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Abstract

The paper provides a detailed assessment of tax expenditures in Pakistan, including an appropriate definition, framework and a methodology for measuring tax expenditures.

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Table of Contents

Executive Summary

Over the past few years, a tax expenditure budget is routinely estimated by FBR and reported in the Pakistan Economic Survey. However, these estimates are incomplete and only a second-best approximation as they do not include a definition of tax expenditures and the methodology used to estimate them. In an effort to overcome these shortcomings, a study is conducted to provide a more detailed assessment of tax expenditures in Pakistan for Financial Year 2011-12, reviewing the definition, coverage and methodology. The year 2011-12 has been chosen due to the availability of complete annual data on tax collections.
It may be recollected that reduction in tax liabilities resulting from various tax preferences such as preferential tax rates, exemptions, deductions, rebates, deferrals, credits, etc. are often used by governments to achieve certain fiscal and social objectives. However, these objectives could also be achieved by using government expenditures programs, hence the name tax expenditures. Tax expenditures are therefore generally reported by countries as part of the budget process. Considerable effort is required to develop and establish a suitable framework to identify, measure and critically assess the merits of tax expenditures on an annual basis. It is encouraging that Pakistan is committed to increasing the transparency of tax policy by providing detailed estimates of tax expenditures.

There is no official definition of tax expenditure in Pakistan. Technically tax expenditures are the gap between potential tax revenue, which does not contain preferential tax provisions, and the net tax revenue or the tax revenue received. In the present study tax expenditure is defined as, "*the tax revenue loss resulting from those preferential provisions of the law that provide certain taxpayers/class of taxpayers or certain sectors with concessions that are not available to other taxpayers or sectors and that results in the collection of fewer tax revenues than would be collected under the basic tax structure"*. The basic tax structure or more commonly 'the benchmark tax' is the one that normally applies to all taxpayers and comprises the main revenue raising components of the tax system. The benchmark tax includes, "*the rate structure, accounting conventions, the deductibility of compulsory payments, and provisions to facilitate administration and provisions related to international fiscal obligations"*. Certain provisions included in the benchmark tax are intended to make the tax system more equitable, fair and easy to administer. In the tax structure of Pakistan, exemptions/concessions are provided in three ways; through various provisions of the law, through various schedules attached to the law or through various SROs that issued from time to time.

As an initial effort, tax expenditures for fiscal years 2011-12 are estimated to be Rs 511 billion. This should be considered as lower bound estimate given data limitations and the resulting choices in methodology. This estimate accounts for tax expenditure provided for in three of the major taxes in Pakistan, namely the personal and corporate income tax, sales tax and customs duties. The tax expenditure estimates for these three taxes are reported separately.

Income Tax
Pakistan's direct tax system consists of a classical income tax, which subjects all income from salaries, business, investment (dividends, interests, rent, royalties), employment related benefits and capital gains as income. However, under Income Tax Ordinance, 2001 various tax expenditures are allowed to Individuals, Association of Persons (AOP) and the corporate taxpayers. Using tax data from actual income and corporate tax returns, it has been estimated that tax expenditure worth Rs.153.13 billion have been granted during 2011-12. Nearly three-fourths of this is attributed to the corporate sector and the rest originates from individuals and AOPs. The heads under which these expenditures are granted are identified in Tables 3 and 4 and the amount for each head has also been reported there.

Sales Tax

Sales tax or GST is imposed on the supply and import of taxable goods. Sales tax exemptions are given at the import stage and on domestic supply of goods and services. Under the existing tax law and rules, certain supplies are either exempt or allowed to be made at a reduced rate which are deemed for purposes of this study to be tax expenditures. Estimates of tax expenditures in sales tax are carried out separately for sales tax on imported supplies and sales tax on domestic supplies as the exemption/concessional provisions differ in these two cases. Tax expenditures worth Rs. 230.27 billion were granted to sales taxpayers during 2011-12. These tax expenditures are estimated on the basis of data reported in GD (Goods Declaration) along with the relevant SRO are given in Table 5 for the import stage of the sales tax. For the domestic stage of the sales tax, tax expenditures have been estimated for four sectors where there is a reduced sales tax rate and some items in the Sixth Schedule. The Sales Tax Model is based on Input-Output tables and sales tax return data are used to compute these estimates. The details are reported in Tables 5, 6 and 7.

Customs Duties

Under the Customs law, exemptions or concession are granted to goods that are imported into Pakistan through SROs, special classification in Chapter 99 of Pakistan Customs Tariff published each year by FBR, and/or through specific rate of tariff. On the basis of these provisions, the tax expenditures under Customs have been estimated to be Rs. 128 billion for 2011-12. Again GD (Goods Declaration) data has been used for these estimates. The details are given in Table 9.

Introduction

1. **The problems of high fiscal deficit, high current account deficit, and high inflation faced by the government of Pakistan today are linked, in one way or another, to Pakistan's weak tax revenue effort.** Increasing the tax to GDP ratio is thus one of the necessary policy adjustments to overcome Pakistan's macroeconomic weaknesses and to safeguard sustained development. Funding public spending through higher fiscal deficits runs the risk of ending up with twin deficits – fiscal deficits and trade deficits -- and inflation. Financing economic development has to come from mobilizing revenues through tapping tax bases in a sustainable manner. Yet, Pakistan's tax collections have failed to improve since the late 1990s. Structural problems, such as narrow tax bases, tax evasion, distrust public institutions by taxpayers or low tax morale, and administrative weaknesses, have taken a toll on tax collection. The tax-to-GDP ratio declined from 10.6 percent in 1999/2000 to 9.5 percent in 2011/12. International experience shows that the simple average of the tax-to-GDP ratio in Bangladesh, India, Nepal and Sri Lanka with similar tax policies and administrative capacity is systematically higher than in Pakistan. Furthermore, countries like India, Thailand, Turkey and South Africa experienced rapid growth and rising tax ratios, while Pakistan saw tax collection rising just in line with economic growth. Over the next five years, Pakistan's development needs require that the tax-to-GDP ratio should increase by at least 5.0 percentage points over and above the GDP growth rate. This would increase Pakistan's tax effort to about 14 percent of GDP, roughly equal to the simple average of tax collections in Bangladesh, India, Nepal, Sri Lanka and Indonesia.

2. **There are concerns that revenue in Pakistan is raised in an inefficient way by favoring certain sectors and economic activities over others.** Some sectors are much more heavily taxed compared to their contribution to GDP than other sectors. An estimate by FBR for the year 2006-07 shows that agriculture accounts for about one-fifth of GDP, yet not more than 1 percent in FBR tax revenues. Services make up almost half of economic value added, but only one quarter of federal (& provincial) taxes due to the low tax receipts from wholesale, retail, and transport. The main reason for this mismatch and low tax effort in Pakistan is attributable to large tax exemptions. As Pakistan's tax rates are not unusual by international standards, the low tax-to-GDP ratio is linked to the narrow effective tax base. The effective tax base is narrow as many economic activities are lightly taxed or exempt by law. The result is that growing activities in Pakistan are exempt from tax which undermines the buoyancy of the tax system. This applies in particular to financial services such as the stock exchange and real estate over the last few years.

3. **Widespread tax exemptions and concessions lead to large tax expenditures.** In the federal tax structure, tax exemptions come in different shapes and forms, including concessions, special regimes, and incentives, but they all amount to an exemption from certain taxes that the tax authorities would otherwise collect from an individual or an organization. While they are part of the government's fiscal activity, they may go unnoticed because the revenue foregone does not explicitly appear in the budget as government spending.

4. **Study of tax expenditures is a relatively recent area of interest in developing countries.** Tax expenditures are one of the many tools that governments use to foster and encourage economic sectors, activities, regions or agents. Reduction in tax liabilities resulting from various tax preferences such as

preferential tax rates, exemptions, deductions, rebates, deferrals, credits etc. are often used to achieve certain fiscal and social objectives. The analysis of tax expenditure not only gives additional information about actual budget expenditures that is not reflected in the spending programs of the government but also identify potential sources of revenue. Such information is important for the government to maintain efficiency, accountability and fiscal transparency. If used properly, tax expenditures can play an important role in helping implement policy priorities.

5. **However, the tax policy should not act as a substitute for a spending program.** There is a growing debate that social objectives should be met through expenditure policies rather than subsidies in the form of tax expenditures. In terms of efficiency, tax expenditures generally have regressive effect. Subsidy given in the form of tax expenditure is equivalent to the marginal tax rate paid by a taxpayer. Because income tax rates are progressive, higher income tax payers enjoy a larger subsidy. For instance a taxpayer in the 35% bracket would avoid Rs.35 in income taxes for each Rs. 100 given as charitable contribution is excluded from tax. Whereas, a taxpayer in the 10% bracket would avoid only Rs.10 for the same contribution.

6. **Care should also be taken that at times tax expenditure has a destabilizing effect instead of stimulating the economy.** As argued by (Listokin, 2012) most tax expenditures especially in case of income tax are procyclical, which exacerbate the business cycle. The income taxes have an automatic stabilizing effect. With rising incomes, disposable incomes rises less because a larger part of income is paid as tax. However, tax expenditures such as charitable contributions or loans for home building vary with the business cycle being higher at business cycle peaks than at business cycle troughs. By allowing charitable contributions tax deductible, government intends to support provision of public goods. But donations are a function of income and a negative shock to income would lead to lower contributions. This would mean decrease in provision of public goods. As a result, tax expenditure would be procyclical, rising sharply during booms and falling during recessions.

7. **It is also advocated that spending programs delivered through tax expenditures should be integrated into the expenditure management system.** This has an advantage of encouraging a comprehensive approach in an expenditure reduction/containment exercise in terms of equity, effectiveness and efficiency. By considering both tax and expenditure initiatives, the burden of controlling spending or achieving deficit reduction targets will be spread more fairly across the beneficiaries of government spending. Moreover, the perceived fairness of the exercise would make it easier to implement the required changes. And by identifying the least effective spending and tax measures, the economic cost of expenditure reduction can be minimized.

8. **The assessment of tax expenditures is often complicated. Since reporting and accounting practices fall far short of what is used for offici**al government expenditures, this makes it difficult, if not impossible, to evaluate the cost, efficiency and distributional impact of tax expenditures. This lack of transparency may invite fiscal opportunism through exemptions for special interest groups. The political economy of granting tax exemptions/concessions is simple but powerful. While the benefits of exemptions/concessions are highly concentrated among the members of the interest group, the costs are often dispersed among all taxpayers. Establishment of an effective and efficient tax system by giving special attention to tax expenditures therefore can play an

important role in developing countries like Pakistan which faces challenges in collecting taxes due to the shadow economy and increased integration with the world economy.

9. **The Government has embarked on the preparation of a report on tax expenditures.** A report on tax expenditures was prepared by the Ministry of Finance in 2011/12. The present study is designed to support the Government's tax reform program, as part of the activities considered in the Project Advance for Revenue Mobilization project. An ad hoc Working Group on Tax Expenditures composed of officers from FBR and the Ministry of Finance has been constituted to undertake this study. The report has been prepared by the consultants as per the terms of reference.

A. Objectives of the Study

10. **The purpose of the study is to undertake a detailed assessment of tax expenditure in Pakistan, including an appropriate definition and methodologies for measuring tax expenditures.** The conceptual framework is provided by the OECD Manual. The broad objectives of the study are summarized as follows:
    - A proper definition of tax expenditure.
    - A full inventory and aggregated overview of tax expenditure measures currently in effect under the income tax, sales tax and customs duties,
    - Development of a methodology and estimation of tax expenditures for the three major taxes.
    - Recommendations for improvements in ongoing and future efforts to estimate tax expenditures and suggestions for withdrawing certain exemptions/concessions in the tax system.

B. Definition of Tax Expenditure

11. **There is no legally stated definition of what constitutes a tax expenditure in Pakistan**. Generally speaking tax expenditures are "provisions of tax law, regulations or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax" (Anderson, 2008). The Public Sector Accounting Standard Board[1] defines tax expenditures as "those preferential provisions of the law that provide certain taxpayers with concessions that are not available to others". Technically, tax expenditures may be defined as the gap between potential tax revenue, which does not contain special tax provisions, and the net tax revenue or the tax revenue received.

12. **There is no globally agreed definition of tax expenditures.** The definition of a tax expenditure differs among countries. Among the OECD countries, Canada defines a tax expenditure as deviations from the benchmark tax system. The tax

[1] The International Public Sector Standard Board (IPSASB) develops high quality Public Sector Accounting Standards, guidance and resources for use by the public sector entities around the world for preparation of general purpose financial statements.

expenditures are defined in France as legal or statutory measures whose implementation induces lower tax revenue for the state in comparison with the application of the benchmark or norm. Japan's legally defined analogue to tax expenditure is "Special Tax Measures." These are provisions that take exception to Japan's fundamental tax principles (equity, neutrality and simplicity) to pursue some other policy objectives. In the United States according to the Congressional Budget and Impoundment Control Act, 1974 (Budget Act), a tax expenditure is defined as "revenue losses attributed to provisions of the federal tax laws which allow a special exclusion, exemption or deduction from gross income or which provide a special credit, a preferential rate of tax or a deferral of tax liability". In South Asia including India, Pakistan and Bangladesh, tax expenditures are not legally defined. These countries do provide estimates of tax expenditures and report them regularly in the budget but in many cases they do so without adopting a well-defined and consistent methodology. According to an OECD report, tax expenditure can take any of the following forms:

- Exemptions: revenue or transactions that are excluded from tax base.
- Allowances: amounts that can be deducted from the tax base.
- Credits: amounts that can be deducted from the tax liability.
- Rate relief: rates lower than those applied generally.
- Deferral: postponement or delay in tax payment.

13. **Identification of a "benchmark tax" is the starting point for classification of tax expenditures in a tax system**. Identifying tax expenditures requires judgment regarding the definition of the benchmark tax; there is no universally accepted definition of the benchmark tax that one can appeal to in classing tax provisions as tax expenditures. The definition of the benchmark is not the same in all countries. As a general principle, "structural elements of a tax system should not be recorded as tax expenditures, while programmatic features should be" (OECD, 2010). According to Kraan (2004), "the benchmark tax includes: the rate structure, accounting conventions, the deductibility of compulsory payments, provisions to facilitate administration and provisions related to international fiscal obligations." Canada includes in the benchmark income tax existing tax rates, tax units as individual, time frame as calendar year and partially inflation adjusted tax base. For the GST, Canada's reference tax system is a broad-based, multistage (with credit relief for business inputs) value-added tax, collected according to the destination principle. In France, a general measure which benefits a large majority of taxpayers is considered part of the benchmark tax or norm. Thus, such provisions which reduce the tax burden on capital income or special allowances for handicapped persons or single parents are not included in the benchmark tax.

C. Pakistan's Taxation Structure and the Exemption Regime

14. Before defining a tax expenditure for Pakistan and describing the benchmark tax, it would be appropriate to first look at the basic tax structure and exemptions and concessions provided in the system under various tax laws. Generally, exemptions/concessions are provided in three ways:
    (a) Through various provisions of the law.
    (b) Through various Schedules attached to the law.
    (c) Through various SROs issued from time to time.

C.1. Direct Taxes

15. **Pakistan's direct tax system consists of a classical income tax.** It subjects all heads of income i.e., income from salaries, business, investment (dividends, interests, rent, royalties), employment related benefits and capital gains as taxable income. There are different rules for determining income chargeable to tax according to the heads of income. Some of the major elements of the system and provisions for exemption/reduction are the following:

   a. Companies including banks are subject to a flat tax rate. Incomes of individuals and associations of individuals are subject to progressive tax rates.
   b. A resident is liable to tax on worldwide income; whereas, the nonresident person is liable to tax on only the Pakistani source income.
   c. There are two different methods to determine the tax liability; the normal tax regime (NTR) and the fix tax regime (FTR). Under the NTR, net chargeable? Income is determined after allowing admissible expenses/deductions against gross receipts from a source of income. Tax is charged on the net income at the applicable rates. Under the FTR or withholding taxes (WHT), tax is deducted at source from the gross amount according to the source of income and is deemed to be the final discharge of tax liability.
   d. Capital gains including all kinds of property and personal effects are taxable at the standard rate, however there are certain exemptions under the Second Schedule.
   e. Dividends are subject to 10% rate of duty. A concessionary rate of 7.5% is applied to certain dividends.
   f. The law exempts certain incomes based on the nature of the industry, its location and for specified periods.
   g. Generally, all expenses incurred for the purpose of business or for deriving certain income are deductible.
   h. The law also provides for deductibility of capital expenditures used in a business or profession and amortization of intangibles.
   i. A loss from any source, except speculation losses or capital losses can be set off against the source of income in the same tax year. Unabsorbed losses can be carried forward for set off for future business income for up to six years.
   j. Unabsorbed tax depreciation, initial allowances and amortization of intangibles can be carried forward indefinitely. Similarly business can be carried forward indefinitely by industries located in Export Processing Zones. There is no concept of carry back of losses in Pakistan.
   k. Depreciation of assets used in a business or profession is allowed at rates between 10-100%. The law also allows initial allowances of 50% or 90% of the cost (in case of plant, machinery and equipment in specified rural areas) for the first time in a tax year.

C.2. Sales Tax

16. **Sales tax is imposed on supply, import, production and manufacturing of taxable goods and provision of specified taxable services.** Major provisions of the law are as follows:

   a. A standard rate of 16% is applied to the actual or deemed value of the supplies.
   b. A zero rate applies to all exports. A rate of zero percent is also applicable for raw materials and finished goods of the specified export oriented

industries[2] and certain supplies included under the Fifth Schedule to the Act.

c. Reduced rates are applied to retailers and certain other supplies.
d. A list of exempt goods is given in the Sixth Schedule to the Act.
e. Import of certain goods is exempt under various SROs.
f. Sales tax paid at the import or local purchase stage can be adjusted as input tax against the output tax, provided the goods produced with these inputs are taxable and are supplied by a registered person.
g. Sales tax is not applicable on supply of goods by suppliers or retailers if their annual turnover over is less than Rs. 5 million.
h. Special procedures are applied to specified goods and services where tax is charged at reduced rate on some goods.

C.3. Customs Duties

17. **Customs duties are levied on imports to Pakistan.** Pakistan's present tariff structure has 6,808 tradable tariff lines (at HS-8 level). The tariff structure has the following characteristics:
    a. The existing tariff structure is based on a cascading principle, i.e. lower duty rates on raw materials and higher duty rates on finished products, with certain exceptions for protection of local industry. Although the average tariff rate is 14.6%, there are tariff peaks i.e. rates above 25% or special rates. There are 9 special tariff slabs mainly for the auto sector, alcoholic beverages and edible oils. The maximum tariff rate is 100%.
    b. Under the law, there are three different ways in which an exemption or concession is granted to goods that are imported into Pakistan:
        i. Through SRO's.
        ii. Through special classification in Chapter 99.
        iii. Through specific rates of tariff i.e. application of specific rates of duty on some products.

D. Tax Expenditure Definition for Pakistan

18. **For purposes of the present study a tax expenditure is defined as, "***the tax revenue loss resulting from those preferential provisions of the law that provide certain taxpayers/class of taxpayers or certain sectors with concessions that are not available to other taxpayers or sectors and that results in the collection of less tax revenue than would be the case otherwise."* This means that in this study all those tax provisions under various tax laws provided to certain categories of persons, certain sources of income, certain categories of goods/ services, certain geographical areas either through total exemption or rate reduction reduce tax liability of taxpayers are categorized as tax expenditures.

19. **The basic tax structure or more commonly 'the benchmark tax' is the one that normally applies to all taxpayers and comprises the main revenue raising components of the tax system.** The benchmark tax includes, "*the rate structure, accounting conventions, the deductibility of compulsory payments, and provisions to facilitate administration and provisions related to international fiscal obligations."* Certain provisions in the tax laws though internationally categorized as tax expenditures have been included in the benchmark tax. In the case of the income tax for instance, different sources of

[2] This includes textile, carpets, sport goods, surgical goods and leather & leather products

income (salaries, business, investment etc.) are not integrated. Certain incomes are subject to separate charges i.e. dividends, royalty, fee for technical services, shipping and air transport income of nonresidents. They do not form part of total income or chargeable? Income and are subject to tax on the basis of gross income. Similarly, certain incomes are treated as final tax liability and are deducted at source i.e. incomes arising from import of goods, supply of goods, execution of contracts, services, export realizations, brokerage and commissions, plying of transport vehicles, profit on debt and prizes and winnings. In addition to separate charges or final tax, certain incomes are also treated as a separate block. These are the incomes which are excluded from the chargeable income for the purpose of calculation of tax and are charged at varying rates depending upon the nature of such incomes i.e. arrears of salary, flying and submarine allowances, property income, business income of retailers, manufacturers of cooking oil, capital gains, etc. All these various treatments of income are included in the benchmark tax for the income tax. Two different individual income tax schedules i.e. salaried and non-salaried and two different tax rates for small and large companies are also part of the benchmark tax.

20. All these elements of the benchmark tax are summarized in the following table.

Table 1: The Benchmark Tax

	Income tax	**Customs**	**Sales Tax**
Tax Base	All income from salaries, business and investment	All imports/exports into/out of Pakistan	All supplies and import, of taxable goods and specified taxable services
Rate Structure	1. 35% for company and 25% for small company 2. 0.5-20% for salaried and 0.5-25% for non-salaried 3. Withholding rates	Tariff ranges from 5-25% with peak at 100%	16% for domestic supplies as well as imports
Deductions	Business Expense, Depreciation		Input tax
Threshold	Rs. 400,000		Rs. 5 million for retailer Rs. 2.5 million for manufacturer
Time	12 months, calendar year	Clearance for home consumption	Monthly
Hard to tax areas/ administrative considerations	Deduction of tax at source		Deduction of tax at source/special procedures
International Commitments	Double taxation treaties	International organizations	International Organizations

21. **The income tax base includes all income from salaries, business, investment (dividends, interests, rent, royalties), employment related benefits and net realized capital gains.** Deductions are allowed for all costs

of producing income. No deduction is allowed for personal consumption expenses. Capital expenditures on business assets are allowed to be deducted over the estimated useful life of the asset using the straight line/diminishing value method. The tax unit is the individual and the tax period is the calendar year (January 1 to December 31. A standard rate of 35% for large companies and 25% for small companies is applied to chargeable income. For individual progressive rates ranging from 0.5-20% for salaried and 0.5-25% for non-salaried individuals. A minimum tax free threshold is Rs. 400,000 for individuals and AOPs. Although the tax is in principle global in its reach, stock market capital gains, property, or rental, income is taxed under a separate schedule as are dividends, interest and lottery earnings. Advance payment of tax and deduction of tax at source is applied at various rates on cash withdrawals from a bank, bank transactions, purchase of motor car, brokerage and commission fees, collection of tax by stock exchange, tax on motor vehicles, CNG stations, electricity consumption, telephone users, sales by auction and purchase of airline tickets.

22. **Sales tax base includes all supplies, import, production and manufacturing of taxable goods and specified taxable services.** The benchmark rate is equal to the standard rate of 16%. Sales tax at import stage is paid at the same time and in the same manner as it is customs duty. For domestic supplies made during a month the tax is paid at the time of the filing of return. The person making taxable supplies is entitled to adjust against the output tax the tax paid on acquisition of inputs used for the purpose of taxable supplies. He/she should have valid invoices in case of domestic supplies or bill of entry in case of imports to claim input adjustment.

23. **For Customs the benchmark tax includes all imports coming into Pakistan**. Pakistan's present tariff structure has 6808 tariff lines (at HS-8 level). The existing tariff structure is based on the cascading principle, i.e. lower duty rates on raw materials and higher duty rates on finished products, with certain exceptions for protection of local industry. Although the average tariff rate is 14.6% there are tariff peaks i.e. rates above 25% or special rates. There are 9 special tariff slabs mainly for the auto sector, alcoholic beverages and edible oils. The maximum tariff rate is 100%.

E. Number of Tax Expenditures

24. **The stated objective of tax expenditures in Pakistan's tax system is to provide incentives for accelerated industrialization, to attract foreign investment and to ensure security of low-income groups.** However, due to lack of oversight, monitoring and evaluation, the impact is not as intended by the government. In this report, tax expenditures for the individual income tax, corporate income tax, customs duties and sales tax (domestic as well as import stage) are reported separately. The following is a list of tax expenditures identified under various tax laws.

E.1. Tax Expenditures under the income tax

25. Under the income tax law various tax expenditures exist for individual, Association of Persons (AOP) and corporate taxpayers. These include exemptions, concessions, deductible allowances, tax credits, zero rate income bracket, special provisions and certain withholding taxes. A brief account of the tax expenditures is enumerated below whereas a summary of tax expenditures can be seen at Annex-I.

26. **The Second Schedule of the Income Tax Ordinance 2001 presents an extensive list of exemptions and tax concessions that take up almost ninety pages of the Income Tax Manual.** This package of exemptions and concessions acts to make Swiss cheese out of the income tax base for both individuals and AOPs. These exemptions broadly include:

- Perquisites including rent and entertainment allowances for certain persons such as the President, Federal Ministers, Governors, Generals, Supreme and High Court Judges
- Certain incomes such as pensions, annuity payments, and fringe benefits provided to employees of transportation companies, schools, hospitals, hotels and restaurants and income derived from holding federal securities
- Income earned by mutual funds, venture capital or investment companies
- Income earned by technical or vocational institutes, text book boards, university established for educational purposes, organizations for promoting games
- Income earned by charitable organizations, nonprofit organizations, foundations or institutions[3]
- Income paid as donation to certain institutions, funds, foundations, societies, boards and trusts[4]
- Income derived by companies located in Export processing Zones and Industrial Zones
- Income earned by IPPs
- Income earned from export of IT services

A complete list of exemptions introduced through various SROs during FY 2012-13 can be seen at Annex-II.

27. **The Second Schedule also provides for preferential tax rates for select groups of taxpayers.** Income from construction contracts and services rendered outside Pakistan are charged at the reduced rate of 1%. A large number of withholding taxes in case of import, local supply of goods, shipping business, steel melters & re-rollers, distributors of cigarette & pharmaceutical products and advertising agents are charged at various concessional rates. Certain categories of dividends also enjoy reduction in tax rate. The details of these concessionary rates are described further in the heading withholding taxes.

28. **Part III of the Second Schedule provides certain persons or classes of persons reduction in tax liability**. Specifically, the following groups enjoy a reduction in tax liability:

- Senior citizens 50% of ordinary tax
- Teachers and researchers 75% of ordinary tax

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[3] At least 25 categories of such institutions enjoy this exemption including Pakistan Agricultural Research Council, Islamabad, Pakistan Engineering Council, Islamic Trade Finance Corporation, The Pakistan Water and Power Development Authority, The Pakistan Council of Scientific and Industrial Research, State Bank of Pakistan and State Bank of Pakistan Banking Services Corporation, International Finance Corporation and the Islamic Chamber of Commerce and Industry.

[4] There are at least 23 broad categories of such organization. Interestingly exemptions withdrawn once are re-introduced after some time such as exemption of donations made to Bank of Commerce and Credit International Foundation for Advancement of Science and Technology withdrawn through Finance Act, 2011 is again restored through S.R.O. 990(I)/2012, dated 18.10.2011.

- Distributors of cigarettes, pharmaceutical goods & fertilizers, rice mills & dealers and flour mills of 80 per cent and poultry industry of 50% of the minimum tax liability
- Oil marketing companies, oil refineries and SSGCL &SNGPL of 99.5% and PIA of 50 % of the minimum tax liability

29. **The size of the income tax base is additionally whittled away by a generous array of tax credits.** These tax credits come in various varieties:

    - A tax credit for charitable contributions to a wide range of sports, religious, cultural, welfare, medical and technology promoting organizations. The amount of the tax credit is limited by a formula which multiplies the ratio of tax liability to taxable income by a tax credit coefficient which is the lesser of the amount of the donation or thirty per cent of taxable income for a person or AOP.
    - A tax credit for investment in new shares (IPOs). For persons, but not companies the credit is limited once again by the product of tax liability to taxable income and a tax credit coefficient that is the lesser of the cost of share acquisition, fifteen per cent of taxable income or Rs.500,000. If the shares are sold within a year of purchase the value of the credit is added back to taxable income.
    - A tax credit for contributions to an approved pension fund. Here the familiar formula is the product of tax liability to taxable income and a tax credit coefficient equal to the lesser of the premium paid or twenty per cent of taxable income.
    - A tax credit for any profit or share in rent, or a share in appreciation of a house paid for by a loan from a recognized lending institution. This de facto mortgage interest credit is limited again by the ratio of tax liability to taxable income multiplied by the lesser of total interest paid, fifty per cent of taxable income or Rs.750, 000.
    - A tax credit for investment in purchase of plant and machinery for BMR of ten percent of amount invested
    - A tax credit for person registered under Sales Tax Act, 1990 of 2.5 percent of tax payable for a tax year, if ninety percent sales are to the sales tax registered persons
    - A tax credit for enlistment in stock exchange of 15 percent of tax payable
    - A tax credit for new industrial undertaking of 100 percent of the tax payable

A wealthy or high earning, taxpayer able to take advantage of all of these credits in a single tax year would have little difficulty in reducing his or her income tax liabilities to zero[5].

30. **In case of corporate income tax other than cost of sales and depreciation allowance for tangible fixed assets, generous deductions**

[5] A simple numerical example can illustrate this outcome. Suppose, as in the example given for charitable contributions, that the taxpayer has a tax liability of 20 and taxable income of 100. Suppose further that the binding limit on the tax credit is the percentage of taxable income allowed for each credit. This means that our hypothetical taxpayer pays interest on his home mortgage in excess of 40 per cent of taxable income, makes a pension contribution exceeding 20 per cent of taxable income and a donation to charity equal to 30 per cent of taxable income. Under these circumstances, assuming the nominal limits are non-binding_ the total tax credit available to the taxpayer is 1/5(.3+.1+.2+.4) x100 = 20 which is sufficient to erase all tax liability.

are allowed for certain costs such as:

- Initial allowance or the first year allowance for the first time or in the year in which the business is commenced
- Accelerated depreciation allowance
- Pre-commencement expenditure
- Interest expenses on company debt
- Expenses for research and development
- Expenses for employee training
- Dividends paid to State financial corporations that have lent funds to the business
- Bad debts
- Amount paid as Zakat
- Compulsory contributions to WWF and WPPF
- Amortization of the cost of intangible assets

31. **Treatment of foreign remittances for income tax purposes is a loophole to avoid taxation.** Under section 111(4) of the Income tax Ordinance, 2001 any amount of foreign exchange remitted to Pakistan through banking channel and is encashed into rupees by a bank is not considered an unexplained income and is not subject to tax. Pakistan annually receives more than US$ 12 billion in foreign remittances. It is feared that people white their black money by converting it into remittances through foreign exchange dealers and then make investment in assets on which tax authorities cannot ask the source of income due to this provision in the law.

32. **The zero rate bracket is another exception to the international standard which establishes a tax free income threshold at Rs. 400,000**. This limit by international standards is unusually large for wage earners. If the average monthly wage in Pakistan is about Rs.10, 000 and this monthly wage translates into an annual income of Rs. 120,000 workers earning an average wage are exempt from income taxation. Even workers earning three times the average wage are liable for no income tax. Similarly a small company defined to be one with turnover of no more than Rs.250 million and a labor force of less than 250 is not "small" when compared with the legal definition of smallness in other countries. Elsewhere, "small" almost never describes firms with more than US$ one million in turnover and more than fifty employees (if an employment restriction exists at all).

33. **Pakistan's tax laws have resorted to an extensive network of withholding measures alibi presence of large informal sector and the low compliance rates.** There are about thirty types of payments (incomes as well as transactions) that are subject to withholding taxes (WHT). An important feature of these WHT is that most of them are final tax liability irrespective of being carried out in formal or informal sector. Not only the various sources of income under these WH categories are charged at different rates but within each category discriminatory treatment for certain class of persons is introduced through allowing reduced rates. For instance there are seven different rates of withholding at import stage, 0.5%, 1%, 2%, 3%, 4%, 5% and 6% against the statutory rate of 5%. Similarly dividends are also charged at 5% and 7.5% whereas the statutory rate is 10%. In case of supplies and contracts also there are four reduced rates other than the statutory rate of 6%. Various types of WHT, the applicable standard & reduced rates and whether final or adjustable are explained in detail in Annex III.

E.2. Tax Expenditures under the Customs

34. **Tax expenditures under customs come in various forms as exemptions, concessions and goods subjected to specific rate of tariff**. Exemptions and concessions under customs can be broadly categorized as:

- Raw materials, sub components, components, assemblies and sub-assemblies
- Raw materials not manufactures locally
- Assembly or manufacture of vehicles,
- Plant, machinery and equipment
- Concessions to privileged persons and individual organizations and
- Concessional arrangements under various bilateral and Regional Agreements

These exemptions and concession are granted through various SRO's, special classification in Chapter 99 and applying specific rate of tariff.

35. **There are five major SROs allowing most of the exemption/concession**. SRO 567(I)/2006 dated May 6, 2006 allows concessional duty rate to certain products. This includes agriculture products, inputs for poultry industry, chemicals, gold, silver, pearls, precious stones, ships, aircrafts, defense stores, agriculture tractors, printing machinery gas operating generators at zero rate of customs duty and equipment used in audio & cinema industry, certain types of trucks, active pharmaceutical ingredients and packing material at 5%. SRO 565 (I)/2006 dated May 6, 2006 allows concessionary duty rates to raw materials used in manufacturing of certain industrial goods. 157 broad categories of such industrial goods have been notified with the raw materials at 8-digit running into thousands at concessionary rate of 5% and 10%. Another concessionary SRO is 575(I)/2006 dated May 6, 2006 that gives exemption to plant & machinery equipment & apparatus including capital goods. Practically all type of plant and machinery imported into Pakistan is included in this concessionary package at the rate of 0-5%. This include agriculture, plant protection, irrigation, dairy, livestock, poultry, fishery and agro based industry machinery and equipment. Moreover, CNG, hospital & medical, hotel, mineral exploration, construction, power generation, oil refinery, renewable energy and navigation equipment enjoy concessions under this arrangement. SRO 655 (I)/2006 and 656(I)/2006 both dated June 22, 2006 are meant for auto sector and allows concessionary rates to raw materials and components not manufactured locally and components imported in kit form for vehicles under chapter 87. The list of all active notifications for exemption/rate reduction on import is placed at end of the report as Annex-IV A

36. **There are various overlapping provisions and distortions in the basic scheme of SRO's.** In year 2000 an attempt was made by FBR to reduce number of SROs, and in that reform exercise various SROs were clubbed together mainly in these three SROs. Unfortunately the task of reforming the exemption regime could not be carried out further. Exemptions are generally granted to various imported goods on the basis of their tariff headings, what complicates this arrangement is the fact that there are hundreds of tariff headings in one SRO and that one particular heading appears in more than one SROs. There is an immense need to rationalize and simplify the general scheme of exemptions so that it becomes easily comprehensible, unambiguous and transparent.

37. **In addition to this, there are special classification provisions in Chapter 99 of Pakistan Customs Tariff** which defines certain categories of goods for exemption. This includes goods imported by diplomats, UN, President, government departments, EPZs and charitable & nonprofit making organizations. Ships, spares, containers, currency notes, medical equipment's, pharmaceutical raw materials, gold & jewelry are also exempt from customs duty under this provision. Moreover, some specific sectors have been granted concession by virtue of making them liable to specific rate of duty instead of ad valorem such as betel leaves, edible oils (under Ch. 15), animal or vegetable fats and cellular mobile phones. Details are provided in Annex III B and III C

E.3. Tax Expenditures under Sales Tax

38. Tax Expenditures under Sales Tax (both for import & domestic) are based on statutory and SRO based exemptions. The statutory zero rating is covered in Fifth while exemptions are allowed through Sixth schedules of the Sales Tax Act 1990. All exports are zero rated which is a standard practice in VAT internationally. However, several other items are also zero rated for import as well as domestic sales tax purposes. These items include supply and import, repair or maintenance of ships, boats, aircrafts, supply to diplomats and international tenders. A reading of the Sixth Schedule suggests that the exemptions are aimed at reducing the sales tax burden on unprocessed and unpackaged goods, inputs used mainly in the production of exempt goods, such as feed, seed, fertilizers and tractors, medical products, reading materials, public sector transport vehicles, transportation means such as buses and ships, imports purchased by hospitals, non-profit organizations, imports for disaster relief and by international agencies and plant and machinery listed in the official Gazette.

39. **A large number of exemptions and reduction in the standard rate of tax have been accorded also through a number of Statutory Regulatory Orders (SROs).**The major SROs allowing concession in rate or exemptions of sales tax on domestic supplies and import are listed as Annex IV. This includes finished products, raw materials, components, sub components, plant and machinery. Exemptions or concessionary rates are also granted to soybean, rape & sunflower seed, High Speed Diesel and cellular phones.

40. **Zero rating of goods, other than those meant for exports, is an unusual feature of domestic sales tax.** In a VAT system generally exports are zero rated. However, in Pakistan zero rating is used more extensively on domestic supplies and inputs used in manufacturing of such supplies. This started in 2004-05 with a zero rating of five export-oriented sectors. The major consideration at that point was to avoid a large amount of refunds accruing because of zero rating of the output. However, with subsequent changes in the procedures and inclusion of goods meant for zero rating has shown how this provision of law has been used by interest groups and influential lobbies to avoid taxation and create distortions in the system. An interesting example is two SROs, 1125(I)/2011 dated December 31, 2011 and 670(I)/2013 dated July 18, 2013. SRO 1125(I)/2011 provided zero rating to all the inputs used in the five export-oriented sectors which was later converted into various rates depending on whether registered as manufacturer,

importer, exporter, retailer or wholesaler[6]. SRO 501(I)/2013 dated June 12, 2013 exempted almost all the products in dairy and meat processing industry from sales tax. Later on through SRO 670(I)/2013 not only most of these goods but also their inputs were zero rated.

41. **On domestic supplies, in addition to exemptions granted under 6th Schedule, various concessionary rate**s are applied to selected commodities. The following table describes such concessional rates.

Table 2: Domestic Sales Tax Rates 2011-12

Sr. No.	Category	Rate
1	Standard Rate	16%
2	Retailers having quarterly turnover up to 1.25 m	0%
3	Retailers – with quarterly turnover exceeding Rs. 1.25 Mil and up to Rs. 2.50 Mil	0.5% of turnover exceeding Rs. 1.25 Mil
4	Retailers - with quarterly turnover exceeding Rs. 2.50 Mil	Rs. 6250 + 0.75% of turnover exceeding Rs. 2.5 Mil
5	Steel Meters and Re-Rollers	Rs. 6/- per unit of electricity consumed
6	Ship breakers	Rs. 4848 PMT
7	Steel melters producing electricity with the help of gas generators	HM3 x 1972 – sales tax paid on gas bill
8	Re-rolling mills on self-generation	Mill size (in inches) x Rs. 38964
9	Sugar	8% FED In VAT Mode
10	Reduced Rates on five sectors on local supplies	5%
11	Reduced Rates on import of seeds by solvent oil extractors canola seeds, etc.	13%, 7%.

F. Measurement Methodology

42. **Tax expenditures are calculated using the revenue forgone method**. This method calculates the tax that would have been payable if there were no tax concessions. The estimates are based on the following assumptions:

   a. The estimates are intended to indicate the potential revenue that could be gained by removing these exemptions or concessions.

[6] Since December, 2011, the SRO has been amended seven times. Various rates for different categories of registered persons have made the discharge of tax liability for the taxpayer much more complicated and cumbersome.

b. The tax expenditure for each concession is determined separately assuming that all other tax provisions remain the same. Many of the tax concessions do however, interact with each other and total impact could be different than what has been estimated for individual provisions.
c. It is also assumed that behavior of the taxpayer remains unchanged.

F.1 Income and Corporate Tax

43. **For income and corporate tax, due to lack of accurate and meaningful data, estimates of only a few of the tax expenditures could be carried out for this study.** Assessment of all tax expenditures is conducted independently based on data obtained from individual and company tax return declarations. Ideally, revenue forgone for all tax expenditures should have been estimated based on a simulation that redoes every taxpayer's tax liability by adding to the taxable base the exempt income or deductions. However, due to non-availability of disaggregated data, the estimates are obtained directly from the aggregate declarations of the taxpayers by applying a tax rate of 15% for Individuals/AOP and 30% for companies[7]. Tax expenditure on deductible allowances and exempt sources of income for individuals/AOPs and companies amounts to Rs. 73.97 billion. The results are reported in the following Table:

Table 3: Tax Expenditure Estimates for Income and Corporate Tax (Rs. Billion)

S. No.	Tax Provision	Income that is not chargeable due to the tax provision		Tax Expenditure 2011-12
		Individual/ AOP	**Company**	**Individual/ AOP**
A	**Allowances**			
1	Zakat	0.45	3.93	0.07
2	WWF	0.17	4.43	0.03
3	Charitable Donations	0.43	0.08	0.06
	Total A	***1.04***	***8.44***	***0.16***

[7] Lower rates are applied to account for adjustment of expenses.

B	***Exempt Incomes***			
1	Salary Income	11.50	N/A	1.72
2	Property Income	2.72	0.16	0.41
3	Business Income	36.02	5.53	5.40
4	Capital Gains	7.03	0.07	1.06
5	Other Sources	62.73	165.32	9.41
6	Agriculture Income	13.04	N/A	1.96
	Total B	***133.04***	***171.08***	***19.96***
C	***Tax Reduction/Credits Averaging***			***5.20***
	Total A+B	***134.09***	***179.52***	
	Total A+B+C			***25.31***
Total Individual/AOP + Company			***97.37***	

44. **WHT at various rates creates distortions in the tax system**. The setting of WHT rates is largely ad hoc and is not based on market analysis of trade margins for these sources of incomes. Moreover, whereas, some of these WHT are adjustable (creditable), most (e.g., interest, dividends and rent) are deemed to be final taxes on these sources of income thus creating another problem of fairness and transparency. Tax expenditures on these three sources of income; import, dividends and contracts is estimated to be Rs. 52.05 billion.

Table 4: Tax Expenditure Estimates for WHT

Rs. Billions

S. No	WHT	Standard Rate	Actual Rev 2011-12 (at various rates)	Estimated Rev 2011-12 (at standard rate)	Tax Expenditure
1	Import	5	70.28	99.56	29.28
2	Dividends	10	12.00	16.51	4.51
3	Contracts	6	99.32	117.57	18.25
	Total		***181.59***	***233.64***	***52.04***

Income earned through export of IT services is exempt from income tax under Second Schedule up to 2016. As indicated by State Bank export of services data for year 2011-12, the value of export of IT services is US$ 248 million. Allowing for 40% of the value as business expenses and applying a tax rate of 25%, the tax expenditure comes to about Rs. 3.72 billion.

F.2 Sales Tax Import

45. **Estimates of tax expenditure in GST at import stage are done through Goods Declaration data.** The difference between the effective rate of sales tax and statutory rate of sales tax is taken as the revenue forgone. SRO based estimates of tax expenditure are presented in the Table below:

Table 5: Tax Expenditure Estimates for Sales Tax Import

Rs. In Billion

S.No	SRO	Description (Concessions available to)	Tax Expenditure
1	SRO1007(I)/2005		0.99
2	SRO115(I)/2008	Gwader Port	0.04
	SRO 575(I)/2006	Plant & machinery	22.14
3	SRO283(I)/2011	Five Zero-rated Sectors	7.02
4	SRO326(I)/2008	Export Oriented Units	0.13
5	SRO483(I)/2008	Machinery & Equipment	0.22
6	SRO539(I)/2008	Inputs of Dextrose & Saline Infusion Sets	0.16
7	SRO542(I)/2008	Cellular Phone sets	9.80

8	SRO551(I)/2008	Import of specified items	16.36
9	SRO509(I)/2008		0.04
10	SRO69(I)/2006		0.55
11	SRO811(I)/2009	Zero rate on Polyethylene & Polypropylene	0.30
12	SRO863(I)/2007	Raw Materials & Sub Components	0.28
13	SRO880(I)/2007	Diagnostic Kits & Equipment's	0.37
		Total	***58.40***

F.3 Sales Tax Domestic

46. **For estimates of domestic tax expenditures under the sales tax, a detailed analysis is carried out using an Input-Output model**. Input-Output (I-O) models are generally used to estimate the potential sales tax revenue from a VAT, tax gap analysis and revenue cost of VAT exemptions. Robina Ahmed and Mark Rider (2013) used an I-O model to calculate Pakistan's tax gap and cost of exemptions by comparing the actual and potential VAT revenues for Pakistan. Similarly, Tuan Minh Le (2007) estimated Romania's VAT base and tax gap using an I-O table. Glenn P. Jenkins and Chun-Yan Kuo (2002) estimated Nepal's sales tax gap by using IO Model.

47. To estimate tax expenditures under the domestic sales tax, we use a detailed Input-Output table including 81 X 81 sectors of Pakistan's economy. The Input-Output table not only provides information on total use or gross sales for each of the 81 sectors in the table, but it also provides crucial information on the value of primary and intermediate use, the value of imports and exports, and the value of investment expenditures. In other words, the I-O table provides the necessary information to model Pakistan's potential sales tax base, including taxable supplies, input credits, and refunds on exports. The most recent I-O table of Pakistan's economy is for 1989-90.[8] The study updated this model to reflect the level of economic activity for 2011-12, using ratios and relationships from the 1989-90 model and 2011-12 national accounts data.

48. By using 1989-90 input output tables as a base we have carried out the following steps to estimate the tax expenditures for the domestic sales tax.

1. Update to 2011-12: The I-O table has been updated by using ratios and relationships from the 1989-90 model and 2011-12 national accounts data.
2. Potential Sales Tax: A sales tax model based on I-O table, taxable activity in the economy, tax rate and taxable sectors is designed to estimate potential output sales tax
3. Adjustment for threshold: The potential sales tax is then adjusted for sector by sector economic activity above threshold level as defined by sales tax law
4. Input tax: Input tax is calculated separately to be adjusted against the output tax
5. Identification of exempt sectors: Sectors exempted under the 6th Schedule of the Sales Tax Act, 1990 and under various SROs are separated as exempt sectors

[8] We obtained the FY 1989-90 I-O table from the FBS.

6. For the present exercise only five export oriented sectors, retailers, sugar and steel sector taxed at reduce rate of sales tax are selected as tax expenditures.[9]
7. Tax Expenditure: Tax expenditure for textile sectors is calculated as the difference between the revenue at reduced rate and potential revenue (adjusted for threshold and input tax) at statuary rate.
8. Tax Expenditure for steel sector is calculated as difference between actual collection at specific rate and potential revenue at statuary rate. Potential revenue is based on output of the steel sector derived from electricity consumed by the steel sector.

49. Tax expenditure on textile sectors, retailers and steel sector is reported in Table below:

Table: 6 Tax Expenditure Estimates for Sales Tax Domestic

Rs. In Billion

S.No.	Description	Tax Expenditure 2011-12
1	Reduced rate for textiles on local supply	36.30
2	Reduced rate for retailers	47.73
3	Specific rate for steel sector	5.54
4	Reduced rate for sugar	8.10
	Total	***97.67***

50. **It is appropriate to caution the reader that these results should be interpreted with some caveats.** Firstly, although we put considerable effort to update the 1989-90 I-O model to represent economic activity in 2011-12 national income accounts, however, our efforts do not capture all the structural changes to the economy that have undoubtedly occurred over the intervening years. Secondly, the assumptions for taxable use and taxable portion above threshold may not completely reflect the actual economic activity being carried out by the taxpayers. Therefore, it is quite possible that tax liability for certain sectors is overestimated and for some underestimated. Nevertheless, the methodology described here has considerable potential as a tool for identifying revenue forgone as result of exemption.

51. **Most of the agricultural produce, livestock and food products are exempt under the Sixth Schedule.** In general the agriculture and food products are exempted from sales tax in any VAT system, however, the processed foods & drinks, processed poultry & meat etc. are usually taxes at the standard rate. Tax expenditure on some of such goods is estimated using data from National Income Accounts.

[9] Five export oriented sectors include, textile, carpets, sports goods, surgical and leather products.

Table: 7 Tax Expenditure Estimates for Sixth Schedule Items
Rs. In Billion

S.No.	Exempt Items	Tax Expenditure 2011-12
1	Meat & Meat Products	37.4
2	Fruits	28.7
3	Cereals & products of Milling Industry	8.1
	Total	***74.2***

The overall tax expenditure for Domestic Sales Tax is around Rs. 171.9 billion, the highest being reduced rate applied to retailers.

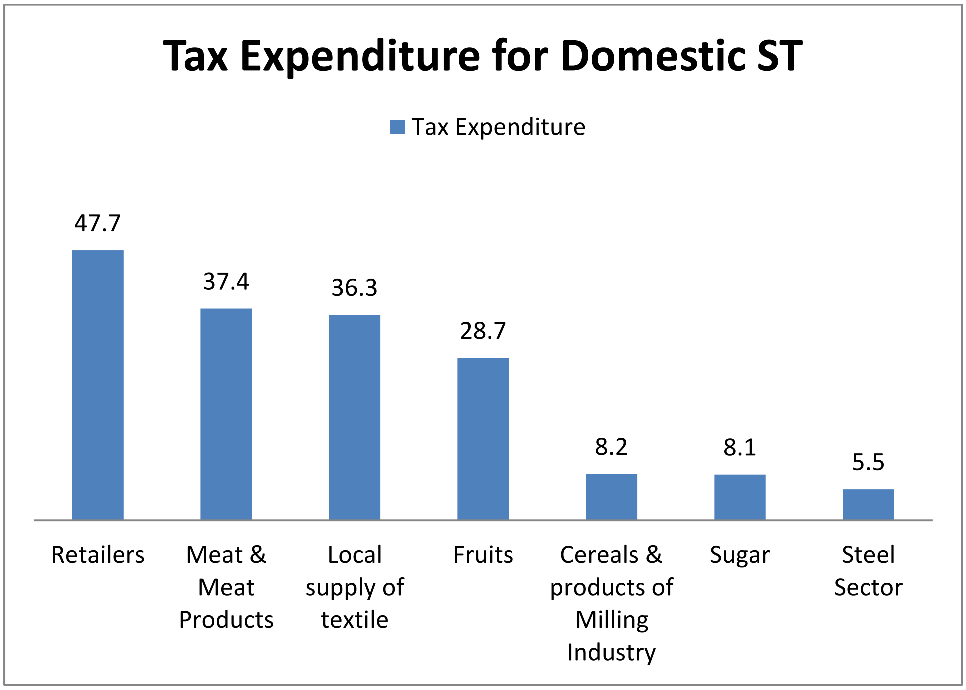

Figure 1: Tax Expenditure for Domestic Sales Tax
Source: Pakistan Economic Survey

52. **Tax expenditure on services is substantial.** Services sector in Pakistan contributes more than 55% towards GDP. However, its contribution in federal sales tax is very low. Only few services are subject to tax and that too under Federal Excise Duty collected in sales tax mode. The federal government has a constitutional right to collect taxes only on the sale of goods (imported, exported, produced, manufactured or consumed) but not on supply of services. The provincial governments have the autonomy to levy sales tax on services. Recently, provincial governments of Sindh and Punjab provinces have established Provincial Revenue Boards and started collecting sales tax on services. However, limited capacity of the provincial governments, a narrow tax base and widespread exemptions has resulted into huge tax expenditures. Using again Input Output

Model, tax expenditure for seven major services which are not yet subject to sales tax is estimated to be Rs. 82.5 billion.[10]

Table 8: Tax Expenditure under Sales Tax on Services
Rs in million

Service	Taxable use	Above Threshold	Output tax	Input tax	Net ST
Transport (Railway)	192403.8	38480.8	6156.9	2780.4	3376.5
Transport (Road)	2394236.9	478847.4	57461.7	15803.7	41658.0
Transport (Water)	5475.8	1095.2	175.2	413.8	-238.5
CMA	50674.0	10134.8	1621.6	343.4	1278.1
Public admin & defense	1284027.9	256805.6	41088.9	28340.1	12748.8
Education	281719.8	56344.0	9015.0	548.9	8466.1
Health care	168113.5	33622.7	5379.6	1538.5	3841.2
Social & cultural ser	287138.9	57427.8	6891.3	1450.5	5440.8
Personal & household	495024.0	99004.8	7920.4	1947.8	5972.6
Total	**5158814.6**	**1031762.9**	**135710.7**	**53167.2**	**82543.5**

F.4 Customs Duty

53. **Tax expenditures for customs duty are estimated based on the Goods Declaration data compiled by the PRAL.** The following steps were involved:
    - Data includes One- Customs data only
    - The total import value and duty collected under each SRO is calculated.
    - Effective rate is calculated by dividing the duty collected with import value
    - Duty under statutory rate applied to each tariff line within each SRO is calculated.

[10] For estimation of tax expenditure only 20% of the taxable use has been taken into account and a compliance ratio of 72% is applied to net sales tax.

- The difference between revenue collected at effective rate and revenue estimated at statutory rate is taken as tax expenditure.

54. The tax expenditure estimated through this methodology is as following:[11]

Table 9: Tax Expenditure Estimates for Customs
Rs. In Billion

S.No.	SRO	Description	Tax Expenditure 2011-12
1	567-2006 (Non - Survey)	General & conditional exemption of CD (non-survey)	23.21
2	656-2006 (OEMs)	Exemption of CD for OEMs of Automotive sector	20.61
3	575-2006(Machinery)	Exemption from CD & ST on import of machinery	11.77
4	655-2006 (Vender)	Exemption of CD for vendors of Automotive sector.	13.58
5	565-2006(Survey Based)	Exemption of CD on import of raw material & components (survey based)	8.16
6	659-2007 (CHINA)	Concessionary import under various SROs from China	15.34
7	678-2004(E&P)	Exemption of CD & ST to exploration & production companies	3.00
8	450-2001 (Cus. Rules)	Customs Rules, 2001.	2.25
9	809-2009(Textile)	Exemption of CD for machinery and equipment imported by textile industrial units	1.03
10	1264-2007 (Malaysia FTA)		2.77
11	570-2005-SRI LANKA		0.25
12	1274-2006(SAFTA)		0.18
13	894-2006 (Pak-Iran FTA)		0.009
	Others		3.64
	SRO based Exemptions		105.80
	Exemptions under CH 99		14.41
	Specific Rate		7.85
	Total		**128.06**

[11] The data includes One Customs only.

55. **Almost 60% of the imports into Pakistan attract no tariff or preferential tariff provided under various SROs.** During the FY 2011-12, against the total imports of Rs. 4.01 trillion, Rs. 2.39 worth of imports are duty free. Out of total 6808 tariff lines (8-digit), 3950 attract one or more notifications. Share of SROs in imports by value is indicated in the following figure:

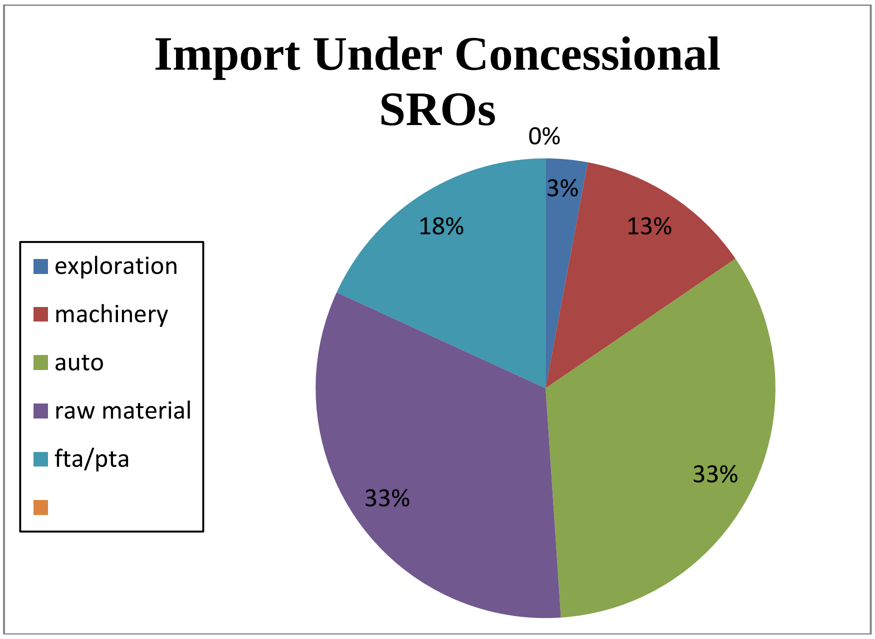

Figure 2: Value of Import under concessional SROs

A further analysis of share of different sectors in exemption regime reflects that the automotive sector enjoys the major share in exemptions.

G. Amount of Tax Expenditure

56. Based on the estimates for individual taxes, the consolidated summary of the tax expenditure for fiscal year 2011-12 is given in Table 8. The overall tax expenditure for 2011-12 has been estimated to be around Rs. 508 billion[12]. If tax expenditure on services is included, overall tax expenditure would increase to Rs.590 billion.

[12] Since a different definition and ad hoc methodologies are used to estimate tax expenditure for earlier years, the estimates provided in the present study are not comparable with the earlier estimates reported in the Pakistan Economic Survey.

Table 10: Tax Expenditure Estimates for All Taxes
Rs. In billion

S. No.	Tax	Tax Expenditure 2010-11
1	Income & Corporate Tax	101.09
2	WHT	52.04
3	Sales Tax Import	58.40
4	Sales Tax Domestic	171.9
5	Custom Duties	128.06
	Total	**511.49**

It may be emphasized that these results do not provide the full gambit of tax expenditures involved in the taxation system. Due to methodological choices and more importantly, the data limitations, it is not possible to estimate all the tax expenditures. Moreover, the tax expenditure estimates are based on the current level of tax compliance. The tax gap analysis done earlier for Pakistan (Ahmed and Rider, 2013)[13], estimated the federal tax gap (difference between actual and potential tax revenue) as 40 percent. The tax gap is much higher for income tax i.e. 60% as compared to 25% for indirect taxes.

57. **From efficiency point of view, the revenue foregone on account of tax expenditure is substantial.** A partial estimate of tax expenditure amounting to Rs.511 billion is 2.5 % of GDP and 27% of the federal tax revenue collected during the FY 2011-12. Due to incomplete estimates it is quite difficult to compare these tax expenditure estimates with other countries. In OECD countries tax expenditure as percentage of GDP varies from 0.29% in Germany to 12.79% in UK. Similarly, tax expenditure relevant to total tax revenue ranges from 8.8% in Germany to 52.9% in Canada.[14] In case of South Asian countries like India and Bangladesh, tax expenditure in India is 4.49% of GDP and 28.62 % of tax revenue and for Bangladesh it is 2.5% of GDP and 31.25% of total revenue.[15]

H. Recommendations

58. **Tax expenditures result in significant revenue loss to the government**. Considering a substantial amount of revenue forgone due to tax expenditures, close attention to tax expenditures is desirable. In the short-run, measures should

[13] The study was originally done as background paper for Pakistan Tax Policy Report using macroeconomic data for FY 2004-05.
[14] As reported in "Manual on Tax Expenditure in OECD Countries", 2010.
[15] The estimates are for the year 2005 reported in "Tax Expenditure in Bangladesh: An Introductory Analysis" by M Ghulam Murtaza and Lutfunnahar Begum, 2006

be taken to generate more revenue, in the long-run, the government needs to remove tax distortions to bring more transparency, accountability and efficiency to the tax system. Some of the short- and long term recommended actions by the government are as follows:

a. **Rationalize withholding tax rates**: The recent trend of resort to WHT extensively is not a healthy sign. WHT being indirect taxes in nature violates the principle of progressivity in the income tax system. Effort should be to use WHT only for undocumented and hard to tax taxpayers and avoid documented sectors like shipping, air freight, CNG operators, insurance etc. Where necessary, tax should be applied at uniform rates. Use of differential WHT rates at import stage complicates the system and creates incentives for misdeclaration. As a short term measure it is recommended that a uniform rate may be applied for all kind of imports. Rate however, may be reduced to 4% rather than the current rate of 6%. Estimates based on customs data for year 2011-12 indicates an additional revenue of Rs. 9.37 billion if uniform rate of 4% is applied on taxable imports[16]. In addition, it is suggested that WHT exemption at import on cellular mobile phones may be withdrawn. This is likely to generate additional revenue of Rs. 4.11 billion. In the long run government may consider using single rate for dividends, supply of goods and contracts also.

b. **Withdraw income tax exemptions (Second Schedule)**: Exemptions and concessions under the Second Schedule are too many and too generous. In the short run, income earned by IPPs, export of IT services, reduction in minimum tax[17] liability to cigarette and pharmaceutical distributers and tax credit for person registered under sales tax may be withdrawn[18].

c. **Rationalize exemptions to charitable organizations**: There is no record of religious, cultural, welfare, charitable, nonprofit or medical & technology promoting organizations with FBR. Around 900 such organizations are registered with Income tax department. They are required to be audited, however, no audit has ever been conducted. Many of these organizations carry out commercial activities also. In Pakistan all such organizations/trusts are required to register under Companies Ordinance, 1984, or Trust Act, 1882 or Societies Registration Act, 1860 or Voluntary Social Welfare Organization Ordinance, 1961. In the medium to long run FBR may consider designing a policy to keep a centralized record of all such organizations in coordination with all these authorities, having these organizations audited at least once in five years and bringing the commercial activities into tax net.

d. Withdraw exemptions to certain sectors: In the long run income earned by mutual funds, venture capitals or investment companies and electrical power companies and oil and mining companies which enjoy unlimited income tax exemptions in terms of concessionary rates, accelerated depreciation allowances and expensing may also be brought under the normal tax regime. Similarly, provisions related to initial

[16] Detailed calculations can be seen at Annex

[17] Minimum tax under section 113

[18] It is difficult to give estimates of impact on revenue as no data is available.

allowance, accelerated depreciation allowance, pre commencement expenditure allowance needs to be revisited.

e. **Rationalize taxation of pension income:** Pensions generally receive favorable tax treatment but not on the scale enjoyed by pensions in Pakistan. Ordinarily, pensions are treated for income tax purposes in one of two ways. Either pension contributions are not tax deductible and the ensuing benefits are non-taxable or, more frequently, pension contributions are deductible and the benefits received are taxable. Because of the tax deferral they permit, both treatments provide for favorable treatment of pension income vis-a-vis other kinds of income.

f. **Reduce the income tax threshold**: There is no scientific method for determining what the "right" level of income tax exemption should be except the general notion that income taxes should not burden the poor in any economy. A useful rule of thumb, frequently encountered in the international tax literature, is that exemption levels should be set somewhere in the vicinity of twice a country's level of per capita income. In case of Pakistan, application of this rule would generate an upper bound for the zero rate bracket of about Rs. 250,000 or about 40 per cent lower than the present amount of Rs 400,000 for wages earners[19] .

g. Withdraw customs duty exemptions (various SROs): Almost 60% of imports are either exempt or assessed at concessional rates. Exemptions and concessions enjoyed by certain products in more than one SROs need to be carefully studied. The automotive sector has been protected through high tariffs. However, the assemblers of vehicles enjoy exemption on import of CKD. The facility has been used for a long time now and the infant industry argument is not valid anymore. Tariff structure for this sector needs to be rationalized. Tariff concessions under various preferential agreements also need to be analyzed. Benefits in terms of market access provided to Pakistan's export products by partner countries should commensurate with concessions provided through these arrangements by Pakistan.

h. Rationalize use of SROs: Over the last few years over reliance on **use** of SROs for incentivizing various sectors or activities has made taxation structure complex, non-transparent and negotiation intensive. Exemptions/concessions are usually provided to large scale manufacturers which penalize SMEs because they procure inputs from commercial importers who import at an MFN rate. It is recommended that concessions provided through SROs should be merged into tariff structure. This will not only reduce dispersion in tariff rate but will help check the element of misclassification.

i. **Withdraw sales tax exemptions on imports:** Other than food the major exemptions of sales tax at import stage are provided to telecommunication equipment including cellular phones and SIM cards, pharmaceuticals and all kinds of machinery Based on 2011-12 imports, tax expenditure on cellular mobile phones alone is Rs. 9.7 billion. In the face of changing industrial needs and structures there is a need to reevaluate these exemptions.

[19] Per capita income for 2011-12 is Rs. 121173 or US$ 1372.

j. **Withdraw exemptions on domestic consumption**. Sales tax is a less efficient tax when compared with other comparable economies. The "C efficiency ratio which is defined as the share of GST/VAT revenues in consumption relative to the standard GST rate is extremely low for Pakistan. For the FY 2011-12 this ratio is 27.9 percent[20]. The reasons behind this weak performance relate to the relatively small size of the domestic tax base. In 2011-12 imports and domestic tax collections were Rs. 430 billion and Rs. 420 billion respectively. Data from the 2011-12 Pakistan Economic Survey indicate that about 55 per cent of all imports are consumption related. Given an import-to-GDP ratio of 17 per cent these numbers imply that the import base for the sales tax is 0.086 of GDP. From the same source, the ratio of private consumption to GDP is 87 percent. If the agricultural sector which is roughly 27 per cent of GDP is factored out of this base the maximum size of the domestic tax base is about 60 per cent of GDP. Given the near equality in revenue collections from imports and domestic activity, implying nearly equal tax bases, it appears that only about 14 per cent of domestic consumption (.086/.60), primarily from the manufacturing sector, is included in the current sales tax base after taking into account exemptions, zero rating and evasion. In other words, the relatively low efficiency rating reflects the relatively small amount of domestic consumption that is captured in the tax base. It is important therefore that in the long run exemptions given on domestic consumption are reduced.

k. **The large tax expenditure on services is a matter of concern.** After 18th Amendment allocation to provinces from divisible pool has been increased. At the same time provinces have been authorized to levy and collect GST on services which were earlier collected by the FBR as federal excise tax in sales tax mode. This has put pressure on the federation to raise additional revenues to compensate for this loss. It is recommended that in order to encourage provinces to mobilize resources, own source revenue generation by provinces may be linked to allocation of resources to them from divisible pool. Provinces should build capacity to manage sales tax on services especially retail and wholesale trade.

l. **Bring domestic supplies of five export oriented sectors under normal tax regime:** Much of the recent wave of zero rating has been inspired by administrative considerations. The primary factor behind the zero rating of textiles, carpets, leather goods and sports and surgical equipment was the large refund claims associated with these activities that were difficult for the FBR to substantiate. Zero rating these activities and most of the inputs used by these activities were a way of handling the refund issue. However, despite zero rating FBR paid Rs. 45 billion as refund to these export oriented sectors. The recent change to tax the inputs at 2% is still a deviation from the normal tax regime and would add to the problem rather than generating any revenue. For instance in case of

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[20] The ratio is calculated by taking ratio of collection of VAT to private expenditure and dividing by standard GST/VAT rate. See Ebrill et al (2001) for an expanded discussion of this efficiency criterion. According, to the findings in this volume, Pakistan's efficiency rating would place it at the regional average for Sub Saharan Africa.

the textile sector alone, based on the input output model, the tax expenditure is estimated as Rs. 47.01 billion.[21] FBR needs to streamline its refund system and strengthen the monitoring and enforcement mechanism to check fraudulent refund claims.

m. **Withdraw zero rating of sales tax on dairy and meat products:** These are the two fast growing sectors in the economy. Livestock including dairy, poultry and meat contributes roughly 12% towards GDP and growing at rate more than 3% over the last few years. Any exemption or zero rating is bound to reduce efficiency of sales tax system.

I. Conclusion

A large amount of tax expenditures poses a serious consideration. It is important that a comprehensive set of estimates of the identified tax expenditures is undertaken, especially in case of income tax, where due to non-availability of data of persons, AOPs and companies having exempt status, tax expenditure could not be estimated. The methodologies developed in the present study may be used to estimate tax expenditure in order to have a complete picture of revenue being foregone as a result of exemptions and concessions given under various laws. There is urgent need to develop a tax expenditure limitation strategy and as a beginning tax expenditure report should be published as part of the government's annual budget document. Tax expenditure management of which reporting and costing are two major elements should make an integral part of government's budget process. Tax expenditure management requires establishment of a framework for identifying, measuring and critically assessing the merits of particular tax expenditure before they are legislated. There should be regular update of tax expenditure analysis which takes account of the social and legal changes over time. Government should periodically determine the cost and justification for its major tax expenditures in detail and justify it on distributional, efficiency or cost effectiveness basis. For instance Korea has a law that subjects tax expenditures to a 5 year sunset clause. In India, estimates of tax expenditure are reported regularly as the "Statement of Revenue Forgone under the Central Tax System" in the budget papers. It is a requirement under the Fiscal responsibility and Budget Management Act, 2003. The contents of the statement are regularly reviewed by the Ministry of Finance and Standing Committee on Finance. Similarly in Chile, it is a constitutional requirement to report tax expenditures. The Chilean Tax Administration conducts an annual estimate of tax expenditures which is included in the Budget of Public Finance. The estimates of tax expenditures in income tax and VAT for the current year as well as the projections for next year are presented in the budget document. Similarly in Brazil, there is an explicit obligation to report tax expenditures in the annual budget.

[21] Assuming zero rate for export, 5% on domestic supplies and 2% on inputs

Annex I: Summary of Tax Expenditures Under Income Tax

	Special provisions	**Exemptions & Special Concessions**	**Second Schedule**	**Deductible Allowances**	**Tax Credit**
1	Initial allowance	Agriculture income	Part-1: Exemption from total income (34 tax expenditures)	Zakat	Charitable donations
2	First year allowance	President's honors	Part-11: Reduction in tax rates (2 tax expenditures)	Workers welfare Fund	Tax credit for investment in shares and insurance
3	Accelerated depreciation to alternate energy projects	Profit on debt	Part- 111: Reduction in tax liability (8 tax expenditures)	Workers Participation Fund	Contribution to Pension Fund
4	Pre-commencement expenditure	Scholarships	Part-1V: exemption from Specific Provisions (22 tax expenditures)		Profit on debt
5	Scientific research expenditure				
6	Employee training and facilities	Support payment under an agreement to live apart			Tax credit to a person registered under Sales Tax Act, 1990
7	Profit on debt	Federal, Provincial and Local Government authorities' income			Tax credit for investment
8	Bad debt	Foreign source income of short term resident			Tax credit for enlistment
9	Consumer loans	Foreign source income of returning expatriates			Tax credit for newly established

10	Profit on non performing debt of a banking company				undertakings
11	Transfer to particular reserve				Tax credit for industrial undertakings established before 1/8/2011

Annex III: Withholding Taxes

S No.	Withholding Tax	Relevant provision	Standard Rate	Reduced Rate	Final/Adjustable
1	Import of goods	sec 148	5%	0.5%,1%,2%,3%, 4%,5%,6%	Final except industrial undertaking
2	Salaries	sec 149			Adjustable
3	Dividends	sec 150	10%	5%, 7.5%,	Final
4	Bank Interest & Securities	sec 151	10%		Adjustable
5	Royalty/Technical Fee	sec 152(1)	15%		Final
6	Contract	sec 152(1A)	6%		Adjustable
7	Insurance	sec 152 (1AA)	5%		Adjustable
8	Supply of goods& services/contracts	sec 153			
i	sale of rice, cotton seed, edible oil		1.5%	1%	Final
ii	other goods		4%	1%	Final
iii	stitching & dying services		0.5%		
iv	transport services		2%		Final/Adjustable
v	other services		6%		Final/Adjustable
vi	Contracts		6%		Final
9	Payment to Non Resident media persons	sec 153A	10%		
10	Exports	sec 154			
i	Goods		1%		Final
ii	Commission		5%		Adjustable
11	Income from property	sec 155			Adjustable
12	Prizes & winnings	sec 156			
i	prize bond		10%		Final
ii	other prizes		20%		Final
13	Petroleum Products	sec 156A	10		Final
14	Withdrawal from pension fund	sec 156B	ARTon the TI of 3 preceding years		
15	Cash Withdrawal	sec 231	0.02%		
16	Registration of New Cars	sec 231B	7500-50000		

17	Brokerage & Commission	sec 233	10%	5%	Final
18	Stock Exchange	sec 233A	0.01%		Final/Adjustable
19	Transport	sec 234			
i	goods transport		Rs.1/kg of laden weight	Rs. 1200 for weight 8120 kg	Final
ii	passenger transport		Rs. 25-100/seat/annum		Adjustable
iii	private motors		Rs. 750-8000		Adjustable
20	CNG Stations	sec 234A	4		
21	Electricity Bills	sec 235			Adjustable
22	Telephone	sec 236			Adjustable
23	Sales through Auction	sec 236A	5		
24	Purchase of Domestic Air Ticket	sec 236B	5		
25	Sales/Transfer of immoveable property	sec 236C			

Annex III A: Tax Expenditures Under Customs

S.No.	SRO	Description	Issue Date
1	277(I)/2010	Duty free import of new car of engine capacity not exceeding 1350cc by a Pakistani disable national.	27-Apr-10
2	809(I)/2009	Exemption of machinery and equipment, if imported by textile industrial units	19-Sep-09
3	41(I)/2009	Incentive Package for special industrial Zones/Economics	19-Jan-09
4	42(I)/2009	Incentive Package for the development of Pak-China Investment Zones	19-Jan-09
5	559(I)/2008	Exemption from Customs Duty and Sales Tax on Import of specified items for Manufacture of Specified Goods for AJ&K (Survey based).	11-Jun-08
6	412(I)/2008	Exemption to cooling towers, heat recovery steam generators and feed water pumps if imported by the New Independent Power Producers (IPPs)	30-Apr-08
7	1261(I)/2007	Free Trade Agreement with Malaysia	31-Dec-07
8	1151(I)/2007	Preferential Trade Agreement between Pakistan and Mauritius	26-Nov-07
9	1121 (I)/2007	Exemption from customs duty leviable on import of vehicle classifiable under PCT 8703 meant for transportation of person having bulletproofing and other security features.	17-Nov-07
10	492(I)/2007	Exemption for vehicle tracking systems	6-Sep-07
11	659(I)/2007	FTA With China	30-May-07
12	395(I)/2007	Exemption from customs duty on import of vehicles by war-disabled defense force personnel	14-May-07
13	43(I)/2007	Exemption from customs duty on Copper Cathodes and Aluminum Ingots	17-Jan-07
14	1274(I)/2006	Exemption of Customs duty on import of goods into Pakistan from SAARC countries under SAFTA agreement	29-Dec-06

15	894 (I)/2006	Exemption from customs duty on import from Iran under Pak-Iran PTA.	31-Aug-06
16	655 (I)/2006	Exemption of customs duty for vendors of Automotive sector.	22-Jun-06
17	656(I)/2006	Exemption of customs duty for OEMs of Automotive sector.	22-Jun-06
18	565 (I)/2006	Exemption from customs duty on import of raw materials, sub-components, components, sub-assemblies and assemblies, for manufacture of specified goods (Survey based).	6-May-06
19	567(I)/2006	Exemption from customs duty on import of specified goods (Non-Survey based).	6-May-06
20	575(I)/2006	Exemption From Customs Duty on machinery and equipment	6-May-06
21	570(I)/2005	Exemption from customs duty on imports from Sri Lanka.	6-Jun-05
22	577(I)/2005	Exemption from customs-duty, sales tax, withholding tax and capital value tax on old and used automotive vehicles.	6-Jun-05
23	678(I)/2004	Exemption from customs duty and sales tax to Exploration and production (E&P) companies on import of machinery, equipment , specialized vehicles/vessels and helicopter etc.	8-Jul-04
24	450(I)/2001	Customs Rules, 2001.	18-Jun-01
25	559(I)/2000	Exemption from payment of customs duties and sales tax on specified goods, if imported by British Airways.	8-Dec-00
26	554(I)/1998	Exemption from customs duty and sales tax on import of machinery for setting up a manufacturing unit or for the expansion, balancing, modernization and replacement (BMR) of existing units.	6-Dec-98
27	71(I)/1995	Exemption from customs duty on import of raw materials for manufacture of goods by such industries which commenced commercial operation up to 30.06.1999 in Special Industrial Zones	19-Jan-95

Annex III B: Tax Expenditures Under CH 99

HS Code	Description	HS Code	Description
99010000	UN	99190000	Temporary imports
99020000	Diplomatic	99200000	Temporary imports
99030000	Grants-in-Aid	99210000	Shipping Containers
99040000	Vehicles in CKD for supply to diplomat	99220000	Ship spares, stores
99050000	UAE and Qatar Sheikhs	99230000	Currency Notes, unused stamps
99060000	President	99240000	Eye cornea
99070000	President's Fund for Afghan Refugees	9925**0000**	**Artificial kidneys, hemo dialysis ma**chines
99080000	Church World Services	99260000	Fisheries Sector
99090000	Articles, value not exceeding Rs.20,000/- per parcel	99270000	Pharmaceutical raw materials for contraceptives
99100000	Samples of no commercial value	99290000	Gold and Jewelry
99110000	Relief for natural disaster	99300000	Federal/Provincial/ Local Government Departments
99120000	Edhi (charitable organization)	99310000	Civil Aviation Authority equipment
99130000	Charitable non-profit making hospital or institution	99320000	Heing, zeera and other medicinal herbs, if imported temporarily
99140000	Charitable hospitals	99370000	Items relating to disabled persons:-

99150000	Charitable hospitals	99380000	Cardiology/cardiac surgery etc.
99160000	Repair and Replacement	99390000	Diagnostic kits for HIV and Hepatitis
99170000	EPZ	99410000	Goods donated to municipal authorities
99180000	Re imported machinery equipment	99420000	The re-rollable scrap having width not exceeding 1000 m

Annex III C: Goods on Specific Rate of Duty

HS Code	Description	HS Code	Description
14049020	Betel leaves	15151900	Others
15079000	other	15162020	Vegetable oils and their fractions
15111000	Crude oil	15171000	Margarine
15119010	Palm Stern	15179000	Others
15119020	RBD Palm oil	15180000	Animal or Veg fats
15119030	Palm olien	71069110	
15119090	others	71069210	
15131100	crude oil	71081210	
15131900	others	85171210	Cellular Mobile phone
15132900	others	85171210	Cellular Mobile phone

Annex IV: Tax Expenditure under Sales Tax (Import)

S.No.	SRO	Description	Issue date
1	69(I)/2006	Sales tax at the rate of fifteen per cent of the value on import of rapeseed, sunflower seed and canola seed by solvent extracting industries	28.01.2006
2	313(I)/2006	Sales tax at the rate of seven per cent of the value on import of soybean seed by solvent extraction industries	31.03.2006
3	911(I)/2007	For the purpose of levy of sales tax on import and supply of high speed diesel oil (HS Code 27.10), the Price Differential Clam (PDC) shall be excluded from the import value or value of supply	08.09.2007
4	542(I)/2008	Exemption from sales tax on the import or/ supply of cellular telephone sets (hand-held sets) to the extent that the effect of sales tax shall be two hundred and fifty rupees per such set	11.06.2008
5	117(I)/2011	Goods produced or manufactured in such areas, where the Sales Tax Act, 1990, is not applicable but are included in the Prime Minister's Fiscal Relief to Rehabilitate the Economic Life in Khyber Pakhtunkhwa, FATA and PATA shall be charged to fifty per cent of the rate leviable if supplied to a person in any area where the Sales Tax Act, 1990 is applicable	10.02.2011
6	180(I)/2011	Fifty percent of rate leviable of sales tax on supplies made of goods, other than cement, sugar, beverages and cigarettes, by the registered persons located in certain districts	05.03.2011
7	1125(I)/2011	Certain goods on which sales tax shall be exempt on the supply and import thereof, or charged zero rate; or the case may be at the rate of five percent subject to certain conditions	31.12.2011
8	77(I)/2004	Sugar purchased and exported by Trading Corporation of Pakistan (TCP), shall be charged to tax at the rate of zero percent subject to certain conditions	28.01.2004

9	433(I)/2005	Facility of zero rating to one hundred completely built manufactured by M/s Hinopak Motors Ltd., for supply to Ministry of Foreign Affairs	14.05.2005
10	646(I)/2005	Zero % rate of sales tax on supply of Hydrogen, Nitrogen & Helium to M/s Pakistan PTA Limited	30.06.2005
11	863(I)/2007	Zero % of sales tax on raw materials, sub-components, components, sub-assemblies and assemblies imported or purchased locally for the manufacture of certain goods	24.08.2007
12	549(I)/2008	Zero % rate of sales tax on certain goods, subject to certain conditions and restrictions	11.06.2008
13	423(I)/2009	Zero percent rate of sales tax on all products, services and equipment for the of Kararo-Wadh section of National highway N-25, supplied to M/s TAISEI Corporation, Islamabad	28.05.2009
14	769(I)/2009	Zero % rate of sales tax on import and supply of polyethylene and polypropylene	04.09.2009

Annex V: Recommendations

S No.	Recommendation	Short term	Medium to Long term
1	Rationalization of withholding tax rates	single rate of 4% for all kind of imports	single rate for dividends, supply of goods & contracts
2	Withdrawal of Income tax exemptions (Second Schedule)	income earned by IPPs, export of IT services, reduction in minimum tax liability to cigarette and pharmaceutical distributers and tax credit for person registered under sales tax	
3			Exemptions to Charitable Organizations
4			Income earned by mutual funds, venture capitals or investment companies and electrical power companies & oil and mining companies
5	Depreciation Allowance	Revise provisions related to DA	
6	Taxation of pension income		Either pension contribution or benefits should be made taxable
7	Lowering of threshold	Be set somewhere in the vicinity of twice a country's level of per capita income.	
8	Withdrawal of customs duty exemptions (various SROs)	Rationalization of tariff structure for automotive sector, exemption to plant & machinery	concessional tariffs under various FTA/PTA

9	Withdrawal of sales tax exemptions (Import)	Telecommunication equipment including cellular phones and SIM cards,	pharmaceuticals and plant & machinery
10	Withdrawal of exemptions on domestic consumption	Review of exemptions under 6th Schedule	
11	Tax expenditure on services		own source revenue generation by provinces may be linked to allocation of resources to them from divisible pool
12	Withdrawal of zero rating to five export oriented sectors	should be under normal regime	
13	A comprehensive estimate of all the identified tax expenditures	A dedicated team to undertake this exercise	
14	Tax expenditure report should be published as part of government's budget document.		A dedicated setup to review and monitor exemption regime