



Federal Tax Ombudsman Secretariat

Proposals for the Budget

Financial Year 2014-15

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1. **Scope of the Proposals**

The economic spectra looming large on the national horizon is what is now driving the national demand for economic reform including broad basing of taxation which is one of the critical keys for bringing about the much needed economic turn-around, fiscal discipline being an uncompromisable national imperative. Wide spread demand for accountability and transparency can hopefully bring about fiscal responsibility, if relentlessly achieved. The key for correction of this paradigm lies mainly in the human resource responsible for tax enforcement as much as in the system design and documentation of economy. There is no quick fix in this day and age. But corrections can be made to avert economic disaster.

The following core issues have been examined quite in detail in FTO Secretariat in consultation with Advisory Committee (Annex-A) for proposals with regard to the budget for FY 2014-15

- i Widening the Tax Base in the Context of a Fair, Just and Transparent Tax System
- ii Diagnosing the Systemic Issues of Tax Maladministration and Suggesting Sustainable Remedies.
- iii Need for a Taxpayers' Bill of Rights.
- iv Expanding FTO's Outreach for Awareness and Suggesting Ways and Means for its Improvement and Sustainability.

Analysis of the recommendations made by four sub-committees (Annex-B) of the FTO's Advisory Committee is also part of it.

2. Executive Summary – Key Recommendations

➤ **Tax Culture for Revival of Economy.**

Pakistan has experimented many ways to develop a tax culture but with least concern to actual stakeholders. The reliance on amnesty schemes, shifting reliance from direct taxes to indirect taxes and on final tax regimes were the measures aiming towards improving collection of revenue alone instead of inculcating tax culture in the country. The behavior of citizens has also not been conducive in discharging their obligation to the State. These factors coupled with many other socio-economic realities promoted low level of compliance in the country.

The aim should be that the tax policies are designed to ensure financing of governmental actions and to achieve sustainable basis for economic growth. The key areas requiring immediate attention are better tax education, simplification of tax procedures, creating conducive social, political and economic environment and developing information technology facilities.

➤ **Transforming FBR into a fully autonomous institution**

There should be a statutory body for policy making process, separate from FBR, represented by; the Planning Commission, Ministry of Finance, Ministry of Law, FBR, professionals and organizations like ICAP, Tax Bars, Chambers of Commerce and Stock exchange. The role and organization of the FBR leaving collection, with related policy formulation, alone with the institution.

This is consistent with best practices worldwide. It would help prevent political interference, foster accountability, and support.

➤ **Use of CNIC as an identifier**

The CNIC number of a person should be the identifier for all tax transactions, both at the Federal and the Provincial level. National Tax Numbers should be restricted to the companies only. A central number will make filing easy for the

tax payers, and will provide access to all information to all the relevant tax collection authorities.

➤ **Integrated Management Systems**

Integrated Management System (IMS) is required which is already in advance stage of development. This data is then compared with the return filed or not filed by the Taxpayers and non-taxpayers. After the automatic data mining there is an audit tracking system which would track the actions taken for record purpose. One latest part of the data warehouse information being used by a large number of countries is online access to each and every transaction taking place in the banks. If this is introduced, then this will take care of the huge tax gap that we have of Tax-to-GDP ratio of almost 79%.

➤ **Computerized Information System**

Efficiency and cost effectiveness can only be achieved if the available technology is properly utilized. FBR has embarked upon a colossal computerization program, which will bear fruit only when a central data warehouse effectively links all departments within FBR, and acquire and disseminate information from and to third party sources especially Financial Institutions. Data mobilization with an integrated database system linked with NADRA will facilitate in coordination and sharing of information between the federal, provincial and local governments.

The complete filing and assessment process must be computerized, with proper authorization checks and internal controls built into the system. Notices and other communication made with the tax payers should be numbered, dated and generated through the system. The system should provide audit trail of each and every assessment, starting from filing till completion of the assessment; even including the proceedings of the cases referred to the Tribunals and the Courts.

➤ **Reform of Tax Administration**

Stability in tenure of senior tax managers, investment in key soft infrastructure (IT); qualified human resource and governance improvements are all urgently required. These actions have been on the tax reform agenda for years, if not decades. The success mainly depends on the decision power and sustained implementation capacity of the political leadership.

Further, transfers and postings before end of the term results in reducing staff's competency, therefore stability of tenure of productive human resource is essential for capacity building coupled with rigorous training in the relevant fields.

Management tools including annual and monthly action plans, regular review of key performance indicators, performance reporting as a monitoring tool, and stringent internal controls, and defined policies and procedures according to function will strengthen the department.

➤ **Independence of Judicial Forums**

The Appellate Forums should be made independent from the formal / informal influence of FBR. The tax adjudication system must rest on fundamentals of independence, insulation and isolation from tax collection. The prosecution has to be separated from adjudication with gradual shift towards independence by transferring the adjudication system under the command and control of independent office or Ministry of Law or most preferable under the respective High Courts in conformity with section 10A of the Constitution. In transitional phase, there should be a bar on repatriation of officials to the administrative function. In long term, there should be a separate process in place for appointments and career management in tax adjudication system.

➤ **Phasing out of Final Tax Regimes**

Gradually phasing out of fixed tax, final tax and minimum tax regimes and moving towards taxation on net income basis.

➤ **Tax Amnesties to be discouraged**

Putting a constitutional bar on tax amnesties providing tax whitening opportunities for future.

➤ **Rationalizations of Tax rates**

Tax rates to be rationalized to bring down to acceptable level to help broadening tax base.

➤ **Others**

Verification of wealth of government functionaries through independent agencies and create deterrence by severe demonstrated punishment in the cases of corruption.

- Undocumented economy to be tackled through measures such as introduction of tax credits on production of evidence of specified expenses and cross verification of payments made for medical, real estate, food etc.
- Review of exemptions available in the taxation laws and bring them to bare minimum level.
- Being provincial subject now after 18th amendments, Federal should persuade the provinces to impose agriculture tax uniformly.

➤ **Charter of Taxpayers' Rights**

Taxpayers' rights need to be effectively protected by enacting a Taxpayers Bill of Rights.

➤ **Strengthening Complementarities' of FTO and FBR**

Complementarities' of FTO and FBR need to be strengthened to synergise effectiveness of tax reform.

3. Analysis of Recommendations

- ❖ A favored public revenue strategy today is to make taxation as "broad-based" as possible that is, to spread it out over all potential sources. The phrase "broadening the tax base" is often used in Pakistan in the context of an extremely narrow base of income tax. Abnormally low number of tax return filers is widely reckoned as the national tax predicament aggravated by a recent disclosure that out of over 180 million people, around one percent file tax returns and less than one fourth of them actually pay income tax. A recent study by NADRA has found that 2.38 million potential taxpayers do not have NTN. Universal Self-Assessment Scheme unbalanced by effective audit has also weakened tax enforcement. Embedded impunity for tax evasion and well-entrenched corruption and inefficiency in the tax collection machinery are the two main causes of narrow tax base. Consequently, the share of income tax in GDP is constantly on the decline from 3.85% achieved in 2006-07, it winded down to 3.3% in 2010-11. But narrow tax base phenomenon cannot be confined only to income tax as the tax bases of sales tax and customs duties are also equally skewed and narrow. Federal exercise being under a phase-out program, is not considered relevant to broad basing.

- ❖ Mainstream view in developed and well-documented economies is that VAT mode of sales tax collection is the most fair system in terms of equity. However, VAT is a miserable mismatch in underdeveloped countries with un-documented economies. In the back drop of lack of documentation, the VAT mode of sales tax collection has been bedeviled in Pakistan by tax frauds, flying and fake invoices, ghost transactions, unlawful and excessive adjustments, undue refunds, and some region-specific exceptions to application of sales tax law. The administrative failure to fully tax the taxable products and services due to acute and wide spread problems of outreach, integrity and efficiency plaguing the available human resource in federal tax administration is compounding the double edged national predicament spelt by sales tax fraud.

- ❖ Whereas indirect taxes are almost invariably being paid by the citizens as part of price of goods and services, these taxes, in the most part, are being retained by middle men and collection agents. Thus the indirect taxes paid do not invariably find their way to the national exchequer. The most disturbing aspect of this situation is that the illicit income dividend being so misappropriated is not essentially forming a part of the taxable income of even those few who graciously file returns. The nation is therefore, losing on both the ends of the taxation continuum. This is precisely what defines our tax predicament, in terms of an extremely narrow tax base, weak enforcement, fast eroding fiscal space and miscarriage of the distributive function of taxation.
- ❖ Customs is no exception. Its base is equally skewed by the parallel regime of smuggling, under-invoicing and mis-declaration of quality and quantity of goods for evasion of customs duties. The operational staff of customs, sales tax and income tax is more on the side of tax evaders and smugglers than on the side of the law. Expertise and efficiency are abundant but these are being effectively and earnestly used in favor of the tax evaders. Paucity of integrity and accountability deficit are the bane of the tax collection system. Supervisory managements are too weak to institute accountability. The policy level of tax administration is highly vulnerable to influential lobbyists and pressure groups. At policy level lack of higher order professionalization has eroded the Competitive ethos of tax Collectors.
- ❖ The most serious problem in the structure of tax administration is that the operational management comprising inspectors, auditors and appraisers mostly belong to influential families and are mainly inducted on sifarish, bribe and graft. Conversely the supervisory and policy levels of administration come through a merit-based competitive examination. They, in the large part, rise from less influential segments of society. This inherent imbalance in the structure of tax administration is spelling disaster to the tax collection system. The corrupt majority in operational management colludes with impunity with tax evaders for sharing the fruits of tax evasion and smuggling. In the ambient

environment of impunity, the supervisory management falls an easy prey to the ambient temptation. Very few in tax administration can stand up and claim moral, financial and intellectual impeccable integrity. Those few, who can claim real integrity to their credit, are too few to redeem the tax collectors as a class. As a result, tax collection system has succumbed to evasion, fraud and corruption. No light appears at the end of the tunnel.

- ❖ Another problem is that the influential among the taxpayers and tax evaders are being over-served, and the ordinary but genuine tax payers are being miserably underserved. An acid test of this perverted paradigm is refunds and duty drawbacks. Those who can influence their way out can get away with even undue tax refunds and duty drawbacks and the un-influential are made to await their turn which takes not months but years on end. In public perception, it is a system of the elite, by the elite and for the elite as it is skewed in a way that the poor subsidize the rich.
- ❖ The most overt consequences of inadequacies of tax administration are manifested by low Tax-to-GDP ratio which has dwindled down from 13.8% in 1980's to 9.1 % in 2012; ever increasing overconcentration of national wealth in fewer hands, fast thinning middle class, burgeoning corruption and flight of capital. Signs and symptoms are also not hard to see that small segments of society who are the biggest beneficiaries of tax evasion are now resorting to warding off possibilities of accountability, by means fair or foul. Consequently, tax evasion and collusion for tax evasion are flourishing and fiscal space is shrinking. The adverse factors responsible for the meltdown of economy have precariously looped into a vicious cycle and become both the cause and effect of each other to render the loop inextricable.

3.1 Tax culture for revival of economy

Pakistan has experimented many ways to develop a robust tax culture. The reliance on amnesty schemes, shifting reliance from direct taxes to indirect taxes and on final tax regimes were the measures aiming towards improving collection of revenue alone

instead of inculcating tax culture in the country. Further, the public behavior has also not been conducive in discharging their tax obligation to the State. These factors coupled with many other socio-economic realities promoted the culture of non-compliance or low level of compliance in the country. Indeed, the aim should be that the tax policies are designed to ensure financing of governmental actions and to achieve sustainable basis for economic growth. The key areas requiring immediate attention are better tax education, simplification of tax procedures, creating conducive social, political and economic environment and above all relentless accountability for tax evasion by influential citizens and collusion and corruption in tax collection machinery.

In order to build a nation with tax ethics, the mission of tax administration should be to recover fair taxes from all segments of the society. Proper training, motivation and education be imparted to tax officials to discharge their duties for ensuring justice and fairness in tax administration. A political environment ensuring use of revenue collection for changes in infrastructure, utility and service distribution, education and training, health concessions and above all visible discrimination in treatment to taxpayers and tax evaders can restore faith of the taxpayers in the government. Focus on information technology for improved communication network, should be the priority for capacity building of tax collection machinery. A tax system equipped with high-tech infrastructure can result in swift and transparent control. Use of web-sites for tax education, digital compliance / convergence, real-time operation, ubiquitous system and open standards certainly help in promoting a demonstrable taxation trend in terms of transparency and fairness.

3.2 Broadening of tax base

In developed economies with over 40% of population paying income tax, broad basing is perceived to streamline and rationalize tax structure by reducing tax expenditure in terms of preferential tax treatments, tax breaks, tax credits and exceptions which carry distortive impact in functioning of the economy. Tax reliefs in the form of tax credits and deductions, or tax rates that are lower than the 'standard rate' are often called tax expenditures, because they can be

equivalent to public expenditure implemented through the tax system. In the efficient economies, the governments periodically assess preferential tax treatments to evaluate whether their economic benefits outweigh their costs. Despite a trend over the last 30 years toward broader tax bases, targeted tax provisions continue to be significant in many countries. Even in those countries like USA and UK which had base-broadening tax reforms in the mid-eighties, special regimes have crept back in. Tax expenditure data in countries like UK and USA suggest that a wide range of tax concessions are still offered in many countries, particularly on the personal income tax and the VAT. The major tax expenditure consists of relief on owner occupied housing, retirement savings, children and families, social benefits, food and necessities, small businesses and R &D expenditure.

- ❖ Good economic reasons for targeted tax reliefs that encourage desirable economic behavior or contribute to efficient redistribution of income are often used to justify special tax treatments. Tax concessions may also be introduced to favor particular interest groups or to reduce compliance and administration costs. Whatever the motivation, tax reliefs entail a loss of government revenue which necessarily means that other taxes have to be higher than otherwise would be or alternatively the governments' direct expenditure would have to reduce. Higher rates may create additional efficiency losses and have adverse effects on income distribution. If the tax relief is based on sound economic reasons, the economy benefits more than its loss of revenue. But if tax concessions are dishonestly or inefficiently granted, the economy stands to irreparable loss for the benefit of the favored few as is the case in Pakistan.

These implications dictate the need for efficiency, fairness and simplicity of taxation design. The penultimate objective of taxation design is to achieve fiscal consolidation matching the economic imperatives underpinned by growth-friendliness. In general, tax base broadening reforms are identified as growth oriented to the extent that they reduce distortions to economic decisions to work, savings, investment and consumption. They should increase output

and improve social welfare. The overall *effect* of targeted tax provisions on efficiency, fairness and simplicity depends on the design of the tax provisions. A country's specific circumstances, particularly regarding its tax *revenue* requirements, redistribution preferences, and the available policy options e.g scope for changes in the tax mix and level of taxes, the degree of development of the tax administration and the economic vs political gain play an important role in cost effectiveness of tax relief and efficiency and fairness of the tax system. Economic analysis of tax reliefs helps in identifying possible candidates for base-broadening tax reform in addition to helping increase government accountability and transparency of tax policy decisions.

Mitt Romney, the Presidential candidate against Obama, presented his vision of broad-basing by lowering tax rates of higher income groups and limiting tax reductions. "I am looking instead to lower tax rates and limit deductions and exemptions in such a way that we have enterprises, small businesses, able to keep more of their capital and at the same time simplify the (tax) code." Glenn Hubbard, Dean of the Columbia University Business School and a Romney adviser, supported this approach stating "what broad basing does is get the tax code a little bit out of the business of picking which industries or sectors should get tax preferences, and more giving it back to individuals." Hubbard also says the powerful impact that broadening the tax base would have on growth. That would mean more long term revenue for the government. Economists say simplifying tax code is a good idea because it is fitted with deductions that distort the economy. So there is a widespread agreement that eliminating deductions would be a good idea that it would at the very best make the tax code fairer and less confusing. On the fiscal discipline side, the mainstream view is for smaller government; a government that cuts avoidable and unnecessary expenditures to stay within its means. Good stewardship of the government money spent is an abiding imperative for fiscal discipline and economic consolidation.

3.3 Pursuit of Equity and Fairness in Taxation

A main normative issue of taxation is the effect of taxes on social welfare, that is, on the public interest in efficiency and equity. A broad based tax is a tax levied on many products or factors of production and paid by many individuals of forms. The broad based taxes that governments use are: the personal income tax, the property tax, the general sales tax, and the value added tax. Economists are also interested in the personal expenditure tax, a variation of the personal income tax that deducts savings from the tax base. The five goals of tax policy are:

(i) Ease of Collection; (ii) Ease of Compliance; (iii) Flexibility; (iv) Efficiency and (v) End Result Equity

The mainstream view is that equity and fairness have to be considered together. The goal of taxation is to achieve the best balance between efficiency and equity. In addition; taxation should conform to the sub-principles of horizontal equity and vertical equity. The quest for horizontal equity is the search for the ideal tax base (e.g two people with the same amount of the tax base would pay the same amount of tax.) The quest for vertical equity is the search for the ideal tax structure, which consists of the tax rates applied to the tax base and allowable deductions and exclusions from the tax base. Economists believe that consumption and income are equally good tax bases. All horizontal equity should mean in taxation is that tax liabilities do not depend, inappropriately, on personal characteristics of taxpayers. The important issue for equity in taxation is vertical equity, the tax structure.

3.4 Base Broadening in the Context of Pakistan

A number of rationalization measures have been achieved as a consequence of reform and restructuring of tax collection system since 1980. However, some critical irritants in terms of multiplicity of taxes, boiling down of oversized withholding income tax regime into an indirect tax with undesirable cost-push implication for the economy, introduction of VAT mode at a high rate of sales

tax; tax and tariff concessions and exemptions and self-assessment without counterbalancing by an efficient and effective audit system, impunity for tax evasion and smuggling; and a widely perceived lack of accountability of tax-administration. Therefore, broad basing of taxation in Pakistan would involve re-evaluation of:

- (i) The Taxation Design
- (ii) Organizational Set-Up
- (iii) Administrative Structure
- (iv) Transparency
- (v) Accountability

Unless an inclusive approach to broadening the tax base is followed, the chances of optimal revenue mobilization will be marginal. Implementing a comprehensive approach to tax base broadening is no doubt an uphill task. The influential tax evaders do not let full reform to go through. A glaring admission in this respect was a statement by the Ex-Finance Minister who told the Senate on September 22, 2010 "on the one hand we talk about self-reliance, but on the other hand people belonging to the elite class resist any move to broaden the tax base."

3.5 FBR Strategy

The Federal Board of Revenue has circulated the guidelines and objectives of its base broadening strategy as under:

- (i) It recommends evaluation and subsequent strengthening of existing physical and human resources, allocating the best resources and establishing new structure of BTB Zones and Ranges.
- (ii) The step include using withholding tax regimes as a BTB tool, taxpayers mapping, field surveys, tapping real estate & motor vehicle registration and other possible *potential* areas for BTB.

- (iii) IT backing of all BTB efforts helping create a databank for analysis and monitoring of BTB targets for each team/unit.
- (iv) A quarterly BTB review of performance of all RTOs so as to review and modify the regional and national BTB strategy. The Chief Commissioners will be required to furnish their Quarterly Review Reports.
- (v) Tracking of potential taxpayers through Nadra records.
- (vi) Detecting Un-Taxed / Black Economy by monitoring of money laundering and flight of capital.
- (vii) Identifying potential taxpayers by focusing:
 - All immoveable property transactions (including agricultural land)Motor vehicles
 - Telephone subscribers
 - Allotment / transfer of stocks & shares
 - Club membership
 - Credit card transactions
 - Real Estate Sector: Un-Taxed Commercial & Rented properties
 - Un-Taxed Middlemen
 - Poorly taxed Food Business
 - Specialist Doctors / Dental Surgeons / Private Hospitals
 - Private Elite Educational Institutions
 - International Organizations
 - Franchises
 - Small scale Manufacturing
 - Services providers (IT / Tele-Communication)
 - Professionals (Lawyers / Consultants / Advisors)
 - Business at Highways / Motorways

- Private Construction Firms / Coys / concerns
- Newly Constructed Shopping Malls / Plazas / Markets.
- Ownership Mapping with the help of concerned Government depts./Authorities
- Booking of potential Tax payers
- Special focus on Property Income cases
- Commercial areas within posh localities
- Disclosure of full banking transaction online

3.6 Direct Revenue Sources - Income Tax

Taxes are just like a fuel to run the machinery of the state institutions and carry out development work in public sector. The National Assembly was informed on 7th June 2011 that Pakistan was second from the bottom among 154 countries on tax to GDP ratio ranking. Comparison of Pakistan with advanced and developing countries shows that Pakistan is on the lower side of number of taxpayers out of total population. The following table illustrates the point of view:

Table: 1

Country	Population	No of return filers	Percentage of filers to total population
USA	293 million (2004)	131.1 million	45%
India	1210.1 million (2011)	33.7 million	2.78%
Pakistan	173.5 million	1.69 million	0.93%

Source: (i) IRS Tax Foundation

(ii) Times of India, May 2, 2012

(iii) FBR and UN population estimates on Pakistan

Table: 2

	2010-11	2011-12
Total revenue collected as income tax	Rs. 602.5 billion	Rs. 740.5 billion
No of return filers in 2011	1.5 million	1.69 million
Collection on demand	Rs72.1 billion (12%)	Rs129.9 billion (17.5%)
Tax paid by non-filers (Mainly Withholding tax and advance payments)	Rs530.4 billion (88%)	Rs608.9 billion (82.5%)

Source: Dawn News 19 August 2012

FBR Quarterly Review: Vol 11, No.4, April-June 2011-12

FBR Statements

The following table indicates the number of return filers which clearly indicates the extent of narrow base

Table: 3

Tax Year	No of persons who filed income tax returns
2008	1.57 million
2009	1.72 million
2010	1.6 million
2011	1.5 million
2012	1.69 million

Source. Business Recorder 25 January, 2013

The above state of affairs reflects the low level of compliance of the population in respect of filing of returns of income as compared to the other countries. Income tax contributed Rs 740.5 billion which constituted 39.3% of total federal tax revenue collected during 2011-12 and represented 3.5% of the GDP. The second and another thing to consider is whether the FBR is collecting taxes only from the return filers or from the non-filers?

Another question is as to which population the FBR wants to target for broadening of tax base. Whether it is more than 80% of the population segment which pay taxes but doesn't file returns. Purpose is to get more returns or revenue.

One estimate could be the number of house-holds living above the poverty line which is 19.753 million (if one earning person per household is taken into account) and the other may be the net paid labor force which is 38.9 million and seems more reasonable. But no data on income distribution is available on this 38.9 million paid labor force. All the paid labor force of 38.9 million can only be netted to tax if all of them are earning minimum annual income of more than Rs.400,000. At present, a mere 3.4 million population has obtained NTN

and out of them just 1.29 million people have filed their income tax returns in 2012. So keeping in view the 38.9 million paid labor force just 1.29 million are filing their returns. The missing figure comes to 37.7 million. However, this figure of 37.7 million needs more refinement by taking into account the level of income whether below the taxable threshold or above the threshold, type of income whether agricultural or non-agricultural income etc. The 37.7 million paid labor force is required to file their income tax returns only if each of them is earning non- agricultural and taxable income above Rs400,000 per annum. Since the data on income distribution among paid labor force is not available accurately therefore the FBR needs to first determine the way-out to ascertain the number of persons earning taxable income of Rs400,000 and above out of total 37.7 million paid labor force.

According to the labor force survey of Pakistan 2011 out of total labor force 37% is engaged in agriculture. So 37% of paid labor force would be out of the purview of FBR as tax on agricultural income is levied and collected by provincial governments. So taking into account the 37% agriculturalists the balance paid labor force comes to 23.8 million (37.7 million - 13.9 million). The figure of 23.8 million would be further squeezed if accurate data on income distribution is applied on the figure. After determining the size of target population we need to specifically move on to hunt the persons who are earning the taxable income but not filing their returns of income. One of the steps is the information collected by the FBR on 3.8 million people who are making foreign tours, maintaining bank accounts and possessing properties but are not on the tax roll. If these 3.8 million people are hunt still 20 million people are left as un-enrolled. There is another question as to whether the 3.8 million people can be made regular taxpayer or not? There is not much certainty for the reason that data available on these persons relates either to expenditure or assets. A person can be taxed on un-explained investment or expenditure under the law only for a specific tax year. He can be brought into the net as regular taxpayer only if it is established that he is doing some business or earning taxable income from other sources.

The second step then should be physical survey of business units in major urban localities by detecting the businesses which are not on the tax roll. This exercise would require much involvement of work-force. To take benefit of modern technology, business directory of Pakistan and of other various cities can be utilized for the purpose. Another option can be outsourcing of trained manpower for the purpose of conducting the survey.

Besides the taxpayers, a survey should also be conducted for bringing more and more persons into the net of withholding agents. Each and every person paying money under different heads or collecting money on account of certain utility services is required to collect withholding taxes. Centralized data on number of withholding agents may be compiled and survey be conducted to find out more and more withholding agents into the net.

Another aspect which we tend to forget while talking about broadening of tax base for increasing the tax to GDP ratio is the contribution of provinces in the taxes. When we talk about collection of taxes only federal taxes come to our mind and with reference to federal taxes only FBR sticks to our mind. Provinces also have a greater role to play in broadening the tax base. When we talk about broadening the tax base it includes all federal and provincial taxes. Overall provincial tax to GDP share has declined from 0.55% in 2009-10 to 0.46% in 2010-11. In order to have a better idea about the contribution of provinces in overall collection of taxes the following table would help us:

Percentage Share of Provinces Own Taxes Out Of Total Budget

(Table: 4)

Province	Year 2000	Year 2005	Year2010	Increase / decrease
Punjab	12.3 %	10.6 %	8.4 %	- 3.7%
Sind	9.6 %	10.3 %	9.2 %	-0.2%
KPK	4.4 %	5.2 %	2.6 %	-5.0%
Balochistan	2.3 %	2.6 %	2.5 %	0.8%
Total	9.3 %	9.2 %	7.4 %	-2.2%

Source: Annual Budget Statements of four provinces for various years

The table shows that except for Balochistan share of taxes in provincial budgets is declining for the last ten years. Overall decline in collection is -2.2%. On the front of tax to GDP ratio provincial shares have also declined from 0.55% to 0.46%. The FBR is not to achieve the target of 15% tax to GDP ratio but provinces have a greater role to play in this regard as they are taxing the agriculture income which constitutes a greater share in Pakistan's GDP. Further, Sales Tax on services has also been started by Sindh and Punjab governments so the responsibility of increase in Tax-to-GDP ratio should be settled now between federal and provincial taxes on the basis of tax potential and targets should be assigned separately to both the federal and provincial governments to achieve overall 15% Tax-to-GDP ratio.

If we compare the role of Indian States and Union Territories in collection of taxes we see that in the year 2009-10 the states collected 25.5% (Figures are derivatives reported in Times of India 31st December, 2009) of country's total revenue which means that around 75% of the revenue was collected by the Centre. In Pakistan if we sum the total taxes collected by provinces for 2010 as reported in the annual budget statements, the figure comes to just Rs63.5 billion. The FBR collected taxes of Rs 1,558 billion (FBR website). If we club both the federal and provincial collection of taxes they come to Rs1,622 billion. The share of provinces in total tax collection comes to 3.9% as compared to India which is 25%. So if the provinces of Pakistan come at par with Indian States in terms of percentage of tax collection of 25% the country can cross the double figure of Tax-to-GDP ratio. For income tax purposes, the population of the country can be categorized as:

- (1) Cases with no incomes or whose incomes are below income tax threshold,
- (2) Cases which fall within the taxable bracket but are exempt from payment of income tax under Schedule" of Income Tax Ordinance: 2001
- (3) Cases which fall within the taxable bracket but have successfully avoided entering the tax net.
- (4) Cases which are within the tax net but under-report their incomes

- (5) Cases which are within the tax net and correctly report their incomes but where there is the possibility of differences with the tax department on the extent of their taxable income.

The first category does not need our attention as they are not our concern.

The second category is documented sector of the economy but exempt from tax under the law. Different persons under this category are exempt from tax by name or by category e.g. welfare institutions. One example is of State Bank of Pakistan which is a corporate body constituted under section 3(2) of the State Bank of Pakistan Act 1956. If the exemption granted to the bank under clause 66 (xx) of the Part I to the Second Schedule of the Income Tax Ordinance, 2001 is withdrawn then FBR can get tax of Rs.91 billion as in the last fiscal year the bank declared its profits for Rs260 billion. Definitely the government would get nothing extra (except impact on revenues in the federal divisible pool) because the government receipt of Rs91 billion as non-tax revenue would be converted into tax revenue. However, the Rs91 billion can enhance the Tax-to-GDP ratio by 0.47%. If withdrawal of just one exemption can increase the ratio by half percent then total impact of withdrawal of exemptions should also be estimated and a step can be taken towards this direction.

The third category is of our utmost importance and this should be our main focus and target population. There are the people who are legally required to file their tax returns and pay taxes. First of all the size and number of this population has to be determined. An *effort* has been made in the above paragraphs to determine the number of such persons which was calculated at 23.8 million. FBR already collected data on 3.8 million people who are living lavishly but are not income tax filers. This is a step in the right direction.

Fourth category also requires our utmost attention as the issue of under-assessment is of more importance. It is a matter of allocation of human resources of FBR as whether to allocate more personnel for increasing the tax base and book new taxpayers or *give* more attention to check under- assessment. The

department should strike a balance between two endeavors in respect of allocation of resources.

There is a wide spread perception that elite class must *be* focused in the short run to net its immense tax potential. For this, it is agreed, that the FBR has to identify the areas where real taxpayers can be found by examining the living style and spending habits of upper middle and elite class. When an individual earns some income, he first of all consumes it in meeting his basic needs and then spends remaining amount in following heads: respectable living' rented or owned premises; respectable transport preferably owned vehicles; best education for children in expensive educational institutions; recreation activities; membership of clubs; investment in real estate, shares trading, and local and international travelling. Respectable housing facility is normally arranged through rented, self-owned or family-owned houses / flats. In each rented house, there are two types of taxpayers, one of which is the tenant and the other is the owner.

One of the adequately documented expenditure indicators in the residential units of the country is the annual consumption of electricity i.e. up to 100 units 45 percent; 101-300 units 40 percent and above 300 units 15 percent. According to an analysis, it is interesting to note that only 15 percent of the domestic consumers consume almost 50 percent of the electricity consumed by all domestic consumers. Here is the real tax base of upper middle and elite class.

The ICAP Taxation Committee Chairman, considered new vehicle buyers property buyers etc. should be tapped to broaden the net tax base. Bringing the consumer affording such high cost assets into the tax base would be advantageous for taxation authorities. The consumers maintaining bank accounts to a certain limit could also be brought into the tax base. It was the time only to bring new consumers in the tax base and make them file yearly returns, the correct payment of tax or its audit is the next step. Every taxpayer should be facilitated by the government to keep them filing returns every year. Moreover, data banks could be established to bring all taxpayers at a single

platform. There should be a single number allowed for all national identity card holders, income tax payers, passport holders etc. to check their status and access them in the quickest way. Rise in documentation of various sectors, which contribute to the economy and introduction of incentive schemes on investment are likely to broaden the taxpayers' base.

ICAP stressed effective legislations of regulations, which requires mandatory incorporation of the documents executed for transfer of properties, shares, vehicles, travels, bank savings and borrowings and other large expenditures. Taxpayers may be given incentive if they provide documented bills of sales, supply, contracts or services to the revenue authority. It strongly recommended the government to establish a Research and Development (R and D) department under the auspicious of Federal Board of Revenue in order to obtain the maximum information of taxpayers and companies. The R & D department should embark on various studies on the factors of undocumented economy, contribution of multiple sectors to the national kitty, scale of economy and generation of potential tax accordingly.

The Karachi Income Tax Bar Association (KITBA) considered to introduce Common Tax Identification (CTI) number to companies and association of persons in order to monitor complete transactions of financial assets across the country, which can scan their maximum income and expense transactions. "This measure would widen the tax net of the country that will also accrue the contribution of direct taxes to the national exchequer," KITBA said and added the tax rates will decrease at different levels subsequently with the growing number of taxpayers.

3.7 Indirect Revenue Sources - Sales Tax

Sales tax is an indirect tax and is charged on the consumption of goods and services. It contributed Rs 804.84 billion (42.7%) of net federal tax revenue collected in 2011-12. Sales tax is collected on VAT mode which is a modern form of sales tax. VAT differs from traditional sales tax which was earlier being

collected in different countries in the form of a turnover tax. Currently, VAT-type sales tax is being collected in more than 150 developed and developing countries. Unlike traditional sales tax, VAT is collected at every stage of the supply chain and the tax paid at previous stage is deducted from the next stage tax conceptually rendering the net tax liability restricted to the value *addition* of the given stage of the supply chain. In this way, VAT is a multi-stage tax with single stage impact. Imports are treated as first stage supply into national economy without any backward linkage for the purpose of tax assessment. VAT is not only a convenient source of revenue generation but is also an effective source of economic documentation. Throughout the world, VAT has increasingly replaced (excise duties) except excises on such externalities of consumption as are believed to be dangerous from the angle of non-productivity or luxury, security of life and health regards, protection of environment protection and avoidance of social evils. At the time of partition, Pakistan inherited a traditional system of sales tax. Capital goods and industrial raw materials were generally exempt. Sales Tax was collected at import as well as at local production stage. Some items were chargeable to sales tax at wholesale stage. There were multiple tax rates including fixed/specific rates and the system was replete with a wide range of exemptions and concessions. Excise duties were more dominantly important than sales tax which was in fact a residual source of revenue income.

Originally, sales tax was a provincial levy. It was federalized in 1951. Old legislation was replaced with the new one, which continued till '1990 when VAT-mode legislation was introduced. Even after federalization, import-related sales tax continued to be collected in the manner applicable to customs duties. Sales tax on domestic production remained collectable in the mode followed for the collection of central excise duties. However, overall management of sales tax was assigned to Income Tax department. As direct taxes remained the predominant concern and priority of the Income Tax officials, sales tax regime over the passage of time, mainly due to the professional neglect and operational non-attention, had developed several serious structural inefficiencies. Domestic sales tax revenue remained as low as only Rs.600 million in 1981-82 when it was

shifted from direct tax administration to indirect administration. The management of sales tax remained so assigned till 2010 when Inland Revenue department was created to undertake composite management of income tax, sales tax and excise duties. During 1981-2000, the following major milestones were achieved to make sales tax a leading national tax domain:-

- i. Sales tax processes and procedures were modernized and harmonized with those of customs and excises to achieve maximum simplification and promote non-interventionist tax management.
- ii. Documentation was streamlined to curtail assessment discretion and ensure progressive multi-tax management efficacy.
- iii. Sales tax system was VAT modeled and constitutional constraints were overcome by bringing services under VAT net either through modified excises or through provincial sales tax legislation.
- iv. New sales tax and excise laws were introduced in 1990 and 2005 respectively to eliminate colonial legacy and bring the national consumption tax management system at par with international standards.
- v. Excises were gradually replaced with sales tax with minimization of exemptions of sales tax. Resultantly, Sales tax collections increased more buoyantly despite low national economic growth rate,
- vi. All the three indirect tax systems (customs, excises and sales tax) were automated with information technology applications. Pakistan emerged as the first country in South Asia to adopt across the board e-filing with a facility of e-payment

Consequently, the revenue of domestic sales tax exponentially increased from Rs. 600 million in '1981-82 to Rs 269 billion in 2009 -10. Sales tax was taken over by IRS without ensuring complete retention of the expertise at the supervisory level due to which the public is facing difficulties in the short run and the tax evaders will take

chances wherever they see weak supervision. Besides, combination of two major taxes one direct and the other indirect, is perceivably fraught with the possibility of aggravating the nuisance value of IRS officials. In view of the serious short term and long term implications, it is believed that it would have been better if the government did not place the sales tax (indirect tax) under IRS. It should have been made an independent service group for induction through CSS by FPSC. Besides, the tax rate needs to be rationalized, 10% Sales Tax is considered appropriate under the VAT System. The rate can be reduced by one percentage point every year when the fiscal space so permits after stabilization of the economy.

3.8 Custom Duties

Customs duties contributed Rs 216.89 billion (about 12%). Customs duties are collected on import and export of goods in terms of the Customs Act, 1969. Before 1970, these duties were collected under the Sea Customs Act, of 1878. The Customs Tariff was initially based on the Brussels Tariff Nomenclature (BTN) developed by the Customs Co-operation Council at Brussels (CCC). The CCC was initially a Western European organization established in 1952 as a support mechanism for European economic cooperation. The CCC was an intergovernmental body to handle customs matters. It began with 17 members which were all European. Pakistan became the first non-European and the 18th member of the CCC on 16 November, 1955. This distinction is recognized and honoured by the organization as a symbol of farsightedness of the customs administration in Pakistan. In 1994 the CCC adopted the working name of World Customs Organization (WTO).

Brussels Tariff Nomenclature [BTN] was replaced in 1987 by Harmonized Description and Classification Code known as HS Code. 179 Countries of the world dealing with 98 percent of world trade have adopted this uniform customs tariff classification system. This HS Code was revised in 2007 and 2012. Pakistan Customs tariff is based on the updated version of 2012. As regards customs calculation, Pakistan alongwith other member countries of CCC, initially followed the Brussels Definition of Value [BDV]. This valuation system was replaced in Pakistan in 2002 by Transaction Value concept by WTO.

Brussels' Definition of Value (BDV) empowered tax administrations to determine normal value on the bases of data of similar goods for purposes of charging customs duties irrespective of transaction value. This flexibility allowed efficient customs administrations to effectively deny the fruits of under-valuation /under-invoicing to the unscrupulous importers. As it was not in the export promotion interest of the developed countries they engineered replacement of BDV with Transaction Value. Being a signatory to the WTO agreement on valuation, Pakistan had to adopt the new concept which denied the ease of determination of normal value and obliged acceptance of declared transaction value unless hard and direct evidence of under-invoicing is available. Requisite evidence is practically more difficult for developing countries than developed countries to come by because of outreach and efficiency problems. Thus, customs administrations of developing countries have become more vulnerable to tax evasion through mis-declaration of value. This vulnerability gets compounded by lack of accountability of tax administration. The customs officers can now easily blame the transaction value system to avoid fixation of responsibility for evasion of duties.

In the customs tariff however, there are no system or design problems. Despite this, tariff classification can be manipulated in collusion with customs examination and assessment staff. Hence the un-abating problem of tax evasion in customs through mis-declaration of quantity, quality and value of goods.

The taxation base in customs is as narrow as in income tax or sales tax as smuggling is a parallel import regime without payment of customs duties and taxes. The sales tax invoices are also being abundantly misused to justify existence of smuggled goods showing these to be regularly imported and duty paid goods. Under-invoicing and mis-declaration have massively skewed the narrow tax base of imports through regular channels. ISAF Containers Scam, Karachi Duties Free Shop (102) Containers Scam, 265 transshipment and transit Container Scam at Port Qasim, the black hole of evasion through provisional release goods under section 81 of the Customs Act, 1969, all constitute major

symptoms of the porous customs administration. The biggest scam is perceived in anti-smuggling operations. Those organized smugglers who collude with the anti-smuggling staff are protected against any intervention. Small scale 'khepias who venture to operate incognito without sharing the fruits of smuggling with customs anti-smuggling staff are efficiently detected and subsequently effectively covered up when the bargain gets settled. A usual indication of this phenomenon can be seen through the deficiencies of material particulars in the seizure reports which help the cooperative culprits to finally get acquitted.

The anti-smuggling and anti-evasion staff falsely attributes information to the higher officers to keep them appeased and pleased with them. Hardly any supervisory officer has the qualms of conscience to repudiate false attribution of information as it yields the entire share of informer's reward to the officer to whom the information is attributed. Secret funds which could be used with advantage to detect evasion and smuggling is mostly misappropriated by the authorized officers. It is a sad story that all the facilities available to the customs officers from duty free customs shops, medical facility, informer's reward, and secret funds have been so blatantly misused that most of these facilities have either been withdrawn, or reduced. The bottom line is that the customs service which is inherently a very decent and sophisticated job, has miserably failed to foster a culture of integrity and efficiency and *esprit d' corps*. Consequently, everybody is on his own. Nobody protects anybody against outside pressure. So everybody finds safety in acquiescence. The collection system is now on the mercy of importers and clearing agents. A well concocted complaint, however false it may be, can land even an efficient and honest officer in serious trouble. So, the number of *trouble seeking* officers for the sake of revenue has sharply dwindled. Indiscriminate payment of double salary equally to the most corrupt and the inefficient has blunted the edge of motivation sought to be injected through monetary incentives. Financial incentives without distinguishing the corrupt from the honest, inefficient from the efficient and the collusive from the upright would be a sheer waste of national resources. Capacity building is another complementary imperative. But the real solution lies in relentless accountability. The corrupt should be relentlessly sacked

and sent home. Instead of amassing easy wealth, they should be sent home and thus made to invest the already amassed wealth in business and industry to sustain their 'royal' living styles. The remaining officers should be given the incentive of double salary provided they undertake to meet the requirements of efficiency and integrity failing which they should also meet the same fate. This is the only way out of the present stalemate. It's a now or never chance. The nation needs to rise to the occasion. The customs administration must face the bitter realities with requisite earnestness to change for the better.

3.9 Tariff Exemptions and Concessions

No exemption or concession of tax or tariff be granted without effectively ensuring transfer of its full benefit to the end consumer. Tea is a case in point. Customs duty on tea has been gradually and substantially reduced during the past few years without ensuring corresponding reduction of retail prices. Thus, the tax expenditure in terms of tariff reduction has been a net loss to the national exchequer without any benefit to the end-consumer. The tea companies appropriated almost the entire benefit as their profit. The argument of smuggling for which tariff concession is sought and granted without ensuring effective reduction in retail price of tea is a farce because smuggled tea competes with retail price of legally imported tea. Smuggling of tea would not stop at all even if tariffs and taxes are reduced to zero unless tea companies correspondingly reduce the retail price on sustainable basis. Therefore, those who indulge in such inefficient tax relief's and tariff concessions must be held accountable for such decisions.

3.10 Free Trade Agreements

Free Trade Agreements are relatively more beneficial to developed economies because of export surplus and other comparative advantages. The template of such agreements has to be re modeled in order to save the free trading partners from any adverse economic implications. For an example, if an intermediate product like PTA is allowed duty free import for the benefit of downstream polyester fiber polyester manufacturing chances of investment in the local manufacturing of upstream products

raw materials of PTA such as Paraxylene and MEG etc. go a begging. As manufacturing is not mostly fully vertically integrated in developing countries, the costs and benefits of duty free trading of intermediate or final products has to be carefully examined futuristically. A selective approach for duty free import would be a better option than a total approach with a few exclusions. In Pakistan-Sri-Lanka free trade agreement for an example, it would have been much better if we had identified the items of our requirement such as tea, rubber, copra, betel leaves and betel nuts in which Srilanka has the competitive strength and export surplus. Sri Lanka could have exchanged these goods with rice, cotton, cotton yarn and cotton cloth from Pakistan with both countries capping the upper limits in terms of value. The lists could be gradually expanded overtime depending on the export surplus strength and import requirements of each country. The impact of duty free exchange on prices has also to be kept under watch for ensuring competitive prices.

This approach would be better for use in future free trade agreements and also at the time of review of the old ones. It would not only reduce Pakistan's tax expenditure on exemption of customs duties (Rs 91 billion during 2012) but also protect the potential upstream manufacturing/production potential of Pakistan. In view of these considerations, our approach to free trade agreements has to be reviewed and remodelled in our national interest; the comprehensive free trade model suiting the developed country notwithstanding.

3.11 Need for Addressing Systemic Issues in Taxation

Any reform vision for redressal of tax maladministration can be successful if the systemic issues are identified, contextualized and articulated at appropriate levels, using the organizational experience gathered over the years, In other words, only 'informed' reform vision is likely to be successful in the modern day governance system. This requires initiation of an overarching reform initiative which has the capacity to sustain itself over a long period of time and has flexibility to absorb and synthesize competing and divergent interests. The Government of Pakistan has been trying for the last two decades to restructure and reform tax administration. Restructuring may have taken place but reform is still a far cry.

The main reasons for deficient reform are basically lack of absorption capacity of the available human resource and weak accountability. The donor driven reform Programmes also fell short of their goals because these lacked enforcement and accountability mechanism in the obtaining environment of impunity for tax maladministration. The need for reform of tax administration is more acute now than *ever* before in view of the critical requirements of macro-economic stability for expanding fiscal space by reducing the fiscal deficit through increased domestic resource mobilization.

Federal Tax Ombudsman is empowered under the law to diagnose, investigate, redress and rectify tax maladministration. It is accordingly delivering speedy and in expensive justice to the tax payers aggrieved by mal administration of tax functionaries. During the last 13 years of its existence since September, 2000, the FTO Office has decided about 20,000 complaints mostly of the least empowered and underserved majority of tax payers. During this period about 1200 review applications were also decided. Based on the diagnosis of individual complaints, the focus of FTO is now converging on addressing systemic issues plaguing revenue efficiency of the tax administration.

The extent of wastage of management time and effort of tax administration on account of systematic issues and the cruel cost of doing business for the aggrieved tax payers can be gauged from the fact that the matter which should not take minutes or hours to resolve in this day and age of automation takes not days, weeks or months but years to get decided, much less to think of getting resolved. The most painful aspect of weak dispute management is that the issues mostly pertaining to the weak and vulnerable among the taxpayer community remain unresolved. It not only indicates the gravity of tax maladministration but also of the undesirable tolerance level of the aggrieved taxpayers who suffer for years, to get their problems decided. They generally avoid making complaints to external for a such as the FTO Office for fear of reprisals which they can ill-afford due to the regular dependence of their businesses on tax functionaries. It is only after their exasperation with endless delays that they take resort to making complaints to any external forum.

The FTO Secretariat has used its in-house capacity of Advisors to diagnose taxpayers' issues by utilizing both the reactive and proactive approaches. While investigating the complaints, systemic issues are diagnosed which taxpayers are repeatedly facing at the hands of tax functionaries. These include inordinate delay, non observance of mandatory time limits, non-responding to taxpayers correspondence, inefficient handling of tax fraud cases, and discriminatory and arbitrary decision making. Proactively, systemic issues are identified and addressed under the own-motion jurisdiction of the FTO.

3.12 Separation of Revenue Policies from Collection

Under current scenario, the FBR plays a fundamental role in formulation of fiscal policies and levy and collection of federal taxes. There is a need to ascertain if there is an inherent synergy in these roles to keep them together in the FBR as at present or separate them to achieve greater focus and improved efficiency. There is an urgent need to restructure the FBR to augment, strengthen and improve its collection policies, methodologies, procedures and technology.

As the FBR starts slipping in collection they may start nudging in the policy to makeup the shortfalls. Such midcourse corrections and adjustments could distort the economic plans and affect the synergy considered essential for healthy economic management. The collection poses serious challenges in the country as a significant part of the economy remains undocumented. It may be a useful reform to keep the singular responsibility of collection with FBR so that they could concentrate all attention and direct all resources to improve collection efficiency. They should, however, be empowered to make policies for collection and administration related to it.

The planners extend the vision, visualize the development goals, fix revenue targets, develop a policy of selective taxation, exploiting fully the synergy of the economy and lay the long thread. The Collectors implement the revenue policy effectively and achieve revenue targets without discrimination, favors or neglect. It may be a gross simplification of the complexity of modern day economy but it typifies the distinction

between the roles of planners and those of the collectors. As with any massive activity, the collectors get so engrossed in the nitty-gritty of collection that they lose the overview needed for policy development. In our case the issues of collection put a backward pressure for shaping the policy, distorting the system and hence the need of systemic reforms. Similarly the roles of operational and supervisory levels of tax collection machinery need to be well-defined and enforced to avoid the ambient confusion which is a main source of evasion and fraud in tax collection.

3.13 Independence of Judicial Forums

The current tax judicial system has failed to meet the minimal requirements of a neutral system for dispensation of justice that should enjoy trust and confidence of the taxpayers, thus require a complete overhaul. The existing system suffers from manifold maladies including:

- (i) At first level of adjudication / assessment, the disputed matters are adjudicated by the departmental officials. Most of these cases are initiated by the same officials or their colleagues working in the tax collecting organization. It is unfair to expect them to dispense justice in such matters as neutral adjudicators.

Tax Collectors, with few noble exceptions, generally have an inherent revenue bias. They are assigned tax collection targets whose achievement or failure to do so determines the basis of their annual performance evaluation. How can they be expected to withdraw a tax demand no matter how unlawful it be?

Tax officials do not receive any formal meaningful training in judicial / quasi-judicial processes and their pre requisites nor are they familiar with principles of statutory interpretation and a voluminous stock of case laws that they should be familiar with in order to do justice to their role as a judge.

- (ii) The second tier of adjudication namely Commissioner of Appeals are also drawn from the FBR officers who report directly to FBR. They too tend to follow the approach of junior colleagues whose decisions they have to review as an

appellate authority. As their postings as appellate authority is not for a fixed period they may not feel and posture independence in their actions.

There is no effective and independent system of monitoring the performance of departmental adjudicating officers: a revenue collecting agency is designed to maximize the turnover and those who help doing so cannot be called to question no matter how questionable their judgments could be on the touchstone of justice, equity and correct / uniform interpretation of taxation statutes.

In the absence of any internal accountability the first and second tier of adjudication are least concerned even if an overwhelming percentage of cases decided by them are thrown out by the superior courts.

- (iii) The final tier of tax adjudication proceedings is the Appellate Tribunals working under the Ministry of Law & Justice. The Tribunals are called to be independent of tax collecting hierarchy and traditionally they have been dispensing justice to some degree though their performance has perhaps not been objectively reviewed / analyzed over the years to determine their efficacy. Appellate Tribunals function as the final arbitrators is marred by the following:
 - (a) In view of the fact that it is difficult to attain justice from the first two tiers of adjudicators, most cases end up at the Appellate Tribunals and their existing capacity has been overlooked . Pendency of certain appeal matters over several years is a matter of common knowledge.
 - (b) Appellate Tribunal generally comprise of Member (Judicial) usually belongs to judicial service (or a practicing lawyer appointed by the Justice Division) and the Accountant Member. The tax laws in Pakistan, like any other country, are complex and their implementation / interpretation entails considerable expertise. Accountant Member's overwhelming experience during service is generally limited to administrative / executive assignments of revenue collectors. More often than not Member Judicial or practicing lawyer appointed by Ministry of Law & Justice Division may

not have reasonable expertise connected to or prior experience in taxation laws and implementation thereof. Consequently the Appellate Tribunal functioning is marked by delays and inefficiencies.

The Sub-Committee considers that it is the time that the Appellate Forums should be made independent from the formal / informal influence of FBR. The tax adjudication system must rest on fundamentals of independence, insulation and isolation from tax collection. The prosecution has to be separated from adjudication with gradual shift towards independence by transferring the adjudication system under the command and control of independent office or Ministry of Law or most preferable under the respective High Courts in conformity with section 10A of the Constitution. In transitional phase, transfer of tax officials to adjudication system should be based on option exercised by tax officials and there should be a bar on repatriation to the administrative function. Alternatively, adjudication may remain with the Tax Departments and Appellate fora should be staffed by well-reputed retired departmental officers of the FBR and higher judiciary to dispose speedy justice internally as is being done by the Federal Tax Ombudsman. In long term, there should be a separate process in place for appointments and career management in tax adjudication system.

3.14 Improvements required / removal of impediments

Corporate income tax rates

Presently, corporate tax income tax rate is 35% in Pakistan. This rate is uniform for all classes of companies and sectors. Globally, and as being experienced in Pakistan, there is a shift towards indirect taxes and consequently, the corporate tax rates have been lowered down. The average corporate tax rate among 116 countries has fallen from 31.92% in 2000 to 25% approximately in 2010. Further, in Pakistan, the listed companies are more documented and subject to stringent corporate compliances as compared to private limited companies, but in taxation both are treated at par.

The sub-committee considers that the static rate of 35% for all classes and sectors is an impediment in industrialization in the country. The need is to rationalize corporate

tax rates and the industries / sectors which contribute more to the economy should be given preferential treatments in taxation policies.

Corporate tax rate for listed companies be reduced to 30% and for industrial undertaking such rate be brought down to 25% at an appropriate time when the fiscal space so permits after stabilization of the economy.

3.15 Amendment in tax laws be publicized before enactment

Historically, the amendment in tax laws are made through the Money bill presented before the legislature generally in the month of June and such amendments are made effective from 01 July. This gives very short time to the stakeholders to review and gauge the impact of such amendments and make suggestions for changes. Further, it causes difficulties in implementation of such amendments due to short of time and thus put the taxpayers in difficult position which sometimes lead to litigation as well.

There should be an independent statutory body to propose amendment in tax laws. In the meanwhile, it is suggested that the amendment in tax laws should be finalized one month before tabling of Finance Bill in the parliament and publicized for comments from stakeholders. This would give a fair amount of time to all the stakeholders to absorb, suggest changes and implement the amendments in tax laws in timely and efficient manner.

3.16 Stay for recovery of tax demands

Due to budgetary pressures, it has been witnessed that the tax authorities frame frivolous demands against taxpayers and then initiate forced recovery measures. This situation causes business threats and on the other hand opens the doors of corruption.

It is recommended that the relevant tax laws be amended in a manner that tax demands raised in an order should remain stayed until decision is given by the first appellate authority. Further, a stay of demand is generally granted for specific period or till the decision in the appeal, whichever is earlier. However, there is a statutory bar on stay for more than six months. Sometimes, the appeals are not decided even in six months. Therefore being no fault on the part of the taxpayer but such unjustified situation put the taxpayers in jeopardy. It is suggested that appropriate amendments

be made in relevant tax laws that the stay of demand granted by an appellate authority shall remain valid / effective until decision given in appeals. If a tax demand is finally upheld by the appellate authorities or decision is given / pronounced, demand may be enforced in line with the decision given by the appellate authority.

3.17 Timely decision by the appellate forums

Presently, either time limits for decision in appeals before the Commissioner (Appeals) and the Appellate Tribunal are not there or the time limits prescribed are dependent on notices by the appellant. This situation causes delay in decision in appeals. Taxpayers are afraid of giving notices prescribed due to apprehension of adverse impact.

It is suggested that all the appellate authorities be time bound to give decisions in appeals within six months of filing of an appeal.

3.18 Time line be defined for service of orders

It has been testified that in some cases assessment orders are served after long period of time, even in some cases orders have been served after years. Further, it has also been testified that in some cases even orders passed are not served and the taxpayers only come to know of such orders at appellate stages.

It is recommended that taxation laws be amended in a manner to provide that an order passed should be served on the taxpayer within 15 days of the date of the order failure to which such an order will have no effect unless reasonable cause exist.

3.19 Tax credits / inputs be allowed on production of original receipts

It is a growing practice of the tax authorities that while framing assessments, due tax credits are not given on the premise of lack of verification from departments own data, in spite of the fact that taxpayers produced all original tax payment receipts. This situation causes hardship to the taxpayer, as due to short credits, erroneous tax demand is created and forced recovery measures are initiated.

It is recommended that appropriate amendment be made in tax laws to bind the tax authorities to give credits for taxes paid / deduction / adjustment on the basis of original tax payment receipts produced by the taxpayer.

3.20 Performance evaluation of field formation not to be solely based on collection

Field formations are pressurized through budgetary targets which impairs their efficiency and fairness in their proceedings. Further, their performance evaluation is generally gauged through revenue collections, irrespective of quality of their work.

It is recommended that while field officers are given revenue targets, their performance evaluation should not be solely based on revenue collection. There should be in place key performance indicators e.g. bench marking for number of audits / assessments to be completed in a year, quality of assessments / audits determined by internal audit, x percentage of orders sustained at appellate tribunal levels, tax collection and refunds, feedback from taxpayers etc. Such Key Performance Indicators (KPIs) should also be known to the taxpayers so that they can give their feedback, on request or own motion, to the FBR directly.

3.21 Expeditious processing of tax refunds

There are statutory time lines in the taxation laws for verification and issuance of claims of tax refunds. However, by and large, such time lines are not observed by the tax authorities which delays refunds of income tax, sales tax, and excise duty and Customs duty drawback claims of exporters.

It is recommended that the FBR should issue necessary instructions to the field formations to timely settle tax refund and duty drawback claims within statutory periods. Further, all refund claims should be processed electronically, from filing of claim till issuance of refund or otherwise, so as to bring transparency in the process and adherence of time lines.

3.22 Issuance of notices from various field authorities

There is a growing tendency to seek information by different tax officers from different regions from a taxpayer. It is suggested that the FBR should direct all the

field formations that all requests for information from a tax payer should be forwarded to the concerned officer having jurisdiction over the case of the taxpayer and after collecting the information required from the taxpayer forward it to the requesting officer. This would ease the taxpayer to comply with notices from one jurisdiction rather than from multiple jurisdictions.

3.23 Short time allowed for compliance to notice

By and large, it is now tendency in the tax officials to issue notices for compliance within few days. These put pressures on the taxpayers as some time the compliance sought involve voluminous information / evidences and sometime pertaining to prior periods which may not be readily available. The tax officials generally resist to give time and levy penalties for failure or delay in compliance

It is recommended that appropriate amendment be made in the taxation laws to provide statutory time of minimum 15 days for compliance to the first notice from the date of receipt and no adverse action to be taken against the taxpayer until a further opportunity is provided for further 15 days.

3.24 Selection of cases for audit without any criteria

Unbridled powers for selection of cases for audit to the Commissioner are used discriminately and without independence of mind which also negates the fair trial envisaged in Article 10A of the Constitution. There has been debates in past on prescription of parametric criteria for selection of cases for audit. However, for one or the other reasons, this could not be done so far.

The sub-committee recommends that the FBR should lay down broad parameters for selection of cases for audit and the field Commissioners while selecting a case for audit should establish in the notice that selection is based on such criteria.

3.25 Taxpayers Bill of Rights

The Government must enact a Taxpayers Bill of Rights on the lines explained below:

Declaration of Intent

The objective of the Government of Pakistan (Government), specifically its Federal Board of Revenue (FBR), is to: (i) provide Pakistan's taxpayers best quality services by helping them understand and meet their tax responsibilities; and (ii) make and apply the tax laws and policies consistently with integrity, certainty and with fairness to all. The taxpayers are entitled to the following rights, which the Government, including FBR, recognizes and undertakes to promote and protect to the fullest extent:

Governing Principles

- (a) A taxpayer shall not be subjected to any form of taxation imposed or any kind of relief from taxes granted by any executive authority by or under any subordinate legislation in accordance with the principle enshrined in Article 77 of the Constitution of Islamic Republic of Pakistan 1973 (Constitution) that: "No tax shall be levied for the purpose of the Federation except by or under the authority of the Act of *Majlis-e-Shoora* (Parliament)." The Government shall not levy any unauthorized or unreasonable tax or grant any relief there from through the issuance or Statutory Regulatory Orders (SROs) or any other executive action without the knowledge and participation of public at large.
- (b) A taxpayer is entitled to have taxes collected and spent for the purposes specified in Articles 3, 37 and 38 of the Constitution. The Government shall ensure that taxpayers are protected from arbitrary and unjust taxation, and go through the process of consultation with the concerned taxpayers before the imposition of new taxes or the revision of existing tax rates.

Right to Information and Assistance

- (a) A taxpayer has the right to obtain complete, accurate, clear, and timely information from FBR regarding the basis for and amount of any tax, interest, and penalties owed or refunded when sent a tax demand or other notice. He shall have the right to know why FBR is asking for information, how it will use it, and what would happen if the taxpayer does not provide requested information. A taxpayer should know exactly what is

being taxed, how much he has to pay and when he has to pay it, meaning that the law should be clear and unambiguous and its interpretation by tax authorities should not only be readily available but also consistently followed.

- (b) FBR shall explain a taxpayer's rights to him and assist him in protecting these rights by providing him the requisite legal and procedural guidance. It shall, *inter alia*, provide assistance through 24-hour online web portal, email and/ or toll free telephone system setup by it to answer any query by a taxpayer.
- (c) A taxpayer has the right to expeditious and cost-effective access to information about various categories of taxpayers, tax defaulters and filers versus non-filers of tax returns or other important aspects of tax administration such as current and development budget revisions in budget, quarter-wise and per annum actual expenditures, quarterly and annual revenue receipts, actual cost of tax collection in comparison to other countries, refunds, status of tax related cases in courts or tribunals, perks and privileges of staff members, contracts, fees paid to consultants or lawyers, disciplinary actions, complaints or appeal procedures, roles and responsibilities of various offices and related officers, and orders, decisions or determinations of public importance.
- (d) FBR shall pro-actively disclose all information of public interest through directories, website or other published materials and, where applicable, expeditiously respond to information requests by taxpayers.

Right to Privacy and Confidentiality

- (a) A taxpayer has the right to privacy and confidentiality unless otherwise specified by law,
- (b) FBR shall maintain confidentiality and not disclose to anyone the information given to it by a taxpayer, except as authorized by law. It shall

use the least intrusive enforcement action to ensure the privacy of a taxpayer. Enforcement and collection costs should be reasonably proportionate to the receipts.

Right to Professional, Fair and Courteous Service

- (a) A taxpayer has the right to be treated professionally, fairly, and courteously.
- (b) FBR shall ensure that its employees serve and treat taxpayers in a professional, fair, courteous and expeditious manner. An aggrieved taxpayer shall be entitled to complain to the concerned employee's supervisor. If the supervisor's response is not satisfactory, the concerned taxpayer shall have recourse to the responsible FBR member or, in his absence, FBR Chairman,

Right to be Heard and Representation

- (a) A taxpayer has the right to be heard and represent himself or be represented by a person of his choice in matters before FBR. A taxpayer may, with proper written authorization, appoint someone else to represent him, a taxpayer may have his representative accompany him to an interview with FBR. A taxpayer may make sound or visual recordings of any meetings with FBR examination, appeal, or collection personnel, provided he informs FBR in writing ten (10) days before the meeting.
- (b) If a taxpayer or his representative is in an interview and asks to consult an expert. Then FBR shall stop and reschedule the interview.

Right to Fair and Just Tax System

- (a) A taxpayer has the right to a Fair, transparent and just tax system based on arm's length and automated tax administration, which protects him from perverse and arbitrary, unreasonable, biased, oppressive or discriminatory decisions, processes, recommendations and actions by FBR. A taxpayer is

responsible for paying only the correct amount of tax due under the law-no more, no less. The tax payable should accord with ability to pay and, if a taxpayer cannot pay all of his tax when it is due, he may be allowed to pay in installments. No coercive measure shall be adopted for recovery unless the appeal of the taxpayer is decided by the concerned tax tribunal.

- (b) FBR shall not use coercive methods of tax recovery in cases where default in payment of tax is not apparent from the record. It shall not deliberately withhold payment of any credits, refunds, compensation, rebates or duty drawbacks due to a taxpayer.

Right to Timely Remedial Action and Relief

- (a) A taxpayer has the right to timely remedial action against illegal and arbitrary acts of FBR, and entitled to relief from penalties and interest under tax legislation because of extraordinary circumstances.
- (b) FBR shall waive penalties when allowed by law if a taxpayer can show that he acted reasonably and in good faith or relied on the incorrect advice of a FBR employee. It shall waive interest that is the result of certain errors or delays caused by a FBR employee.

Right to Administrative Review

- (a) A taxpayer has the right to administrative review by the Federal Tax Ombudsman,
and any subsequent representation before the President of" Pakistan in tax maladministration cases. He has the right not to pay tax amounts in dispute unless the Federal Tax Ombudsman directs otherwise after a hearing in the case.
- (b) The Federal Tax Ombudsman shall help a taxpayer to enforce the rights granted under this Charter if the taxpayer has tried unsuccessfully to resolve the issue with FBR.

Right to Judicial Appeal

A taxpayer has the right of appeal or review of his case before an independent judicial tax appellate system if he disagrees with FBR about the amount or his tax liability or FBR collection actions. A taxpayer has the right to seek additional judicial remedy in court.

Revenue Division/FBR and Federal Tax Ombudsman must synergize their Complementarities to eliminate maladministration by tax functionaries.

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