The Pakistan Business Council

FOSTERING ECONOMIC GROWTH

(A Company set up under Section 42 of the Companies Ordinance 1984)

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Mr. Muhammad Aurangzeb
Federal Minister of Finance and Revenue
Government of Pakistan
Islamabad

Dear Minister,

Proposals for the Federal Budget 2024-25

The Pakistan Business Council (PBC) understands the government's challenges in preparing the federal budget proposals. We also appreciate your personal efforts to secure the next IMF program, which is vital to the country's economic stability. The trajectory of inflation and the policy rate is in the right direction. The PM's announcement on reducing power tariffs for industry will also have a positive impact. However, we are disappointed at the impact that the budget proposals will have, in combination with earlier gaps in the fiscal regime, on the formal, tax-paying sector of the economy. A budget that targets a sharp increase in the tax-to-GDP target without creating equitable and sustainable means of generating taxable income and without a meaningful reduction in government expenditure will inevitably result in growing the already disproportionate burden of taxes on existing taxpayers.

None of PBC's major recommendations to reduce the heavy burden of taxes on the formal sector and promote scale and competitiveness have been considered in the proposals. Our recommendations included

- phasing out of Super Tax, starting with exports and dividends.
- withdrawing double taxation of inter-corporate dividends and restoring the letter and spirit of group taxation as enacted in the FA 2007/8.
- reducing the corporate tax rate gradually to align with emerging markets.
- stemming brain drain and capital flight from the country.
- reducing the impact of the 1.25% minimum turnover tax on current loss-making companies by lowering the rate and allowing adjusting of the previous 2 years and future 5 years tax liability.
- addressing the anomaly of minimum tax on turnover of businesses, such as those in SEZs, that are entitled to tax holidays. Also, the tax on their dividends should be reduced to 15%.

At a minimum, this government's first budget could have provided a roadmap to attract and retain investment. Instead, the proposals will discourage foreign and local investment, especially in the export sector.

While we appreciate the measures taken to penalize non-filers, there remains scope for improvement. Annexure Three sets out some additional measures to consider.

For your urgent attention, we seek the withdrawal of and changes in many of the regressive and misadvised budget proposals, as follows:

EXPORTS

Our exports are not just a significant component of the economy; they are a vital lifeline for balancing the external account. The country's financial stability demands a significant increase in exports. Therefore, we are deeply concerned about the budget proposals that will have a significantly detrimental effect. Instead of facilitating and reducing the cost of exports, the proposals exacerbate the disadvantaged position that exporters face compared to other countries—please refer to Annexure One. Pakistan is disadvantaged in all six key measures vs. Bangladesh, India, Vietnam, Indonesia, and Egypt. Keeping the exporters free from the hassle of filing returns and dealing with notices while not offering rebates like Bangladesh or India was one positive factor that has been taken away.

The current simple and transparent 1% tax, which is collected from export proceeds, is proposed to be doubled. Furthermore, exporters will be assessed at a 39% (corporate plus Super Tax) rate on a Normal instead of the current FTR regime. This tax impact will be more than three times that of Bangladesh and twice that of Vietnam, Egypt, etc. When the adjustable half (1%) of the deduction from export proceeds exceeds the assessed liability, obtaining refunds will be at the mercy of bureaucratic delays. It will likely result in harassment and extortion. In addition, it will create a cash flow burden on exporters. We propose an urgent and comprehensive review of all the factors impeding export competitiveness instead of a piecemeal fiscal intervention that leads to further deterioration. Pending the outcome of this review, the present FTR regime, with a tax impact comparable to Bangladesh, may be maintained.

GST ON TIER-ONE POS REGISTERED OUTLETS

To encourage documentation, the tier-one POS registered textiles and leather outlets were provided with a reduced GST rate of 15%. The Budget proposal is to increase this to the standard rate of 18%, which will thwart the growth of POS integration. If we are serious about pursuing POS integration and encouraging retailers who pay sales tax and eventually income tax as per their actual sales, we recommend enhancing the differential instead of withdrawing it.

LEVEL PLAYING FIELD FOR THE FORMAL SECTOR

Several budget proposals that have a detrimental effect on the formal manufacturing sector need to be reviewed. We list three:

Packed Dairy Products

Moving the hitherto zero-rated packed milk, infant formula, baby food, and fortified nutrition products to an 18% GST rate will increase the price differential with loose and often adulterated milk. The higher price will impede the growth of safe and nutritious products in a country suffering from malnourishment and also undermine the formal tax-paying sector to benefit the informal untaxed sector. Unscrupulous sellers of open milk will also exploit the opportunity by raising the price of their supplies, leading to inflation.

Biscuits, Candies and Soft Drinks

The Rs. 15/Kg FED levy on sugar supplies to biscuits, candies, and soft drinks manufacturers will hurt the compliant sector, putting it at a disadvantage relative to the informal sector. The higher cost will also reduce the export competitiveness of these products.

Flat steel, CRC, and GI

Local manufacturers will continue to face significant disadvantages under the proposal to allow FATA/PATA units to import flat steel, CRC, and GI at a reduced sales tax rate of 6%. This concession will be misused by selling products outside FATA and PATA, thereby affecting the sales and profit of the tax-paying units in the rest of the country and causing a significant loss of tax revenue. In order to save the local industry and precious foreign exchange, local industry should be provided with terms similar to foreign suppliers when they sell inputs for flat steel, CRC, and GI to importers in FATA/PATA.

Recycling Industry

The recycling industry is in the early stages of development in the formal sector and is vital for the country's sustainability. The requirement for those in the formal sector to withhold 80% of the sales tax applicable on the supply of waste paper, paper board, and plastic will severely impact its cash flow and undermine its competitiveness compared to the informal sector, yet produce no additional revenue for the government.

All these measures must be reconsidered to level the playing field for the formal sector.

WITHDRAWAL OF ZERO RATING FOR SALES TAX ON LOCAL INPUTS FOR EXPORTS

The proposed withdrawal of sales tax zero-rating under the Export Facilitation Scheme on the supply of local inputs to exporters is highly regressive, and the current position should be maintained. The proposed change will disadvantage domestic manufacturers of intermediate inputs as exporters who can import free of duty and sales tax would prefer to import instead of waiting for sales tax refunds on local supplies.

TAX ON SALARIED EMPLOYEES

The 119% increase in the number of Pakistanis emigrating is surely a major cause for concern. Many of these individuals are experienced, high-quality professionals that the formal sector is losing. The proposed changes in slab rates, particularly the earlier application of the 35% top rate, will accelerate this brain drain. The formal sector not only loses talent when individuals emigrate but also suffers from their transition to the informal, untaxed sector. Salaried employees bear numerous costs that the state is meant to but fails to cover. The proposal to increase tax revenue from this sector is unjust. Unlike a government, which can print money and borrow to fund the 20-25% increase in salaries of its employees, the private sector will be adversely affected by a higher brain drain as professionals seek lower-taxed environments in and outside Pakistan.

ANOMALY IN TAXATION OF GAINS FROM THE SALE OF SHARES OF PRIVATE COMPANIES

Capital gain from the disposal of immovable properties and shares of listed companies is proposed to be charged tax at 15% irrespective of the holding period; however, gain on disposal of shares of private companies, irrespective of the holding period, is proposed to be chargeable to capital gains tax at applicable slab rate up to a maximum of 45%. This is an apparent anomaly that will discourage foreign investment. A shareholder proposing to enter into a JV arrangement with a foreign partner must offer his shareholding to foreign investors; however, the tax rate of 45% will discourage such transactions. This anomaly must be removed by subjecting such gains to the 15% tax rate applicable to other assets.

DISALLOWANCE OF SALES PROMOTION AND ADVERTISING COSTS

For a company that pays royalties and technical fees to an associated company, the finance bill proposes to disallow 25% of such company's expense on sales promotion, advertisement, and publicity. This disallowed portion would be allowed as a tax deduction to the associate receiving the royalty or technical fee. However, when such an associate is a foreign company, it will be unable to avail of this tax allowance as its royalty income would have been charged under the final tax regime. At a time when the country is trying to attract fresh FDI, arbitrary changes in the fiscal regime for existing MNCs are extremely disappointing and should be withdrawn. Also, local holding companies without income other than dividends and royalties from subsidiaries will suffer as they will not be able to take full advantage of the tax deduction proposed in the budget.

WITHDRAWAL OF POWERS TO ISSUE EXEMPTION CERTIFICATES

Currently, the Commissioner holds the authority to issue exemption certificates in cases where a person's income is exempt from tax or is subject to a 100% tax credit, such as in the case of non-profit organizations. Additionally, the Commissioner can issue exemption certificates for payments related to the sale of goods, services rendered, and the execution of contracts by both resident and non-resident persons, subject to certain conditions. It is pertinent to note that the exemption certificate is issued based on estimated tax liability filed by the taxpayers and can attract penal provisions if the estimates are incorrect. However, it is now proposed that the Commissioner's authority to issue exemption certificates be withdrawn. The Commissioner would retain the authority to issue certificates for a lower tax rate. We believe this proposal is unwarranted, especially for those whose income is exempt from tax or is subject to a 100% tax credit under specific provisions.

PBC, as a matter of policy, does not promote sectoral interests. The relevant trade associations will highlight their concerns directly to you.

In Annexure Two, we set out certain additional matters that must be reviewed.

We look forward to an early opportunity to discuss our concerns.

Yours faithfully,

Ehsan Malik

ANNEXURE ONE

Comparison of Export Competitiveness

Particulars	Pakistan	Bangladesh	India	Indonesia	Vietnam	Egypt	Advantage of Pakistan over any other country?
Tax on Exports	2% of Proceeds or 29% of taxable income, whichever is higher **[Proposed]**	For individuals/partnerships: 50% of exporters' income is exempt from tax. The reduced rate for companies is 10% of profit for LEED-certified companies and 12% for others. The government provides a cash rebate of up to 4.5% based on the destination of exports.	No concessional tax rate; however, huge Production Linked Incentives [PLI] are available to encourage companies to increase their production capacity	Lower rate depending on the sector, investment value, etc.	Lower rate of corporate tax ranging between 10% & 17% for exporters meeting certain criteria	Free Zone Enterprises with export sales of 50% or more are Exempt	NONE
Super Tax	Upto 10%	N/A	N/A	N/A	N/A	N/A	NONE
Gas (Boiler)/MMBTU	$8.50	$7.20	$6.5	Not available	$9.8	Not available	NONE
Gas (Captive)/MMBTU	$11.15	$7.20	$6.5	Not available	$9.8	Not available	NONE
Electricity /kwh	$0.18	$0.09	$0.04	$0.10	$0.06	$0.09	NONE
Benchmark interest rate	20.5%	7.45%	6.80%	6.52%	4.75%	19.25%	NONE

ANNEXURE TWO

Additional Matters Requiring Review by Government and the Anomalies Committee

(Please refer to the letter dated 18th June on the main matters requiring urgent review)

Serial #	**IRS Department**	**Proposed Change**	**Current Status**	**Impact of Proposed Change**	**PBC Proposal**	**Rational**
1.	Income Tax	**Section 147(4) & 147(6):** The prior year's turnover for advance tax purposes shall be calculated at 120%, and the commissioner has been empowered to reject the estimate filed by the taxpayer.	The prior year turnover for advance tax purposes is being calculated at 110% and the commissioner does not have the power to reject estimates filed by taxpayer.	Will increase the discretionary powers of the Commissioner and increase working capital requirements	Withdraw the proposed amendment	Will increase the cost of doing business
2.	Income Tax	**Section 182(35)** Incomplete particular or information at the time of filing of Income Tax return. It is proposed to impose a penalty of Rs. 500,000 or 10% of taxable amount	**No provision**	No opportunity for the taxpayer to submit requisite information/particular	Withdraw the proposal	Can lead to undue harassment of taxpayer
3.	Income Tax	**Section 191(1)A** Prosecution for Failure to Furnish Information in Return of Income	**No provision**	No opportunity for the taxpayer to submit the requisite information	Withdraw the proposal	Can lead to undue harassment of taxpayer

Serial #	IRS Department	Proposed Change	Current Status	Impact of Proposed Change	PBC Proposal	Rational
4.	Income Tax	**<u>Income Tax - First Schedule, Part IV, Division V</u>** Federal Board of Revenue (FBR) has proposed 75% W.H.T tax for late filers under this category.	W.H.T is charged @ 15% across all individuals irrespective of filer or non-filer.	The telecom infrastructure cannot handle multiple tax rates, leading to operational inefficiencies and increased consumer costs.	Withdraw this amendment	Reduce the cost of doing business
5.	Income Tax	**<u>Section 182:</u>** In case of the Income Tax General Order, where implementing agencies do not block SIMS or mobile phones or fail to disconnect utility connections or comply with the newly introduced bar on foreign travel, a penalty of Rs.100 million will be imposed upon the implementing agency for first default and Rs.200 million for each subsequent default.	**<u>No provision</u>**	Utilities, Telcos and the formal sector are unpaid facilitators of the FBR and do not deserve such severe penal consequences	Withdraw this amendment	Makes it difficult to do business
6.	Income Tax	**<u>Advance Tax on Sales to distributors, dealers and wholesalers,</u>**	Currently, manufacturers and commercial importers are	Operational and compliance issues	The proposal should be withdrawn	Increase in cost of doing business and likelihood of being passed

Serial #	IRS Department	Proposed Change	Current Status	Impact of Proposed Change	PBC Proposal	Rational
		<u>retailers – Section 236G & 236H</u> It is proposed that every manufacturer or commercial importer collect an advance tax of 2% on sales made to distributors, dealers, and wholesalers. Similarly, for sales to retailers, the advance tax has been increased to 2.5%	required to collect advance tax on sales to distributors, dealers, and wholesalers in certain sectors, and rate of advance tax is 0.2% Similarly, the rate of advance tax is 1%, which is collected from non-filer retailers.			on to consumers, thus impeding competitiveness of the formal sector
7.	Income Tax	**<u>Income Tax - Section 153(1)(a) read with Division III of Part I of First Schedule</u>** It is proposed to increase advance tax in the case of a company to 9% & 11% for others of the gross amount payable for toll manufacturing	In case of a company, it is currently 5% and 5.5% of the gross amount payable for others	Operational and compliance issues	Proposal should be withdrawn	Reduce the cost of doing business
8.	Sales Tax	**<u>Section 25 & 25 AB</u>** The commissioner is empowered to audit the taxpayer's sales tax affairs.	**<u>No provision</u>**	The Board is already empowered to conduct an audit of Sales Tax u/s 72B of the Sales Tax Act.	Withdraw this amendment	This unnecessary burden on the compliant taxpayers can possibly lead to “fishing notices.”

Serial #	IRS Department	Proposed Change	Current Status	Impact of Proposed Change	PBC Proposal	Rational
9.	Sales Tax	**<u>Sales tax - Section 2(44) and Section 3</u>** Sales tax is proposed to be levied on "advance payment" or sale of goods, whichever is earlier.	Sales tax is currently applicable on goods at the time of sale.	Increased working capital cost in addition to operational and compliance hassle.	Proposal should be withdrawn	Increases the cost of doing business

ANNEXURE THREE

Further ways to enhance tax revenue from the informal sector

1. Bar non-filers from acquiring motor vehicles and real estate.

2. Prevent non-filers from availing the tax status of filers by switching in and out of filing when it suits them, such as when acquiring motor vehicles. Also, make wealth tax reconciliation a requisite for maintaining a filer status.

3. Bring FBR valuations to market price to realize the full potential of tax revenue.

4. Agriculture accounts for a large portion of GDP with an extremely low revenue contribution. Moreover, the agriculture sector is the biggest parking lot for corruption and illegal money. If agriculture tax is not paid to provincial authorities, FBR must be allowed to collect tax as per the Income Tax Ordinance, 2001. If tax is paid to provincial authorities, a federal tax return must be filed along with a wealth reconciliation.

5. Advance Tax on the purchase and sale of land by housing societies is not collected due to the “Transfer of Files” practice. To ensure transparency and documentation, societies should be required to record and register each purchase/sales transaction with the Real Estate Regulatory Authority [RERA].

6. Publicize the sales tax/income tax payment of leading restaurants online to ensure that they declare their full sales and pay appropriate income tax.

7. The advance income tax of 5% collected from Electricity bills issued to non-filers (not having STRN)/unregistered industrial connections) should be increased to 30%.

8. The advance income tax of 7.5% collected from non-filer domestic connections can be increased to 20% if the bill exceeds 200,000 per month.

9. An advance tax of 20% should be levied on gas bills issued to non-filer Industrial / Commercial connection holders.