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Looking at Pakistani Presumptive Income Tax through principles of a good tax?

Najeeb Memon*

Abstract

This paper concerns the use of an appropriate Presumptive Income Tax (PIT) regime for informal economies. Regular income tax due to high bookkeeping costs stimulates activities in the informal economy. Consequently, many developing countries rely on PIT regimes. However, the adequacy of the current PIT regimes to tackle informal economies has received little attention from researchers particularly in terms of the principles of a good tax system. This paper analyses the PIT regime of Pakistan, one of the largest informal economies in Asia, for its adequacy in this regard. The findings reveal that being a turnover based PIT design, Pakistani PIT is technically complex and impose high compliance costs on small business. The Pakistani PIT also does not adhere well with the efficiency and equity principles because it does not secure neutral tax treatment for all types of business sectors. The findings of inadequacy of the Pakistani PIT are also reflected in the stagnant tax base, lower tax to GDP ratio and the persistently large informal economy in Pakistan.

1. INTRODUCTION

The large informal economy is major obstacle in the implementation of income tax in developing countries.[1] Therefore, income tax is incapable of securing its objectives including revenue collection.[2] Since the informal sector mainly arises from the high compliance costs of normal income tax[3] (that is, a tax charged on taxable income which is worked out after deduction of allowances and perquisites etc) and weak tax administration,[4] consequently, many developing countries, some on the recommendations of the donor agencies[5] have switched over to a presumptive form of

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[1] James Alm, Jorge Martinez-Vazquez and Friedrich Schneider, 'Sizing the Problem of Hard to Tax' (2003) Andrew Young School of Policy Studies, Georgia State University, May 2003, 19 < http://aysps.gsu.edu/publications/2003/hardtotax.pdf> at 15 May 2008.

[2] Friedrich Schneider and Bettina Hametner, 'The Shadow Economy in Columbia: Size and Effects on Economic Growth' Working Paper No. 0703 Department of Economics, Johannes Kepler University of Linz, Austria, January 2007, 5.

[3] See Schneider and Hametner, above n 2, 4.

[4] Alm et al above n 1, 19; Robin Burgess and Stern Nicholas, Taxation and Development' (1993) 31 Journal of Economic Literature, 776.

[5] Engelschalk Michael, 'Small Business Taxation in Transition Countries' World Bank, Washington DC, at 2.

income tax. Presumptive Income Tax (PIT) regimes are now integral components of tax systems of many Eastern European, Asian, African and Latin American countries.[6]

This tax policy shift is due to PIT's merits of simplicity[7] and efficiency which helps tax compliance by taxpayers.[8] For its simplicity a PIT is easy to enforce, hence, is also a solution to the weak tax administration of these countries.[9] However, whether the PIT regimes used in the developing countries have all these virtues is yet an un-explored area. Despite widespread use of PITs in many developing countries such as indicator based PIT in transitional European countries and asset based PIT in Latin American countries to tackle the informal sector, little research has been undertaken to assess existing PIT regimes for tackling the informal economy.

This paper analyses the PIT regime of Pakistan, one of the large informal economies in Asia, for its adequacy to control an informal economy. After reviewing the causes of the informal economy in general and in the context of Pakistan, the design of Pakistani regime and its features are evaluated against the principles of a good tax system as ranked in context of informal economies.[10] Taxation of income from assets (e.g. dividends, interest, and rental income) is beyond the scope of this paper, because, this paper mainly focuses on business and professional incomes, which constitutes the major share of informal activity.

The findings reveal that being a turnover based PIT design, the Pakistani PIT is technically complex and imposes high compliance costs on small business. The Pakistani PIT also does not adhere well with efficiency and equity principles because it does not secure neutral tax treatment for all types of the business sectors. The findings of inadequacy of the Pakistani PIT are also reflected in the stagnant taxpayer base, lower tax to GDP ratio and the persistently large informal economy in Pakistan.

The remaining paper has 7 sections. Section 2 provides an overview of the informal economy. Section 3 highlights the nature of the Pakistani informal sector. In Section 4, the methodology for the use of principles of a good tax system is set out. The provisions of the Pakistani PIT are summarized in Section 5. Section 6 assesses the adequacy of the Pakistani PIT to tackle the informal economy in light of the principles of a good tax system. Finally, Section 7 concludes the paper.

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[6] TJ Steenekamp, 'A Tax on Gross Fixed Assets as Minimum Corporate Tax for South Africa' (2000):68(3) South African Journal of Economics, 183.

[7] Vito Tanzi and Milka Casanegra de Jantscher, 'Presumptive Income Taxation: Administrative, Efficiency & Equity Aspects' Working Paper No. 87/54, IMF, 17 August 1987, 8< http://papers.ssrn.com/sol3/papers.cfm?abstract_id=884840> at 12 October 2008.

[8] Efraim Sadka and Vito Tanzi, Tax on Gross Assets of Enterprises, as a Form of Presumptive Taxation Working Paper No. 92/16, IMF, February 1992, 6 < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=884616> at 24 June 2009.

[9] Sonia Gandhi, 'Presumptive Direct Taxes,' The World Bank 2002, 7 <www.worldbank.org/publicsector/pe/Tax/presumptivedirecttaxes.html> accessed on 13 September 2007.

[10] Memon Najeeb, (2010) 'Prioritizing Principles of a Good Tax System for Small Businesses in Informal Economies' 25:1 Australian Tax Forum, Australian Institute of Taxation, 67.

2. INFORMAL ECONOMY

Despite considerable research on the informal economy, the subject is still controversial particularly regarding its definition and estimation procedures.[11] Generally, the informal economy is defined as "those economic activities and the income derived from them that circumvent or otherwise elude government regulation, taxation or observation".[12] The informal economy is also used as a proxy for Hard-to-Tax Taxpayers (HTT).[13]

Small businesses form the core cluster of the informal economy.[14] Small businesses usually are grouped with medium enterprises and both are referred in the literature as Small and Medium Enterprises (SME). The SME sector includes farmers, traders, small scale manufacturers and small scale businesses engaged in the service sector such as lawyers, doctors, repair workshops and restaurants.[15] The statistics confirm that SMEs constitute 80-90% of the workforce and over 50% of the GDP in the informal economies.[16]

2.1 Causes and Size of Informal Economy

Informal economies are created and sustained by three most important factors in the developing countries. First is the high tax compliance cost. The high compliance costs for small business is due to complex laws and procedures such as keeping accounts for the determination of income.[17] Second is weak and corrupt tax administration.[18] Third is the high tax burden due to high tax rates.[19] Memon has shown that these factors have led to the growth of the informal economy.[20]

The extent of the size of the informal economy is generally estimated by comparing the total number of businesses with the registered ones in the country or by comparing the registered businesses with the total population. For example, in Rwanda out of

[11] Schneider Friedrich and Klingmair Robert, 'Shadow Economies around the World', 2004 Working Paper No. 0403 Department of Economics, Johannes Kepler University of Linz, Austria, 3.

[12] Feige Edgard, 'The Underground economies, Tax evasion and information distortion', (1989) Cambridge University Press; this definition is also referred in Dell'Anno Roberto, 'Estimating the Shadow Economy in Italy: A Structural Equation Approach' (2003) Discussion Paper, Department of Economics and Statistics, University of Salerno.

[13] See Alm et al, above n 1, 4.

[14] Designing Tax System for Micro and Small Businesses: Guide for Practitioners (2007) International Finance Commission (IFC), World Bank, Washington DC, 3.

[15] Gunther Taube & Helway Tadesse, 'Presumptive Taxation in Sub-Saharan Africa: Experience and Prospects' (1996) Working Paper, International Monetary Fund, 3.

[16] Stern Richard and Loeprick Jan, 'Small Business Taxation: Is this the Key to Formalization? Evidence from Africa and Possible Solutions', (2007) FIAS Tax Team, World Bank Group, 3.

[17] Shabsigh Giath, 'The Underground Economy: Estimation, and Economic and Policy Implications: The Case for Pakistan' (1995) Working Paper International Monetary Fund; also see Sandford C T and Hasseldine J, 'The Compliance Costs of Business Taxes in New Zealand' (1992) Institute of Policy Studies Victoria University of Wellington, Wellington.

[18] See Alm et al, above n 1, 19.

[19] Cebula Richard J., 'An Empirical Analysis of the Impact of Government Tax and Auditing Policies on the Size of the Underground Economy: The Case of United States, 1993-94' (1997) 56:2 American Journal of Economics and Sociology, pp.173-185.

[20] Memon Najeeb, 'Is Income Tax Responsible for Large Informal Economies?' (2010) 14:1 The Asia Pacific Journal of Taxation, pp. 107-126.

70,000 micro and small enterprises only 1000 are registered with the tax authority. In Philippines, registered VAT taxpayers constitute 0.32% of the total population.[21]

More accurately, using scientific techniques, such as the Electricity Demand Method the average size of the informal economy in Africa, Asia, South America, OECD and Eastern European countries is computed at 41%, 26%, 41%, 18% and 38% respectively.[22] The size is further enlarged by the recent worldwide growth in the service industry.[23] The statistics of the size of informal economies show that a large part of the total economy goes un-taxed in the form of the informal sector.[24] More aptly, the statistics reflect the massive 'tax base gap'[25].

2.2 Implications of Informal Economies and a Remedy

An informal sector has many adverse implications. The informal economy is hard to tax. It also develops among the wider population, a perception of unfairness[26] which promotes non-compliance and thus jeopardizes revenue collection.[27] Poor revenue collection is reflected in a low direct tax to GDP ratio in developing countries as compared to developed countries. For instance, the ratio is 7% in the sub-Saharan region but 22% in industrial countries.[28] Beyond that, the advantage of not paying tax in the informal sector causes allocation of more resources to this less productive sector[29] which ultimately could cause an economic recession.[30]

PIT regimes are recommended for their simplicity to facilitate taxpayers' compliance and enforcement by tax administration because it is 'just not possible' to tax the actual small businesses in informal economies[31] as the determination of actual income involves high costs such as that of bookkeeping. More aptly, the main rationale behind the use of the PIT is to promote compliance of small taxpayers by simplifying income tax procedures[32] and consequently reducing compliance costs. The PIT is also easier to implement by weak tax administrations which are unable to determine the actual income of the large number of small businesses in developing countries.[33]

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[21] See IFC, above n 14, 5.

[22] Schneider Friedrich, *'The Increase of Size of the Shadow Economy of 18 OECD Countries: Some Preliminary Explanations'* (2000) Paper presented at the Annual Public Choice Meeting, March 10-12, 2000, Charleston, S.C.

[23] See Alm et al, above n 1, 1.

[24] See Taube and Tedesse, above n 15, 3.

[25] See Stern and Loeprick, above n 16, 3.

[26] Gloppen Siri and Rakner Lise, '*Accountability Through Tax Reform*', 2002 Institute of Development Studies (IDS) Bulletin Vol.33, 2002.

[27] See Alm et al, above n 1, 20.

[28] Auriol Emmanuelle and Warlters Michael, 'Taxation Base in Developing Countries' (2005) 89 Journal of Public Economics 626.

[29] See Alm et al, above n 1, 27.

[30] See Alm et al, above n 1, 38.

[31] See Tanzi and Casanegra, above n 7, 15; also see Makedonskiy S.N, 'Taxation Mechanisms Based on Simplified and Indirect Evaluation of Tax Liabilities' (2005) Russian-European Centre for Economic Policy (RECEP), 4. Memon also reaches the same conclusion after analyzing the causes of informal economies (see Memon, above n 18).

[32] Parthasarathi Shome, 'Tax Administration and Small Taxpayer', Policy Discussion Paper No. PDP/04/02, International Monetary Fund, May 2004, 7 < http://www.imf.org/external/pubs/ft/pdp/2004/pdp02.pdf> at 12 December 2007.

[33] Memon Najeeb 'Analysis of Presumptive Income Tax for Small Business in Large Informal Economies: A case of Pakistan' (2010) PhD Thesis, The University of New South Wales, Australia.

However, despite the above theoretical merits of PIT, there is no conclusive evidence that a PIT can largely tackle informal sectors in developing countries. In Ukraine for example, contradictory findings are recorded for changes in the informal economy in the period after the imposition of a PIT.[34] In Eastern European countries, the lack of stability, transparency and focus and unjustified generosity of the PIT regimes is blamed for their failure.[35]

3. INFORMAL ECONOMY IN PAKISTAN AND THE USE OF PIT

Pakistan is one of the emerging economies of the world. In recent years, the major contribution to its economy has come from the services sector.[36] However, most businesses in the service sector are small in size and these operate in the informal sector. This is reflected in the large share of the informal economy in the country's GDP. The size of the informal sector in Pakistan is estimated at 39.5%.[37]

The services sector or more simply, the informal sector in Pakistan, is dominated by small business. More specifically the service sector contributes 53.3 % to GDP through 2.65 million enterprises[38] which are SMEs.[39] According to the Economic Census of Establishment Pakistan, these entities constitute 80% of the total enterprises in Pakistan (i.e. 3.2 million).[40] The capital investment on average in the SME sector is less than 1 million rupees (A$15,385).[41] For this reason it is stated that Pakistan's economy is an economy of SMEs.[42]

The specific reasons why small business in Pakistan operates in the informal sector are the same as in other parts of world as discussed in the preceding section of this paper. Broadly, taxation is identified as the main constraint in the SME growth.[43] Sixty seven percent of the enterprises surveyed have stated that the tax regulations as most problematic.[44] Pakistan ranks at 140th on the ease of paying taxes.[45]

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[34] Thieben Ulrich, 'The Impact of Fiscal Policy and Deregulation on Shadow Economies in Transition Countries: The Case of Ukraine' (2001) 114: Public Choice, 308.

[35] See Engelschalk, above n 5, 1-7.

[36] 'Trade in Services: An Answer Book for Small and Medium Sized Exporters' ITC/P216.E/TSS/BAS/07-VIII Trade Secrets Series, International Trade Centre UNCTAD/WTO/Small & Medium Enterprise Development Authority (SMEDA) Pakistan, 2007, 143 <http://www.smeda.org/downloads/TradeinServices-Pakistan.pdf> at 8 July 2009.

[37] Friedrich Schneider, Shadow Economies and Corruption All over the World: New Estimates for 145 Countries (2007), Economics 2007-9, 17 (The Open Access, Open Assessment E-Journal) <www.economics–ejournal.org/economics/ journal articles> at 16 November, 2008.

[38] Pakistan, 'Economic Survey of Pakistan 2006-07' Government of Pakistan, 60 <http://www.accountancy.com.pk/docs/economic-survey-of-pakistan-2006-07.pdf> at 12 March 2008.

[39] Economic Census of Establishment of Pakistan (2005) Federal Bureau of Statistics of Pakistan.

[40] Economic Survey, above n 38.

[41] Shahab Khawaja 'Unleashing the Potential of SME Sector with a Focus on Productivity Improvements' presented at Pakistan development Forum – 2006, 2 <www.smeda.org.pk> at 7April 2009.

[42] 'Developing SME Policy in Pakistan' SME Issues Paper –For Deliberation by SME Task Force' Policy Planning and Development Department, SMEDA, 2006, 1 < www.smeda.gov.pk >at 4 April 2009.

[43] Khawaja, above n 41, 5.

[44] SME Task Force Report, above n 42, 7.

[45] Usman Khan, 'Assessment of the Provincial Legal and Policy Framework Related to Private Sector Development' Final Report of the Economic Advisor, Commerce and Investment Department, Government of Punjab, 2007, 6.

Tax related costs are relatively more serious for small business because of its regressive effects.[46] More aptly, compliance costs are similar for taxpayers who have a turnover of 1 or PKR50 million (A$65,000) in a year. In most cases for income tax, small business has to keep books whose cost is higher than their tax liability. For example, the cost of maintaining accounts is approximately PKR 27,000 (A$350) in Pakistan[47] where the average income of small business is PKR 100,000 (A$1,400). Fundamentally, the maintenance of books of account and hiring a professional for tax compliance purposes is not possible for small businesses due to cost constraints.[48] Further, sole proprietors of small businesses are also often deficient in accounting skills[49] which makes tax compliance hard for them.

The assessment of income includes discretion for the tax administration and which may ultimately provide an opportunity to harass taxpayers. Besides that, the task of the determination of income for a large number of small businesses is beyond the capacity of the tax administration in Pakistan.

Like any other informal economy and for reasons mentioned above, small business prefer to operate in the informal sector, therefore, growth in the tax base, which is the manifestation of taxpayers' compliance, is stagnant.[50] The poor income tax to GDP ratio (that is percentage of GDP collected as income tax) in Pakistan which hover around 3.5% of GDP as compared to the average ratio 7% or 22% in developing and developed countries respectively as discussed in section 2.2 of this paper, clearly indicates that a large component of national income escapes taxation. Consequently, the lack of revenue hampers development projects which when coupled with the misallocation of resources to the informal economy, causes Pakistan to persistently remain a developing rather than becoming a developed state.

In the recent past, the Government of Pakistan has identified the SME and services sector as top priority.[51] Small Medium Enterprise Development Authority (SMEDA) in Pakistan, therefore, suggests fiscal facilitation (ie. assisting the taxpayers through easy procedures and education) and 'simplification in the regulatory environment'.[52] The Asian Development Bank (ADB), in its report, suggested the adoption of a Self Assessment Scheme (SAS) would reduce the interface required between the tax officials and the payers.[53] It was even suggested to use a 'fixed tax' based on assets in

[46] See Chris Evans, Katherine Ritchie, Binh Tran-Nam and Michael Walpole, 'Taxation Compliance Costs: Some Recent Empirical Work and International Comparisons' (1998) 14:2 Australian Tax Forum, 93-122.

[47] For part time salaries of accounting graduates see http://www.bayrozgar.com/Accounts-Tax-CS-Audit/Accountant-(Part-Time)-13534.html at January 25, 2011. The cost of bookkeeping through online services is also available on various websites.

[48] Khawaja, above n 41, 9; SME Task Force Report, above n 42, 7.

[49] Khawaja, above n 41, 12.

[50] SME Task Force Report, above n 42, 6.

[51] 'SME Led Economic Growth – Creating Jobs and Reducing Poverty: SME Policy 2007' SMEDA, Ministry of Industries, Productions and Special Initiatives, Government of Pakistan, 2007, 8 <http://www.smeda.org/downloads/SME_Policy_2007.pdf> at 10 October 2009.

[52] SME Policy, above n 42, 15.

[53] Faisal Bari, Ali Cheema and Ehasan ul Haq, 'Barriers to SME Growth: An Analysis of Constraints' Working Paper No.3 Asian Development Bank, October 2005, 65 <http://www.adb.org/Documents/PRM/Working_Papers/wp-03.pdf> at 12 March 2009).

order to help small businesses in the retail, restaurant and hotel sector.[54] In light of these recommendations, a PIT regime was introduced in Pakistan.

4. PRINCIPLES OF A GOOD TAX SYSTEM

Earlier literature on the principles of a good tax system in general and in the context of informal economies in particular suggests focusing upon simplicity, equity and efficiency'[55] when evaluating a tax system.[56] Further, Memon suggests that the requirements of developed and developing countries differ hence ranking of these principles to cater for requirements of large informal economies should be taken in account while assessing a tax system.[57] More simply, Memon suggests that simplicity should be preferred over efficiency and the later over equity in developing countries due to the specific characteristics of these countries.

4.1 How to Determine Simplicity in a Tax System

As discussed in section 2.2, simplicity in the tax system plays a crucial role in improving small businesses' compliance and consequently in controlling the informal sector. Although simplicity has many facets like certainty, consistency and clarity [58] for assessing any tax regime, simplicity could be examined from two perspectives. [59] First is the technical complexity, which reflects clarity, certainty, consistency, stability and flexibility in the language and content of a tax code. Second is the operational complexity, which covers both the administrative and compliance costs. More aptly, technical complexity reflects the causes of the increased cumbersomeness in the tax code. The operational complexity, on the other hand, is the manifestation of technical complexity plus 'the burden of documentary requirements'[60] in form of financial costs to prepare those documents. This break up of tax complexity clarifies, 'the intricate connection between complexity and compliance and administrative costs'[61]. The above interpretation also explains how a simple rule (from a technical perspective) can be expensive to comply with, if it imposes a huge burden of documentary evidence.[62]

As measuring simplicity quantitatively is a very hard task, a qualitative analysis of the Pakistani PIT is made in this paper. Consequently, in its first stage, Pakistani PIT is analysed qualitatively for all the facets of technical complexity. However, the analysis of the facets of technical complexity is made from the legal perspective (similar to the

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[54] Khawaja, above n 41, 9.

[55] Alley C. and Bentley D., 'A Remodelling of Adam Smith's Tax Design Principles', (2005) Law Papers, Faculty of law Bond University, 580.

[56] Memon, above n 10, 67.

[57] See Memon, above n 10.

[58] Graeme S. Cooper, 'Themes and Issues in Tax Simplification' (1993) 10, Australian Tax Forum, 424.

[59] 'A Tax System Re-designed: More Certain, Equitable and Durable' Review of Business Taxation Report by John Ralph, Rick Allert and Bob Joss, July 1999, 106 <http://www.rbt.treasury.gov.au/publications/paper4/index.htm> at 12 May 2009.

[60] It is referred by Cooper as the number of tasks demanded form the taxpayer to perform (see Cooper, above n 58, 447).

[61] This connection is identified as a complex link in Simon James 'Tax Simplification is a not a Simple Issue: The Reasons for Difficulty and Possible Strategy' (2007) Discussion Paper No. 07/18 ISSN 1472-2939 School of Business & Economics, University of Exeter, 2007, 7.

[62] Margaret McKerchar, Kristen Meyer and Stewart Karlinsky, 'Making Progress in Tax Simplification: A comparison of the United States, Australia, New Zealand and the United Kingdom' Working Paper No. 49, Research Series, Faculty of Law, University of New South Wales, 2008, 370.

methodology used by Taylor)[63], rather than from the linguistic perspective. In the referred study Taylor had evaluated a possible impact of reducing complexity in the tax code on minimizing the tax compliance costs. Taylor examined the legal complexity of Australian income tax law in terms of redundancy, superfluousness, grouping according to rational scheme, frequency of changes and ambiguity in interpretation of provisions of the law. In the next stage, the Pakistani PIT is qualitatively analysed for operational complexity with reference to the administrative and compliance costs. This qualitative analysis is based on the size of the tax return, the computation details, bookkeeping requirements, documentary requirements, audits and costs related to appellate procedures.

4.2 How to Determine Efficiency in a Tax System

The efficiency of a tax system is mainly assessed from its substitution effect (known as dead weight loss) and its neutrality in tax impact. Despite the clarity of the concept of deadweight loss[64], it is widely acknowledged that it is hard to measure quantitatively the impact of any taxation in terms of the deadweight loss or even in terms of 'the quantum of the substitution effect'.[65] The Meade report mentions this limitation in the following terms:

> *'It is not possible to take into account all the indirect effects of given tax arrangements on economic efficiency'*[66]

A qualitative evaluation is also difficult in terms of the substitution and deadweight loss, because, the behaviour of all the actors of economy is quite un-predictable. On the other hand, it is equally hard to make quantitative estimates of the level of the neutrality in a tax system particularly in view of its many facets such as neutrality in tax treatment of various sectors, of various classes of income and of risk exposures.

In view of the above limitations for assessing efficiency, it is suggested that a qualitative analysis be made on the basis of the extent a tax measure is 'neutral' in its treatment of income.[67] Nevertheless, while applying this approach, all the facets of economic neutrality need to be judged. This approach would be consistent with the Strong Foundation document, which states:

> *'…tax design in a complex environment is as much art as it is science: judgement is often as important as fact and analysis.*[68]

In addition to the neutrality of a tax regime, efficiency can also be assessed from the burden of taxation[69] (that is, the tax liability) which varies depending upon the

[63] Christopher John Taylor, 'Beyond 4100: A Report on Measures to Combat Rising Compliance Costs Through Reducing Tax Law Complexity' (Report, Taxation Institute of Australia, 2006).

[64] Keith Bain 'The Principles of Taxation- Part I' Notes on Public Finance, University of East London, Department of Economics, 2000, 4 at <http://homepages.uel.ac.uk/K.Bain/tax1.pdf> at 6 January 2009.

[65] Bain, above n 64, 2.

[66] The Structure and Reform of Direct Taxation, Report of a Committee chaired by J.E. Meade, The Institute of Fiscal Studies, 1978 (London: George Allen & Unwin), 11.

[67] Haig, Robert Murray., 'The Concept of Income – Economic and Legal Aspects' in Musgrave R.A. and Shoup C.S. (ed.) Readings in the Economics of Taxation (1959), 54-76; Haig's chapter was originally published in 1921.

[68] Ralph J, Allert R and Joss B., 'A Strong Foundation: Establishing Objectives, Principles and Processes' Discussion Paper I, Review of Business Taxation, Commonwealth of Australia, November 1998, 67 <www.rbt.treasury.gov.au> at 14 April 2009.

applicable tax rates.[70] This approach is identical to that adopted by Memon for analysis of various PIT designs.[71]

4.3 How to Determine Equity in Tax System

The term equity is used for even-handed treatment of taxpayers in tax system. Equity has conventionally been understood to have two facets. The first facet is known as horizontal equity, which states that taxpayers under identical economic circumstances should be taxed identically.[72] The second facet is called vertical equity, which postulates that those taxpayers, who have better economic circumstances (i.e. higher ability to pay), should contribute more than others to the treasury.[73]

Horizontal equity is essential for perceptions of fairness and encouraging compliance by small business.[74] On the other hand, vertical equity is essential for distribution of wealth.[75] However, achieving vertical equity is difficult, therefore, it may be given less preference in informal economies compared to horizontal equity.[76]

For taking decisions regarding the horizontal equity in a tax system, it should be conceded at the beginning that 'measuring equity is not easy'[77]. A qualitative evaluation is not possible due to the multiplicity of the variables involved and innumerable categories and levels of income in an economy. Since neutrality of a tax measure is a bedrock for both efficiency and equity principles[78], the analysis regarding the efficiency principle will be relevant to horizontal equity. In addition, some aspects of neutrality having a direct impact on horizontal equity can be examined such as treating equals equally. Vertical Equity, on the other hand, can be assessed by the extent of progressivity in a tax system.

5. OVERVIEW OF PAKISTANI PIT REGIME

In this section, all the relevant provisions of the Income Tax Ordinance of Pakistan 2001 (hereinafter called ITO 2001) of Pakistan are described.

5.1 Pakistani PIT for Informal Sector

The ITO 2001 contains a number of PIT provisions, which tax the professional and business income of both small entrepreneur and large corporate entrepreneurs. More

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[69] Michael Dirkis, 'Is it Australia's? Residency and Source Analysed', Research Study No 44, Australian Tax Research Foundation (2005) 50.

[70] Report of the Royal Commission on Taxation, chaired by Kenneth LeM. Carter (1966) Vol.2, 118.

[71] Memon , above n 33, 143.

[72] Ralph, above n 68, 63; also see 'Reform of Australian Tax System' Draft White Paper Australian Government Publishing Service Canberra, 1985, 14.

[73] Ralph, above n 68, 63; Draft White Paper above n 72, 14.

[74] Draft White Paper, above n 72, 14.

[75] Memon above n 11, 89; also see Felice Russo, 'Vertical Equity and Welfare: Which Effective Redistribution? An Application of Italian Data' (2004) Societa Italiana di Econmia Pubblica, Universita Di Pavia.

[76] Memon, above n 10, 92.

[77] Taxation Review Committee, chaired by K.W. Asprey, Full Report (1975), 13; Meade Report, above n 67, 13 states that 'Unfortunately, in considering the tax side of the budget equation neither 'horizontal equity' nor 'vertical redistribution' are in fact straightforward simple objectives, and in judging any particular tax structure, it is necessary to consider in more detail, how these ideas should be interpreted'.

[78] Ralph, above n 68, 75.

generally both corporate and non-corporate businesses are eligible for the Pakistani PIT. Small business is mostly required to comply with more than one of these provisions depending upon the nature and scope of their activities. A summary of these provisions is given below.

5.1.1 Withholding based PIT for Local Business Activity (Sections 153, 156A, 234, 234A and 205 read with Section 169)

The receipts of small business from the supply of goods[79], execution of contracts[80], provision of services[81], sale of compressed natural gas (CNG) and petroleum products and brokerage and commission are liable to withholding tax (WHT) under s 153, 234A, 156A and s 205 respectively. The tax so deducted is the final discharge of a tax liability under legal PIT (ie. a PIT regime created through legislative action where proxy of income is used for charging income tax and there is no discretion with the tax administration) enacted through the deeming provisions (those are provisions which treat something such as turnover as income by legal fiction) which are contained in the section 169(1). The WHT rate on petroleum products, CNG and brokerage is 10%, 4% and 10% under Div. VIA, VIB to Part III and Div. II to Part IV to Schedule I respectively. For activities covered under section 153, WHT rates under the Div. III Part III to Schedule I are as follows:

- For sale of rice, cotton seed or edible oils, 1.5% of the receipts
- For sale of any other goods, 3.5% of the receipts
- For transport services, 2% of the receipts
- For any other services, 6% of the receipts
- For contracts, 6% of the receipts.

Any taxpayer with these activities is only required to file a single page statement along with the 'certificate of WHT deduction' or 'tax payment receipt' under ss 115(4). This regime does not envisage the maintenance of accounts or the requirement for an audit. However, it is noted that linking PIT with WHT has complicated the compliance requirements for taxpayers for the following reasons. First, since corporations, registered firms and Associations of Persons (AOPs) are the statutory WHT agents, only those transactions of small business are subject to withholding tax which are executed by them with the WHT agents. Thus, small business usually transact with each other (i.e. as part of the informal sector) to avoid withholding tax and consequently being taxed under the PIT regime. More aptly, the PIT regime could be effective only in catching a non compliant business, when they are transacting with the WHT agents and those who do not transact with WHT agents generally escape taxation.

When small business do not transact with the WHT agents (who predominantly operate in the formal sector), then they are not subject to the WHT and consequently

[79] Section 153 (9) provides that in this section "sale of goods" includes a sale of goods for cash or on credit, whether under written contract or not.

[80] However, it is not explained in the tax code that how a contract of services and supplies could be distinguished from "execution of contracts" as services and supplies could also be made through a contract and have different applicable tax rates. Thus, the term "execution of contract" has led to ambiguities giving rise to a constant source of litigation.

[81] Section 153 (9) provides that in this section, – "services" includes the services of accountants, architects, dentists, doctors, engineers, interior decorators and lawyers, otherwise than as an employee.

fall within the ambit of the normal income tax. Under the regular regime, small business is required to file their tax return under s 114 and is assessed pursuant to the Universal Self Assessment Scheme (USAS) under s 121. A return filed under s 114 must be audited and small businesses have to prove the veracity of the declared version by keeping accounts. Consequently the taxpayer is exposed to all the complexities of ITO 2001 and the compliance costs increase enormously. Such high compliance costs discourage voluntary compliance.

Second, when only some of the taxpayer's transactions are subject to WHT and fall within the PIT, then his/her remaining transactions are taxable under the normal income tax regime. In this scenario the operating expenses would be apportioned to each of the parts for the determination of the profits to be taxed. The allocation method is prescribed in s 67 read with Rule 15 of Income Tax Rules 2002.

The method of allocation of the costs requires accounting information to be provided. Consequently, a taxpayer has to keep accounts for both of the activities. Moreover a taxpayer with "hybrid" activities has to file both the tax return and statement and is also potentially liable to a tax audit.

5.1.2 Withholding Based PIT for International Business Activity (Sections 148 and 154 read with Section 169)

When a person makes commercial imports and exports, its receipts are going to be subjected to the WHT under s 148 and 154 respectively. The Customs Department and banks are the WHT agents for this most documented sector. The tax so deducted is the final discharge of tax liability under the legal presumption, which is enacted through the deeming provision contained in ss 148(7), 154(4) and 169(1). The WHT rates for exports and imports are 1% and 2% under Div. IV of Part III and Part II to the Schedule I respectively.

For income deemed from any of these activities, a taxpayer is only required to file a single page statement along with the 'certificate of WHT deduction' or 'tax payment receipt' under ss 115(4). This regime does not envisage the maintenance of accounts and requirement for an audit.

It is noted that when only part of a transaction falls under any of the preceding WHT based PIT provisions then the taxpayer suffers from hybrid tax treatment. This means for the remaining transaction he/she has to file the regular return and operating expenses have to be apportioned between two streams of income. Consequently the compliance costs increase enormously for the same reasons as mentioned for the hybrid activities in the preceding section.

5.1.3 Tax on retailers (Section 113B)

Retailers, which are organized as sole proprietor or AOP, can use the option of paying tax at 0.75% of the turnover (as prescribed in Div. IA of Part I to Schedule I of the Ordinance) under s 113A. Similar retailers having turnover of more than 5.0 million rupees are liable to tax at 1% of the turnover under the s 113B. Both payments are the final discharge of their tax liability. The retailers are required only to file a single page statement under ss 115(4).

5.1.4 Widespread WHT Regime

Besides the above withholding taxes, which fall within ambit of the PIT regime, small business is also liable to WHT in respect of the following activities under various sections of the Income Tax Ordinance, 2001:

- 231A Cash Withdrawal from
- 236 Telephone Use
- 235 Electricity Use
- 234 Registration of Motor Vehicles
- 231B Purchase of Motor Vehicles

6. ANALYSIS OF THE PAKISTANI PIT

The Pakistani PIT is analysed against the principles of simplicity, equity and efficiency as follows. Despite describing the Pakistani PIT in section 5, for better comprehension, a reader is advised to have the ITO 2001[82] available alongside due to numerous referencing to bare legislation in this analysis. Nevertheless, most important PIT provisions are annexed to this paper for quick reference. At the end of this section, the results of the analysis are compared to the well known performance benchmarks of a tax system such as taxpayer base and revenue collection.

6.1 The Pakistani PIT and Simplicity

In the first stage, consistent with section 4, simplicity in the Pakistani PIT is analysed qualitatively for the facets of clarity, certainty, consistency, stability and flexibility. This legal analysis, which pertains to the technical complexity of the regime, is conducted in the pattern adopted by Taylor.[83] In the next stage, the operational complexity of the Pakistani regime is analysed qualitatively for compliance costs such as bookkeeping, documentary requirements and details of computation. At this stage, the enforcement costs are also analysed qualitatively.

6.1.1 Technical Complexity

The clarity, certainty, consistency, stability and flexibility of the Pakistani PIT is assessed in this part of the paper through the total number of provisions, the number of redundant provisions, superfluous words and sentences and frequency of changes in the regime.[84]

6.1.1.1 Number of Provisions

Consistent with section 5, the Pakistani PIT system has a very large number of substantive provisions. Although the Pakistani PIT system contains three regimes, it is primarily based on the direct and reverse WHT. There is a wide range of economic activities, which are subjected to withholding tax and for each of them, the ITO 2001 contains a separate fully fledged regime within the Ordinance. However, in total, there

[82]The link to the Income Tax Ordinance 2001 of Pakistan is <http://www.fbr.gov.pk/newdt/ITordinance/ITOrdinance2009/ITaxOrdinance2001ut28-10-2009.pdf>.
[83]Taylor, above n 63.
[84] This analysis is based on the approach adopted by Taylor, above n 63.

are ten different activities which are subjected to WHT based final tax regimes. All the remaining withheld taxes are allowed as a credit against a taxpayer's assessed income tax liability.

A small business is influenced by most WHT provisions, because it usually has parts of different activities which are subject to WHT. Sometimes the same activity is subjected to tax twice. For example, when imported goods are supplied by the business, then they are subjected to WHT both at the import and supply stage. Consequently, the law contains provisions for exemption from application of the WHT at one of the stages. For example, s 153(5)(a) deals with exemption from WHT when tax is already deducted at the time of import under s 148. The ITO 2001 includes a series of provisions to prevent taxpayers from being subject to double withholding.

Additionally, in the ITO 2001, there are number provisions which contain exemptions and reductions in rates or liabilities in respect of the PIT regime. These are inserted to offer fiscal concessions to some industrial sectors, perhaps for promoting economic growth. There are 30 such provisions in the Second Schedule to the ITO 2001.

Further, there are some supporting provisions which are explanatory in nature and these also add to the volume of PIT legislation. These include explanations and definitions for the terms used in different PIT regimes such as definitions for terms of 'services' and 'supplies' used in PIT under s 153. Also, for retailers and rent earners, there are separate PIT regimes in the tax code, which also have explanatory provisions.

In all, the Pakistani PIT system has three types of PIT regimes, which operate through numerous provisions of the ITO 2001. In addition, the Pakistani PIT in terms of the number of provisions (which are not logically grouped – see 6.1.1.3), is technically complex and consequently this may make compliance difficult.

6.1.1.2 Rules Rendered Unnecessary Due to Subsequent Developments

The author could only locate one provision in the Pakistani PIT which has become completely redundant due to subsequent amendments in the regime. After the repeal of subsection 6B of s 153 (which had brought supplies by association of persons and individuals under the final tax regime), there is no need to retain the exemption from application of this provision by clause 46B of Part IV of the Second Schedule. Its presence only adds to the technical complexity. In view of this single redundancy, it can be concluded that the Pakistani PIT does well in this regard.

6.1.1.3 Grouping According to a Rational Scheme[85]

It is recognised that the basic choices in tax design involve grouping according to a rational scheme. An appropriate grouping of the provisions, for instance in accordance with the nature of the income and type of statutory obligation, helps lead to quick compliance. It also reduces the uncertainty and the time consumed in cross referencing the legislation.

[85]Vann called it grouping by mechanical function: see Richard J. Vann, 'Improving Tax Law Improvement: An International Perspective' (1995) 12 Australian Tax Forum 193, 193.

This feature is completely ignored in the Pakistani PIT regime. For example, the final tax treatment of dividends is grouped with Chapter II, which is primarily concerned with the charge of tax. This is done despite the fact that its withholding section is rightly grouped in Division III to Part V of Chapter X (this chapter is titled as "Procedure"). Similarly, the treatment of the withheld tax in this regard as a final tax is given in Section 8 of Chapter II (this Chapter is titled as "Charge of Tax"), whereas the same treatment for all other withheld taxes is covered in the Section 169 of Chapter X of the ordinance.

In the same vein, it is noted that WHT collections in respect of brokerage and commission, transport businesses, and CNG stations, which should have been placed in Chapter X, are grouped in Chapter XII under the title of "Transitional Advance Tax Provisions", despite the fact that these have been a permanent feature in the Pakistani Tax Code for more than the last 15 years. Even if it was necessary to keep them separate, the chapter should have been put next to Chapter X or could have been made a separate part of Chapter X for the purpose of quick referencing.

Lastly, the final tax regime for shipping is inserted by clause 21 in Part II of Second Schedule, instead of by an insertion in Chapter X or Chapter IX (the latter is titled as "Minimum Tax"). This is an example of the worst form of grouping, because Part II of the Second Schedule contains provisions envisaging a reduction in rates for certain classes of taxpayers and the presence of charging provision for shipping business in that Part appears ectopic (that is, out of place or abnormal position).

6.1.1.4 Superfluous Provisions, Words and Sentences

ITO 2001 should not have any superfluous provisions and more ideally, the law should not have any superfluous words or sentences in the provisions. This attribute is important to ensure the policy intention of the ITO 2001 is unambiguous. It is also important for reducing the time consumed in complying with the law. This aspect seems to have been ignored in drafting the Pakistani PIT legislation, as seen in the following examples:

(i) Despite the presence of Section 169(1), which eloquently lists withheld taxes that are a final discharge of tax liability, the following separate provisions are inserted in the respective withholding tax sections. These are simply a duplication of legislative intention and policy.

Profit on debt	s.150(3)
Income of supplies, rendering of services and execution contracts	s.153(6)
Brokerage and commission	s.233 (3)
Income from sale of commercial imports	s.148(7)
Income from exports	s.154(4)
Income from sale of petroleum products	s.156A(2)
Income from sale of CNG products	s.234A(3)
Income from transport	s.234 (5)

(ii) Sections 148(2) and s 153(4) which deal with issuance of an exemption from the application of WHT are redundant because s 159(3) empowers the Federal Board of

Reserve[86] to issue an exemption to any taxpayer in respect of all or any WHT. More simply, when the blanket power is given to the Board through one provision, there is no need for this separate provision. Such duplication should be avoided to ensure the legislation is concise thus reducing the time needed to comply with it. Thus, s 148(2) should be omitted.

(iii) The scope of 'contract' in s 153(1) is limited as follows:

> *"(1) Every prescribed person making a payment in full or part including a payment by way of advance to a resident person or permanent establishment in Pakistan of a non-resident person -*
>
> *(a) for the sale of goods;*
>
> *(b) for the rendering of or providing of services;*
>
> *(c) on the execution of a contract, other than a contract for the [sale] of goods or the rendering of [or providing of] services,*
>
> *shall, at the time of making the payment, deduct tax from the gross amount payable at the rate specified in Division III of Part III of the First Schedule"*

Examination of the scope of contract, as laid out above, shows that the section contains some superfluous words. The use of the words "other than a contract for the sale of goods or the rendering of [or providing of] services" does not bring any clarity to the concept of the 'contract' in general and the constituents of the term 'contract' in particular. It may be because every contract involves some kind of services and/or sale of goods. More simply, it is hard to determine when a supply of goods and rendering of services is an execution of the contract; or when a supply of goods and rendering of services is not an execution of a contract. These terms such as 'execution of contract' are artificial and have no commercial distinction on many occasions and therefore adds to ambiguity and uncertainty.

These ambiguities have led to tax litigation and conflicting judgements by the courts. In the case of *Assessee v Department*[87], receipts of a cricketer from a contract with the Pakistan Cricket Board were taxed under the normal income tax regime as service receipts by the assessing officer. In that case, Mr. Jawaid Masood Tahir Bhatti, Judicial Member of the Income Tax Appellate Tribunal of Pakistan (ITAT), held that these are contract receipts.

On the other hand, the recent decision of the Sindh High Court in the case of *M/S Premier Mercantile Services v CIT Karachi*[88] says that anything not covered under 'supplies' and 'sale of goods' as per the definition in the ITO 2001 are contract receipts. The relevant clauses of s.153(9), which set out scope of contracts by excluding 'services' and 'sale of goods' are reproduced below:

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[86] Federal Board of Revenue: the income tax authority under Income Tax Ordinance 2001 (Pakistan) s 207.

[87] ITA No. 1850/KB to 1852/KB of 2002 (2004 PTD 2749) decided on 24th May, 2004. The matter was decided in the favour of the cricketer that such receipts are contractual in nature and fall within the ambit of PIT regime.

[88] See Premier Mercantile Services v CIT Karachi 2007 PTD 2521.

> *"services" includes the services of accountants, architects, dentists, doctor, engineers, interior decorators and lawyers, otherwise than as an employee.*
>
> *"sale of goods" includes a sale of goods for cash or on credit, whether under written contract or not.*

In this case stevedoring services of the taxpayer were taxed by the revenue department under the normal income tax regime as services, which fall outside the ambit of the PIT. The court by agreeing with the taxpayer held that service receipts which are not covered within the definition of 'services' as envisaged in subsection (9), shall fall within the ambit of "contract", if these are performed under the contract.

The court failed to give a logical reason as to why it included service contracts of this type, and not other services contracts, within the scope of 'contracts'. A plain reading of s 153 does not even impliedly suggest that all services would be split between those falling in clause 'b' and those falling under clause 'c' on the basis of the definition given in s153 particularly when that definition is 'inclusive' in nature.

(iv) Clause 42 of Part IV of the Second Schedule, which exempts operators of chemical and oil terminals from the application of the PIT, is also superfluous, because all companies which provide services are excluded from the ambit of the PIT by s 153(6). Since all the operators of the terminals in Pakistan currently are organized as companies, and sea terminal businesses fall within the ambit of the service industry, they already enjoy the exemption by s153(6). Thus, clause 42 is redundant.

6.1.1.5 Frequency of Changes in the Regime

Despite the fact that the Pakistani PIT in the ITO 2001 is the replica of the earlier PIT regime contained in the repealed Income Tax Ordinance, 1979 it still has undergone several amendments. Almost every Finance Bill brings repeated changes in every activity covered under the PIT, which manifoldly increases its underlying uncertainty. This all makes the tax code quite unstable and unclear. Some examples on this tendency follow:

(i) The deduction of tax on profit on debt under s 151 for a non corporate taxpayer was not a final discharge until an insertion of subsection (3) in s 151 through the Finance Bill 2006. This changed the tax liability for a non-corporate taxpayer.

(ii) The insertion of clause (bb) to s 153(5) through the Finance Bill 2007 provides an exemption to ginners (who separate seeds from cotton in order to produce cotton lint) from application s 153(1). There are two observations in this regard. First, it should be grouped with other exemptions provided in Part IV of the Second Schedule. Second, this insertion appears superfluous, because, after making the payment the ginner can obtain an exemption certificate from the Commissioner under s 159(1). Alternatively, the ginner can deposit the tax on behalf of the payer and provide him/her a copy of a tax payment receipt. The latter arrangement seems convenient to both the parties and thus is prudent in business terms. Thus, the addition of clause (bb) adds to the complexity of the legislation.

(iii) In respect of s 153, until 2002 only professional services were liable to withholding of tax. Later, all types of services were subjected to WHT through the Finance Bill 2002. Subsequently, the tax so withheld was treated as a final discharge of tax liability by an amendment in the Finance Bill 2006.

(iv) A concession for providers of services to exporters of textile products is inserted as subsection (1A) of s 153. The tax rate for them now becomes equivalent to that applicable to exports generally. Besides the fairness and the neutrality issues in this amendment, the reduction in tax rates should have been grouped with a reduction in the rates for other taxpayers in Part II of the Second Schedule.

(v) By inserting the second proviso to s 153(6), through Finance Bill 2007, advertising receipts by print media and the sale of goods and execution of contracts by listed companies are taken out of the ambit of the PIT. In the context of principles of a good tax system, although the exclusion of listed companies is explicable, it is difficult to understand the rationale of exempting a type of business (that is, print media) from the PIT regime. [89]Moreover, this exemption should have been inserted in the Second Schedule where other exemptions are grouped.

(vi) Suppliers of own manufactured goods (only companies) were exempted retrospectively from the ambit of the PIT through the insertion of subsection (6A) of s 153 by Finance Bill 2005; which was further amended in 2008 to suspend the retrospective application of the exemption.

(vii) The insertion of clause 47D in Part IV of Second Schedule allowing the PIT regime to apply to cotton ginners coincided with the omission of clause 40 of the Finance Bill 2005, which contained the option of the PIT for all manufacturers. This option was initially withdrawn retrospectively in order to curb tax avoidance through transfer pricing in the pharmaceutical industry, who used to file returns under the PIT option. But later for unclear reasons, clause 41A was inserted by the Finance Bill 2005, which again offered the option for all activities to use the PIT pertaining to periods before 2005. This clause was later also omitted by Finance Bill 2008. Frequent legislative amendments have the potential to create additional uncertainty and compliance costs for taxpayers.

(viii) The insertion of subsection (6B) of s 153 appears to be due to an error because individuals and AOPs were already falling within the ambit of the PIT. This insertion was then later correctly identified as a redundant provision and removed by the Finance Act 2008. This type of arguably hasty insertion and subsequent removal only adds complexity to the law.

(ix) Subsection (8A) of s. 153 of the Finance Bill 2006, which increased the rate of withholding tax rate for the payees when they failed to provide their tax identification number, was also withdrawn immediately after its insertion through Finance Bill 2007.

In all, the Pakistani PIT has been subject to significant and repeated changes even after the promulgation of the new Ordinance in July 2001. For instance, in Part IV of the Second Schedule, which contains the exemption from the application of PIT related WHT and the applicability of the PIT regime, 68 amendments have been made since 2001; which includes 22 new insertions, 35 removals and 11 substitutions. Moreover, even the definition of the prescribed person in s 153 has been amended six

[89] Generally, exempting a high profit yielding activity from the ambit of PIT is considered as a concession because then such a business declare lower incomes in a collusive arrangement with the accounting professionals and tax administration.

times. Finally, in the simplest regime of retailers, more than seven amendments have been made since its introduction in 2004. In view of the above, it seems that what was opined by Ahmad and Stern in 1991 still holds true:

> *"The Pakistani tax system has developed as a series of ad hoc measures dictated largely by short term pressures and the immediate convenience and relative ease with which extra revenue can be generated."*[90]

6.1.1.6 Ambiguity of the Interpretative or Explanatory Provisions

Some interpretative and explanatory provisions which suffer from ambiguities are outlined in this part of the paper.

(i) The collection of tax under s 151 on interest payments to individuals is not treated as income under the definition clause 29 of s 2 despite ITO 2001 treating tax withheld on it as the final discharge of tax liability under s 169.

(ii) Although the definition of services and sale of goods is provided in s 153(9), (reproduced earlier in this section), the definitions have created more uncertainty and ambiguity. The definition of the 'contract' is not provided in s 153(9), perhaps because of an inability of the legislature to define it after excluding services and supplies from its scope. A contract without services and supplies would be nothing but a hollow assignment. This is discussed further in the efficiency section of this analysis.

(iii) Since manufacturers are excluded from the ambit of PIT under s 153, a manufacturer is defined in subsection 9 of s 153:

> *"manufacturer" for the purpose of this Section means, a person who is engaged in production or manufacturing of goods, which includes-*
>
> *(a) any process in which an article singly or in combination with other articles, material, components, is either converted into another distinct article or produce is so changed, transferred, or reshaped that it becomes capable of being put to use differently or distinctly; or*
>
> *(b) a process of assembling, mixing, cutting or preparation of goods in any other manner.*

This definition does not seem clear and may add to the ambiguity. For example, under this definition, particularly due to the words 'or preparation of goods in any other manner', even a service provider of any type such as a wood cutter or sizing in the textile industry can claim to be a manufacturer if that treatment provides it some tax benefit.

(v) The insertion of the presumptive regime in the Second Schedule for shipping business is ambiguous regarding the return filing and assessment requirements. All other incomes falling within the ambit of the final tax regimes are deemed to have been assessed under s 120 and consequently such businesses with incomes falling within the ambit of the final tax regime are absolved from filing a return under

[90] Ehtisham Ahmad and Nicholas Stern, The Theory and Practice of Tax Reform in Developing Countries (1991), 2.

subsection (3) of s 169. The ectopic insertion of this final tax regime for shipping activities or its incorrect grouping has resulted in the omission regarding its assessment and filing requirements in subsection (3) of s 169.

6.1.1.7 Provisions Where the Literal Meaning is Never or Rarely Enforced

The pertinent example here is clause (d) of subsection 153(5) which is related to payment for securitization of receivables by a Special Purpose Vehicle to the Originator. In the real business world, these situations are quite rare. Similarly, the literal meaning of 'manufacturer' cannot be applied to the definition given under s 153 because it has an inclusive feature and therefore has widespread connotation. The same is also true for the definitions of contract, sale of goods, and services given under s 153. More aptly, it is hard to strictly include all business activities and sectors within the the literal meanings of these terms. The use of such words therefore only adds to the technical complexity.

6.1.2 Operational Complexity

As follows, the operational complexity of the Pakistani PIT regime is analysed qualitatively in terms of the compliance burden such as bookkeeping and other documentary requirements. More specifically, it is examined in the context of the average liability of small business (that is, the ratio of compliance costs to tax liability).

As discussed in section 5, small taxpayers in Pakistan mostly have to maintain books of accounts[91], because the probability that all the transactions undertaken will fall within the ambit of the PIT regime is very low.[92] The only exception when a taxpayer is not required to keep accounts is when 80 percent or more of his/her receipts are subjected to WHT. [93]

As discussed in section 3, in small businesses, compliance costs associated with the maintenance of accounts are regressive. It is noted that the cost to maintain accounts can amount to a large percentage of the income earned by a taxpayer. Compliance costs can even be higher than the tax liability itself. For instance, a taxpayer having income at PKR 192,000[94] (which is maximum income of individuals constituting 65% population) shall bear a tax liability of PKR 7,680 under the normal income tax regime, which is equivalent to approximately one fourth of the compliance costs related to bookkeeping.

Further, the WHT on various activities, which are not covered under PIT, require small businesses (even those who fall under PIT) to interface with the tax administrator in order to get a refund of tax withheld on those activities. In the absence

[91] Internal costs on the recording data and acquiring knowledge to comply with tax obligations are virtually all the compliance costs (see Cynthia Coleman and Chris Evans, 'Tax Compliance Issues for Small Business in Australia' (2003) in '*Taxing Small Business: Developing Good Tax Policies*' Neil Warren (ed.), Australian Tax Research Foundation Conference Series 23, 163).

[92] It may be, because, only a few business activities are covered under PIT. Moreover, transactions within the formal sector are only subject to WHT which is a prerequisite to be eligible for PIT. Thus, activities, which are subject to WHT, fall outside the ambit of PIT.

[93] *CBR Circular N0: 12* of 1991, Federal Board of Revenue of Government of Pakistan.

[94] PKR192,000 is the maximum income of 65 percent population in Pakistan (see '*Nature and Extent of Corruption in Pakistan*' Transparency International Pakistan, March 2002, 20).

of an electronic refund mechanism, many small businesses do not even apply for the refund due to fear of being harassed by the tax administration. The gap in the total number of SMEs (that is, 3.2 million) in Pakistan and total number of registered taxpayers (that is, 1.2 million) supports this contention. Byrne describes such withheld taxes in Latin American countries as de facto final assessment regimes.[95] This loss of refund is an additional tax compliance cost.

It is noted that in the Pakistani PIT, there is no satisfactory simplified regime for small entrepreneurs in Pakistan. As compared to other PIT designs available such as indicator based PIT or an asset based PIT[96], even when all the taxpayers' receipts are subject to WHT, the PIT based on the WHT is not simple, because taxpayers have to keep records for both the turnover and taxes withheld throughout the year. On the other hand, retailers who fall under the simplified non-WHT based turnover tax regime have to keep a record of turnover only. Moreover, the tax liability is uncertain in the retailer's regime, because the adjustment for taxes withheld under various provisions of the WHT regime against the liability under the retailers regime is not clear in the law. This means that the retailer bears additional tax burden for other WHTs, which are not the final discharge of the tax liability.

Lastly, the high level of technical complexity in the Pakistani PIT, as discussed in the preceding section, tends to increase the uncertainty and ambiguity, which consequently increases compliance costs. In all, the Pakistani PIT is complex from an operational perspective.

Regarding the enforcement aspect of operational complexity the Pakistani PIT, being a turnover based PIT, is not easy to monitor in cash based economies and therefore is not a good tax design. Additionally, the Pakistani PIT is hard to enforce and comply with, because, most taxpayers either fall within the normal income tax regime or have to face a hybrid treatment and consequently have to keep books of account. Only a small number of taxpayers fall within the ambit of the PIT, when their total receipts are subject to WHT.

Finally, using a PIT regime based on WHT Pakistan with weak administration is simply "going from bad to worse". The monitoring of WHT is harder than implementing the normal income tax due to the intricacies in handling the voluminous information required. Moreover under this regime, WHT agents assume the role of tax administrators and in an environment where they are not being effectively monitored. It makes the role of a WHT agent problematic and the fair implementation of the regime doubtful. Therefore, the Pakistani PIT is not easy to enforce. Because of its ineffective implementation, this regime could even be suspected of becoming counterproductive in terms of the equity and efficiency principles.

6.2 Pakistani PIT and Efficiency

Consistent with section 5, neutrality is a bedrock of the efficiency principle. Therefore, the Pakistani PIT is analysed initially against all facets of neutrality. Later,

[95] Peter D. Byrne, 'The Business Asset Tax in Latin America – No Credit Where It Is Due' (1994) *Tax Notes International* 529, 533.

[96] Memon, Najeeb, 'Presumptive Income Tax Designs for Improving Small Business Compliance' (2009) 15:4 *New Zealand Journal of Taxation Law and Policy*, pp.275-297.

the deadweight loss caused by the Pakistani PIT, which is linked to its tax design, is assessed.

6.2.1 Neutrality

The Pakistani PIT is analysed against six aspects of neutrality as follows.

6.2.1.1 Neutrality in Tax Rates, Expenditures and Concessions

Tax rates, which determine the tax burden in any tax system in general and the PIT regime in particular, should be chosen on some logical basis. The rates in the PIT for small business should be fixed in proportion to the average income of relevant sectors or any other rational basis.[97] More simply, different profit margins demand different tax rates for each business activity in order to bring neutrality in tax treatment. Thus, a turnover based Pakistani PIT should have classifications and rates on the same basis or a similar logical basis. But regrettably, this aspect is completely ignored in the Pakistani PIT.

For instance, the PIT rates on turnovers prescribed under s 153 are without any rationale. All services are being taxed at the same rates irrespective of the industrial sector. Similarly, all supplies are taxed at identical rates which disregard their nature. Further, all contracts are treated as on par without paying any heed to the nature and value of the contract. The profit margins among all these activities are usually different from sector to sector; and also for the level of turnover. Thus, subjecting them to a uniform tax rate violates neutrality in terms of equal tax burden for equal incomes.

Moreover, within WHT based PIT regimes, some activities are taxed at high rates and others at very low rates. Exports are taxed at 1% and imports at 2%, but fabric imports are taxed at 1%. Transport services are taxed at 2% and other services at 6%.[98] The difference in tax rates is without any sufficient economic rationale (for example, one of an average income). Even the difference in tax rates does not correspond to differences in the profit margin from these activities. Robina and Rider show that contractors pay 20 percent of federal tax receipts in Pakistan, even though they account for only 2.3 percent of its GDP.[99] This discriminatory treatment of different activities in terms of different tax rates, without paying any heed to the actual or average income of those activities, causes allocation of resources to low taxed sectors at the expense of high taxed ones and consequently economic distortion.

It is worthy to refer to decision of the Indian Supreme Court in case of *Kunnathat Thathunni Moopil Nair etc. v State of Kerala and another*[100] which lays down broad guidelines for taxation in this regard. The facts of the case were that a petition was filed challenging the constitutionality of Travancore-Cochin Land Tax Act 15 of 1955.

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[97] Robina Ather Ahmed and Mark Rider, 'Pakistan's Tax Gap: Estimates by Tax Calculation and Methodology' Working Paper No. 08-11, Andrew Young School of Policy Studies, December 2008, 36.

[98] The textile related services for exports are taxed at 0.5% under section 153(1A). The tax rate on imported fabric is reduced from 2% to 1% by clause 9 to the Part II of Second Schedule.

[99] See Ahmed and Rider above n 97, 27.

[100] *Kunnathat Thathunni Moopil Nair etc v State of Kerala and another* AIR 1961 SC 552; 3 SCR 67.

Section 4 thereof provided that there shall be charged and levied basic tax at uniform rate in respect of all lands in the state of Kerala of whatever description and held under whatever tenure.

The Indian Supreme Court held that:

> *"Similarly, different kinds of property may be subjected to different rates of taxation, but so long as there is a rational basis for the classification. Art. 14 will not be in the way of such a classification, resulting in unequal burdens on different classes of properties. But, if the same class of property similarly situated, is subjected to an incidence of taxation, which results in inequality, the law may be struck down as creating an inequality amongst holders of the same kind of property*." (*Kunnathat Thathunni Moopil Nair etc. v State of Kerala and another* at page 90)

The classification and rates in the Pakistani PIT is also without any rationale and therefore appear confiscatory because they result in unequal tax burdens on different classes of businesses. This shows that the lack of classification and rates (which results in a loss of neutrality) in the PIT legislation, being confiscatory in nature, not only has adverse economic consequences, but arguably also destroys the legitimacy of such legislation. Taxing the turnover without further distinguishing the economic activity is not a neutral classification.

Further, originally the Pakistani PIT had some sub-categories for the different types of exports depending on the extent of value added by the exporter and some sub-categories in terms of the difference in values of the contract and these were subjected to different tax rates. This shows that there is a scope of improving the classification and developing sub-classifications in order to make tax incidence neutral and equitable. It is pertinent to note the suggestion made by the Supreme Court of Pakistan, in the case of *Ellahi Cotton Mills Ltd v CIT*, on the point of confiscatory nature of the PIT legislation:

> *"We have no doubt that if the representatives of the business community take up the question of reasonableness of the above rates of tax provided under Section 80C, 80CC and 80D with the government, the same would be given the due consideration, particularly keeping in view that there is good equation between the business community and the government in power. No government of any worth would like to destroy the industries and the business of the country by imposing taxes at the rates which may be confiscatory or expropriatory." (Ellahi Cotton Mills Ltd v CIT [1997PTD1555] at Paragraph 26 of the order)*

Lastly, the Pakistani PIT provides concessions in different forms through the Second Schedule of ITO 2001. Besides exempting from tax total income of some classes of income, a number of concessions are inserted in the form of lower tax rates, rebates in tax liability and exemptions from the application of the PIT regime. The total number of the concessions, with respect to taxes collected at source, is 30. Most of the concessions appear completely without any economic rationale and are detrimental to neutrality of the regime.

6.2.1.2 Neutrality in all Classes of Income

The Pakistani PIT regime is not neutral for all classes of income. The tax rate for the interest income falling within the ambit of WHT based PIT under s 151 is 10 percent.

Similarly, the tax rate for rental income at the lowest bracket is 5 percent. In both these PIT regimes, gross receipts are relatively closer to the actual income, because only a few deductions are admissible against the receipts. Consequently, the tax burden on taxpayers falling within the ambit of these PIT regimes is low.

As compared to that, gross receipts of business or professional activities are subjected to tax rates ranging between 1-10% (such as those falling within the ambit of sections 148, 153, 156 and 233) which impose a higher effective tax liability, because the income from these activities constitutes a relatively small part of their overall receipts. In other words, there are several expenses deductible from business and professional turnovers before arriving at net profit figure. More simply, interest receipts due to less admissible expenses are almost equal to net profits from investment; whereas net profits from investment in a business venture reflect only a small component of its total receipts.

For example, Mr. A receives interest income of PKR65,000 from his interest bearing securities. This income is taxable under the PIT at 10% and consequently bears tax at PKR 6500. The effective tax rate for this income is also 10%, because no deductions are admissible against the receipts of PKR65,000 which are earned on the securities financed by his investment of Rs. 650,000 made up of savings. On the other hand, Mr. B receives receipts of PKR 650,000 on account of supplies he makes to his customers. These receipts also fall within the ambit of PIT at a tax rate of 3.5% and consequently bear tax of PKR 22,750. If this is assumed that net profit margin of this trading activity is 10%, then, the tax of Rs. 22, 750 on his income (which @ 10% of net profit margin stands at PKR 65,000) means he bears an effective tax rate of 35%. More simply, if the supplier earns net profits equivalent to the profits on bank deposits then it bears a much higher tax burden.This indicates that investment in trading bears higher effective tax rate as compared to investment in bank deposits.

6.2.1.3 Neutrality in Tax Burden for all Types of Legal Persons

The Pakistani PIT is not neutral in terms of its treatment for different types of legal persons which may encourage business to organize in a form which acts as tax shelters. Following are some examples in this regard.

(i) The interest income of corporate entities under s 151 is excluded from the ambit of the PIT. On the other hand, the interest income of AOP, individuals and partnerships is taxable under the PIT. This all creates an avenue for tax planning and results in higher economic costs.

(ii) Services income under s 153 in respect of corporations is taken out from the ambit of PIT by the first proviso to subsection (6). This exclusion from PIT provides an opportunity to evade taxes under the normal income tax regime by having a collusive arrangement with the tax authorities because now very low or nil tax liability can be assessed under the normal tax regime.[101] This discrimination opens a door for tax planning and ultimately influences the way the business may be organized.

(iii) The income from a supply of goods by a corporate manufacturer is taken out of the ambit of PIT by subsection (6A) of s 153. This provision creates a distinction in

[101] See above n 89.

the treatment between the corporate and the non-corporate sectors. This would have exactly identical consequences as discussed in respect of the services sector in the preceding paragraph.

(iv)The income of listed corporations from the sale of goods and execution of contracts is outside the ambit of PIT by clause (ii) of the second proviso to subsection (6) of s 153. It perhaps is done to encourage listings in the stock exchange but it may cause wider negative economic ramifications. For instance, all the private companies or partnerships may not be ready in terms of other financial indicators to change their form and obtain listing and consequently the tax system would be discriminating against them. This intervention through tax policy, to influence the choice of form of business organization, appears unprecedented at least in Pakistan.

(v) The income from commercial imports by large import houses, irrespective of the form of business organization, is taken out of PIT by clause (d) to subsection (7) of s 148. Those corporations, which are conducting trading houses, are exempt from both PIT regimes under sections 148 and 153, if they meet certain conditions. This favourable treatment to large importers may become detrimental for small entrepreneurs which may make them uncompetitive and may ultimately wipe them out from the market.

6.2.1.4 Neutrality in Availability of Tax Avoidance Opportunities

The Pakistan PIT creates evasion opportunities, which substantially distorts economic decision making. These opportunities arise both when all or even a part of a taxpayer's receipts fall within the ambit of the PIT regime. These opportunities are primarily due to ambiguous definitions and the scope of the terms 'services', 'supplies' and 'contracts'[102] in the law. A few examples in this regard are outlined as follows:

(i) Taxpayers can split the contract to label part of their receipts as being from supplies rather than the contract so as to bear less tax. For example, Mr. Z has contracts for the supply and installation of solar energy equipment. If it is assumed that the cost comprises PKR 1,500,000 for the equipment and PKR 500,000 for the installations, this makes a total of PKR 2,000,000. In case Mr. Z makes one deal for the sale and installation then he bears tax at 6% and the total liability stands at PKR 120,000. Alternatively, if he separately treats the sale as a supply and the installation as a service charge then the supply of the equipment bears tax at 3.5% and the installation service bears tax at 6%. Consequently, the total tax liability by splitting the contract would stand at PKR 52,500 (for supplies) plus PKR 30,000 (for services), a total of PKR 82,500. This shows that the tax liability can be significantly reduced by structuring a transaction. Moreover, the larger the value of transactions, the more attractive is it to undertake tax planning.

(ii) Sometimes a taxpayer may make choices by playing on the ambiguities in the statutory definitions of the different activities. For example, services are not distinguished between businesses of providing services such as airlines and couriers. It is noted that when taxpayers earn greater profits, then they prefer to be assessed under the PIT; and when they earn low profits, they want to be assessed under the normal income tax regime, by claiming that they are just a business and do not fall within the

[102]The definitions of these terms in law are already reproduced in the preceding section of simplicity.

definition of services under s 153. The tax administration, in order to collect more revenue or sometimes for dishonest motives, also uses the same loopholes. For instance, manufacturing activities such as dyeing have been taxed by the revenue administration under the PIT as service receipts. More simply, there are claims and counterclaims regarding the nature of the same receipts.

Additionally, the exclusion of services from contracts in the subsection defining the scope of PIT under s 153, as reproduced earlier in section 6.1.1.4, also has created another series of litigation.. For instance, in the same earlier mentioned case of *Premier Mercantile Services v CIT Karachi,* the Sindh High Court despite the exclusion of the word 'professional' from the definition of services, the Court upheld that the taxpayer fell under the ambit of PIT as a contract and that its services were not those which were covered within the definition provided in subsection (9).

On the other hand, the services of the cricketer, as mentioned earlier in the case of *Assesse v Department*[103], were also held by the Income Appellate Tax Tribunal (ITAT) of Pakistan to fall outside the ambit of the services both under ITO 2001 and the now repealed ordinance. The Tribunal held that these kind of services are a contract and not services by giving a reasoning based on the Contract Act, 1872, which was completely different than the reasoning followed in the earlier decisions:

> *"It is elaborated that the term services is applied where the person is dictated in respect of 'what to do' and 'how to do', whereas under the strict definition of the contract a person is only explained for 'what to do'. He is not explained that how he has to do his work. Otherwise, under the Contract Act, there are only three ingredients of the contract i.e. offer, acceptance and consideration. In the present case, there is a contract but under the contract, there is no limitation upon the appellant 'how to do'." (page 4)*

Conversely, in the case of *CIT v Khursheed Ahmad*[104], the taxpayer filed a return under the normal income tax regime for its income from janitorial services and the tax department taxed it as a contract under the PIT. The Lahore High Court decided the matter in favour of the taxpayer as follows:

> *"A plain reading of the provision Section 80C will not leave any doubt that rendering of services have been provided exemption even if the same are in execution of a contract. The various principles of interpretation of fiscal statute like application of law in its natural meaning and favour to the taxpayer in case of doubt, provides guideline and following the same it we hold that the department's presumption is without any support or argument".*[105]

The above conflicting claims and judicial pronouncements are evident of the embedded complexity in the regime, which provides a breeding ground of tax arbitrage opportunities and corruption.[106]

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[103] ITA No. 1850/KB to 1850/KB of 2002 (2004 PTD 2749).

[104] CIT v Khurshid Ahmed 2008 PTD 1243, Paragraph-8 of the order.

[105] This case pertains to the repealed ordinance which had an almost identical PIT regime.

[106] In addition, the argument of the court is bad in law as it ignored the fact that the definition is inclusive' which broadens the scope of the services falling in its ambit. A similar finding was given while describing the scope of 'income' in the Constitution (where income has an inclusive definition) by the

The sale and buy back transaction executed between businesses and leasing companies to raise finance was taxed by the tax department under the PIT as a sale. The Lahore High Court decided the matter against the department in the case of *CIT v JD Sugar Mills Ltd.*[107] In this case the taxpayer JD Sugar Mills Ltd sold and bought back part of its plant with a leasing company. Subsequently, the legislature inserted the remedial provisions as clause c to s 153(5), to exempt such transactions from the ambit of PIT. But that adds to the complexity of the tax code. It is pertinent to mention here that in this case, the court observed that WHT agents deduct tax on behalf of the tax agency even if the payment does not fall in the ambit of any of the items (services, supplies and contracts), perhaps because of the fear of incurring penalties for non-compliance of the WHT regime under the law.[108]

The above mentioned cases are just a few examples, but the actual number of cases all over Pakistan on these or similar issues could, in my view, be numerous and only an empirical study of the statistics of the legal division of Federal Board of Revenue could provide an accurate figure.

(iii) Furthermore, when a taxpayer's activities fall partly under the normal income tax and partly under the PIT regime, there is an opportunity for tax avoidance by claiming more of the expenses within the normal income tax and less within the PIT because in the PIT, which is final discharge of tax liability, these expenses do not help in reducing the tax liability. This opportunity arises due to the ambiguous Rule 13 for allocation of expenses. Consequentially, voluminous litigation is pending in the courts, which increases tax planning costs and also adversely impacts the economy.

(iv) The Pakistani PIT also encourages tax evasion and avoidance through collusive arrangements. For instance, big manufacturing units create sister concerns to obtain all services from them at inflated costs (as the sister concerns fall within the PIT) and reduce their overall tax liability. Similarly, professionals can take advantage of the PIT for services income by substituting regular employment with a service contact. More simply, they prefer a service agreement, which falls under the PIT under s 153 read with s 169. The tax burden for the same receipts under the PIT is much less as compared to tax payable under the salary regime.[109] Employers might also prefer this collusive arrangement with professionals to reduce the employer's costs. This causes a loss of revenue, whose quantum is yet to be ascertained. Some companies even use service contract arrangements as a channel to siphon profits outside the company, by hiring friends and relatives under these contractual arrangements. Such friends are then paid high sums as service fees to claim huge deductions against profits of the company. Depending upon the type of company, the company tax rate ranges between 30-40%. Moreover, due to the lack of imputable income, a taxpayer may camouflage

SC of Pakistan in the famous case of Ellahi Cotton Mills Ltd v Federation of Pakistan. The SC held that 'the fact that the word 'includes' has been employed and not the word 'means' indicates that the definition given in Article 260 for the above term is not exhaustive'.

[107] See CIT v J.D Sugar Mills Ltd 2009 PTD 481.

[108] See CIT v J.D Sugar Mills Ltd 2009 PTD 481.

[109] The services are taxed at rate of 6%, whereas the tax rate for the highest slab bracket is 25% of salary income is 20% under Para 1A of Div. I of Part I to Schedule I.

profits from other activities as arising from an activity falling within the ambit of the PIT.[110]

6.2.1.5 Neutrality in the Tax Burden Regarding the Choice of Capital Structure

PIT is inherently against the debt financing of the company because it takes away the tax shelter which debt financing provides under the normal income tax. But, consistent with SME studies in Pakistan, most small businesses are funded by equity; hence this disadvantage makes little difference for them. Nevertheless, in strict terms of the criteria of neutrality, the PIT takes away the advantage of the debt financing which is considered as a cheap source of finance. Businesses which are mostly financed by debt may face more fluctuations in their income in case they fall under the PIT. More simply, increased fluctuation in Earnings after Interest and Tax (EAIT) in a risky business would be aggravated when debt comprises most of its capital. This discourages debt financing in the risky business (see Table 1 below).

Table 1: Increased Fluctuation of Take Home Income under PIT[111]

Normal Income Tax Regime			
	2007 PKR	**2008 PKR**	**2009 PKR**
Turnover	5,000,000	4,500,000	2,000,000
Expenditure	(4,000,000)	(4,000,000)	(3,000,000)
EBT	1,000,000	500,000	(1,000,000)
Tax at rate as per Div I, Part I of the First Schedule	(210,000)	(50,000)	(000)
Earning After Tax	790,000	450,000	(1,000,000)
Change from Previous Year	100% (Base Year)	57%	-13%
Presumptive Income Tax Regime			
	2007 PKR	**2008 PKR**	**2009 PKR**
Turnover	5,000,000	4,500,000	2,000,000
Expenditure	(4,000,000)	(4,000,000)	(3,000,000)
EBT	1,000,000	500,000	(1,000,000)
Tax on Contracts at Rate of 6%	(300,000)	(270,000)	(120,000)
EAT	700,000	230,000	(220,000)
Change From Previous Year	100% (Base Year)	33%	-31%

[110] It is recommended to reintroduce the concept of imputable income in the PIT as it was present in Section 80C(5A) of the repealed ordinance which provided that where an assessee derives income from any source which is subject to tax in accordance with the provisions of this section, and the tax liability is less than the tax payable on such income had it not been chargeable to tax under this section, the difference in tax shall be payable in accordance with Section 54 along with the return of income provisions of sub-Section (4) notwithstanding (for details see the repealed Income Tax Ordinance 1979 of Pakistan).

[111] The author's own calculations.

6.2.1.6 Neutrality in Assigning the Role of Withholding Tax Agent

When the tax agency assigns a business the role of being a WHT agent, then, it increases its compliance costs. It involves shifting the role of tax collection to business and such a role incurs time and monetary costs. On the other hand, when some businesses are specifically exempted from performing that role, then, it means they have been favoured in terms of the compliance costs. For example, AOP is required under the law to act as a WHT agent under s 153 whereas other legal persons such as individuals are exempted from this role. AOP, therefore, is comparatively at a disadvantageous position in terms of compliance burden.

6.2.2 Overall Tax Burden

The Pakistan PIT is detrimental to work and entrepreneurship for several reasons. First, it is noted that differential tax treatment for each class of income discourages a taxpayer to take multiple ventures, because doing so increases the volume and cost of compliance. Second, the fixed tax rates on turnover without relation to the intricacies of this proxy base, generates higher tax liability with the increasing turnover irrespective of the level of actual profits. Since the turnover is a direct reflection of increased effort as a result, this regime becomes a disincentive to carry out more effort. Moreover, the tax rates are too high in some sectors e.g. supplies and contracts and consequently business risk is multiplied in those sectors. More aptly, a PIT with a low tax rate is helpful in tackling the informal economy, because it decreases economic gains from operating in the informal sector by reducing the technical compliance burden.[112] Thus, the Pakistani PIT is not appropriate in this regard. However, despite the higher burden, the marginal tax rate in the Pakistani PIT is zero, when the income is beyond the level where tax liability corresponds with the prescribed tax rates of PIT, which is an incentive for high performing taxpayers and businesses.

6.3 Pakistani PIT and Equity

Since neutrality is a bedrock of both efficiency and horizontal equity, the findings of analysis made in section 6.2 for the efficiency principle are equally relevant to horizontal equity. Nevertheless, in this section, those aspects of neutrality, which have a direct impact on horizontal equity, are analysed. Vertical equity, on the other hand, is assessed by the level of progressivity in the PIT regime.

6.3.1 Neutrality in Tax Treatment of Employed and Self-Employed Taxpayers

The Pakistani PIT for self-employed persons violates the equity principle. The main concern is that those who are falling within the PIT are not allowed any basic exemption. Thus, a taxpayer under the PIT regime which has turnover of just PKR 1 million (A$ 9,000) has to pay tax at rate of 5% (that is, PKR 50,000 (A$550)). Alternatively, under the normal income tax, this taxpayer, if it is assumed that the net profit margin is 10%, would declare income of PKR 100,000 (A$1,100) and will pay no tax as this level of income as it falls below the taxable limit. The tax paid under the PIT by this taxpayer is more than

[112] Memon, above, n 20.

double the tax liability of a taxpayer, who declares net income of PKR 0.5 million (A$5,500) under the normal income tax; or is equivalent to the liability of a retailer who opts for a fixed tax and has turnover of PKR 50 millions (A$ 600,000). It shows that small businesses, which fall within the ambit of the PIT, bear a relatively higher tax burden.

Comparisons of tax liabilities of self-employed persons between the PIT and normal income tax for various activities; and of the tax liability between employed and self employed persons is given below in Tables 2, 3 and 4. This comparison clearly demonstrates the discriminatory treatment in the Pakistani tax system. In Table 2, the self employed medical doctor bears a different tax when compared to an employed medical doctor. Even a medical self-employed doctor, who falls under the normal income tax regime, pays a different amount than the one who falls under PIT. Further, self-employed professionals of different sectors also bear different tax burdens and that differential treatment is not supported by any logic.

Table 2: Comparative Tax Liability of Employed and a Self-Employed Professionals[113]

Doctor Employed	Doctor Self –Employed under the Normal Income Tax Regime	Doctor Self –Employed under PIT Regime
Salary 300,000 Tax at 0.75% 2,250 Under Para 1(A) Div. I to Part I of Ist Schedule	Under the normal income tax regime a taxpayer deducts expenses which are un-verifiable and usually constitutes 70-80% of the receipts. Net Profit 60,000 Tax at 0% NIL Under Para 1 Div. I to Part I of the First Schedule	Receipts 300,000 PIT tax at 6% 18,000

In Table 3, the self employed lawyer bears tax liability different than the one borne by the self employed transporter despite the same volume of receipts.

Table 3: Comparative Tax Liability of various Self Employed Persons Falling Within the Ambit of PIT u/s 153[114]

Self- Employed Lawyer	Self –Employed Transporters
Receipts 300,000 PIT tax at 6% 18,000	Receipts 300,000 PIT tax at 2% 6,000

[113] The author's own calculations.
[114] The author's own calculations.

In Table 4 below, it highlights that despite the same volume of turnover, a trader of rice bears a different tax liability as compared to a trader of yarn.

Table 4: Comparative Tax Liability of Suppliers of Different Commodities Falling Within the Ambit of PIT u/s 153[115]

Self- Employed trader of rice		Self –Employed Trader of yarn	
Receipts	300,000	Receipts	300,000
PIT tax at 1.5%	4,500	PIT tax at 3.5%	10,500

6.3.2 Neutrality among Taxpayers with Different Levels of Turnover

Identical tax rates in the PIT for various activities do not reflect identical tax treatment because they are applied on turnover rather than on actual income. Businesses even in the same sector with different turnovers may or may not have identical profit margins due to a difference in their break-even points (that is, level of sales where total costs equal total revenue and no profit is made) in accordance with the concepts of costing; and due to different business strategies of their owners (for example, selling more at low margins or selling less at high margins). The Pakistani PIT, therefore, does not tax equals equally.

The Pakistani PIT may therefore favour taxpayers with high turnover, who have crossed the breakeven point much earlier than those with low turnover. For example, a taxpayer with turnover of PKR 25,000 (A$230) is subjected to a tax rate similar to that of taxpayer from an identical sector, which has turnover of PKR 5 million (A$5,500) despite the fact that they both may not have similar profit margins. The taxpayer with a very low turnover may not yet have even achieved the breakeven point, but still has to bear a tax burden. This regime favours taxpayers with a high turnover. Similarly, this regime is also detrimental to those businesses which follow a strategy of selling more at low margins compared to those selling less at high margins.

Therefore, in a turnover based PIT, some equality can be achieved only by grouping taxpayers in accordance with their operational gearing and different business strategies in order to charge tax close to the tax on their actual income.

6.3.3 Vertical Equity

As I suggest, the progressive tax rates are not suggested due to the inherent conflict between vertical equity and efficiency principles.[116] For vertical equity, the only recommendation is that the taxpayer, who earns more, should proportionally pay more to the tax administration. This is on the basis that in my view, proportional vertical equity generates a sensible balance between two tax objectives; the ability to pay and the incentive to work. Consequently, in the Pakistani PIT, a similar rate for all levels of turnover is quite appropriate for vertical equity.

[115] The author's own calculations.
[116] See Memon, above n 10.

6.4 Looking at Performance Benchmarks

The Pakistani PIT fails to do well when measured against the benchmarks of tax performance as considered in this paper. This is evident from the stagnant base, (see Table 5) and the revenue collection from the small business jurisdiction (see Table 6) and the low tax to GDP ratio (see Table 7)**.** Table 1 shows an insignificant increase in number of returns filed and tax paid by the non-salaried class. There is no considerable increase in taxpayer registration. The increase in registration in retailers is because for them, the PIT regime essentially acts similar to a concession – as reflected in the insignificant revenue collection (see Table 5) – as it has a hard to enforce turnover based design and a tax rate of half a percent.

Table 6 reflects the poor revenue collection in tax jurisdictions (zones) dealing with small businesses of two large cities in Pakistan. This may explain why the Pakistani nation, with a population of 160 million, has just 2.28 million registered taxpayers. Table 7 shows that the tax to GDP ratio in Pakistan is falling.

Table 5: Income Tax Returns/Statements During 2005 to 2008[117]

PKR in millions

Taxpayers	**2005**		**2008**	
Returns	No. of Returns Received	Tax Paid (PKR)	No. of Returns Received	Tax Paid (PKR)
Non-Salaried Individuals	**510,189**	**1,540.00**	**616,395**	**1,461.50**
Statements				
Importers	9,826	2.55	15,425	0.9
Exporters	8,967	13.92	10,212	1
Contractors/ Suppliers	**33,993**	**6.62**	**32,266**	**6.2**
Other(including Retailers)	**36,378**	**114.43**	**1,171,656**	**165.8**

Table 6: The Collection from Non-Corporate Jurisdictions of Karachi, Lahore[118]

PKR in millions

	2001-02	**2005-06**
CIT, `A' Zone, Karachi	851	1,138
CIT, `B' Zone, Karachi	559	437
CIT, `C' Zone, Karachi	1,670	NA
CIT, `E' Zone, Karachi	741	885
CIT, `A' Zone, Lahore	966	2,988
CIT, `B' Zone, Lahore	2,035	-
CIT, `C' Zone, Lahore	6,506	10,207

[117] CBR Quarterly reviews for Jan-March 2008, Fiscal Research and Statistics, Directorate Research& Statistics accessed through http://www.fbr.gov.pk/DRS/Default.asp on 17/11/2008 at 12:15PM.
[118] See above n 118.

Table 7: GDP and Tax to GDP ratio of Pakistan for last ten years[119]

PKR in millions

YEARS	GDP (calculated under Market Prices))	Total Taxes		DIRECT TAXES	
		Collection (Net)	Tax to GDP ratio (%)	Collection (Net)	Tax/GDP Ratio (%)
1998-99	2,677,656	370,436	12.61	110,207	3.75
2002-03	4,875,648	528,857	10.85	151,898	3.12
2007-08	8,723,215	1,060,576	10.12	387,819	3.70
2010-11	18,116,453	1,558,015	8.6	602,451	3.33

Source:
Federal Board of Revenue Year Book 2010-11 Source: Statistical data (Historical) Fiscal Research and Statistics, Directorate Research & Statistics accessed through http://www.fbr.gov.pk/DRS/Default.asp on 25/1/2013.

More aptly, the 'estimates show that the informal sector over the years is grown in Pakistan from 36.8% in 1999-2000 to 39.5% in 2004-05'[120], which reflects at least partly the failure of the regime to encourage the transition from informal to formal sector.

In all, the poor performance of the PIT may be reflection of the findings of the above analysis such as the existing complexity in the procedures and the lack of perception of fairness arising from poorly designed tax rates which fails to provide neutrality in its tax treatment.

7. CONCLUSION

Many developing countries rely on the PIT regimes to collect taxes from large informal economies. This reliance is result of their inability to enforce normal income tax because of high compliance costs and weak tax administration. The merit of the simplicity in an ideal PIT such as being less costly to comply and easy to enforce makes it theoretically superior to a normal income tax in large informal economies. However, despite the widespread use of the PIT, there is little research on its ability to tackle large informal economies.

This paper analyses the PIT regime of Pakistan, one of large informal economies in Asia for its adequacy to control informal economy. After reviewing the causes of the informal economy in general and in context of Pakistan, the design of the Pakistani regime and its features are evaluated against principles of a good tax system as ranked in the context of informal economies.

[119] See above n 118.
[120] See Schneider, above n 38.

The findings reveal that being a turnover based PIT design, the Pakistani PIT is technically complex and imposes high compliance costs on small business. The Pakistani PIT also does not adhere well to the efficiency and equity principles because it does not secure neutral tax treatment for all types of business sectors. The findings of inadequacy of the Pakistani PIT are also evident in a stagnant taxpayers base, lower tax to GDP ratio and a persistently large informal economy in Pakistan.

The above findings suggests that current turnover PIT designs may be replaced with a better alternative such as an asset based PIT design or a PIT design based on economic indicators. In the event that the replacement of the PIT is not currently possible, complexities identified in the section of simplicity are suggested to be removed through a legislative review; and for efficiency, a detailed classification of industrial sectors with separate tax rates for each class could be provided to ensure neutrality in tax treatment.

Like any other study, the findings of this paper also suffer from some limitations such as these are not supported with sufficient empirical analysis particularly with respect to PKR value of compliance and enforcement costs resulting from the legal complexities identified in this paper, quantum of tax revenue which is lost due to existing tax arbitrage opportunities in the tax code and actual volume of shifting of tax incidence in the turnover based PIT design.

Lastly, there is scope of further research with respect to Pakistani PIT regime. As stated earlier, some more empirical evidence may be gathered to endorse the findings of the qualitative analysis made in this paper. For replacing the existing turnover based PIT design with a better alternative, an experimental study at a small scale is suggested to evaluate pros and cons of all other PIT designs which are in practice in several transitional European and other developing countries such as an asset based PIT design or an indicator based PIT design. However, the willingness of the government in this regard is a prerequisite.

APPENDIX: MAIN PIT PROVISIONS OF THE INCOME TAX ORDINANCE, 2001

Section 67 Apportionment of Deductions.- (1) Subject to this Ordinance, where an expenditure relates to –

(a) the derivation of more than one head of income; or

(ab) derivation of income comprising of taxable income and any class of income to which sub-Sections (4) and (5) of Section 4 apply, or;

(b) the derivation of income chargeable to tax under a head of income and to some other purpose,

the expenditure shall be apportioned on any reasonable basis taking account of the relative nature and size of the activities to which the amount relates.

(2) The Board may make rules under Section 237 for the purposes of apportioning deductions.

Rule 13 of Income Tax Rules 2002:- (1) This rule applies for the purposes of Section 67, which provides for apportionment of expenditure incurred for more than one purposes.

(2) Any expenditure that is incurred for a particular class or classes of income shall be allocated to that class or classes, as the case may be.

(3) (a) Any common expenditure including financial expenses, excluding relatable or attributable to the non-business advances or loans and amount at (2); relatable to business including presumptive and exempt income, shall be allocated to each class of income according to the following formula, namely:-

A x B/C

where –

A is the amount of the expenditure incurred;
B is the total amount gross receipts (without deduction of expenditures) for the tax year for the class of income; and
C is the total amount gross receipts (without deduction of expenses) and net gains for the tax year of all classes of income;

(b) where, however, there is net gain, brokerage, commission and other income is to be taken and turnover of such transactions is taken at these figures, such income is to be compared with gross profit from business for adopting figures for component "B" and "C" of the formula at (a) above.

Section 151 Profit on Debt: (1) Where

(a) a person pays yield on an account, deposit or a certificate under the National Savings Scheme or Post Office Savings account;

(b) a banking company or financial institution pays any profit on a debt, being an account or deposit maintained with the company or institution;

(c) the Federal Government, a Provincial Government or a Local Government pays to any person profit on any security other than that referred to in clause (a) issued by such Government or authority; or

(d) a banking company, a financial institution, a company referred to in sub-clauses (i) and (ii) of clause (b) of sub-Section (2) of Section 80, or a finance society pays any profit on any bond, certificate, debenture, security or instrument of any kind (other than a loan agreement between a borrower and a banking company or a development finance institution) to any person other than financial institution the payer of the profit shall deduct tax at the rate specified in Division I of Part III of the First Schedule from the gross amount of the yield or profit paid,……., at the time the profit is paid to the recipient.

148. Imports.- (1) The Collector of Customs shall collect advance tax from every importer of goods on the value of the goods at the rate specified in Part II of the First Schedule.

(2) Nothing contained in sub-section (1) shall apply to any goods or class of goods or persons or class of persons importing such goods or class of goods as may be specified by the Board.]

(5) Advance tax shall be collected in the same manner and at the same time as the customs-duty payable in respect of the import or, if the goods are exempt from customs-duty, at the time customs-duty would be payable if the goods were dutiable.

(6) The provisions of the Customs Act, 1969 (IV of 1969), in so far as relevant, shall apply to the collection of tax under this section.

[(7) The tax collected under this section shall be a final tax 5[except as provided under sub-section (8)] on the income of the importer arising from the imports subject to sub-section (1) and this sub-section shall not apply in the case of import-

(a) raw material, plant, machinery, equipment and parts by an industrial undertaking for its own use;
(b) fertilizer by manufacturer of fertilizer; and
(c) [motor vehicles] in CBU condition by manufacturer of [motor vehicles].]
(d) large import houses, who,-
    (i) have paid-up capital of exceeding Rs.[250] million;
    (ii) have imports exceeding Rs.500 million during the tax year;
    (iii) own total assets exceeding Rs.[350] million at the close of the tax year;
    (iv) is single object company;
    (v) maintain computerized records of imports and sale of goods;
    (vi) maintain a system for issuance of 100% cash receipts on sales;
    (vii) present accounts for tax audit every year;
    (viii) is registered with Sales Tax Department; and
    (ix) make sales of industrial raw material of manufacturer registered for sales tax purposes.]

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

(9) In this section –

"Collector of Customs" means the person appointed as Collector of Customs under section 3 of the Customs Act, 1969 (IV of 1969), and includes a Deputy Collector of Customs, an

Additional Collector of Customs, or an officer of customs appointed as such under the aforesaid section;

"value of goods" means the value of the goods as determined under the Customs Act, 1969 (IV of 1969), as if the goods were subject to *ad valorem* duty increased by the customs-duty, federal excise duty and sales tax, if any, payable in respect of the import of the goods.]

Explanation.- For the purpose of this section the expression "edible", "edible oils" includes crude oil, imported as raw material for manufacture of ghee or cooking oil.]

153. Payments for goods and services. — (1) Every prescribed person making a payment in full or part including a payment by way of advance to a resident person or permanent establishment in Pakistan of a non-resident person—

(a) for the sale of goods;
(b) for the rendering of 3[or providing of services;
(c) on the execution of a contract, other than a contract for the [sale] of goods or the rendering of or providing of services,

shall, at the time of making the payment, deduct tax from the gross amount payable at the rate specified in Division III of Part III of the First Schedule.

(1A) Every exporter or an export house making a payment in full or part including a payment by way of advance to a resident person or permanent establishment in Pakistan of a non-resident person for the rendering of or providing of services of stitching, dying, printing, embroidery, washing, sizing and weaving, shall at the time of making the payment, deduct tax from the gross amount payable at the rate specified in Division IV of Part III of the First Schedule.

(2) The gross amount payable for a sale of goods shall include the sales tax, if any, payable in respect of the sale.

(4) The Commissioner may, on application made by the recipient of a payment referred to in sub-section (1) and after making such enquiry as the Commissioner thinks fit, allow, by order in writing, any person to make the payment without deduction of tax.

(5) Sub-section (1) shall not apply to –

(a) a sale of goods where –
  (i) the sale is made by the importer of the goods;
  (ii) the importer has paid tax under section 148 in respect of the goods; and
  (iii) the goods are sold in the same condition they were in when imported;
(b) a refund of any security deposit;
(ba) a payment made by the Federal Government, a Provincial Government or a [Local Government] to a contractor for construction materials supplied to the contractor by the said Government or the authority;]
(bb) a cotton ginner who deposits in the Government Treasury, an amount equal to the amount of tax deductible on the payment being made to him, and evidence to this effect is provided to the ―prescribed person;]
(c) the purchase of an asset under a lease and buy back agreement by a modaraba, leasing company, banking company or financial institution; or
(d) any payment for securitization of receivables by a Special Purpose Vehicle to the Originator.

(6) The tax deducted under this section shall be a final tax on the income of a resident person arising from transactions referred to in sub-section (1) or (1A):

Provided that sub-section (6) shall not apply to companies in respect of transactions referred to in clause (b) of sub-section (1) [Provided further that this sub-section shall not apply to payments received on account of—

(i) advertisement services, by owners of newspapers and magazines;
(ii) sale of goods and execution of contracts by a public company listed on a registered stock exchange in Pakistan; and
(iii) the rendering of or providing of services referred to in sub-clause (b) of sub-section (1):

Provided that tax deducted under sub-clause (b) of subsection (1) of section 153 shall be minimum tax.]

(6A) The provisions of sub-section (6) in so far as they relate to payments on account of supply of goods from which tax is deductible under this section shall not apply in respect of [a company] being a manufacturer of such goods.

(8) Where any tax is deducted by a person making a payment to a Special Purpose Vehicle, on behalf of the Originator, the tax is credited to the Originator.

(9) In this section, "prescribed person" means –

(a) the Federal Government;
(b) a company;
(c) an association of persons [constituted by, or under,] law;
(cc) a non-profit organization;
(d) a foreign contractor or consultant;
(e) a consortium or joint venture;
(f) an exporter or an export house for the purpose of sub-section (1A) ;
(g) an association of persons, having turnover of fifty million rupees or above in tax year 2007 [or in any subsequent tax year];
(h) an individual, having turnover of fifty million rupees or above in the tax year 2009 or in any subsequent year.]

(11) "services" includes the services of accountants, architects, dentists, doctors, engineers, interior decorators and lawyers, otherwise than as an employee.

"sale of goods" includes a sale of goods for cash or on credit, whether under written contract or not.

"manufacturer" for the purpose of this section means, a person who who is engaged in production or manufacturing of goods, which includes-

(a) any process in which an article singly or in combination with other articles, material, components, is either converted into another distinct article or produce is so changed, transferred, or reshaped that it becomes capable of being put to use differently or distinctly; or

(b) a process of assembling, mixing, cutting or preparation of goods in any other manner.]

154. Exports. — (1) Every authorized dealer in foreign exchange shall, at the time of realization of foreign exchange proceeds on account of the export of goods by an exporter, deduct tax from the proceeds at the rate specified in Division IV of Part III of the First Schedule.

(2) Every authorized dealer in foreign exchange shall, at the time of realization of foreign exchange proceeds on account of the commission due to an indenting commission agent, deduct tax from the proceeds at the rate specified in Division IV of Part III of the First Schedule.

(3) Every banking company shall, at the time of realization of the proceeds on account of a sale of goods to an exporter under an inland back-to back letter of credit or any other arrangement as prescribed by the [Board], deduct tax from the amount of the proceeds at the rate specified in Division IV of Part III of the First Schedule.

(3A) The Export Processing Zone Authority established under the Export Processing Zone Authority Ordinance, 1980 (VI of 1980), shall at the time of export of goods by an industrial undertaking located in the areas declared by the Federal Government to be a Zone within the meaning of the aforesaid Ordinance, collect tax at the rate specified in Division IV of Part III of the First Schedule.]

(3B) Every direct exporter and an export house registered under the Duty and Tax Remission for Exports Rules, 2001 provided in Sub-Chapter 7 of Chapter XII of the Customs Rules, 2001 shall, at the time of making payment for a firm contract to an indirect exporter defined under the said rules, deduct tax at the rates specified in Division IV of Part III of the First Schedule.]

(3C) The Collector of Customs at the time of clearing of goods exported shall collect tax from the gross value of such goods at the rate specified in Division IV of Part III of the First Schedule.]

(4) The tax deducted under [this section] shall be a final tax on the income arising from the [transactions referred to in this section].

113A. Tax on Income of certain persons. — (1) Subject to this Ordinance, where a retailer being an individual or an association of persons has turnover upto rupees five million for any tax year, such person may opt for payment of tax as a final tax at the rates specified in Division IA of Part I of the First Schedule.

(2) For the purposes of this section, —

(a) "retailer" means a person selling goods to general public for the purpose of consumption;

(b) turnover shall have the same meaning as assigned to it in sub-section (3) of section 113.

(3) The tax paid under this section shall be a final tax on the income arising from the turnover as specified in sub-section 1[(1)]. [The retailer shall not be entitled to claim any adjustment of withholding tax collected or deducted under any head during the year.

233. Brokerage and commission. — (1) Where any payment on account of brokerage or commission is made by the Federal Government, a Provincial Government, a [Local Government], a company or an association of persons constituted by, or under any law (hereinafter called the "principal") to a person (hereinafter called the "agent"), the principal shall deduct advance tax at the rate specified in [Division II of] Part IV of the First Schedule from such payment.

(2) If the agent retains Commission or brokerage from any amount remitted by him to the principal, he shall be deemed to have been paid the commission or brokerage by the principal and the principal shall collect advance tax from the agent.

(3) Where any tax is collected from a person under sub-section (1), the tax so collected shall be the final tax on the income of such persons.

Clause (21) of Part III to the Second Schedule: In the case of any resident person engaged in the business of shipping, a presumptive income tax shall be charged in the following manner, namely:-

(a) ships and all floating crafts including tugs, dredgers, survey vessels and other specialized craft purchased or bare-boat chartered and flying Pakistan flag shall pay tonnage tax of an amount equivalent to one US $ per gross registered tonnage per annum; and

(b) ships, vessels and all floating crafts including tugs, dredgers, survey vessels and other specialized craft not registered in Pakistan and hired under any charter other than bare-boat charter shall pay tonnage tax of an amount equivalent to fifteen US cents per tonne of gross registered tonnage per chartered voyage provided that such tax shall not exceed one US $ per tonne of gross registered tonnage per annum:

Provided that the reduction under this clause shall not be available after the 30th June, 2020.

*Explanation***.-** For the purpose of this clause the expression “equivalent amount” means the rupee equivalent of a US dollar according to the exchange rate prevalent on the first day of December in the case of a company and the first day of September in other cases in the relevant assessment year.”]