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Pakistan National Business Agenda 2010

The National Business Agenda (NBA) identifies some of the policy/legislative changes perceived by Pakistani industry as important to improving the business environment in the country. Specifically the NBA identifies issues in four areas of policy, the rationale for required change and specific recommendations for reforming the policy/ legislation.

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EXECUTIVE SUMMARY

The Pakistan Business Council (PBC) is a private sector business advocacy group founded and funded by 14 (now 28) of Pakistan's largest business groups including multinationals. One of the founding objectives of the PBC is interacting with government, legislature and various regulatory bodies to improve the macro business environment of the country. The PBC follows an "evidence based" advocacy strategy relying heavily on regional and international best practices.

The National Business Agenda (NBA) identifies some of the policy/legislative changes perceived by Pakistani industry as important to improving the business environment in the country. The NBA identifies issues in four areas of policy, the rationale for change, and finally the specific recommendations for reforming the policy/ legislation. The four areas which the NBA concentrates on are:

1. Consolidation of industry in Pakistan
2. A level playing field for industry
3. Broadening the tax base
4. Development of human capital in Pakistan

1.0 Consolidation of Industry in Pakistan:

Pakistan industry by and large is fragmented with no group or individual player in any industry large enough to successfully compete with its regional or global competitors. Pakistani companies have not only lost share in international markets; they have in the past decade lost out to cheaper and better quality imports in their domestic markets. The government realized the need for scaling domestic companies in 2007, drafting the Holding Company Legislation with a view to providing an environment for consolidation and growth of the group companies. However since the inception of this law, not a single group has been able to benefit from its provisions, primarily due to the shortcomings in the law. Policy and legislation changes being proposed are:

INCOME TAX LAWS AS THEY RELATE TO HOLDING COMPANIES		
Existing Situation	Proposed Change	Rational for Change
Section 59B(2)(b): "A company within the group engaged in the business of trading shall not be entitled to avail group relief"	Section 59B(2)(b) to read: "A company (not being a company operating trading houses as defined under clause 57 of Part IV of the 2 nd Schedule of the Ordinance) engaged in the business of trading shall not be entitled to surrender the loss" Explanation: for the purpose of this paragraph, a company would not be considered to be engaged in the business of trading unless more than 30 percent of declared turnover is from business of trading.	This change will make the legal provisions consistent with the spirit of the concept and underlying understanding of the taskforce formed for this purpose. Moreover trading activity up to the extent of 30 percent of the turnover is proposed not to disqualify the claim. As a Large Trading House entails a significant investment and creates real jobs in the economy, it is proposed to make it eligible to surrender its losses.

INCOME TAX LAWS AS THEY RELATE TO HOLDING COMPANIES		
Existing Situation	Proposed Change	Rational for Change
Section 59B	To allow retrospective application of the law, the following explanation to be inserted after Section 59B: Explanation: The amendment in this Section by the Finance Act 2009 shall be deemed always to have been enacted and shall have effect accordingly.	In order to make the amendments applicable for pending cases.
Section 103(A): “Any income derived from inter-corporate dividend within the group companies entitled to group taxation under Section 59AA of Section 59B”	Section 103(A) to read: “Any income derived from inter-corporate dividend within the group companies” Explanation: For the purposes of this clause term within the group mean companies within a group as registered under the Group Companies Registration Regulation 2008	To streamline exemption on inter-corporate dividends.
Section 59B(2)(a): “there is continued ownership for five years, of share capital of the subsidiary company to the extent of fifty-five percent in the case of a listed company, seventy-five percent or more, in the case of other companies”	Section 59B(2)(a) to read: “there is from the date of surrender of loss , continued ownership for five years of share capital of the subsidiary company to the extent of fifty-five percent on the case of a listed company, or seventy-five percent or more, in the case of other companies”	Ambiguity in the law is being construed to read as five years prior ownership of the company by the group for it to qualify for surrender of losses.

2.0 Level Playing Field for Industry:

The organized, taxpaying sector of the economy is under threat of being overwhelmed under the onslaught of the unorganized, informal non-taxpaying sectors of the economy. This threat is compounded by the impact of the smuggling, under invoicing, and dumping that takes place through the Afghan Transit Trade. The formal sector which was estimated at less than 40% in the 1980s is now estimated at between 60 – 70% of the GDP. The policy / legislative changes suggested are briefly summarized below:

LEVEL PLAYING FIELD FOR INDUSTRY		
Existing Situation	Proposed Change	Rational for Change
Commercial Importers are charged a presumptive tax rate of 5% which is also their final tax liability	Commercial importers should be brought into the normal tax regime. Until this can be accomplished, the previous rate of Presumptive Tax of 6% should be reintroduced.	Increases government revenue while at the same time helping to reduce the impact of undervalued imports
Pakistan allows Afghanistan Transit facility under the 1965 Afghan Transit Trade Agreement (ATTA)	Ideally the customs tariffs and other levies charged on imports by the governments of Pakistan and Afghanistan should be harmonized to reduce the smugglers incentive. While this is being done, the following measures should be taken by the government of Pakistan: • Reintroduce the Negative List for ATTA. • Quantitative restrictions need to be placed on ATTA based on demand conditions in Afghanistan. • The Government of Pakistan can collect on behalf of the Afghan Government, duties and taxes applicable to imports into Afghanistan	These measures will reduce the excess quantities which are imported under the ATTA and destined for Pakistan. Will also lead to revival of manufacturing in Pakistan and increased revenues for the Government
Across the board massive under invoicing, dumping of imported products	Depending on industry input, values should be fixed for import consignments; basis of valuation can be area, weight, volume etc. The old Customs General Order 25 needs to be revived. This allowed local manufacturers the option to buy at a 10% premium any consignments which appeared undervalued. Pakistan can impose some Non Tariff Barriers such as designating some specific ports for clearance of some items	Allow industry to fairly compete with imports, government to benefit from increased revenue.
Import valuation data and sales tax, FED deposited by various units is not public information	Values at which import shipments are cleared whether through PRAL or CARE needs to be public information. To protect confidentiality the name of supplier maybe withheld. Sales tax and federal excise duty deposited by local manufacturers should be published as was the practice in the past	Greater transparency at import stage. Will reduce incidence of mis-declaration of imports as well as help in reducing misreporting of production data.

3.0 Broadening of the Tax Base:

The current Tax-to-GDP ratio of less than 9.0% is not sustainable; this low tax collection rate means that the government faces a perpetual revenue shortfall which severely hampers its efforts to improve the living conditions of the poor segments of the population. The root

cause of this revenue shortfall is the exclusion of major segments of the economy from the tax base (agriculture, most services and real estate from the tax net) and the high rates of taxation (Pakistan has one of the highest rates of personal and corporate income tax in the region). To increase tax collection without increasing the incidence of taxation on the existing taxpayers, it is imperative that the tax base be broadened. Drastic and innovative measures are required to bring, sectors of the economy which are currently not taxed into the tax net. The measures being proposed to broaden and to rationalize the tax rates are given below:

BROADENING OF THE TAX BASE		
Existing Situation	Proposed Change	Rational for Change
Rate of sales tax in Pakistan is 17%	Reduce rate of Sales Tax by 1.5% per annum so that it is 10% by 2013	High rates of Sales Tax encourage evasion and serve as an incentive for staying in the informal sector. Low rates will lead to greater compliance and reduce cost of doing business in the formal sector, encouraging more businesses to formalize.
A watered down sales tax regime that keeps major sectors of the economy out of the tax net	Replace the existing sales tax regime with an across the board value added tax (VAT) on goods and services	An across the board VAT with minimum exemptions will lead to greater documentation of the economy. It will also bring sectors of the economy such as most professional services into the tax regime.
No corporate investment tax credit in Pakistan	A 15% investment tax credit as was the practice in the past. Section 107 A of the Income Tax Ordinance 1979 needs to be restored	To regain its competitiveness, Pakistani industry is in dire need of upgrading both technology and machinery. Investment tax credit will not only help Pakistani industry regain its lost domestic market share, it will also allow it to compete with regional players.
No tax on real estate developers / builders	Real estate developers should be taxed on a per square foot basis for built up property and a per square yard basis on land developed for sale.	No rational for keeping sector outside of the tax net.

BROADENING OF THE TAX BASE		
Existing Situation	Proposed Change	Rational for Change
A very low taxpayer base (about 1.0 million in a population of about 170.0 million)	Filing of tax returns be mandatory for persons who: • have a credit card in their name, • have taken a personal loan from any financial institution, • have traveled outside of Pakistan in the last financial year, • are members of a private club, • are members of a professional body,	Greater documentation of the economy, greater tax collection

4.0 Development of Human Capital in Pakistan

Each year the Government of Pakistan collects billions of rupees under the heads of the Workers Profit Participation Fund (WPPF) and the Workers Welfare Fund (WWF). This is in addition to the funds collected as part of the employees' old age benefits and the social security contributions. These "funds" are collected for the improvement of the human capital of the country and have for the most part failed to deliver.

In view of the steady deterioration in the stock and capacity of the human capital available to industry, Pakistan will lose its ability to compete even in those products which are classified as "assembly line". The participation of the private sector is vital for improving Pakistan's human resource base; proposals for improving the quality of the human capital are given below:

DEVELOPMENT OF HUMAN CAPITAL IN PAKISTAN		
Existing Situation	Proposed Change	Rational for Change
The WWPF & the WWF (total 7% of profits) have failed to contribute towards improving the quality of human resources in the country	Listed companies should be allowed to spend up to 50% of their contribution on technical training programs Alternatively the rate rates of WPPF & WWF should be reduced by 50%	Industry driven technical training programs will lead to the development of a human resource pool which is in line with industry needs

1.0 INTRODUCTION

The Pakistan Business Council (**PBC**) is a private sector business advocacy-cum-think tank setup in 2005 by 14 (now 28) of Pakistan's largest business groups including multinationals. To ensure that the PBC has the widest representation of progressive business views, only one company can represent a group. The council is a not-for-profit organization registered under Section 42 of the Companies Ordinance 1984, has a 14 member Board of Directors and is run by a professional staff led by a paid full time CEO. Though not required by law, the PBC where possible follows the Code of Corporate Governance as applicable to listed companies.

One of the founding objectives of the PBC is interacting with the government, legislature and various regulatory bodies to improve the macro business environment of the Country. The PBC follows an "evidence based" advocacy strategy relying heavily on regional and international best practices. In the short time period that the PBC has been in existence, it has managed to achieve, in cooperation with other stakeholders, important legislative changes, these include:

- The Holding Company Law 2007
- The Law on Import Houses 2007
- The Real Estate Investment Trust Law 2008
- The Law on Venture Capital and Private Equity 2009
- The Special Economic Zones Act –Under legislation

In addition the PBC works very closely with the government and various sector regulators like the State Bank of Pakistan (SBP) and the Securities and Exchange Commission of Pakistan (SECP) through taskforces, working groups, committees etc.

The National Business Agenda (NBA) is an advocacy tool that contains specific legislative requirements that need to be changed to bring about an improvement in the business climate as well as suggesting reforms to current legislation to make these more relevant to the local economies. As the NBA is developed and advocated by local organizations like the PBC, it is easier to garner buy in from both the government and other business constituencies.

The list of legislative issues which the PBC membership identified as important for inclusion in the NBA was extensive and covered a wide range of issues, too many to examine in depth. As such, it was agreed to limit the scope of the NBA to four areas of common concerns for businesses in the formal or organized sector of the country and where legislative intervention will bring about a positive change in the near and medium. The emphasis in the Pakistan NBA is therefore on the macro business environment as opposed to the sector specific micro issues which are the concerns of industry and sectoral business associations.

The four macro business environment issues identified are:

1. Consolidation of industry in Pakistan
2. A level playing field for industry
3. Broadening the tax base
4. Development of human capital in Pakistan

A brief summary of the issues in each area, the proposed legislative changes, and the rationale for change is briefly discussed in the following sections. The PBC asks business leaders to review this NBA and to forward their comments for incorporation so that this NBA has broad support of the formal, organized business sector of the country.

2.0 CONSOLIDATION OF MANUFACTURING

Pakistani industry is characterized by a lack of scale. This lack of scale has severely hampered the competitiveness of the Pakistani firm vis-à-vis competitors in the regional and global markets. This means that critical investments in technology upgrades, human resource training and R&D have not occurred. This lack of investment has translated into not only a loss of market share for Pakistani firms in international markets, but also harms sales in domestic markets where they have steadily lost market shares to foreign competitors.

Increasingly the “large” Pakistani manufacturing concerns look like “cottage industries” in comparison to their regional and global competitors. This was not always the case. In the 1960s the nascent Pakistani conglomerates were labeled as some of the most progressive in the region. Fifty years on, very few, if any, of them survive in their original form. The breakup of large family businesses on the death of the family patriarch is frequently listed as one of the major causes of the failure of sustainable family businesses in Pakistan. A detailed analysis in 2006 by the PBC concluded that there appeared to be no incentive for entrepreneurs to consolidate their various businesses. Consolidation would not only lead to sustainable businesses but also provide a framework to ensure that family businesses survive the founding generation. Even in the textile sector, there appeared to be no serious efforts to consolidate, with each part of the chain appearing to operate independently leading to a great deal of task replication. Groups with interests in spinning, weaving, processing and garments appeared to be operating each unit as a standalone unit.

An analysis of the countries progressing from early-stage conglomerated family businesses in the 1960s to large international conglomerates today seemed to point to the need for a framework that encourages consolidation under a holding company structure. Though corporate groups in Pakistan were allowed to file tax returns as single entities, there was prior to 2007 no provision for transfer of losses between group companies or between the group companies and the holding company (the concept of group relief). Profitable companies in the group could not nurture startups.

In 2006 – 07 the PBC, with cooperation from the Institute of Chartered Accountants in Pakistan (ICAP), advocated with the Ministry of Finance to allow group relief for entities that fulfilled registration requirements as notified by the Securities and Exchange Commission of Pakistan (SECP). These registration laws require a holding company to hold at least 55% equity in a publicly listed company and/or 75% in a private limited company.

In the Finance Act 2007, the Government of Pakistan allowed the concept of group relief in Pakistan for the first time. International experts hailed the Pakistani law as the most progressive in the region. In the interim some operational flaws have surfaced that need to be addressed.

2.1 The Definition of Trading

To prevent misuse of the provision of group relief, it was envisaged that trading losses would not be adjustable under the provisions as written. However some tax officials are not allowing profitable manufacturing concerns with some trading interests to take on the losses of other group companies even though the loss making entities are manufacturing concerns. The explanation given to businesses is that “trading” is not permissible under the holding company law and that it makes no difference if the company engaged in trading is a profitable group company. Section 59B(2)(b) of the income tax law reads:

“A company within the group engaged in the business of trading shall not be entitled to avail group relief”

To ensure that the intent of policymakers can be implemented, it is proposed that Section 59B(2)(b) should be revised to read:

“A company (not being a company operating trading houses as defined under clause 57 of Part IV of the 2nd Schedule of the Ordinance) engaged in the business of trading shall not be entitled to surrender the loss”

Explanation:

“for the purpose of this paragraph, a company would not be considered to be engaged in the business of trading unless more than 30 percent of declared turnover is from business of trading.”

2.2 Application of the Law –retrospective vs. prospective?

As a number of applications are pending with the tax authority, PBC proposes that the provisions of the law be retrospectively applied with the following clause inserted after Section 59B:

Explanation:

“The amendment in this Section by the Finance Act 2010 shall be deemed always to have been enacted and shall have effect accordingly”

2.3 Exemption of Inter-Corporate Dividends from Tax

For companies to operate under a holding company structure it is important that inter-corporate dividends be exempt from tax. The way the law is structured at the moment, dividend income received by the holding company or by group companies from sister concerns in which they have investments are subject to a mandatory 10% withholding tax. This compulsory deduction is counterproductive to the formation of holding companies. Withholding tax on dividends is being deducted under the following provisions of the Income Tax Law:

Existing Section 103(A):

“Any income derived from inter-corporate dividend within the group companies entitled to group taxation under Section 59AA of Section 59B”

The following amendment is proposed in Section 103(A):

Section 103(A) to read:

“Any income derived from inter-corporate dividend within the group companies”

Explanation:

For the purposes of this clause, the term within the group mean companies within a group as registered under the Group Companies Registration Regulation 2008

Table 1 on the following page summarizes the PBC’s proposals for removing the current flaws in the law as they relate to holding companies.

Table 1: Summary of Changes Required in the Income Tax Laws as they relate of Holding Companies:

INCOME TAX LAWS AS THEY RELATE TO HOLDING COMPANIES		
Existing Situation	Proposed Change	Rational for Change
Section 59B(2)(b): “A company within the group engaged in the business of trading shall not be entitled to avail group relief”	Section 59B(2)(b) to read: “A company (not being a company operating trading houses as defined under clause 57 of Part IV of the 2nd Schedule of the Ordinance) engaged in the business of trading shall not be entitled to surrender the loss” Explanation: for the purpose of this paragraph, a company would not be considered to be engaged in the business of trading unless more than 30 percent of declared turnover is from business of trading.	This change will make the legal provisions consistent with spirit of the concept and underlying understanding of the Taskforce formed for this purpose. Moreover trading activity up to the extent of 30 percent of the turnover is proposed not to disqualify the claim. As a Large Trading House entails a significant investment and creates real jobs in the economy, it is proposed to make it eligible to surrender its losses.
As a number of applications are pending with the tax authority, PBC proposes that the provisions of the law be retro-prospectively applied with the following clause be inserted after Section 59B	To be inserted after Section 59B: Explanation: <i>“The amendment in this Section by the Finance Act 2010 shall be deemed always to have been enacted and shall have effect accordingly”</i>	In order to make the amendments applicable for pending cases.
Section 103(A): “Any income derived from inter-corporate dividend within the group companies entitled to group taxation under Section 59AA of Section 59B”	Section 103(A) to read: “Any income derived from inter-corporate dividend within the group companies” Explanation: For the purposes of this clause term within the group mean companies within a group as registered under the Group Companies Registration Regulation 2008	To streamline exemption on inter-corporate dividends.

3.0 LEVEL PLAYING FIELD FOR THE ORGANIZED SECTOR

In Pakistan the organized, taxpaying sector of the economy is under threat of being marginalized by the informal, non-taxpaying sectors. The informal sector which was estimated at less than 40% about 20 years ago is now estimated at close to 70% of the total economy in Pakistan. As the informal sector has grown, so has its power to overcome any efforts made by the government to bring the sector into the formal sector. Whether it is the retail / wholesale sector, the constructions sector, the small workshops in the urban centers of the major cities, the transportation sector, even professionals such as doctors, engineers, lawyers, etc., the common denominator is to stay in the informal, non-tax paying sector of the economy.

A major argument often put forward by the informal sector is that the informal sector is the backbone of the economy, and that as the majority employers in the economy, regulations should apply to them.

It is not the small retail shop or the small weaver on the fringes of poverty and barely surviving, but the medium sized transporters, retailers and wholesalers that need to be formalized.

Some of the measures being proposed to document the informal sector are briefly discussed below:

3.1 Better documentation of commercial importers

Commercial importers are a major source of distortion in the economy. Implementation / interpretation of the commercial law favor the unscrupulous commercial importers. On the payment of a flat 4% withholding tax at the import stage- which is treated as his final tax liability, the commercial importer is asked no further questions regarding who he sells the product to, at what price and the profit that he makes on it. Unscrupulous commercial importers have driven the legitimate importers out of the market by underselling them by indulging in massive duty evasions through under-invoicing and nonpayment of sales tax.

The domestic manufacturing sector has suffered as the tariff protection given to it by the government has been nullified. It is important that the activities of the commercial importers be streamlined. The measures being proposed include:

- In addition to moving commercial importers into the normal tax regime, the rate of withholding tax should be increased to 6%. When moving into the normal tax regime, no refunds should be allowed for any losses claimed by commercial importers.
- A minimum value addition of at least 10% on imported products and additional sales tax to be charged on the value addition.
- Commercial importers should be regulated with a minimum waiting / vetting period through the issuance of a sales tax registration for commercial importers.

3.2 Restrictions on the Afghan Transit Trade

In 1965 Pakistan and Afghanistan signed a transit trade agreement that allowed Afghanistan – a landlocked country – to use the port of Karachi for international trade. Over the years, massive abusive of the concessions allowed under the Afghan Transit Trade (ATT) has become a major source of smuggling into Pakistan of raw materials and finished goods which, though imported

for use in Afghanistan, end up in Pakistan. The higher import duties in Pakistan vis-à-vis Afghanistan are frequently cited as a major cause of cross border smuggling. The nominal rate of duties in Afghanistan is between 2 – 3% on most imports. This duty differential is exacerbated by the high rates of sales tax on imports (16% of the duty paid value) in Pakistan. When the sales tax element is added to the high import duties; incentive for smuggling increases manifold.

Industrial units in the Khyber Pakhtoonkhwa province and in Northern Punjab are bearing the brunt of this onslaught. Furthermore, as the transportation networks improve and the traders become bolder, goods smuggled under the garb of ATT are slowly affecting domestic manufacturing units as far south as Karachi. To promote taxpaying, employment-generating domestic manufacturing entities, it is important for Pakistan to take measures to initially reduce and then to eliminate the menace of smuggling under the ATT. As better policing of the porous Afghan-Pakistan border does not appear at the moment to be the solution, the PBC suggests the following administrative measures:

- Reintroduction of a negative list for goods being allowed transit through Pakistan for use in Afghanistan.
- Placement of quantitative restrictions on imports destined for Afghanistan, that reflect the level of Afghan consumption.
- Collection of duties and sales tax at Pakistani rates in Karachi and transferring the same to the Afghan government for refunding to their importers.
- Allowing only goods which have been imported through a letter of credit to transit through Pakistan.

3.3 Greater Transparency in Operations of Revenue Departments

The current practice of not disclosing information by the revenue departments leads to massive malpractices. In the past data relating to the collection of central excise duty along with the details of the reporting manufacturing units was public information. Similarly the values at which various import consignments were cleared by customs were also public information. In the past few years this information has not been published. The PBC proposes:

- Information on sales tax and federal excise duty paid by individual domestic manufacturers and service providers should be public information.
- Values at which import consignments have been cleared by customs should also be public information.

Table 2 on the following summarizes these proposals

Table 2: Summary of Proposals and Rationale for Providing a Level Playing Field to the Organized Sector

Existing Situation	Proposed Change	Rational for Change
Commercial Importers are charged a presumptive tax rate of 5% which is also their final tax liability	Commercial Importers should be brought into the normal tax regime. Until this can be accomplished, the previous rate of Presumptive Tax of 6% is reintroduced.	Increased Government revenue while at the same time helping to reduce the impact of undervalued imports
Pakistan allows Afghanistan Transit facility under the 1965 Afghan Transit Trade Agreement (ATTA)	Reintroduce the Negative List for ATTA Quantitative restrictions need to be placed on goods transiting under the ATTA. The quantities allowed to be based on demand conditions in Afghanistan. The Government of Pakistan collects on behalf of the Afghan Government, duties and charges as applicable to imports into Pakistan and transfers the same to the Afghan Government to refund to Afghan importers. Allow transit only for those goods which have been imported through a letter of credit.	These measures will reduce the excess quantities which are imported under the ATT and destined for Pakistan. Will also lead to revival of manufacturing in Pakistan and increased revenues for the Government
Across the board massive under invoicing, dumping of imported products	Depending on industry input, values should be fixed for import consignments, basis of valuation can be origin, weight, volume etc. The old Customs General Order 25 needs to be revived. This allowed local manufacturers the option to buy at a 10% premium any consignments which appeared undervalued. Pakistan can impose some Non Tariff Barriers such as designating some specific ports for clearance of some sensitive items which are prone to mis-declaration.	Allow industry to fairly compete with imports, Government to benefit from increased revenue.
Import valuation data, sales tax, federal excise deposited by various units is not public information	Values at which import shipments are cleared whether through PRAL or CARE needs to be public information. To protect confidentiality name of supplier maybe withheld Sales tax and federal excise duty deposited by local manufacturers should be published as was the practice in the past.	Greater transparency at import stage. Will reduce incidence of mis declaration both in imports as well as help in reducing misreporting of production data.

4.0 BROADENING THE TAX BASE

In Pakistan the current tax-to-GDP ratio is less than 9.0%, which is much lower than the average of 17 - 18% for countries at Pakistan's level of development. The low tax collection does not allow the government the fiscal space that it requires to provide relief to the citizens. Low tax collection also delays investments needed in infrastructure to lay the foundation for the optimal growth rate of at least 8.0% per annum, a growth rate which is crucial if Pakistan is to move to the next level of developed countries.

In Pakistan the major problem is the narrow tax base, with less than 2.0 million registered taxpayers in a population of more than 180 million. The solution is not in increasing the tax rate but in broadening it. Currently very large segments of the population are outside of the tax net. It is important to bring these people in, just as it is important to improve the tax management system so that taxpayer, tax collector interaction is reduced to a minimum.

Though there are a number of options available for increasing the tax base, some suggestions include:

4.1 Reduce the Rate of Sales Tax

Pakistan's sales tax rate is one of the highest in the region, at 17%; the incentive to stay out of the tax net is huge. To improve compliance and to ensure that the informal sector enters the documented sectors, it is important to reduce the rate of sales tax in the country. The PBC proposes progressively reducing the sales tax rate by 1.5% per annum so that it is 10% by 2015. Simultaneously the formal sector should commit to purchasing from registered suppliers so that there is an incentive for companies to come into the sales tax regime through formalization.

4.2 Introduction of an across-the-board VAT

Introducing an across the board value added tax VAT is must for Pakistan. The VAT system by the manner in which operates, "forces" documentation and hence formalization of the economy. The current zero rated sectors (textiles, leather, carpets, surgical and sports goods) also need to be brought into the VAT net. Additionally a VAT on services needs to be introduced. Pakistan cannot afford to have major segments of the economy such as professional services, real estate, and capital gains, out of the VAT regime. To encourage greater compliance with the VAT, the push will need to come from the demand side. Some of the measures proposed include:

- Companies including insurance firms will not be allowed to claim as expenses; supplies, raw material, and services on which VAT has not been paid.
- For individuals, only those expenses will be allowed that are supported with VAT paid invoices.
- The government should offer a national lottery in which consumers with VAT paid receipts can participate, to receive a refund in the case of fraud on the business side of the equation. Consumers will be required to log on and enter the details of the invoice in question, which the computer will then verify with data submitted by the retailers. Any discrepancy in data submitted by the consumer will be sent to the consumer with the option to make a formal complaint. Any short filing discovered will lead to the

retailer being fined 10 times the sales tax amount and the consumer receiving a 20 times VAT refund adjustment against his tax liability.

4.3 Compulsory Filing of Tax Returns

Irrespective of whether the filers have income which is taxable, the following individuals will be required to file tax returns:

- Any person who has a credit card must file a return; failure to file a return will automatically block transactions on the card.
- Any person who has taken a personal loan from a financial institution
- Any person who is a member of a professional body.
- Any Pakistani who takes an international trip. Exemptions should only be offered to those who have gone on a religious pilgrimage and to workers who have remitted foreign exchange in the last year.
- Any person who is in possession of a car that is less than 3 years old and has an engine capacity of more than 800CC.
- Any person who at any day in the preceding year had more than Pak Rupees 500,000 in his / her personal account. This applies to both current and saving accounts.
- Any person who owns urban property in Pakistan. Some relief maybe offered to those who own an apartment of less than 900 square feet or a house built on less than 120 square yards.

4.4 Tax on Real Estate

In boom times phenomenal gains are made in the real estate sector. Even in depressed times, real estate is viewed as a safe haven for investment especially gray income. The PBC proposes that:

- Real estate developers are taxed at Rs.100 per square yard on any land developed for sale.
- For builders of apartments, a tax of Rs.50 per square foot is charged.
- On developed land lying unutilized in the urban areas, a flat annual tax at Rs.1,000 per square yard be imposed. This will have the additional benefit of bringing land into the market thereby reducing prices.

Table 3 on the following page summarizes the proposals made to broaden the tax base

Table 3: Proposals for Broadening the Tax Base

Existing Situation	Proposed Change	Rational for Change
Rate of sales tax in Pakistan is 17%	Reduce rate of sales tax by 1.5% per annum so that it is 10% by 2014	High rates of sales tax encourage evasion and serve as an incentive for staying in the informal sector. Low rates will lead to greater compliance and reduce cost of doing business in the formal sector encouraging more businesses to formalize.
A watered down sales tax regime that keeps major sectors of the economy out of the tax net	Replace the existing sales tax regime with an across the board value added tax VAT on goods and services	An across the board VAT with minimum exemptions will lead to greater documentation of the economy. It will also bring sectors of the economy such as most professional services into the tax regime.
No corporate investment tax credit in Pakistan	A 15% investment tax credit as was the practice in the past. The old Section 107 A of the Income Tax ordinance 1979 needs to be restored.	To regain its competitiveness, Pakistani industry is in dire need of upgrading both technology and machinery. Investment Tax Credit will not only help Pakistani industry regain its lost domestic market share, it will also allow it to compete with regional players.
No tax on real estate developers / builders	Real Estate developers should be taxed on a per square foot basis for built up property and a per square yard basis on land developed for sale.	No rational for keeping sector outside of the tax net.
A very Low Taxpayers Base (about 1.0 million in a population of about 180.0 million)	Filing of tax returns be mandatory for persons who: • have a credit card in their name, • have taken a personal loan from any financial institution, • have traveled outside of Pakistan in the last financial year, • are members of a private club, • are members of a professional body.	Greater documentation of the economy, greater tax collection

5.0 DEVELOPMENT OF HUMAN CAPITAL IN PAKISTAN

The UNDP's latest Human Development Index (HDI) ranks Pakistan 144th out of total 178 countries. According to UNDP's HDI report, Pakistan faces enormous challenges, including poverty, poor healthcare facilities, illiteracy and a continuously soaring population. With a population in excess of 180 million of which 40% is less than 15 years of age Pakistan is sitting on either a population bomb or a population gold mine.

While there is no doubt that the government is aware of the tremendous potential that this young population offers, it is also important to realize that the government does not have the capacity to fully exploit this resource.

In this part of the NBA, the emphasis is on what the private sector can do to contribute to the near, medium and long term development of Pakistan's human capital. The PBC realizes that it cannot take on the mantle of reforming the entire education system, but it is confident that given the right policies, it can improve the human capital that directly impacts the competitiveness of firms in the formal sector.

Each year the government collects billions of rupees under the heads of the Workers Profit Participation Fund (WPPF - 5% of profits) and the Workers Welfare Fund (WWF - 2% of profits). This 7% of profits is not accounted for and for the most part is wasted. The formal sector would like to propose the following:

- Listed companies are allowed to retain 50% of the contribution that they pay under the heads of the Workers Profit Participation Fund and the Workers Welfare Fund.
- This 50% retained by the companies must be spent on welfare and development of their workers.
- An independent Board consisting of government, employers, workers, civil society is formed to monitor the company's initiative.
- The funds retained by the companies are transferred into a separate account and a Board consisting of management and workers administer the funds.

Table 4 on the following page summarizes the proposals for improving the human capital in the country.

Table 4: Summary of Proposals for Developing the Human Capital of Pakistan

Existing Situation	Proposed Change	Rational for Change
The WPPF & the WWF (total 7% of profits) have failed to contributed towards improving the quality of the human resources in the Country	Listed companies be allowed to spend up to 50% of their contribution on technical training programs. Alternatively the rates of WPPF & WWF be reduced by 50% (2.5% of profits for WPPF and 1.0% of profits for the WWF)	Industry driven technical training programs will lead to the development of a human resource pool which is in line with industry needs