

Islamabad, July 17, 2005. SEC and CBR had set up a Joint Task Force for formulating a corporate tax policy aimed at encouraging corporatization and a progressive development of the Corporate Sector. The Task Force in its attached Report submitted various recommendations in April 2005.

SECP has been in continuous dialogue on the changes recommended by the Task Force in order to further the cause of development of the corporate sector as part of the avowed objective of the Government to boost the national economy. SECP is pleased to say that several recommendations of the Task Force have been accepted by the Government in the first phase. The accepted recommendations include the following:-

- (1) The concept of “small company” has been introduced to allow tax concessions to small companies, defined to mean a company registered on or after the first day of July, 2005, under the Companies Ordinance, 1984 (XLVII) of 1984, which,
 - (i) has paid up capital plus undistributed reserves not exceeding twenty-five million rupees;
 - (ii) has annual turnover not exceeding two hundred million rupees; and
 - (iii) is not formed by the splitting up or the reconstitution of business already in existence.
- (2) Corporate tax rate for small companies has been slashed by 50%. These companies shall now be taxed only at 20% only. This would encourage non-corporates to convert into corporate entities.
- (3) Withholding tax of 3.5% on supplies has been a major irritant and was discriminatory as between corporates and non-corporates, particularly, in the same business. This withholding requirement has been abolished for small companies.
- (4) Non-listed companies which decide to list their securities on a stock exchange and expand their shareholders base would receive a tax rebate of 1%. It is hoped the bigger corporates would use this as an encouragement for soliciting public participation in their securities.
- (5) Losses on amalgamation have hitherto been allowed to be adjusted

on amalgamation of companies in the financial sector. Henceforth, this adjustment would also be available to industrial undertakings. It is hoped this would encourage revival of sick industrial units.

- (6) Group relief in income tax has been available to companies in the industrial sector only. This concession would now be available to companies in service sector, as well.
- (7) Capital gains of stock exchange brokerage firms shall not be taxed if they convert into corporate brokerage house upto 30th June, 2006. This is expected to help conversion of individual brokerage houses into corporate brokerage houses and result in more transparent transaction handling.

SECP encourages businesses presently functioning as sole proprietorships and partnerships to register as small companies under the Companies Ordinance, 1984 and avail one or more of the tax advantages listed above. Other business concerns which do not fall in the category of small companies can also avail tax advantage relevant to their case. It is hoped these tax reforms would be very useful for development of corporate sector in Pakistan.

REPORT OF
THE TASK FORCE
ON
CORPORATE TAX POLICY

April 14, 2005

Task Force on Corporate Tax Policy

Islamabad, April 14, 2005

Dr. Tariq Hassan,
Chairman
Securities and Exchange Commission of Pakistan,
NIC Building, Islamabad

Dear Mr. Chairman,

We the Members of the Task Force on Corporate Tax Policy are pleased to submit herewith our Report. We consider it appropriate to state that the original Terms of Reference were suitably modified in view of another Task Force established by the CBR for the same purpose. The Revised Terms of Reference primarily focus on measures required to promote corporatization of businesses presently operating in non-corporate mode as well as those considered necessary for facilitating existing corporate entities.

The Task Force had extensive discussions with the business and professional bodies as well as persons who were familiar with the tax and non-tax constraints towards corporatization of small and medium businesses. The names of Trade Bodies and professional organizations which met the Task Force and submitted their view points (verbally and in writing) are stated in Chapter I of the Report.

Chapter II of the Report examines significant aspects of existing corporate tax policy, besides identifying and delineating the issues and concerns.

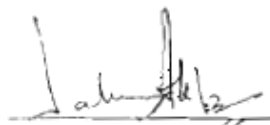
Chapter III of the Report contains the discussion and analysis made by the Task Force along with its recommendations on Corporate Tax Policy and the specific changes required in furtherance of that policy.

Chapter IV of the Report provides a summary of the recommendations made by the Task Force on both tax and non-tax matters.

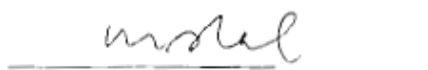
We generally believe that the policy and administrative changes are necessary to augment Government's other policies for economic development and reduction of poverty in the country. We also believe that a liberal tax policy approach may result in short term revenue losses but in longer term it would help the economy to grow faster as a result of increased investments, higher productivity and employment opportunities. We also believe that over the years, notwithstanding lower tax rates, increased compliance and lesser incentives for tax evasion and avoidance would generate higher revenue resources to the Government.

We believe that the recommendations made by this Task Force would assist the Government in better understanding of the issues and concerns of the business community and help in corporatization of small and medium businesses and further documentation of economy.


Justice (R) Saleem Akhtar



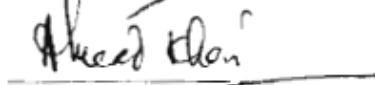
M.S. Lal



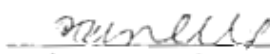
Abdul Rehman Qureshi



Ahmad Khan



Mukhtar Ahmad Gondal



Abdul Hameed Chaudrhi



Syed Mohammad Shabbar Zaidi



Syed Fayyaz Mahmud



ACKNOWLEDGEMENT

The Task Force wishes to offer its profound gratitude to all the stakeholders and the professional bodies who appeared before the Task Force and assisted the Task Force in understanding and identifying issues relevant to corporatization.

The Task Force is also grateful to the Securities and Exchange Commission of Pakistan and the Central Board of Revenue for facilitating the deliberations of the Task Force and providing technical support.

The Task Force wishes to acknowledge the work of its Member, Mr. Ahmad Khan and Member/Secretary Syed Fayyaz Mahmud for preparation of this report.

Table of Content

<i>Letter of Transmittal</i> _____	i-ii
<i>Acknowledgement</i> _____	iii
 Chapter I – Task Force and Its Scope of Activities	
1. Introduction _____	1
2. Composition of the Task Force _____	1
3. Terms of Reference of the Task Force _____	1-2
4. Revised Terms of Reference _____	2
5. Methodology Used by the Task Force _____	3
6. Meetings with Trade Bodies _____	3
7. Meetings with Professional Organizations _____	3
8. Meetings with Individuals _____	3
 Chapter II – Corporate Taxation System in Pakistan	
1. Tax Collecting Agency _____	4
2. Income Tax Law in Pakistan _____	4-6
3. Tax Administration _____	7
4. Income Tax Rates-----	7-8
5. Minimum Tax _____	8
6. Withholding Tax _____	8-9
7. Tax on Inter-corporate Dividend Income _____	9
8. Tax on Transfer of Assets on Corporatization _____	9
9. Losses on Amalgamations _____	9
10. Group Company Relief _____	9
11. Non-Tax Levies _____	9-10
12. Documentation of Economy _____	10
13. Audited Financial Statements _____	10-11
14. Issues of Tax Administration _____	11

Chapter III – Important Issues, Discussion and Recommendations

1.	Issues Identified for Consideration_____	12
2.	Broad Policy Guidelines_____	13-14
3.	Corporatization Level and Tax Compliance_____	14-15
4.	Corporate Tax Rates_____	15-19
5.	Tax Rebate for Listed Companies _____	19
6.	Lower Income Tax Rates for Small Companies_____	19-21
7.	Withholding Tax on Payments for Supply of Goods_____	21-22
8.	Taxation on Corporatization _____	22
9.	Minimum Tax _____	23
10.	Taxation of Inter-corporate Dividends _____	23-24
11.	Losses on Amalgamation _____	24-25
12.	Group Relief _____	25
13.	Sales Tax _____	25-26
14.	Issuance of Refunds and Rebates _____	26-27
15.	Various Levies on Corporate Entities_____	27-29
16.	Cost of Running a Company_____	29
17.	Erosion of Limited Liability_____	30
18.	Stamp Duty_____	30

Chapter IV: Summary of Recommendations

Appendices_____

Appendix 'A'	SECP letter dated December 27, 2004 constituting the Task Force
Appendix 'B'	Summary of Issues Identified in the Meeting <i>Of the Task Force with Stakeholders</i>
Appendix 'C'	<i>List of Bodies/Associations/Individuals interviewed by the Task Force</i>

List of Tables

Table 2.1:	Revenue to GDP Ratio in Pakistan _____	5
Table 2.2:	Taxes as Percentage of GDP of Developed Countries _	6
Table 2.3:	Tax Rates for Companies in Pakistan _____	8
Table 4.1:	Number of Companies Registered Category-wise As on March 28, 2005 _____	14-15
Table 4.2:	Corporate Tax Rates in Various Countries _____	16-17

CHAPTER I

TASK FORCE AND ITS SCOPE OF ACTIVITIES

1. Introduction

In pursuance of a decision, the Securities and Exchange Commission of Pakistan (SECP) and the Central Board of Revenue (CBR) constituted a joint task force on December 27, 2004 to formulate a corporate tax policy aimed at encouraging corporatization in the country and a progressive development of the corporate sector.

2. Composition of the Task Force

The task force comprises of the following:

- | | | |
|----|---|-----------|
| 1) | Mr. Justice (R) Saleem Akhtar,
Former Federal Tax Ombudsman | Chairman |
| 2) | Mr. M.S. Lal, Member (P&TR), CBR, | Member |
| 3) | Mr. Abdul Rehman Qureshi, Adviser, SEC | Member |
| 4) | Mr. Ahmad Khan, former Member, CBR/MCA | Member |
| 5) | Mr. Mukhtar Ahmad Gondal,
Chief (Direct Taxes Policy), CBR
(Now Member Income Tax Appellate Tribunal) | Member |
| 6) | Mr. Abdul Hameed Chaudrhi, FCA | Member |
| 7) | Syed Mohammad Shabbar Zaidi, FCA | Member |
| 8) | Syed Fayyaz Mahmud, Director SEC | Secretary |

The Task Force was required to complete its task within a maximum period of two months, i.e. by February 28, 2005. The Task Force, after carefully considering the Terms of Reference in its first meeting and the amount of work involved, felt that it would not be possible to accomplish the assignment within the given timeframe. It, therefore taking into account all the relevant factors, decided to submit its report by April 15, 2005, 2005.

3. Terms of Reference of the Task Force

The Terms of Reference of the Task Force, as originally framed, were as under:

- To review the existing legal and policy regime for corporate tax with a view to developing an effective corporate tax policy aimed at enhancing corporatization and progressive development of corporate sector.
- To review the applicable tax rate; multi-tiered taxation, sales tax; Turnover Tax; Withholding Tax; Professional Tax; and the Capital Value Tax as well as the procedure for filing the tax returns by companies.

- (c) To suggest tax reforms in various areas such as rationalization of tax rates, streamlining of sales tax refunds, extension of sales tax coverage to more sectors, documentation of entire value chains across most areas, and reduction in interface between taxpayer and tax officials.
- (d) To examine the prospects of broadening of the tax net to unregistered enterprises so as to sustain revenue in a reduced tax rate scenario and induce the conversion of unregistered entities into corporate enterprises.
- (e) To suggest reforms that provides effective mechanisms and a level playing field between registered and unregistered enterprises.
- (f) To suggest viable tax administration measures for implementation of the recommended reforms.

4. Revised Terms of Reference of the Task Force

During its first meeting at Karachi, the Task Force observed that Government has already constituted a Task Force in the CBR to review the national taxation policy in a broader context and that the said Task Force, through a comprehensive examination of all policy and administration issues concerning direct and indirect taxes, is expected to submit its recommendations for inclusion in the Budget for 2005-6. The relatively broad terms of reference given to the Task Force on Corporate Tax Policy were considered overlapping with those of the other. It was, accordingly, agreed that the Task Force on Corporate Tax Policy would concentrate on the Tax Policy with the emphasis on the significant role of the corporate sector in the economic development of the country through corporatization and a progressive development of the corporate sector.

Viewed in that backdrop, Terms of Reference were reviewed and it was decided that this Task Force would concentrate on the following matters only which would constitute as the Revised Terms of Reference:

- (a) To review the existing legal and policy regime for corporate tax with a view to developing an effective corporate tax policy aimed at encouraging corporatization and progressive development of corporate sector.
- (b) To review the applicable tax rate; multi-tiered taxation; sales tax; Withholding Tax; Professional Tax and Capital Value Tax with a view to suggesting tax reforms in rationalization of tax regime.
- (c) To review the procedures for filing of tax returns, audit, assessment and collection.
- (d) To review tax refund procedures for various taxes.
- (e) To suggest tax policy and administration measures that provide level playing field for corporate and non-corporate sectors.
- (f) To suggest viable tax administration measures for implementation of the recommendations.

5. Methodology Used by the Task Force

In view of the importance of the issues involved and their wide ranging implications, it was decided to meet and solicit views of the trade bodies, professional organizations, knowledgeable individuals in the relevant fields and the public at large on corporate tax policy with special reference to the TORs and how far the present policy encourages or discourages documentation of the economy through corporatization. Accordingly, various trade bodies and professional organizations, were invited to the meetings of the Task Force which were held at Islamabad, Karachi and Lahore.

6. Meetings with Trade Bodies

The Task Force invited and heard the following Trade Bodies:

- Federation of Pakistan Chamber of Commerce and Industry
- Overseas Investors Chamber of Commerce and Industry
- Karachi Chamber of Commerce and Industry
- Lahore Chamber of Commerce and Industry
- American Business Council
- All Pakistan Textile Mills Association
- Sialkot Chamber of Commerce and Industry

7. Meetings with Professional Organizations

The representatives of the following professional organizations appeared before the Task Force on invitation and were heard at length:

- Institute of Chartered Accountants of Pakistan
- Institute of Cost and Management Accountants of Pakistan
- Karachi Income Tax Bar Association
- Lahore Income Tax Bar Association

8. Meetings with Individuals

The Task Force gave open invitation to the public at large and small and medium size entrepreneurs in particular, to share their perceptions with the Task Force. The following persons appeared before the Task Force for expressing their point of view on the subject:

- Mr. Mohsin Khalid, Former President Islamabad Chamber of Commerce and Industry
- Mr. Ahmad Parekh
- Mr. Ehsan A. Saleem
- Mr. Rehan Naqvi, Tax Consultant
- Mr. Saadat Chaudhry, FCA

CHAPTER II

CORPORATE TAXATION SYSTEM IN PAKISTAN

1. Tax Collecting Agency

Central Board of Revenue, Government of Pakistan, is the tax collecting agency for all Federal taxes. It is also empowered by the provinces to assess/collect sales tax on services otherwise falling under the jurisdiction of provincial governments.

2. Income Tax Law in Pakistan

On the income of corporates and non-corporates, income tax is levied and collected under the Income Tax Ordinance, 2001. The new law has replaced the repealed Income Tax Ordinance, 1979. Under the new law, several innovative concepts have been introduced in the subjects like tax avoidance and evasion, taxation of non-residents, thin capitalization, have been introduced. The new law has also been substantially amended in the past two years to remove major technical and operational difficulties.

In computing income from business, profession and vocation, all expenditure wholly and exclusively incurred for the purposes of carrying on of these activities is allowed as deductions. There exists an extensive mechanism for withholding taxes – primarily by the corporate sector on various payments. This is in the nature of both adjustable advances as well as what constitutes as full and final payment (PTR). CBR, as an announced policy, is moving towards adjustability of withholding taxes rather than treating these as full and final taxes.

As a policy, Government has done away with most tax holidays and sectoral tax exemptions. The concept of tax rebates, credits and investment allowances has also been almost eliminated. Over the years tax rates have been rationalized to a great extent. Exemption limit for personal taxes has been substantially increased.

CBR has performed well during the last few years despite several constraints. Its revenues in absolute terms have increased substantially, particularly from income and sales tax. Revenues from excise duty have remained more or less constant because of its shrinking role; while customs duties have declined due to major reductions in tariff rates and declining imports. The tax base, however, remains narrow and skewed. As indicated in the Table 2.1 below, Tax/GDP Ratio, notwithstanding substantial increase in revenues, is around 11%. Tax/GDP ratio of CBR revenues has increased from 9.2 % from 1999-2000 to 9.5% in 2003-2004. The overall Tax/GDP ratio also increased from 10.7% to 11.8% during the same period.

Table 2.1: Revenue to GDP Ratio in Pakistan

FY	Total Revenue	Total Taxes (F+P+S)	Total Federal Tax Revenue (F+S+FTT)	Federal Taxes (CBR)	Non Tax Revenue
90-91	15.9	12.6	12.0	10.8	3.4
91-92	17.7	13.4	12.8	11.5	4.3
92-93	17.4	12.9	12.4	11.4	4.6
93-94	17.2	13.2	12.7	11.0	4.0
94-95	16.9	13.7	13.2	12.0	3.2
95-96	17.2	14.3	13.7	12.5	2.9
96-97	15.6	13.2	12.6	11.5	2.4
97-98	16.0	13.2	12.6	11.0	2.8
98-99	15.8	13.2	12.7	10.5	2.7
99-00	13.5	10.7	10.2	9.2	2.8
00-01	13.4	10.7	10.2	9.4	2.7
01-02	14.2	10.9	10.5	9.2	3.3
02-03	14.9	11.5	11.1	9.6	3.4
03-04	15.1	11.8	10.7	9.5	3.3

A comparison of taxes as percentage of GDP of few developed countries is given below in Table 2.2

Table 2.2:

COUNTRY	Personal Income	Social Contributions	Corporate / Profits	Value Added	Excise	All Taxes All Levels
Australia	12.3	-	4.5	4.0	4.4	30.1
Austria	10.4	14.9	3.1	8.2	3.4	45.4
Belgium	14.5	14.4	3.6	7.2	3.3	45.0
Canada	13.0	5.1	3.5	5.1	3.1	35.1
Czech Republic	4.8	17.1	4.2	6.9	4.0	38.8
Finland	14.1	12.4	4.9	8.5	4.7	46.1
France	8.0	16.3	3.4	7.5	3.5	45.0
Germany	10.0	14.6	0.6	6.7	3.5	36.8
Greece	5.4	11.4	3.4	8.6	4.4	36.9
Hungary	7.6	11.6	2.4	9.9	5.0	39.0
Japan	5.5	10.3	3.5	2.4	2.1	27.3
Luxembourg	7.2	11.2	7.5	6.1	4.6	40.7
Mexico	-	3.2	-	3.6	5.9	18.9
Netherlands	6.5	14.2	4.1	7.4	3.6	39.5
New Zealand	14.5	-	3.8	8.7	1.7	33.8
Norway	10.5	8.9	94.1	8.1	4.9	43.3
Poland	7.9	10.2	2.0	7.3	4.7	33.6
Slovak Republic	3.5	14.4	2.2	7.4	3.3	32.3
Spain	6.9	12.6	2.8	6.0	3.5	35.2
Sweden	16.4	15.3	2.9	9.1	3.5	51.4
Switzerland	9.8	7.8	3.1	4.1	2.5	30.6
Turkey	7.7	7.2	2.4	8.1	5.5	36.5
United Kingdom	11.3	6.3	3.5	6.8	4.4	37.3
United States	12.2	7.1	1.9	-	1.8	28.9
OECD Avg. (Unweighted)	10.0	9.4	3.5	6.9	4.0	36.9

These ratios do not compare well with other Asian countries. Except for Bangladesh, in all other Asian countries, the Tax/GDP Ratio exceeds 12%. In most developed tax jurisdictions, Tax/GDP Ratio (for taxes other than social contributions) varies between 20 – 30%. Un-weighted average for OECD Countries is around 26%.

3. Tax Administration

CBR has initiated a series of major reforms in tax administration concerning all taxes in the light of the Report of the Task Force on Reform of Tax Administration (April 14, 2001). These include changes in the organization, transition from traditional jurisdictional to functional delineation of administrative functions/set ups, development of personnel skills and institutional capacities, prompt and judicious dispute resolution, development of integrated data bases for improving revenue resources and transparency in tax matters, measures to encourage voluntary compliance, selective audits/examinations based on objective criteria, prompt clearance of imports/exports/issuance of refunds/export rebates, facilitation in filing of tax documents, tax assessment and collections.

Taxpayers' facilitation, simplified procedures and prompt case processing, streamlining the tax assessment, audit, collection and refunds undermine the reform effort. There are, however, several system bottlenecks that require immediate resolution. The taxpayers, we observe, continue to face difficulties in meeting the filing requirements along with tax documents/returns, obtaining timely assessment orders and tax refunds/rebates. CBR has yet to develop a seamless system of tax collections and develop adequate data base reflecting taxpayers profile – leading to removing difficulties in verification of challans, and eliminating various filing requirements. Personnel skills in handling tax audits are still not adequate to eliminate the subjectivity in tax assessments. Instances of mal-administration and mal-practices have also been brought forth before the Task Force. CBR is not, as yet, able to transact its business in an efficient and cost effective manner.

The Task Force expects that, in the wake of seriousness in reform of tax policy and administration, most of the problems presently faced by the taxpayers would be removed.

4. Income Tax Rates

While the individuals are essentially taxed on graduated tax rates (7.5% to 35% on various income slabs), companies are taxed at a flat tax rate. However, different rates are applicable to banking, public (other than banking) and private companies. Presently, the applicable tax rates on banking, non-banking public companies and private companies are 44%, 35% and 41% respectively (tax rates applicable in 2004). Government has also announced a clear policy and time frame for reduction in corporate tax rates. By the year 2007, all types of companies would be charged the uniform tax rate of 35%. The tax rate differential between listed and non-listed public companies would also disappear. This would result in removing the existing tax difference between various types of companies. It would also match with the maximum tax rate of 35% for individuals, AOPs and partnerships.

Table 2.3: Tax Rates for Companies in Pakistan

Tax Year	Banking Companies	Public Companies other than banking companies	Private companies other than banking companies
2003	47%	35%	43%
2004	44%	35%	41%
2005	41%	35%	39%
2006	35%	35%	37%
2007	35%	35%	35%

5. Minimum Tax

An important distinction between the corporate and non-corporate sector has been made through the levy of minimum tax on the former. Previously, it was also applicable to the partnership firms.

The concept of ‘minimum tax’ was introduced in the income tax law during early 1990s when Government was following a liberal tax holiday regime for the corporate sector to attract investment in priority sectors of economy and the less developed geographical regions in the country. In the wake of tax reforms for mobilization of tax revenues, Government desired that businesses enjoying tax holidays or running consistent losses must make some contribution to the treasury. The resident companies were, accordingly, required to pay a ‘minimum tax’ at the rate of 0.5% of their turn over notwithstanding that these were not required to pay any tax due to loss, tax exemption, rebates and other factors.

Presently, section 113 of the Income Tax Ordinance, 2001 provides that where the ‘minimum tax’ exceeds the actual tax liability, the excess amount of tax paid can be adjusted against future tax liability and carried forward up to five years.

6. Withholding Taxes

There is an extensive withholding tax regime applicable to most transactions and types of income. Some of these taxes are in the nature of adjustable advances. Others fall under the presumptive tax regime (PTR) that is to say full and final tax liability.

The concept of withholding taxes on income other than salaries was first time introduced in 1968. The Income Tax Act, 1922 was amended to provide that payments

made by the Government, statutory bodies, companies and other corporate bodies for execution of contracts, supplies and services would be subject to withholding tax at the prescribed rates. These deductions, which were initially by way of adjustable advance, were brought under presumptive tax regime in early 1990s. Partnerships, AOPs and individuals are exempt from the responsibility to withhold the tax on these payments.

The withholding tax rate on payments for supply of goods (which is considered most relevant for its purposes by the Task Force) is 3.5%

7. Tax on Inter-corporate Dividend Income

Dividends are taxed @ 10% under the presumptive tax regime (PTR). Inter-corporate dividends received by listed companies and insurance companies are charged to 5% of the gross amount of dividend

8. Tax on Transfer of Assets on Corporatization

The provisions of sections 95, 96 and 97 of Income Tax Ordinance, 2001 govern the taxation of transfer of capital assets at the time of conversion of a business entity from one form to the other. There appears some ambiguity as to the application of these provisions including divergent court rulings in this matter.

9. Losses on Amalgamations

Under the present provisions of Income Tax Law, in case of two corporate entities amalgamating under section 287 of the Companies Ordinance, 1984 or section 48 of the Banking Companies Ordinance, 1962, losses of the amalgamated entity are not allowed to the amalgamating entity except where the amalgamated entity is a bank or financial institution.

10. Group Company Relief

The present law contains provisions on group company relief to 'industrial undertakings'. The concept of 'industrial undertakings' has been defined in the Income Tax Ordinance, 2001. This provision does not apply to other than 'industrial undertakings'.

11. Non-Tax Levies

In addition to income tax, customs duty, sales tax and excise duties, businesses are also subject to non-tax contributions such as EOB, Social Security, Workers Profit

Participation (WPP) and Workers Welfare Fund (WW). These contributions were made compulsory in mid-seventies for labor benefits.

WPPF has been established under the Companies Profits (Workers' Participation) Act, 1968. This scheme is applicable to all companies (registered under the Companies Ordinance, 1984) and running 'industrial undertakings' as well such other concerns notified by the Government where the number of workers employed by it are 50 or more, paid up capital of the company is Rs.2 million or more, and the value of fixed assets of the company is Rs. 4 million or more. Industrial undertakings encompass institutions/organizations/enterprises/establishments engaged in manufacturing, assembly and processing of goods, ship-building, transformation, generation, etc. of electrical energy, mining and oil/gas refining and marketing. Companies are required to contribute 5% of their annual profits to the Fund. Workers also contribute part of their income to the Fund. All workers (whose average monthly emoluments do not exceed Rs.5000per month) are eligible to the benefits of the scheme and to participate in the fund. 100% of the annual income of the Fund is to be distributed to the workers. The management of the Fund vests with the Board of Trustees comprising management and workers' representatives subject to Government directions.

WW contribution is collected under the Workers Welfare Fund Ordinance, 1971. The Fund consists of an initial contribution of Rs.100 million made by the Federal Government and the, annual contributions made by the industrial undertakings (whose annual income is not less than the Rs.100, 000) @ 2% of their assessed income in a year. WW contribution is collected by the income tax department along with income tax. The law provides application of the Fund towards establishment of housing estates/houses for workers and other welfare projects. Government has constituted a Governing Body consisting of Secretary Ministry of Labour (as Chairman) and up to 18 members from amongst Provincial Governments, employers and employees. The Governing Body allocates moneys out of the Fund to the provincial governments, agencies of the Federal Government and body corporate for the purposes of the Fund (to be spent by the Workers Welfare Boards).. Finally end up as part of Government's overall budget; these levies for all purposes become a tax charge.

12. Documentation of Economy

Presently, income tax law provides for payment of P&L expenses exceeding the prescribed threshold through cheques, etc. On the contrary, there is no such provision concerning manufacturing and trading expenses. The expenses paid in cash are not allowed as deductible while computing the taxable income.

13. Audited Financial Statements

Companies' accounts require statutory audit which are to be filed alongwith their income tax returns. Public companies are also obliged to file with the SECP their

financial statements duly audited by chartered accountants as required under the Companies Ordinance, 1984.

In contrast, businesses carried on in non-corporate forms, neither requires statutory audit of their accounts nor an extensive set of account books are to be kept for this purpose. This is an obvious advantage available to partnerships, AOPs and individuals.

14. Issues of Tax Administration

Notwithstanding these measures, the Task Force desired to carefully look at some aspects of the reform process, particularly those concerning issuance of refunds, selection criteria for tax audits, filing of tax documents including the withholding tax statements. Task Force also identified Universal Self Assessment Scheme as an area of interest for scrutiny, as well as the mindset of tax payers and tax officials and the tax dispute adjudication and resolution system.

CHAPTER III

IMPORTANT ISSUES, DISCUSSION AND RECOMMENDATIONS

The Task Force, after listening to and discussing with the stake holders their view point (as summarized in Annex 'A') on various issues concerning corporate tax policy, corporatization and factors discouraging the small and medium businesses (SMEs) to convert to corporate form, identified the most relevant issues and had threadbare discussion thereon. Some of the points raised by the stakeholders, although quite valid, were considered falling outside the terms of reference of the Task Force. These were, therefore, left for the consideration of CBR's Task Force on Tax Policy.

The discussion encompassed the legislative history of the relevant provisions, the economic and tax policy considerations underlying introduction of these provisions, and the justification for their retention, modification or abolition. On the basis of discussion within the Task Force, concrete recommendations were evolved. These recommendations represent the consensus of all members.

1. Issues Identified for Consideration

The Task Force identified the following tax and non-tax issues for its consideration/detailed discussion.

- Corporatization level and tax compliance.
- Corporate tax rates – in general and for SMEs.
- Tax Rebate for listed companies.
- Withholding tax regime particularly concerning supply of goods and services.
- Taxation on corporatization of non-corporate businesses.
- Minimum Tax on companies.
- Holding companies - Taxation of dividends particularly inter-corporate dividends.
- Treatment of business losses on amalgamation of businesses.
- Taxation of capital gains on disposal of shares of listed companies.
- Issuance of tax refunds/rebates.
- Stamp duty on transfer of assets while converting from non-corporate to corporate form of business.
- Non-tax levies on businesses.
- Cost of formation and running a company.
- Erosion of limited liability due to the requirements of SBP Prudential Regulations.

The Task Force examined the above stated issues in the context of the historical and present economic and tax policy framework of the Government.

2. Broad Policy Guidelines

The Task Force, having regard to the need for encouraging corporatization, the development of corporate sector and as a step towards mitigating the problems faced by the corporate entities, both structural and administrative, developed the following corporate tax policy guidelines.

- (i) Provide concessionary tax rates for SMEs converting to corporate form.
- (ii) Listed companies may be given tax rebate to encourage enlisting at stock exchanges. This would promote investments in capital market by the public at large.
- (iii) As a measure for expanding tax base, CBR should allot NTN numbers to all companies on the basis of information provided by SECP notwithstanding whether or not companies themselves make application for this purpose.
- (iv) Government should remove all tax and non-tax impediments in conversion of non-corporate business to corporate status.
- (v) In order to encourage corporatization, there should be visible differential in tax rates between corporate and non-corporate entities.
- (vi) Government should provide level playing field for corporates in matters of taxation such as minimum tax and withholding taxes
- (vii) Audited accounts of the companies, which maintain proper/prescribed books and submit along with their tax returns, should be generally accepted by the tax authorities unless there are certain valid grounds for disagreement.
- (viii) Government should avoid double taxation of corporate income by abolishing tax on inter- corporate dividends.
- (ix) Amalgamation of corporates should be encouraged so that companies grow in size.
- (x) Concept of group taxation should be further developed.
- (x) The SECP should not insist on adherence to International Accounting Standards (IAS) by small companies.
- (xi) The SECP should provide a concessionary fees regime to small companies, and improve its information dissemination program concerning incorporation of SMEs.

- (xii) Mindset of tax payers and tax officials to be reformed by creating awareness and introducing human resource development schemes.
- (xiii) Provide independent and confidence inspiring tax fiscal justice system and strengthen alternate dispute resolution mechanism.

3. Corporatization Level and Tax Compliance

According to the data provided by SECP, there are 45,610 companies incorporated as on March 31, 2005. These include 610 public listed companies; 2198 unlisted public companies and 41,462 private limited companies (detail provided in Table 4.1 below). On the contrary, the information provided by CBR indicates that only 21,500 companies have obtained National Tax Number from the CBR and are reflected on its Master Index Register. Out of these companies, only 13,000 companies filed income tax returns for the year 2004/05.

The Task Force, however, observed that these numbers do not reflect the factual position as regards the filing of the income tax returns by the companies, as many registered companies are not engaged in business. or they are engaged in businesses taxed under Presumptive Tax Regime – there being no requirement for filing of tax returns.

Table 4.1: Number of Companies Registered Category -wise As on March 31, 2005

Category	No.
Total number of Public Listed Companies	610
Total number of Public Unlisted Companies	2198
Total number of Private Companies other than SMCs	41462
Total number of Single Member Companies	219
Associations Not for Profit	291
Companies limited by guarantee	56
Trade Organizations	167
Unlimited liability companies	5

Foreign Companies	595
Other statutory corporations	4

The Task Force, nevertheless, believes that certainly there is large potential for raising tax revenue in view of the present Tax-to-GDP ratio being only 11.8% in 2003/04 notwithstanding that the revenue receipts have shown impressive growth in absolute terms – Rs.395 billion in 1998/99 to Rs.518 billion in 2003/04.

Compared with the similarly circumstanced countries with the Tax-to-GDP ratio exceeding 12% and ranging between 20% - 30% for industrialized countries, there is immense potential for improvement. The Task Force has no doubts that the Government needs to follow the strategy of increasing tax revenue by enlarging the tax base and not through the higher tax rates. In its view point, relatively high tax rates (such as 35% on corporate sector, maximum income tax rate of 35% on individuals and sales tax rate of 15%) may prove to be counter productive; having adverse effect on the process of widening of tax base. Disproportionate burden on tax paying businesses and individuals induces tax evasion and violates the principle of horizontal equity.

4. Corporate Tax Rates

The general tax levels in a country, in addition to several other considerations, influence domestic investment decisions and flow of Foreign Direct Investment. Under comparable circumstances, a country with lower corporate tax rates stands a greater opportunity of attracting Foreign Direct Investment projects than a country with higher tax rates. Tax evasion and avoidance could also decline with decrease in tax rates as it may not be of overall advantage to the businesses in long term.

The present corporate tax rates (i.e. 44% for banking companies, 35% for public limited companies other than banking companies, and 41% for private limited companies) as well as the announced rate reduction to 35% for all types of companies by the year 2007 are still higher than those prevalent in several other jurisdictions as given in Table 4.2.

Table 4.2: Corporate Tax Rates in Various Countries¹

Country	Income Tax Rate
Argentina	30-35%
Australia	30%
Austria	34%
Bangladesh	10-25%
Belgium	33.99%
Brazil	34%
Bulgaria	19.50%
Canada	36.60%
China	33%
Cyprus	10-15%
Cyprus (Offshore)	4.25%
Czech Republic	28%
Denmark	30%
Egypt	40%
Estonia	0% (Accrued)
Finland	29%
France	34%
Germany	25%
Greece	35%
Hong Kong	18%
Hungary	16%
India	36.75%
Indonesia	30%
Ireland	13%
Israel	34%
Italy	33%
Japan	30%
Latvia	15%
Lithuania	15%
Luxemburg	30%
Malta	35%
Mexico	33%
Monaco	33%
Morocco	35%
Netherlands	29-34.5%
Nepal	15-25%
Norway	28%
Philippines	32%

¹ Source: Price Water Coopers

Poland	19%
Portugal	27.5%
Romania	25%
Russia	24%
Saudi Arabia	45%
Singapore	22%
Slovakia	19%
Slovenia	25%
South Africa	30%
Spain	35%
Sri Lanka	10-35%
Taiwan	25%
Thailand	30%
Turkey	33%
UK	30%
USA	35%
Vietnam	28%
Zambia	15%

The above table clearly shows that the corporate tax rates in most tax jurisdictions are lower than 35%. In several countries, much lower rates (varying between 15-25%) are applicable. Ireland applies as low a rate as 12.5%. Singapore decided in 2002 to bring corporate and personal income tax rates to 20% within three years from 24.5% and 26% respectively – almost in line with Hong Kong where corporate tax rate is 16%.

Table 2.3 reflects Pakistan Government's decision for progressive reduction in corporate tax rates over the period 2003 -2007 to a uniform rate of 35% by June 2007. It appears that the policy decision to gradually reduce corporate tax rates to 35% was taken in the backdrop of global trends to reduce corporate and personal tax rates. What is, however, significant for Pakistan is to carefully consider whether the proposed reduction to 35% by year 2007 is in line with countries competing for FDI or desiring to improve their GDP growth around 8% during the next few years.

The stakeholders consider the 35% tax rate on the higher side. They also felt that given the highest marginal tax rate of 35% for partnerships, AOPs and individuals, there was not much tax incentives for conversion of these entities to limited companies – particularly in view of the additional obligations of withholding taxes on payments for supply of goods and services, increased obligations for maintenance of records, audit and compliance to SECP in the form of periodic reporting on various accounts.

For smaller businesses, the increased non-tax obligations such as reporting and compliance requirements, non-awareness regarding the perceived benefits arising from corporate mode of conducting businesses, with no corresponding tax benefits were seen as some of the primary reasons for non-conversion to companies.

In view of the above stated position, business and professional community suggested further reduction in tax rates in the overall interest of private sector participation in the economic growth process.

Therefore, the important issues before the Task Force were:

- i. Whether the tax rates to be applicable to the corporate entities by 2007 were realistic and in keeping with the over all economic development efforts, and in comparison with lower corporate tax rates charged in most developing/developed jurisdictions?
- ii. Whether they were conducive to the corporatization of businesses presently operating in non-corporate mode which were subject to lower effective tax rate (rather than the highest marginal rate of 35%) particularly as they would be exposed to compliance of several other tax and non-tax provisions?
- iii. Whether it would be of substantial advantage to the overall economic development, in terms of attracting higher/additional investment, not to wait for the year 2007 to reduce the corporate tax rates to 35% (or a lower rate if considered appropriate) and announce the proposed reduction in year 2005?
- iv. Whether the tax differential between listed and non-listed companies should be continued after achieving the uniform tax rates for all types of companies is an incentive for listing or not?
- v. Whether it makes it rational to provide a lower tax rate for 'small companies' to provide incentive to partnerships, AOPs and individuals engaged in small and medium businesses to convert to private limited companies?

The Task Force has carefully examined these issues and is of the view that the proposed corporate tax rate of 35% is definitely higher compared with that in most developed and developing countries. It does not sufficiently support the level of investment/activities required to achieve Government's targeted GDP Growth of 7.5 - 8%. The said rate also creates definite tax disadvantage for businesses operating in non-corporate mode if they decide to corporatize as the effective tax rate in their case would always be below 35%.

The Task Force, accordingly, recommends that

- **The proposed tax reduction to 35% for Private Companies, which is otherwise effective from tax year 2007 may be made effective upfront from tax year 2005.; and**

- **The proposed reduction of tax rates in case of banking companies may be continued as provided in the Income Tax Ordinance, 2001.**

5. Tax Rebate for Listed Companies

The Task Force understands that the Government is keen to see more and more new listings of companies to attract general public participation in the industrial progress of Pakistan. Though lately some public offers have taken place but these are mainly under privatization program of the Government and some in the mutual funds sector. Private industrial units are still shy of getting themselves listed. The reasons for this were stated to be as under:-

- i) Until June, 2002, there was a substantial tax rate difference for listed companies. Unlisted companies were subject to income tax rate of 43% whereas listed companies had a tax rate of 35%. In the budget of 2002-03, Government decided to reduce the tax rate on unlisted companies by 2% every year bringing it at par with listed companies by financial year beginning July, 2006 leaving no tax incentive for listed companies. Tax rate for financial year beginning July 2004 for unlisted companies is 39% whereas for listed companies it is 35%.
- ii) Tax rate on dividend from unlisted companies and listed companies have become the same i.e. @ 10%. Again no advantage provided to listed companies. Until June, 2002, tax rate on dividend from unlisted companies was 20%.

The Task Force has considered various views concerning the continuation of tax rate differential for listed companies.

The Task Force, accordingly, recommends that the listed companies (i.e. companies quoted on stock exchange), other than banking companies, may be subject to tax rate at 30% with effect from tax year 2005.

6. Lower Income Tax Rate for Small Companies

At present, there is no incentive for small and medium size businesses to convert themselves from non-corporate to a corporate entity. In real sense, with reference to income tax rates, there is a disincentive as partnerships, AOPs and individuals are taxed at graduated rates with a maximum rate of 35 percent applicable to income exceeding Rs 700,000. The effective tax rate for non-corporate entities at comparable incomes is much lower than the present corporate tax rate of 41% (and 10% tax on dividends) for private limited companies.

Most of the small and medium businesses believe that their tax liability is expected to substantially increase as a consequence to conversion from non-corporate to corporate form of doing business.

There is merit in the stand point of the taxpaying community even in the context of the reduced tax rate of 35% by 2007. While the existing corporate entities might be living with the present tax regime for several reasons, for businesses conducted as partnerships, AOPs and individuals the level of taxation and other levies is considered as a disincentive towards corporatization.

Given the reality that businesses must, as a process of natural development, conduct their affairs in more organized mode, Government's corporate policy in general and tax policy in particular must provide adequate mechanism/incentives to facilitate the corporatization process.

Examined in the historical perspective, small and medium size companies were, in the past, provided tax rebates ranging from 10 to 15 per cent of the tax. Such rebates were discontinued in early 80s. Task Force has observed that the tendency to have sizably reduced tax rate for small companies is getting increasingly popular in most countries. In UK, while the highest personal tax rate is 40%, for large and small companies it is 30% and 19% respectively.

Table 4.3: A Comparison of Tax Rates between Individual, Small Company and Large Company

Country	Tax Rates		
	Individual	Small Company	Large Company
UK	40.0%	19.0%	30.0%
Netherlands	52.0%	29.0%	24.5%
Germany	48.5%	*	25.0%
Turkey	40.0%	*	33.0%
Ireland	42.0%	*	25.0%
Australia	47.0%	*	30.0%
China	45.0	*	33.0%
Malaysia	28.0%	20.0%	28.0%
India	31.5%	*	35.9%

Following this trend, the Task Force considers that appropriate reduction in tax rates for small companies would stimulate the corporatization of businesses conducted in non-corporate form.

The Task Force, accordingly recommends introduction of a lower corporate tax rate of 20% for 'Small Companies'.

For this purpose, 'small company' may be defined to mean a company with 'paid up capital plus undistributed reserves' not exceeding Rs. 25 million or turnover of Rs.200 million.

7. Withholding Tax on Payments for Supply of Goods

The law provides for withholding tax of 3.5% on all payments for supply of goods and services purchased by the companies. Accordingly, companies are required to act as withholding agents for the State without any compensation. Instead of getting reward for this service, they are penalized for any lapse, whether intentional/willful or otherwise. Further, in most situations, given the fact that the suppliers of goods and services are reluctant to pay 3.5% tax on their payments (in contrast to no such obligation existing in case of such supplies to the non-corporate entities), mostly these taxes have to be borne by the companies themselves. The stakeholders generally consider this as a disadvantage in doing business in a corporate form as the withholding tax requirement ends up in their being non-competitive with their non-corporate competitors.

The stakeholders mostly proposed deletion of provisions concerning the withholding tax on payment for supply of goods and services.

The essential question before the Task Force was, whether in view of the disparity between companies and non-companies, does it serve as disincentive towards corporatization of businesses operating in a non-corporate form; if yes, what could be the most optimal arrangement to remove this disparity providing a level playing field without causing hemorrhaging in CBR revenues?

Further, the Task Force was also confronted with carefully considering that in the event that the withholding tax on payments for supply of goods and services can not be levied on non-corporate sector or it can not be withdrawn on the corporate sector is it appropriate to exempt the 'small companies' from such responsibility or to reduce the statutory rate of withholding tax to serve as adequate incentive for corporatization of small businesses.

The Task Force, accordingly, considered several alternatives proposed by the stakeholders, including the following.

- Abolition of the provisions concerning 3.5% tax on payments for supply of goods to provide level playing field to businesses irrespective of the form of doing business.
- Creating the rate differential for 'small business companies' to encourage non-corporate businesses to limited concerns.

While the first option has the inherent possibility of substantially impacting the revenue stream in short term, it has the advantage of creating level playing field for all businesses. – leading to encouraging corporatization of partnerships, AOPs and individuals with large turnovers (comparable with most private limited companies). The reduction in withholding tax rates would reduce the cost differential between the corporate and non-corporate entities.

The second option of creating the rate differential between small and large companies would create unnecessary distortions.

The Task Force, after due consideration of the relative cost of goods to corporate and non-corporate entities, also concluded that for most non-corporate businesses, particularly the small and medium size businesses, the responsibility as withholding agents was a real disincentive towards corporatization.

In the light of its deliberations on the above options, the Task Force recommends ;

- **Withholding tax rate on supply of goods for all type of companies may be reduced to 1.5%.**
- **Furthermore the withholding tax requirements which are presently applicable only to companies be extended to all persons registered with the Sales Tax Department to provide a level playing field and also to offset the revenue loss resulting from the proposed reduction.**

8. Taxation on Corporatization

Corporatization of a partnership, AOP or individual leads to a taxable incidence. This was considered one of the major hurdles for corporatization of businesses. Most stakeholders suggested tax exemption of such gains.

To facilitate and encourage corporatization, the need for tax exemption of such gains was expressed.

The question before the Task Force was whether these provisions are clearly understood or they require further simplification to ensure that there is no tax on transfer of these assets on conversion of one form of business to another. This was particularly relevant in cases of individuals, AOPs and partnerships engaged in large businesses and desiring to convert to limited concerns.

The Task Force recommends that amendment be made in the law that there should not be any tax on conversion of non-corporates to corporate entities.

9. Minimum Tax

The stakeholders expressed (during the meetings) that since this provision is applicable to companies only and imposes a charge of minimum tax even where a company is not liable to taxation due to any other provision in the Income Tax Ordinance, 2001, it not only creates inequity in tax matters on policy and economic grounds but also acts as one of the stumbling blocks towards the corporatization process. The stakeholders observed that it was unfair as it places companies at a disadvantage as compared to other forms of businesses. It was also inequitable to perceive turnover as a basis of taxation. They further felt that its adjustability against future tax liability is not sufficient to offset the inherent weaknesses of the levy of minimum tax.

The fundamental question before the Task Force was to consider whether the levy of 'minimum tax' in the wake of tax policy regime discouraging tax exemptions and holidays erstwhile available to the corporate sector (and for all practical purposes such incentives regime having been discontinued) was justifiable on economic/tax policy grounds, and had any merits in its continuation.

The Task Force has observed that 'minimum tax' based on turnover has not been a welcome taxation measure since its introduction in early 90s. Although the sting of this tax has been softened last year when section 113(2)(c) was amended and any excess tax paid as minimum less the actual liability determined through the final return was allowed to be carried forward for five years, the Task Force believes that with most tax holidays, tax credits and rebates having been withdrawn or phased out, there is no justification for continuation of this provision.

The Task Force, accordingly, recommends abolition of 'minimum tax'.

10. Taxation of Inter-corporate Dividends

Almost all business and professional bodies during their meetings with the Task Force stressed upon tax exemption of inter-corporate dividends. The basic argument advanced was that dividend is distributed out of the profits which remain available after payment of corporate tax and this tantamounts to multiple taxation of the same income. Secondly, in case of inter-corporate investments the same income is taxed again and again. This was stated to be a major impediment towards promoting holding companies. Revenue loss to the exchequer due to withdrawal of tax, it was stated, would not be much as 50% of the market is owned by the government and about 8% by Mutual Funds which are already exempt from this tax. Around 17% of the market is owned by the corporate presently subject to 5% tax rate on dividends. Hence, only 25% of the market owned by the individuals would be affected. It was stated that it would encourage small investors.

Yet another suggestion was that the tax rate on dividend declared by listed companies to individual shareholders be reduced to 5% from 10%. The revenue loss due

to this reduction was expected to offset against additional revenues forthcoming from increased listings, normal growth and higher dividends as a result of this incentive.

Given the legal position that there was no concept of 'underlying tax' in the Income Tax Ordinance, 2001 (as against several other countries not charging tax on dividends distributed out of taxed corporate profits as received by the companies), the focal point before the Task Force for discussion was whether such taxation of inter-corporate dividends was justified on policy grounds and its exemption would serve as a strong incentive towards private limited companies converting into public companies of course, with a larger and extended capital base?

The Task Force has considered the tax policy dimensions of this matter in some what details. There are equally valid arguments for and against tax exemption of inter-corporate dividends. Several South Asian countries follow the principle of tax exemption on distribution of taxed corporate profits.

Seen in the context of the prevailing exclusions as mentioned above, the Task Force does not foresee much revenue loss on this account. There is, however, definite advantage in terms of positive impact on formation of holding companies that can play positive role in corporatization of businesses and play significant role in the economic development of the country. This could also positively impact flow of foreign capital investment in Pakistan.

The Task Force, accordingly, recommends for exemption of inter-corporate dividends from the levy of tax.

11. Losses on Amalgamation

Under the present tax law, in the case of amalgamation of two corporate entities under Section 287 of the Companies Ordinance, 1984 or Section 48 of the Banking Companies Ordinance, 1962, losses of the amalgamated entity are not allowed to be carried forward except where the amalgamated entity is a bank or a financial institution. This provision is contained in Section 57A of the Income Tax Ordinance, 2001 read with section 2 thereof. Other sectors are not allowed the facility available to banks. Stakeholders consider this as a hindrance in the growth of corporate sector and the revival of sick units. It was argued that Government may consider extension of this provision to all companies.

The question before the Task Force was whether in order to promote corporatization and formation of larger businesses the concession to carry forward of losses be made available to all amalgamating companies in all sectors subject to the condition that such amalgamation is undertaken by way of section 287 of Companies Ordinance, 1984, or section 48 of Banking Companies Ordinance, 1962? In case yes, would it be appropriate to assume that the proposed measure would be in line with the

Government's overall economic policies, and would not be an unnecessary drain on its revenues?

The Task Force, accordingly, recommends that the provisions of Section 57A may be extended to all companies engaged in 'industrial undertaking' in the interest of overall growth of the economy, appropriate utilization of existing industrial capacities and improved employment opportunities.

12. Group Relief

The stakeholders recommended that the overall economic policies pursued by the Government warrants expanding the scope of 'industrial undertakings' for the purpose of group company relief in terms of inclusion of several important activities such as hotels, information technology, communications, shipping, transport and any other sector approved by the Government for this purpose. The down side of inclusion of these activities is that this provision may not lead to the late 1968 economic scenario and result in formation of large economic groups which may not be desirable.

The Task Force examined this aspect of the matter in details. Given that most developed countries follow the concept of group company relief in their taxation laws and that the Government has already taken the initiative toward this end, it would be rational to extend the benefits of the present law to the service sector as well.

The Task Force, accordingly, recommends that the Government may consider inclusion of service sector for the purpose of group relief.

13. Sales Tax

A general view has been expressed that the present rate of sales tax levy @ 15% is excessive and should be reduced to 10%. It was emphasized that reduction in tax rate would help in increased mobilization of resources in two ways. Firstly, the hidden urge of the tax evader would be extinguished reducing incidence of tax evasion. Secondly, the tax net would be enlarged because people will be more compliant and straightforward in discharging their social responsibility as a tax payer.

The Task Force discussed this proposal with the stakeholders in details. It was pointed out that except for a few selected countries viz: Canada, Indonesia, Philippines, South Africa and Taiwan, in all other countries the rate of sales tax/VAT was comparable or higher than that in Pakistan. The stakeholders generally observed that given the extent of poverty and much lower consumable surplus available to majority of population in Pakistan, 15% tax rate was on the higher side Further, as the present sales tax regime does not fully permeates to the retail stage and that the non-corporate entities

at different stages of economic activity have larger possibilities for tax evasion, higher tax is a disincentive for conducting businesses in corporate mode.

The Task Force, after careful consideration of the sales tax rates in Pakistan and other tax jurisdictions, its adverse social and economic impact on consumers, particularly on their cost of living, recommends that the sales tax rates may be gradually reduced (by 1% annually) until it reaches 12% in 2008

14. Issuance of Refunds and Rebates

It was pointed out that notwithstanding the public announcements from CBR for speedy issuance of tax refunds there were large number of pending small and huge refunds due to genuine taxpayers. The tax authorities, even at the cost of their reputation, were reluctant to issue refunds. This causes harassment to taxpayers and, invariably leads to malpractices. The Task Force was requested to suggest appropriate measures for timely issuance of refunds and rebates.

The Task Force is fully cognizant of the issues involved in delayed processing of refund/rebate cases. The structural problems, particularly the higher withholding tax rates and the tax collection mechanism under which particulars of individual business entities on whose behalf such taxes are withheld/paid are not reflected in the tax payment challans, absence of an appropriate integrated data base on tax assessed and paid for by each taxpayer, input/output data on exported goods/services, etc. creates difficulties in issuance of timely tax refunds/rebates. Governance issues delaying the refunds/rebates include malpractices and inefficiency on the part of relevant personnel.

Task Force has also observed that the issuance of delayed refunds is a big irritant, particularly for two reasons. Firstly, excessive tax is realized through various modes of tax collections, i.e. minimum tax, withholding tax, advance tax but the excess amount of tax recovered is not returned expeditiously. Secondly, such delays occur in the department mostly due to delays involved in verification of the tax having been collected and credited to the Department.

Considering the seriousness of this matter, Task Force shared the concerns of the taxpaying community and suggests for appropriate remedies by the CBR. In this regards, the Task Force recommends that:

- i. The procedure for tax payments and verification of challans may be improved.
- ii. Refunds should be allowed on the basis of evidence acceptable for assessment subject to a percentage check afterwards. If an excess refund is detected, then the same may be recovered from the taxpayers. In case of willful claim for excessive tax refunds, law may provide for exemplary penalties.

- iii. Time limit for issuance of sales tax refunds, similar to that provided in the income tax law may be prescribed in the Sales Tax Act, 1990.
- iv. Refunds should be generated through computer systems. Manual processing of refunds may ultimately be discontinued
- v. Where necessary, certificates for exemption or withholding at reduced rates may be issued expeditiously.
- vi. Adjustment of excess payments of income and sales tax, excise and customs duties may be allowed against the demand for any of these taxes. Where required, provisions for this purpose may be made in the relevant law.
- vii. Disposal of appeals may be expedited. It should be made mandatory to give appeal effect of the decision in appeal notwithstanding that the Department prefers appeal against such decision. The tax refund, if any, arising out of the appeal effect should be promptly issued.
- viii. The recently introduced Alternate Dispute Resolution Mechanism being a positive step towards out-of-court-settlement may be encouraged and improved where ever necessary.

15. Various Levies on Corporate Entities

Most stakeholders felt strongly that the following levies act as additional burden on businesses and should be abolished to lessen the taxation burden and to reduce the cost of doing business. Alternately, the utilization of funds collected through these levies, particularly Workers' Profit Participation Fund and Workers' Welfare Fund, should be left to the businesses for utilization on the welfare of their employees. The levies identified were:

- Social Security
- Employees Old Age Benefit contribution
- Workers' Profit Participation contribution
- Workers' Welfare contribution

The Task Force examined this issue in the light of the legal position explained in Chapter Two of this Report. WPP applies to companies engaged in 'industrial undertakings' as well as such other companies as are notified by the Government where the number of workers employed and the value of fixed assets of the company exceeds the prescribed limits. Companies are required to contribute 5% of their annual profits to the Fund. Workers also contribute part of their income to the Fund.

WW is levied under the Workers Welfare Fund Ordinance, 1971. The Fund consists of an initial contribution of Rs.100 million made by the Federal Government and annual contributions made by the industrial undertakings @ 2% of their assessed

income in a year. The Fund is applied towards establishment of housing estates/houses for workers and other welfare measures.

While the WPP is levied only on companies engaged in industrial undertakings, WWF is applicable to all industrial undertakings irrespective of these being companies or otherwise. WPPF is managed by the Board of Trustees comprising two representatives of employers and employees of the concerned company and one nominated by the Government. On the contrary, Government, through the Governing Body headed by the Secretary Ministry of Labour (as Chairman) and members from amongst Provincial Governments, employers and employees allocates moneys out of the Fund to the provincial governments, agencies of the Federal Government and body corporate for the purposes of the Fund (to be spent by the Workers Welfare Boards).

The fundamental issue, however, remains that the funds collected through these levies, particularly WWF, are to some degree under Government control. Businesses may not, therefore, have the free access to these funds and the choice to spend on activities perceived as welfare activities by them or their employers. They may not also have access to the total amount of contributions made by them and their employers and the Government may decide on allocation formulae suited to these enterprises.

In the context of workers sharing the corporate profits, stakeholders have stated that the idea of increasing per worker share in the Workers' Welfare Fund and Workers' Profit Participation Fund would not resolve the issue as even in that case, on account of certain limits (which will always exist), bulk of the funds will in any way end up as being taxes. As an alternate solution, it has been suggested that concerned companies may be allowed to use these funds for providing housing, health or education for their workers.

Task Force understands that social security is a provincial subject and its services are visible. Similarly, Employees Old Age Benefit Institution is also performing well by giving pensions to the disabled or deceased workers. Both the aforesaid institutions do not deserve to be disturbed.

On the other hand, Workers' Profit Participation Fund allows small amounts ranging from Rs. 2,500 to Rs. 6,000 per worker to be used for workers' welfare by the transfers within the company. Balance amount is transferred to Workers' Welfare Fund where the spill-over from Workers' Profit Participation Fund and direct contributions to Workers' Welfare Fund accumulate. We further understand that only 45-50% of the amount accumulated in Workers' Welfare Fund has so far been released for workers welfare schemes.

The Task Force, accordingly, recommends that:

- i. The entire amount accumulated or to be accumulated in future should be utilized by the Government for the purpose for which these contributions are made by the companies.**

- ii. **The limit of in-company utilization should be substantially increased to allow profit distribution by the trustees of the Fund within each company, say to the extent of 90% of the deduction on account of WPPF. The remaining amount of WPPF and WFF can be used by the Provincial Governments through welfare schemes as hitherto but for workers of companies who are not using the facilities of in-house utilization of 90% as aforesaid.**

The Task Force has observed that these levies do not significantly serve as a disincentive towards corporatization because of the additional financial burden on businesses intending to operate in a corporate mode.

16. Cost of Running a Company

During the Task Force meetings, several organizations, particularly the All Pakistan Textile Mills Association and Sialkot Chamber of Commerce & Industry stated that the costs involved in registration as a company and its subsequent operations were high and should be reduced. In this connection, the registration fee payable at the time of incorporation, the charge registration/de-registration fee payable when credit limit is obtained from bank or is to be enhanced, the fee payable to auditor of a company and the costs of hiring an accountant and a company secretary were mentioned and discussed and it was clarified that registration fee has been reduced by SECP for small companies. As for other charges/fees were concerned, those have been prescribed having regard to cost of the improved services provided by SECP.

The Task Force has observed that SECP has progressively reduced registration fee for small companies in as much as companies with a nominal capital of Rs. 100,000 can now be registered on payment of a fee of Rs. 2,500 only as against Rs. 10,000 levied in 1997.

The Task Force, while appreciating these steps, recommends that:

- i. **SECP may further reduce its registration fees for companies treated as 'small companies' (up to paid up capital of Rs.25 million).**
- ii. **Compliance and reporting requirements, particularly the adherence to International Accounting Standards (IAS), may not be insisted in case of 'small companies'.**
- iii. **SECP should review maximum fees so as to rationalize the fees by lowering the existing fee structure.**
- iv. **SECP should also look at its regulatory framework with a view to rationalize and make it cost effective for the compliance.**

17. Erosion of Limited Liability

Several stakeholders strongly agitated that the basic concept that formation of a company limits the liability of its members has been negated by the banking sector in as much as when a credit is obtained by a company from banks, they require a personal guarantee from the directors of the company. Therefore, the personal properties of the directors are charged. There is no limit on their liability as is envisaged by the company law. Accordingly, there is no benefit of formation of a company. There are only negative points.

The Task Force appreciates the stakeholders' view that why form a limited liability company when liability is to be unlimited due to personal guarantees obtained by banks from the directors at the time of sanctioning loans.

The Task Force, accordingly, recommends State Bank of Pakistan to review its instructions to the banks requiring obtaining of personal guarantees from directors of a limited company.

18. Stamp Duty

Several stakeholders pointed out that at the time of conversion of a business from a non-corporate status to a corporate status, the assets such as land and buildings are required to be re-registered in the name of the company. Under the Stamp Laws, such transfers are registered on payment of stamp duty at the prescribed rates. It has been stated that while the Punjab Province levies such duty, other provinces do not require payment of stamp duty. This, in the view of the stakeholders, operates as a discouragement to convert.

The Task Force has considered the implications of the said transfer of assets at the point of conversion of a business from non-corporate to corporate mode.

The judgment of the Sindh High Court is conducive to the growth of corporatization. The Task Force recommends that a uniform law should be introduced following the viewpoint of the Sindh High Court. the provincial Governments

CHAPTER IV

SUMMARY OF RECOMMENDATIONS

1. Broad Policy Guidelines

The Task Force, having regard to the need for encouraging corporatization, the development of corporate sector and as a step towards mitigating the problems faced by the corporate entities, both structural and administrative, developed the following corporate tax policy guidelines.

- Provide concessionary tax rates for SMEs converting to corporate form.
- Listed companies may be given tax rebate to encourage enlisting at stock exchanges. This would promote investments in capital market by the public at large.
- As a measure for expanding tax base, CBR should allot NTN to all companies on the basis of information provided by SECP notwithstanding whether or not companies themselves make application for this purpose.
- Government should remove all tax and non-tax impediments in conversion of non-corporate business to corporate status.
- In order to encourage corporatization, there should be visible differential in tax rates between corporate and non-corporate entities.
- Government should provide level playing field for corporates in matters of taxation such as minimum tax and withholding taxes
- Audited accounts of the companies, which maintain proper/prescribed books and submit along with their tax returns, should be generally accepted by the tax authorities unless there are certain valid grounds for disagreement.
- Government should avoid double taxation of corporate income by abolishing tax on inter- corporate dividends.
- Amalgamation of corporates should be encouraged so that companies grow in size.
- Concept of group taxation should be further developed.
- The SECP should not insist on adherence to International Accounting Standards (IAS) by small companies.

- The SECP should provide a concessionary fees regime to small companies, and improve its information dissemination program concerning incorporation of SMEs.
- Mindset of tax payers and tax officials to be reformed by creating awareness and introducing human resource development schemes.
- Provide independent and confidence inspiring tax fiscal justice system and strengthen alternate dispute resolution mechanism.

2. Corporate Tax Rates

- **The proposed tax reduction to 35% for Private Companies, which is otherwise effective from tax year 2007 may be made effective upfront from tax year 2005.; and**
- **The proposed reduction of tax rates in case of banking companies may be continued as provided in the Income Tax Ordinance, 2001.**

3. Tax Rebate for Listed Companies

The listed companies (i.e. companies quoted on stock exchange), other than banking companies, may be subject to tax rate at 30% with effect from tax year 2005.

4. Lower Income Tax Rate for Small Companies

Introduce lower corporate tax rate of 20% for ‘Small Companies’.

For this purpose, 'small company' may be defined to mean a company with 'paid up capital plus undistributed reserves' not exceeding Rs. 25 million or turnover of Rs.200 million.

5. Withholding Tax on Payments for Supply of Goods

- **Withholding tax rate on supply of goods for all type of companies may be reduced to 1.5%.**
- **Furthermore the withholding tax requirements which are presently applicable only to companies be extended to all persons registered with the Sales Tax Department to provide a level playing field and also to offset the revenue loss resulting from the proposed reduction.**

6. Taxation on Corporatization

Amendment be made in the law that there should not be any tax on conversion of non-corporates to corporate entities.

7. Minimum Tax

Abolish 'minimum tax'.

8. Taxation of Inter-corporate Dividends

Exempt inter-corporate dividends from the levy of tax.

9. Losses on Amalgamation

The provisions of Section 57A may be extended to all companies engaged in 'industrial undertaking' in the interest of overall growth of the economy, appropriate utilization of existing industrial capacities and improved employment opportunities.

10. Group Relief

The Government may consider inclusion of service sector for the purpose of group relief.

11. Sales Tax

The Task Force, after careful consideration of the sales tax rates in Pakistan and other tax jurisdictions, its adverse social and economic impact on consumers, particularly on their cost of living, recommends that the sales tax rates may be gradually reduced (by 1% annually) until it reaches 12% in 2008

12. Issuance of Refunds and Rebates

- The procedure for tax payments and verification of challans may be improved.
- Refunds should be allowed on the basis of evidence acceptable for assessment subject to a percentage check afterwards. If an excess refund is detected, then the same may be recovered from the taxpayers. In case of willful claim for excessive tax refunds, law may provide for exemplary penalties.
- Time limit for issuance of sales tax refunds, similar to that provided in the income tax law may be prescribed in the Sales Tax Act, 1990.

- Refunds should be generated through computer systems. Manual processing of refunds may ultimately be discontinued
- Where necessary, certificates for exemption or withholding at reduced rates may be issued expeditiously.
- Adjustment of excess payments of income and sales tax, excise and customs duties may be allowed against the demand for any of these taxes. Where required, provisions for this purpose may be made in the relevant law.
- Disposal of appeals may be expedited. It should be made mandatory to give appeal effect of the decision in appeal notwithstanding that the Department prefers appeal against such decision. The tax refund, if any, arising out of the appeal effect should be promptly issued.
- The recently introduced Alternate Dispute Resolution Mechanism being a positive step towards out-of-court-settlement may be encouraged and improved where ever necessary.

13. Various Levies on Corporate Entities

- **The entire amount accumulated or to be accumulated in future should be utilized by the Government for the purpose for which these contributions are made by the companies.**
- **The limit of in-company utilization should be substantially increased to allow profit distribution by the trustees of the Fund within each company, say to the extent of 90% of the deduction on account of WPPF. The remaining amount of WPPF and WFF can be used by the Provincial Governments through welfare schemes as hitherto but for workers of companies who are not using the facilities of in-house utilization of 90% as aforesaid.**

14. Cost of Running a Company

- **SECP may further reduce its registration fees for companies treated as 'small companies' (up to paid up capital of Rs.25 million).**
- **Compliance and reporting requirements, particularly the adherence to International Accounting Standards (IAS), may not be insisted in case of 'small companies'.**
- **SECP should review maximum fees so as to rationalize the fees by lowering the existing fee structure.**

- **SECP should also look at its regulatory framework with a view to rationalize and make it cost effective for the compliance.**

15. Erosion of Limited Liability

State Bank of Pakistan to review its instructions to the banks requiring obtaining of personal guarantees from directors of a limited company.

16. Stamp Duty

The judgment of the Sindh High Court is conducive to the growth of corporatization, a uniform law should be introduced following the viewpoint of the Sindh High Court.

Appendix 'A'

**SECP letter dated December 27, 2004 constituting the
Task Force**

**SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
NIC BUILDING, 63-JINNAH AVENUE
(COMPANY LAW DIVISION)**

No. CCL/1/19/SEC/2004

Islamabad, December 27, 2004

Subject **Constitution of the Task Force on Corporate Tax Policy**

In pursuance of the decision made by the Securities and Exchange Commission of Pakistan (SEC) and Central Board of Revenue (CBR), the SEC is pleased to notify the constitution of a Task Force to formulate a corporate tax policy aimed at encouraging corporatization and progressive development of the corporate sector in the country. The Task Force shall comprise the following:

Mr. Justice (R) Saleem Akhtar	Chairman
Mr. M.S. Lal, Member (P&TR), CBR, Islamabad	Member
Mr. Abdul Rehman Qureshi, Commissioner, SEC	Member
Mr. Ahmad Khan, former Member, Monopoly Control Authority	Member
Mr. Mukhtar Ahmad Gondal, Chief (Direct Taxes Policy), CBR, Islamabad	Member
Mr. Abdul Hameed Chaudhri, FCA, Lahore	Member
Syed Mohammad Shabbar Zaidi, FCA, Karachi	Member
Syed Fayyaz Mahmud, Director, SEC	Secretary

2. The Task Force is required to complete its task within a maximum period of two months.

3. Terms of Reference of the Task Force would be as under:

- a) To review the existing legal and policy regime for corporate tax with a view to developing an effective corporate tax policy aimed at enhancing corporatization and progressive development of corporate sector.
- b) To review the applicable tax rates; multi-tiered taxation, sales tax; Turnover Tax; Withholding Tax; Professional Tax; and the Capital Value Tax as well as the procedure for filing the tax returns by companies.
- c) To suggest tax reforms in various areas such as rationalization of tax rates, streamlining of sales tax refunds, extension of sales tax coverage to more sectors, documentation of entire value chains across most areas, and reduction in interface between taxpayer and tax officials.

- d) To examine the prospects of broadening of the tax net to unregistered enterprises so as to sustain revenue in a reduced tax rate scenario and induce the conversion of unregistered entities into corporate enterprises.
- e) To suggest reforms that provides effective mechanisms and a level playing field between registered and unregistered enterprises.
- f) To suggest viable tax administration measures for implementation of the recommended reforms.

(Abdul Rehman Qureshi)
Commissioner (CL)

Copy forwarded for information to:

1. Mr. Justice (R) Saleem Akhtar, M 53/2/1 , Khayaban-e-Ittehad, Phase-Vu, DHA, Karachi.
2. Mr. M.S. Lal, Member (P&TR), CBR, Constitution Avenue, Sector G-5, Islamabad.
3. Mr. Abdul Rehman Qureshi, Commissioner, SEC, NIC Building, Jinnah Avenue, Islamabad.
4. Mr. Ahmad Khan, former Member, Monopoly Control Authority, House # 24, Central Avenue, Fizaiya, Islamabad Highway Road, Rawalpindi.
5. Mr. Mukhtar Ahmad Gondal, Chief (Direct Taxes Policy), CBR, Constitution Avenue, Sector G-5, Islamabad.
6. Mr. Abdul Hameed Chaudhri, FCA, Hameed Chaudhri & Co., P.O. Box – 386, HM House, 7-Bank Square, Lahore.
7. Syed Mohammad Shabbar Zaidi, FCA, A.F. Ferguson & Co., 2nd Floor, State Life Building No. 1-A, 1.1. Chundrigar Road, P.O. Box 4716, Karachi.

Appendix 'B'

Summary of Issues Identified in the Meeting Of the Task Force with Stakeholders

1. Overseas Investors Chamber of Commerce & Industry (OICCI)

The following proposals were made:-

- Lower corporate tax rates to attract investments and align rates with global and regional trends.
- Lower tax burden on salaried employees through reducing tax slabs, tax credit on car and durable capital goods, full mortgage relief, removal of cap of basic salary and double taxation of perquisites.
- Widen customs tariff gap between raw materials and finished goods; provide relief for environmental and corporate social responsibility projects.
- Excise duty may be restricted only to luxury goods, and input/output mechanism as in GST may be allowed on items where duty is not to be eliminated.
- Reduce GST rate from 15% to 10%; GST may be payable on transfer of title rather than on advance received; and eliminate Third Schedule (all companies should be subject to sales tax at their selling price).
- In order to make manufacturing more competitive:
 - Eliminate WPPF and WFF (exclusive to manufacturing),
 - Introduce holding company concept to facilitate revival of sick units and offset of tax breaks (both credits and losses),
 - Exempt inter-company dividends; and
 - Reduced corporate tax to SMEs (to encourage growth and corporatization),
 - Tighten implementation of IPR violations and smuggling,
 - Improved infrastructure in utility charges, efficient road and port operations,
 - Rationalize taxation of related party transactions.

2. American Business Council

- Make manufacturing more competitive:
 - Eliminate WPPF and WFF and allow companies to use this fund to build schools, hospitals and carry out other welfare activities that directly benefit the low income employees.
 - Reduce cost of utilities for manufacturing concerns.
 - Reduce corporate tax rates by 5% to cap at 30%.
 - Corporate tax rates for public companies should be kept lower than private companies.
- Personal tax rates
 - Reduce the highest rate to 30%
 - Simplify structure by reducing number of slabs.
 - Allow tax credit on cars and durable capital goods.
 - Provide full mortgage relief; remove cap on basic salaries.
 - Avoid double taxation of excess perquisites.
- General Sales Tax (GST)

- Reduce GST rate from 15% to 10%.
- GST should be payable on transfer of title and not on advance payment of goods.
- Remove tax differential between registered and unregistered entities through some incentive mechanism for registered entities (such as rebate on utility bills), elimination of withholding tax on utilities for registered entities, and a moratorium on GST audit
- Simplification of payment and submission process.
- Customs duties
 - Introduce 0% duty on raw materials and equipment.
 - Maintain cascading of duties and remove all anomalies.
 - Introduce bulk duty bracket at 15% to 20% which is 10% to 5% below finished products to encourage local packing.
- .Central Excise Duty
 - Eliminate CED on all items except cigarettes, beverages, cement and POL products.
- Presumptive Taxes: trading and manufacturing income should be allowed to be merged for tax assessment.
- To help corporatization
 - Professional tax may be abolished.
 - Introduce a Code of Conduct in tax department for taxation officers providing timeframe and quality standard for tax assessments, replies to taxpayers and mode of relationship with taxpayers.
 - Abolish withholding tax on telephone, electricity and motor vehicles for corporate sector.
 - For sales tax audits, appoint independent and qualified auditors to verify replies to audit observations at the cost of audit department.
 - Introduce holding company concept to facilitate revival of sick units.
 - Allow past losses of merging companies for combined company assessment.
 - Offer incentives to SMEs by way of reduced corporate tax rates.
- Provide relief to retirees and widows by way of 100% income tax exemption to working widows and levy of 50% of last three years' average tax rate to others.

3. Karachi Chamber of Commerce and Industry

- Remove following anti-corporatization provisions from the income tax law:
 - Withholding taxes, double taxation of perquisites in the hand of employees and employers, rejection of audited accounts, excessive litigation imposed on companies increasing cost of doing business, mal-administration and mal-practices,

- Commissioners powers to re-characterize income and deductions u/s 109, additions u/s 113(3) & (4), amend assessments u/s 122(2), enter & search business premises u/s 175(2), obtain information u/s 176 of Income Tax Ordinance 2001, and tax recovery u/s 11A and burden of proof u/s 37A/2(37) of Sales Tax Act, 1990.
- Reduce corporate tax rates for public and private limited companies to 20% and 25% respectively (by 2007).
- Reduce sales tax rate to 10%.
- Reduce multiplicity of taxes; abolish professional tax and infrastructure cess.
- Ensure proper cascading of customs duty structure on raw materials, components, etc to provide reasonable protection; exempt from duty industrial raw materials, plant & machinery.
- Complete sales tax audits within prescribed time frame after providing adequate opportunity to registered persons.
- For prompt issuance of sales tax refunds, adopt UK System based on automated processing. Submission of a copy of supplier's return and his own registration certificate may be considered sufficient for the purposes of return without waiting for correction record from STARR.
- Allow duty draw backs to the maximum extent to make exporters competitive in international market.
- Adopt the strategy of increasing tax base (including extension of federal income tax to the agriculture sector) rather than tax rates for revenue mobilization

4. Lahore Chamber of Commerce and Industry

- Reduce corporate tax rates.
- Abolish withholding taxes on supply of goods and services.
- Exempt inter-corporate dividends.
- Improve the selection process for tax audits.
- Eliminate mal-administration and mal-practices.
- Improve tax refund processes.

5. Karachi Stock Exchange

- Ensure stability and consistency in economic policies to promote investment e.g. exemption of capital gains on disposal of shares of listed companies on a long term basis.
- Exempt inter-corporate dividends. There would not be substantial loss as 50% market is owned by Government and 8% by mutual funds (which are already exempt), and 17% by corporate which are subject to 5% tax on dividends. Alternatively, reduce tax on dividends received by individuals from 10% to 5%.
- Retain 10% tax rebate for listed companies, particularly as the listed companies are subject to the Code of Corporate Governance subjecting them

to much desired discipline to protect shareholders interest.

- There should be tax rate differential between listed and non-listed companies i.e. listed and non-listed companies taxed @30% and 35%. The proposed reduction for listed companies may be gradually achieved until year2007.
- Review personal income tax rates to promote savings and investment. Similarly, restore investment allowance for investment in shares of listed companies.
- Align tax jurisdiction of Taxation Officers to specific sectors to improve tax audits, etc.

6. Sialkot Chamber of Commerce and Industry

- Reduce cost of formation of corporate entities.
- Reduce corporate tax rates to the extent that there is a visible advantage to the corporate sector.
- Abolish 'minimum tax' on companies.
- Abolish withholding tax on payments for supply of goods and services to provide level playing field to corporate and non-corporate sectors.
- Restore incentives like those available Clause 118D and 118E of the Income Tax Ordinance, 1979.
- Introduce necessary changes in SBP Prudential Regulations removing the requirement of personal guarantees of directors for bank borrowings – thus reviving the concept of limited liability under Company Ordinance, 1984.

7. All Pakistan Textile Manufacturers Association (APTMA)

- Revitalize the present system of corporate taxation through reduction in corporate and personal tax rates, abolishing of tax on inter-corporate dividends, removal of withholding tax on supply of goods and services, parity between corporate and non-corporate sectors in respect of documentation requirements (e.g. payments through cheques), tax audits, filing requirements, levy of professional tax and statutory audits.
- Strictly follow provisions of Section 170 of IT Ordinance, 2001 in issuance of tax refunds.
- Improve personnel capacities and skills through adequate training with banks, stock/commodity exchanges, and firms of chartered/cost accountant firms.

8. Institute of Chartered Accountants

- Remove tax rate differential between listed and non-listed companies through elimination of 10% rebate for the latter.
- Maximum tax rate for corporate entities may be reduced to 30%.
- For salaried class, 35% rate should apply to income exceeding 2.5 million.
- Introduce concept of holding companies whereby multiple taxation on inter-company dividends should be done away for resident and non-resident companies.

- Group relief provisions may be extended to hotels, information technology, communications, shipping, transport and sectors approved for this purpose by CBR.
- Benefits of Section 57A (in case of amalgamating companies) may be extended to 'industrial undertakings'.
- Withholding tax rates on supplies and imports may be reduced from 3.5% to 2.5% and 6% to 5% respectively with the choice to opt for PTR.
- Extend the applicability of Section 113 (i.e. levy of minimum tax) to all taxpayers having business income.
- Allow 10% rebate in tax liability (with some conditions) during the three initial years in cases of section 95, 96 and 97 to promote corporatization and encourage conversion of AOPs, etc. to companies.
- Cooperative societies engaged in real estate business may be deemed as companies for tax purposes to encourage corporatization of real estate sector.
- Extend capital gains exemption to insurance companies.
- Amend provisions of Section 17(a) of I.T. Ordinance, 2001 to allow expenditure on repairs and maintenance equal to 1/5th of annual letting value of property or the actual expenditure, whichever is higher.
- Interest income on surplus funds earned by businesses may be treated as 'business income' rather than 'income from other sources'.
- To encourage private sector to invest in health and education of its employees, allow special credit of 15% of tax liability to such companies.
- Audited financial statements should be honored and rejected only on justifiable grounds in which case the matter be referred to ICAP.
- Repeal WWF and WPPF. In case these are continued, companies may be allowed to retain surplus funds to be utilized for employees' welfare.
- Simplify process of formation and liquidation of companies.
- Rescind CBR Circular on cash receipts (concerning P&L expenses) to promote documentation by allowing cash receipts and payments.
- Abolish Section 111(4) of the Income Tax Ordinance, 2001 on foreign remittance. In the mean time, allow amnesty on declaration of foreign assets by paying tax@15%.
- Integrate SECP and CBR data bases/sales tax and income tax audits, reconcile income tax and sales tax returns, reduce sales tax rate to 10%.

9. Institute of Cost and Management Accountants

- Define objectives taxation policy and rationalize existing tax laws.
- Increase highest marginal personal income tax rate on income exceeding Rs.5 million from 35% to 45%; reduce corporate tax rate to 30%.
- Extend the withholding tax net to all classes of persons (withholding agents) as it is presently biased in favor of non-corporate businesses; relax penalty provisions for non-compliance; simplify the process for giving tax credit for taxes withheld; improve STAR System of sales tax refund.
- Simplify the tax returns and filing process; educate taxpayers on their tax obligations, requirement for statutory audit may be extended to all classes of

taxpayers.

- Allow 5% tax rebate to sole proprietors of businesses.
- Decide on criteria for selection of cases for tax audit in consultation with taxpaying community/representative bodies. Selection should be on random basis rather than focusing on certain classes of taxpayers.
- Do not delegate powers u/s 122 to the Taxation Officers; where taxpayers accept their omission/mistake matter should end. Reassessment should not be more than twice and restricted to the 5 years period since filing of the tax return, and based on definite information/evidence.
- CBR to issue strict instructions for timely issue of tax refunds and a clear mechanism for verification of tax already paid.
- Improve decision making process through improved skills and elimination of disparity resulting from low skills vs. technology inputs in tax administration; introducing higher integrity levels and doing away with mal-administration/mal-practices, discretionary powers; independent and prompt dispute resolution; living salaries to tax officials; improved infrastructure and support facilities.
- Increase the period for depositing of taxes withheld to 30 days; authorize appellate authorities to grant stay of payment of 15% tax u/s 127(2) or grant interim relief.
- Prescribe time limitation for invoking the provisions of Section 111 and 161 of the Income Tax Ordinance, 2001.
- Introduce a provision for loss carry back to relieve businesses from financial strain in the year of loss and encourage them to re-invest.

10. Lahore Tax Bar Association

- Abolish 'minimum tax' u/s 113 of Income Tax Ordinance, 2001.
- Withholding tax provisions u/s 150 to 156, particularly section 153, only impact the companies. Remove these provisions from the statute to provide level playing field to the corporate entities.
- Reduce the corporate tax rates to 35% with immediate effect rather than waiting until 2007.
- Abolish tax on inter-corporate dividends including those received by insurance companies.
- Detailed tax returns may be required only from taxpayers selected for tax audit.

11. Adamjee Insurance Company Ltd. /International General Insurance

- Extend the tax exemption of capital gains on disposal of shares of listed companies to insurance companies.

12. Rehan Hasan Naqvi (Tax Practitioner)

- Reduce corporate tax rates as, given the relatively low personal tax rates,

- businesses in non-corporate mode are a preferred option.
- Relieve corporate sector from the responsibility to withhold tax on payments for supply of goods and services as it makes them less competitive Vis a Vis non-corporate entities which are under no obligation to withhold such taxes.
 - Reduce penalties for non-compliance/ delay in depositing of taxes withheld.
 - Exempt inter-corporate dividends.
 - Improve tax collection procedures.
 - Abolish Section 113A - being discouragement to corporatize.
 - Multiplicity of taxes discourages corporatization – taxes be rationalize.
 - Withholding taxes on payments for supply of goods and services is biased towards companies.

13. Mohsin Khalid (formerly President Islamabad Chamber of Commerce & Industry)

- Small businesses do not opt for corporate structure for reasons of family tradition, increased documentation requirements, dilution of ownership, increased cost for statutory audits, higher level of compliance and transparency, increased level of taxation, more stringent tax audits and regulatory compliance.

14. Ahsan Saleem (Entrepreneur)

- Small businesses do not convert into companies primarily for reasons that there are no tax inducements, there are rapid changes in taxation policies concerning corporate sector e.g. payments by cheques, small investor is mostly not familiar with the English language in which corporate laws are written.

15. Ahmad Parekh

- Income tax rate for public companies, which is at par with private companies be rationalized.
- Legal requirements under Companies Ordinance 1984 & of SECP for listed companies are too many & too strict, and be made much simple.
- Fruitless formalities and higher cost for EOBI, Social Security and unnecessary Labour laws which are merely a wastage of time and many a time where productive results are not achieved, be made very simple in consultation with chamber of commerce.
- Export refinance at concessional rate be provided to Cos.
- Levies such as workers welfare fund and excess of workers profit fund, which are collected by Government of Pakistan be abolished.
- Stock Exchange listing fees should be bare minimum.

- Sales tax audit of listed public limited companies be made friendly and convenient.

Appendix 'C'

**List of Bodies/Associations/Individuals interviewed by
the Task Force**

(1) Bodies:

(A) Federation of Pakistan Chamber of Commerce and Industry represented by:

1. Mr. Shahid Ahmed Khan
2. Mr. Amjad Rafi

(B) Overseas Investors Chamber of Commerce And Industry represented by:

1. Mr. Zahid Zaheer, Secretary General
2. Mr. Nadeem Karamat
3. Mr. Parvez Ghias

(C) Karachi Chamber of Commerce and Industry represented by:

1. Mr. Junaid Ismail Makda
2. Mr. Abdul Qadir Memon

(D) American Business Council represented by:

1. Mr. Saad Amanullah

(E) All Pakistan Textile Mills Association represented by:

1. Mr. Mushtaq Ahmad Vohra, FCA
2. Mr. Muhammad Younus Nawab
3. Mr. Mazhar Saleem Shah

(F) Lahore Chamber of Commerce & Industry represented by:

1. Mr. Sheikh Muhammad Asif
2. Mr. Muhammad Khalid Rafiq
3. Mr. Shahzad Azam Khan

(G) Sialkot Chamber of Commerce and Industry:

1. Mr. Zulfikar A. Nasir, Chartered Accountant
2. Mr. Liaquat Mahmood Baig, Advocate
3. Mr. Muhammad Akram Raza, President Sialkot Tax Bar Association

(H) Karachi Stock Exchange represented by:

1. Mr. Moin M. Fudda, MD
2. Mr. Muhammad Siddique Dalal, Director
3. Mr. Shehzad Chamdia, Director

(I) Procter & Gamble Pakistan (Pvt) Limited represented by:

1. Mr. Saad Amanullah Khan

(2) Professional Organizations:

(A) Institute of Chartered Accountants of Pakistan represented by:

1. Mr. Nasimuddin Hyder, FCA
2. Mr. Khaliq-ur-Rehman, FCA
3. Mr. Asad Ali Shah, FCA

(B) Institute of Cost and Management Accountants of Pakistan represented by:

1. Mr. Qaisar Mufti, FCMA
2. Mr. Muhammad Ashraf Bawany, FCMA
3. Mr. Shaukat Hayat Khan Baloch, FCMA

(C) Karachi Tax Bar represented by:

1. Mr. Younas Rizwani
2. Mr. Ali A. Rahim

(D) Lahore Tax Bar represented by:

Mr. Rashid Rehman Mir, President

(3) Individuals:

1. Mr. Mohsin Khalid, an educated small investor and former President Islamabad Chamber of Commerce and Industry
2. Mr. Ahmad Parekh, a chemical engineer and businessman
3. Mr. Ahsan Saleem, a businessman
4. Mr. Rehan Naqvi, Tax Consultant
5. Mr. Saadat Chaudhry, FCA, consultant to a group running big business as AOPs