TAX (GST)

Issue

In many developing countries, such as Pakistan, India, Mexico, etc., GST is a key revenue source as high unemployment and low per capita income render other income sources inadequate. Instead of introducing or using other tax sources thus creating more bureaucracy and complexity of collection, it is ideal to expand GST to apply across all sectors of the economy. Unlike other collection sources, GST offers a steady stream of income and is collected evenly over the entire fiscal year.

An effective indirect tax system needs to evolve if Pakistan has to keep up with the pace of commercial and technological change. Instead of increasing the Sales Tax rate as done last year, the tax net need to be broadened. Sales Tax Rate applicable in Pakistan is already at higher side as given below in the table:

Country	GST Rates	Pakistan Higher by
Pakistan	17.0%	-
India	12.5%	4.5%
Indonesia	10.0%	7.0%
Hong Kong	0.0%	17.0%
Singapore	7.0%	10.0%

Proposal

To expand the tax net, attracting entities register for GST is critical. Some ideas for creating incentives and dispelling fear for potential entities to enter the GST net are:

Expansion and Communication:

1. The GST rate should be reduced to be comparable levels vs. other Asian markets which will encourage registration. A general economic model is that if GST exceeds 10%, people start engaging in widespread tax evading activity.
2. The GST process should be simplified to enable medium and small sized trader's to understand the 'concept; easily. The documentation requirements should be reduced to avoid unnecessary work.
3. Special team using 3rd party qualified companies should be brought on-board and who will work with businesses to help them understand and file for GST. This is in line with FBR work towards enhancing cooperation and helping in expanding the GST net.
4. The Government should run media and awareness programs to publicize these incentives and to explain the easy user friendly filing and collection system.

Incentives to Attract Registration:

1. No sales tax audits be carried out for newly registered small traders during the first 5 years of an entity's registration. Only exception will be if the entity claims any refunds, in that case for verifications.
2. Small traders, having limited turnover, may be allowed to file a sales tax return once every 6 months. This will make the compliance easy for small traders.
3. The same newly registered small traders be offered lower income tax rates for first three years in case they opt for sales tax registration.

Benefit

- a. This will discourage evasion and encourage participation with a win-win situation for registered entities.
- b. Expansion of tax net is the only viable solution to a prosperous Pakistan.
- c. Newly registered entities will pay some tax as compared to their 'ZERO CONTRIBUTION' today.

2 A) Proposed Value Added Tax to Replace Current GST

Issue

It has been learned that the Government is planning to replace the General Sales Tax (GST) with Value Added Tax (VAT) in Pakistan. This is a major change and a key source of income for the Government and ABC is concerned that it should be designed to create a win-win for all parties involved.

Proposal

While this is a welcome sign to modernize and rationalize the taxation regime, and also encourages documentation of economy, the government should keep the following things in mind while implementing this change:

1. Properly involve and consult all relevant stakeholders, including companies, trade and consumers on the implementation mechanism of this regime.
2. A proper, layman type communication need to be carried out including neighborhood seminars to answer any concerns and stamp out misinformation.
3. If a change is made, companies should be given a 6 month period before it is effective to reflect it into their systems and pricing. Less time will result in quality issues and confusion which may work against VAT acceptance.
4. Both VAT & GST sometimes tend to place a disproportionate burden of taxes on the poor and this should be avoided to the extent that is possible by making essential items zero rated or putting them under reduced rate categories.
5. Rates of VAT should be consistent and aligned with other regional countries.

Benefit

Ownership of all the stakeholders, and finally having an equitable and simplified regime,. This will facilitate compliance.

2 B) Toll Manufacturing - Ambiguity

Issue

Previously, the definition of the term 'Supply' included the term "*Other Disposition*" as part of supply. In terms of Para 1(E) of Sales Tax General Order (General Order) No. 3/2004 dated 12 June 2004, the Board had opined that return of goods processed by the vendor back to the principal tantamount to "*Other Disposition*" and accordingly liable to sales tax. The present definition has brought '*Other Disposition*' out of the definition of 'Supply'.

Proposal

Since toll manufacturing appear to be out of 'Supply', it is suggested that Part I(E) of General Order may also be withdrawn to avoid potential problems for the taxpayers during audit. If this is not the intention, then the term "*Other Disposition*" should be inserted in the definition of *Supply*'.

Benefit

To overcome the existing anomaly in tax laws and to ensure consistency in compliance of tax laws

2 C) Suspension without notification

Issue

At present, any taxpayer may be suspended on mere suspicion of tax fraud, etc. This results in immediate blockage of refunds accruing to corresponding buyers.

Proposal

To curtail the abuse of such provision, it is proposed that before declaring any person as blacklisted / suspended, the charge for issuing fake invoice or committing tax fraud should also be established in the Order-in-Original.

Further, input tax credit on account of purchases by a genuine buyer (from a subsequently declared blacklisted person) should be allowable to the extent of purchase until date of suspension.

Benefit

To avoid delays in claiming genuinely available tax credit

2 D) Withholding of Sales Tax

Issue

Through SRO 704(I)/2009 dated July 30, 2009, tax payers registered with LTU are required to withhold sales tax at 1% from payments made to non-LTU registered persons. It is an extra burden as the taxpayers are required to withhold and deposit the sales tax, issue certificate to the taxpayers, and maintain record. This requires additional resources and cost of doing business increases unnecessarily.

Proposal

Withholding of sales tax at 1% be done away with.

Benefit

Elimination of complications and ease of operation for the tax payers together with reduced operational costs.

2 E) Blacklisted Suppliers

Issue

Sale tax department is issuing notices under rule 12(5) of the Sales Tax Rules, 2006 contending the adjustment of input tax paid by the registered persons on the invoices issued by the suppliers which were blacklisted subsequent to the supply date. Such notices are being issued without considering the fact that the Company has suffered and paid input tax on bona fide transactions and there is no collusive arrangement with (unrelated) suppliers of goods, which is evident from the fact that the corresponding supplier has been blacklisted subsequent to the transaction with the buyer. This black listing also results in disallowance of input tax by FBR portal, if this vendor is black listed at the time of the return submission.

Proposal

FBR needs to issue guidance on this issue to collecting units so that tax payers are not unnecessary bothered. This is especially important as most of the vendors in these cases are on active tax payers list when purchases were made from them.

Benefit

Collecting taxes is a state responsibility and hence it should not be the tax payers who should be made responsible for an action done by another tax payer.

3. EXCISE DUTY ELIMINATION**3 A) Eliminate Excise but if needed, introduce Consumption Tax****Issue**

Excise Duty is an additional tax burdening consumers. Key source of government revenues should be just three, i.e. General Sales Tax, Custom Duty and Corporate/Personal Income Tax.

Proposal

Eliminate Excise Duty from all items and if it is important for the government to curtail or discourage consumption of any category, a consumption tax be levied. However, this consumption tax should be reviewed and decided by industry and not levied across board like Central Excise Duty.

Benefit

By reducing tax burden from industry and consumers, both affordability as well as consumption will increase thus impacting GST/VAT positively and off setting hurt from CED elimination.

3 B) Eliminate Special Excise Duty (SED)**Issue**

1% SED was imposed with effect from July 1st, 2007 in the Finance Act. This is an additional burden to the already heavily taxed industries. We believe this is contradictory to the government's consumer benefiting economic policies and will encourage inflation via higher prices. Furthermore, adding such duties and taxes on the regulated industry leaves the industry more exposed to parallel imports, which in essence is at the expense of the regulated industry and ultimately a loss to the national exchequer.

Proposal

SED should be immediately withdrawn from all industries.

Benefit

Better consumer value, lower inflation and reduction in tax burden to the already heavily taxed industries, thereby, providing flexibility to reinvest in the market to grow business and contribute towards increasing Government revenue.

Also the concept of levying consumption tax will allow government to dialogue with each industry and justify additional taxation if needed.

4. PERSONAL INCOME TAX

4 A) Tax Relief for lower Salaried Class

Issue

Government's effort in revising the salary slab structure & taxing the salary on gross amount along with the reduction of rates to maximum of 20% is appreciated. However the lower salaried class individuals have still to pay taxes which are a huge burden for these individuals considering the rate of inflation and consequently rising prices of consumable items specially food which constitutes a major portion of the spending budget of low income individuals/families. Exemption is available only up to Rs. 300,000 only.

To note that payroll tax is not the only income tax being paid by salaried class. They also pay income tax in form of withholding taxes on utilities, phone bills etc. Since they are not required to file income tax return, most of them do not claim refunds of these withholding taxes.

On the other hand, the contribution of lower salary class of people in government exchequer is immaterial and this estimated to be less than **0.05%** of total national tax revenue.

Proposal

It is recommended that salaried class individuals should be given exemption up to Rs. 500,000 and amount earned above this limit should be considered as taxable.

Benefit

Relief to the lower salaried class may be given specially in the current tough economic times.

4 B) Introduction of a "Tax Payer Card"

Issue

Individual Tax payers in Pakistan are not incentivized hence many stay out of the tax net. General impression is that getting into the Tax Net entails complexities and additional tax burden.

Proposal

Introduce a *"Tax Payer Card"* to all individual tax payers with clear benefits (*some suggestions' below*):

1. Quick processing of application and 50% discount on government fees like passport fee, NIC fee, driving license fee; waiver from police enquiry etc.
2. Waiver on loan processing fee and any other one time charges taken by banks for Loan/finance processing.
3. Reduced markup rates for these tax payers on loan taken from Nationalized Banks.
4. Waiver from CVT which is being paid by individuals on purchase of various items such as Property, Vehicles, International Air tickets etc.
5. Preference and discount on motor vehicle registration fee and annual vehicle tax
6. Waiver of references for opening of new bank accounts, and obtaining credit cards etc.

7. Preference/priority in obtaining new connections for utilities like electricity, telephone, gas and water.

Minimum criteria for people who get the "Tax Payers Card" should be those tax payers who have filed and completed tax returns for last 3 fiscal years. A proper mechanism may be established to monitor these tax payers on an annual basis to facilitate the process.

Benefit

This card and its benefits will motivate the tax payer to pay proper tax and get valued returns thereon and will also induce tax evaders to pay their due share of taxes.

4 C) Elimination of Cap on exemption of Interest on House Loans

Issue

In today high inflationary times, house building has become a huge burden on citizens of Pakistan. Based on current law, tax rebate on interest paid on Housing Finance loan is available to tax payer subject to the lower of :

- i) Actual amount paid, or
- ii) Rs. 750,000/-, or
- iii) Amount not exceeding 40% of taxable income

With the high cost of building materials and increased financing this is not much of an incentive any more.

Proposal

No cap should be placed on tax rebate on interest paid on Housing Finance loan to an existing tax payer

Benefit

Encourage tax payer as the perceived benefit to existing tax payer is significant. It will significantly help lowering the burden of building a house for tax payers.

4 D) Simplify Income tax return and Wealth Statement Bracket Increase

Issue

1. Currently tax payers who have 100% of their income arising from salary are also required to file a return in lieu of a certificate from the employer resulting in an extra work for these employees.
2. Further under section 116, every resident taxpayer filing a return of income for any tax year whose last declared or assessed income or the declared income for the year, is Rs 500,000 or more shall furnish a wealth statement for that year along with such return. This is a cumbersome process and the criterion needs to be raised.

Proposal

1. It is suggested that the annual return filed by the tax payer employer should be accepted as a tax return and employee should not be asked to file it separately on September 30 each year. The format of this salary certificate should be defined by the FBR so that it meets their need as well.
2. Criteria of submission of wealth statement should to be raised to Rs. 1.5 million.

Benefit

The above shall result in reducing the work for salaried tax payer and also make the tax administration easy.

4 E) Tax on Employers' Contribution to Recognized Provident Fund**Issue**

Through the Finance Act 2008 an amendment was made in the Income Tax Ordinance 2001 whereby any amount in excess of 1/10th of salary or Rs. 100,000 whichever is lower is to be included in the taxable income of the salaried person.

Taxation on salary income is levied by section 12 on receipt basis only, whereas contribution to provident fund is credited to the fund account and received by the employee on cessation of employment. Further, employer contribution can also be withheld by the employer if employee is charged with misconduct. Therefore, it is only at the time of retirement or resignation that receipt of provident fund contribution can be assessed with certainty.

Proposal

Due to above anomalies and complexities, tax on Provident fund contribution is unwarranted and should be withdrawn.

Benefit

This will result in reducing the already heavy tax burden on salaried class. Further PF contribution being a retirement benefit, should not be brought into tax net.

4 F) Withholding tax on Banking Transactions**Issue**

There are a large number of salaried individuals paying taxes on their salaries, and again paying withholding tax on their banking transactions. Banking transactions; including demand drafts, pay orders, telegraphic transfers, and transactions exceeding the threshold of Rs. 25,000 in a single day chargeable to withholding tax at the rate of 0.3%

Proposal

All modalities remaining the same, i.e. rate of withholding tax remains at 0.3%, adjustable against the final / annual tax liability, etc, but threshold be increased from 25,000 to 50,000

Benefit

Reduce complexity.

4 G) Small Payments for Prize and Winnings

Issue

Companies, especially FMCG offering prizes for promotion of sales are required to deduct tax and furnish the name, address and NTN of the recipient. Where the prizes offered are of a nominal value such as cigarettes lighters, wall clocks, toys, etc, it is practically impossible to deduct tax and furnish the details required.

Proposal

To make the system workable, prizes offered by companies valued at less than Rs. 10,000 should not be subjected to deduction of tax.

Benefit

Reduction in administrative work for the tax payer.

5. FINAL TAX REGIME

Issue

Presently corporate tax under PTR is collected on company revenues – this is illogical and not fair. Today all import businesses pay taxes whether they make profit or not. Due to this, new manufacturing businesses cannot utilize their earlier year tax losses when they import product to test the market, or during the interim period of setting up manufacturing facility.

Major multinational companies who want to enter Pakistan are reluctant as they cannot utilize their earlier year tax losses when they import product to test the market, or during the interim period of setting up a manufacturing facility.

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 is no discrimination in incidence by one sector over the other. FTR disturbs both these aspects.

Proposal

Manufacturers cum importers assessed under NTR, meeting certain preset criteria, should be given option to merge their manufacturing and trading profits for the purpose of their final tax calculations. Preset criteria will limit possible abuse & only those companies should be allowed to opt who meet minimum criteria on investment in fixed assets, or company turnover.

In addition companies falling under FTR and making losses should not be subject to WWF levy,.

Benefits

Encourage foreign companies to test market new product on import basis and then set-up manufacturing once market potential confirmed. In addition, simplicity of tax regime will make taxation much more transparent and in line with global standards for investors.

6. TAX CREDIT ON BAD DEBTS

6 A) Prior Years Bad Debts Disallowed by the Tax Authorities – Up to Calendar Year Ended December 31, 2007

Issue

One of the biggest hurdles that is currently being faced by the banking industry is the disallowance of bad debts written off in earlier years up to calendar year ended December 31, 2007 (tax year 2008). Huge amounts have been disallowed to banks on an arbitrary basis under the provisions of Section 29 & Section 29A of the Income Tax Ordinance, 2001. The FBR through its letter dated December 23, 2009 (addressed to the ICAP) had agreed to insert transitional provisions in the form of Rule 8A which states that bad debts disallowed up to December 31, 2007 (i.e. tax year 2008) which are neither claimed nor allowed as a tax deduction in any tax year would be allowed to be deducted in the year in which they are written off. Subsequently, Rule 8A was inserted in the Seventh Schedule through Finance Act 2010 and was made part of law. However, the wordings used in Rule 8A re "neither claimed nor allowed" is ambiguous and needs further clarification. The reference to "neither claimed nor allowed" would deprive large amounts of bad debts that have been claimed in the past, but were disallowed by the tax authorities. Also, Rule 8A creates an ambiguity on such disallowed bad debts that were either directly written off or were written off in the years upto December 31, 2007 (tax year 2008) for the reason that it permits a deduction in the year a debt is written off.

Proposal

As highlighted above, further clarity is required for the wordings used in Rule 8A re "neither claimed nor allowed". It cannot be the intention of law to disallow such amounts which were claimed by the tax payer in the past, but were disallowed by the tax authorities. We further recommend that in order to save the banks from hardship of writing off deferred tax asset, reclaim of prior year bad debts directly written off as well as provisions should also be allowed through Rule 8A without any distinction.

Benefit

Significantly impact viability and effectiveness of banks to operate in Pakistan and also help reduce their effective tax rate.

6 B) Allowance of Bad Debts Expense Post Calendar Year Ended December 31, 2007

Issue

The taxability of the Banking Companies in Pakistan is governed by the Seventh Schedule to the Income Tax Ordinance, 2001 whereby provisions for advances and off balance sheet items are allowed as a deduction upto a maximum of 1% of advances for corporate business and 5% for consumer and SME business provided a certificate from the external auditor is furnished by the banking companies to the effect that such provisions are based upon and are in line with the Prudential Regulations issued by the State Bank of Pakistan. Provisions in excess of 1% of advances for corporate would be allowed to be carried forward to succeeding years, which is fine. However, although the Finance Act 2010 increased the deduction threshold for consumer & SME business from 1% to 5% of advances, it was not clear whether provisions in excess of 5% of advances would also be allowed to be carried forward to succeeding years.

Proposal

We recommend that it should be clarified that the provisions in excess of 5% of advances for consumer and SME advances are also eligible to be carried forward to succeeding years as is the case for all other advances. Failure to do so would lead the banking industry to write off the existing deferred tax asset in huge amounts currently appearing in its balance sheet.

Benefit

SME & consumer business would be given a chance to grow which would benefit the economy of the country.

7. ELIMINATE SALES TAX ON PHARMACEUTICAL INPUTS

7 A) Make Pharmaceutical Raw Materials Zero Rated for Sales Tax

Issue

Sales Tax being paid on packaging material utilities and other supplies used in manufacturing pharmaceutical products is adding to the product cost. Since the final product is exempt from Sales Tax, the tax paid can neither be passed on to the consumer nor can be claimed as input tax. This is also against the philosophy of sales tax which is supposed to be borne by the consumer.

Proposal

Pharmaceutical products, their raw materials and packaging materials should be removed from the list of exempt items and be zero-rated for Sales Tax purposes.

Benefit

Reduce the cost of doing business for pharmaceutical and hence reduce medicine inflation.

7 B) Custom Duties on Pharmaceutical Raw Materials

Issue

Since the prices of Pharmaceutical products are frozen for almost 10 years whereas the costs have increased manifold during that period, the government in order to compensate the industry had reduced custom duty on pharmaceutical raw material to 5% in 2008. However certain raw materials are still subject to a custom duty ranging from 10% -25%.

Proposal

Custom Duty on all Pharmaceutical Raw Materials be reduced to 5%

Benefit

Reduction in cost of doing business and a justified tax structure on a leading industry of the country

7 C) High Duties on Basic Hospital Supplies

Issue

Currently Custom Duty, FED and Sales Tax being levied on basic hospital supplies are very high and make it difficult to provide basic medical care to the lower class and poor.

Proposal

To help the Government deliver their objective of facilitating the common man in obtaining basic medical care, it is suggested to lower Customs Duty and do away with Sales Tax on basic hospital supplies. It may be noted that lowering of duty will not affect local industry as except for bandages, others are not produced locally

	DESCRIPTION	CURRENT DUTY STRUCTURE IN %					PROPOSED DUTY STRUCTURE IN %				
		CUSTOM DUTY	FED	SALES TAX	SALES TAX	W.H TAX	CUSTOM DUTY	FED	SALES TAX	SALES TAX	W.H TAX
1	Hospital Disposable and Consumables	20	1	16	2	4	10	0	0	0	2
2	Wadding Gauze & Bandages	25	0	16	2	4	10	0	0	0	2

1	Includes Diagnostic or Laboratory Reagents (HS Code 3822.0000), Ostomy Use (HS Code 3006.9100) Surgical Gloves (HS Code 4015.1100)
2	Wadding Gauze & bandages (HS Code 3005.1090)

Benefit

Make medical assistance affordable to the poor.

8. INCONSISTENCY IN COMPUTING VALUE OF IMPORTS**Issue**

As per the Income Tax Ordinance, 2001, the Commissioner may, in respect of any transaction between persons who are associates, distribute, apportion or allocate income, deductions or tax credits between the persons as is necessary to reflect the income that the persons would have realized in an arm's length transaction. In making any such adjustment, the Commissioner may determine the source of income and the nature of any payment or loss as revenue, capital or otherwise.

However, the authority does not take into account the value determined by the custom under section 25 of the Custom Act, 1969. This result in additional payment of tax on same valuation of imported goods.

Proposal

The Income Tax law should be amended to ensure consistency in the determination of imported goods' value, i.e. the value determined under the Customs Act, 1969 should be used as the basis for valuing imported goods by the Commissioner.

Benefits

This will result in clarity in the application of law and remove unnecessary time delay and redundancy in ascertaining value of imported goods. Moreover, it will also ensure fair application of law.

PROCEDURAL PROPOSALS

1. GENERAL SALES TAX RELATED

1 A) Section 8B of the Sales Tax Act 1990 should be abolished / amended

Issue

Section 8B of the Sales Tax Act, 1990 restricts the adjustment of input sales tax to the extent of 90% of the output during a tax period while filing sales tax cum federal excise return. Section 8B also restricts the sales tax input adjustment paid on fixed assets in twelve equal monthly installments. However, certain categories of registered persons are excluded from the purview of Section 8B of the Act by virtue of SRO 647(I)/2007. As a result of compliance of Section 8B of the Act, the registered person has to be obliged to maintain excessive records. Further, the registered person has also to face cash flow problems. Since this scheme is not applicable for all categories of registered persons, therefore the business community is conceiving this scheme based on discrimination.

Proposal

Since Section 8B is distortion of VAT laws, therefore it is suggested that this section should be abolished to allow full input sales tax adjustment in the same month.

Benefit

1. Restore cash flow flexibility to the tax payers.
2. Avoid undue hustle to get the refund claim approved from the department.
3. Reduce complexity of record keeping by both tax payer and government.

1 B) Section 48 of the Sales Tax Act, 1990

Issue

Section 48 gives overwhelming powers to tax officials but fails to include clauses that restrain the authorities from committing excesses. For pending matters, even involving minor liability, undue pressure is imposed on tax payers by exercising Section 48.

Proposal

All cases should be decided as per the strict interpretation of law. Section 48 should not be exercised unless the case under litigation has undergone two appellate proceedings. In this regard, the honorable High Court in a recent judgment has held that the recovery action against the registered person cannot be taken unless the case has been heard by a forum outside the jurisdiction of Federal Board of Revenue. Based on this position, it is suggested that Section 48 of the Act may be amended in a manner that recovery proceedings are initiated by the department after issuance of 2nd appellate order.

We may wish to refer to “**Law of the People’s Republic of China on Tax Administration (Promulgated on NPC Chairman Order [2001] No. 60 on April 28, 2001)**” as best practice guideline. Although the measures for collection (e.g. written notification followed by detention, seal off or sale of goods to recover tax over dues) are similar to our law to certain extent but Article 43 advises caution on part of tax authorities and sets out penalty for irresponsible action by tax officials.

Chapter III Tax Collection: Article 43

In the event that the tax authorities abuse the power of taking measures for preserving tax revenue or compulsory measures for law enforcement or take measures for preserving tax revenue or compulsory measures for law enforcement inappropriately, thus hurting the legitimate rights of the taxpayer, withholding agent or tax payment guarantor, the tax authorities shall be responsible for compensation in accordance with the law.

Benefit

1. Reduce the widening of gap between Government and taxpayers, thereby, enhance confidence.
2. Avoid loss of revenue to the tax payer and Government exchequer.
3. Enhance image of the country in local and foreign investor’s circles.

2. AMENDMENT OF ASSESSMENT – SECTION 122

Issue

Under section 122 of the Income Tax Ordinance, 2001, a return of income once filed is deemed to be the final assessment order. However, the Commissioner is authorized to revise an assessment order within a period of five years. The period of five years allowed to the Commissioner is extremely long and impractical, and in effect could cause a lot of problems for the assesses.

Proposal

We recommend that the time period allowed to the Commissioner to amend an assessment order be reduced from a period of five years to two year. We further recommend that a time frame of 60 days should be fixed for the Commissioner to complete this audit from the date it is started.

Benefit

The proposed amendment will ensure that tax inspections are not kept pending and commissioners issue NOC’s in a reasonable time period whereby easing recordkeeping and processing burden on companies.

3. APPEAL PROCESS – SECTION 124/127/129/131/132

Issue

The entire appeal process is longwinded and tedious, having the following drawbacks:

1. Under ITO-2001, there is a provision in law (132-2A) which requires the Income Tax Appellate Tribunal (ITAT) to dispose all appeals within six months of filing. However, practically this provision is never invoked and Tribunals take long time in deciding cases.
2. Where CIT (A) or ITAT provided direct relief to the assessed, the Commissioner under section 124 (4) is required to issue the appeal effect order within two months. In practice, this is rarely done as it would lead to refunds being assessed, which would disrupt the tax officer's revenue targets.

Proposal

We recommend that the entire appeal process from the time the assessee files its return to the time when an assessment is deemed to be complete, should not exceed two years. The following steps should be taken to ensure the above.

1. A time frame should be introduced, whereby ITAT is required to give its decision within 3 months of filing of an appeal, as is currently the case with CIT (appeals) and it should be strictly followed. In case no notice of hearing is issued by the ITAT, the relief sought by the appellant in the appeal shall be deemed to have been granted
2. We recommend that the two months period stipulated in law should be strictly adhered to. In the event the time frame of two months is breached, it should be stated in law that the assesses may assume that relief is deemed to have been given, i.e. the appeal effect order stands issued in favor of the assesses, and where payment has been made a refund stands determined.

Benefit

It will save significant resources of corporate taxpayer as well as re-build confidence in investing and growing their business in Pakistan.

4. STREAMLINING IDEAS FOR COLLECTION OF TAXES

4 A) Streamline Collection of General Sales Tax

Issue

Multinational and many local public banks provide electronic payment facilities to their clients for their payment processes. These banks receive electronic instructions from clients and transfer the money. Presently the National Bank of Pakistan (NBP) is providing these facilities to collect tax only to customers who have bank accounts in online branches of NBP. Companies, who have availed electronic banking facilities through banks other than NBP, are not in a position to pay taxes via their normal payment systems and they have to maintain a manual payment system only for one or two monthly tax payments.

Proposal

FBR should convince NBP to provide electronic banking facilities to taxpayers for tax payments without requiring to maintain bank accounts with NBP.

Or alternatively, commercial banks be allowed to collect tax from their customers (i.e. tax payers) at their counters as agents of NBP. The proceeds could be transferred to NBP on a mechanism similar to nostro & vostro accounts between banks. This way NBP will receive the funds on almost real time basis and on the front end it should resolve problems faced by tax payers.

Benefit

It will simplify the process without requiring NBP to invest in e-banking and to avail benefit from synergies of others banks who have e-banking facilities. This proposal will expedite the tax collection process and make life easier for companies.

4 B) Streamline Collection of Withholding Taxes

Issue

In May 2009, the Federal Board of Revenue issued new tougher guidelines, whereby it was stipulated that tax so deducted by a payer must be deposited into the Government Treasury within 7 days from the end of each week ending on every Sunday. This, effectively means that a weekly deposit is now required to be made by the payer instead of the fortnightly payment under the previous rule.

Proposal

It is recommended that payers should be allowed to deposit all withholding tax deducted during the month on the 7th of the following month.

Benefit

This will result in time saving for the companies. Withholding taxes will be deposited into the Government Treasury on a monthly basis without any loss of revenue to the Government.

4 C) Electronic Filing of Return

Issue

Through the Finance Act 2008, FBR made changes in the I.T. Ordinance 2001 to enable tax payers to file the Tax Return electronically. This is being followed by Corporate Tax Payers.

It has been observed that Tax Authorities issue notices for filing of return of Income at their local office in hard form also, along with all annexure.

This is creating hard ship to the tax payers as in some cases hard copy of return duly authenticated by authorized person are not retained or in certain cases acknowledgement receipt issued after filing the return electronically are not retained.

Proposal

The FBR should issue clear instruction to all tax offices not to insist filing of hard copy of return after it has duly filed electronically.

Benefit

This will be a great convenience for tax payers as well as promotion of IT culture in the Pakistan.

4 D) Payments to Non Resident Persons under Section 152 of the Income Tax Ordinance, 2001

Issue

Currently, law requires payers to seek written permission from the tax authorities at the time of making technology and training related payments to a non-resident person outside Pakistan without any deduction of tax. In recent times, it has glaringly been highlighted that the tax authorities are extremely reluctant to issue nil withholding tax certificates that would facilitate such payments to non-residents without any tax deduction. Law stipulates that after an application is made by the tax payer for a nil withholding tax certificate, the tax authorities must respond to it within 30 days of receiving the application. In reality, months go by without any response being received and this result in delayed payments to service providers situated outside Pakistan.

Proposal

It is recommended that the tax authorities examine each application received for a nil withholding tax certificate, and give its decision based on the merits of the case within the time frame of 30 days as stipulated in law. In case, no response is received from the tax authorities within 30 days, it will be deemed as accepted by tax authorities for nil withholding tax. There is absolutely no justification in not responding within the 30 day time frame allowed as this causes unnecessary hardship to tax payers who have to meet the expectation of non-resident service providers to make this payment within a reasonable time frame.

Benefit

Service providers outside Pakistan may stop the existing contract or may not be keen to renew the same as payments are not received on a timely basis which in turn would harm the economy of the country.

4 E) Unwarranted notices received u/s 176 of the Income Tax Ordinance 2001

Issue

Numerous notices have been issued by FBR through Regional Tax Offices (RTOs), Large Taxpayers Units (LTUs), and other taxation office for verification of income tax payments by companies which supplied goods in preceding years. FBR is now asking the withholding tax collecting companies, or to say the companies which have deducted the withholding tax, on receiving supply of goods and services from the company which has rendered services and supplied goods. The details of the tax deducted by them against the supply have already been provided by the companies which have rendered services and supplied goods to the income tax department. This tax deducted has been claimed by the suppliers by providing challans of tax deduction and payment proof from the recipient companies to the tax authorities for claiming refunds.

Both companies in their annual statements have already supplied this information which is now available with the tax authorities. Hence it is frustrating and surprising that income tax authorities are asking for re-confirmation of the confirmed positions with them because these refunds are claimed to be of last and preceding financial year.

The companies which have been issued notices have been further warned that in case they do not provide the evidence whereby the tax so collected from the taxpayer has been deposited in the government treasury, tax payer will not claim credit of said tax.

This has created tremendous work load pressure on the companies to reconcile and provide the same information which was already provided before.

Proposal

It is recommended that verification of tax challans be made through the FBR electronic system as the taxpayers are filing the tax deduction statements on monthly basis which also contains the information of the Tax Payment Receipt Numbers. Such notices should be only issued in cases where the taxpayer has not already submitted the information.

Benefit

This will help reduce unnecessary workload on the companies to provide the same information twice and let them focus on value added work.

4 F) Average Rate of Tax on Severance Payments

Issue

Severance payments to employees are taxable in the hands of individual at last three years average tax rate, as provided under section 12(6) of the ordinance. However section 149 requires employers to withhold tax from such payments at the current rates of tax. This gives rise to large refunds for individual employees in most cases have to be unnecessarily pursued and take a long time and lots of efforts to realize.

Proposal

Section 149 be amended to provide withholding of tax on severance payments at average rate of last three years, as provided in section 12(6) of the ordinance.

Further, section 149 be amended to authorize employer to adjust refunds due to the employee as per return filed.

Benefits

Just and equitable withholding tax regime, eliminating unnecessary hardships for salaried individuals.

Similarly, adjustment of refunds would also help the employees to get the benefit of instantly, instead of going through the cumbersome process.