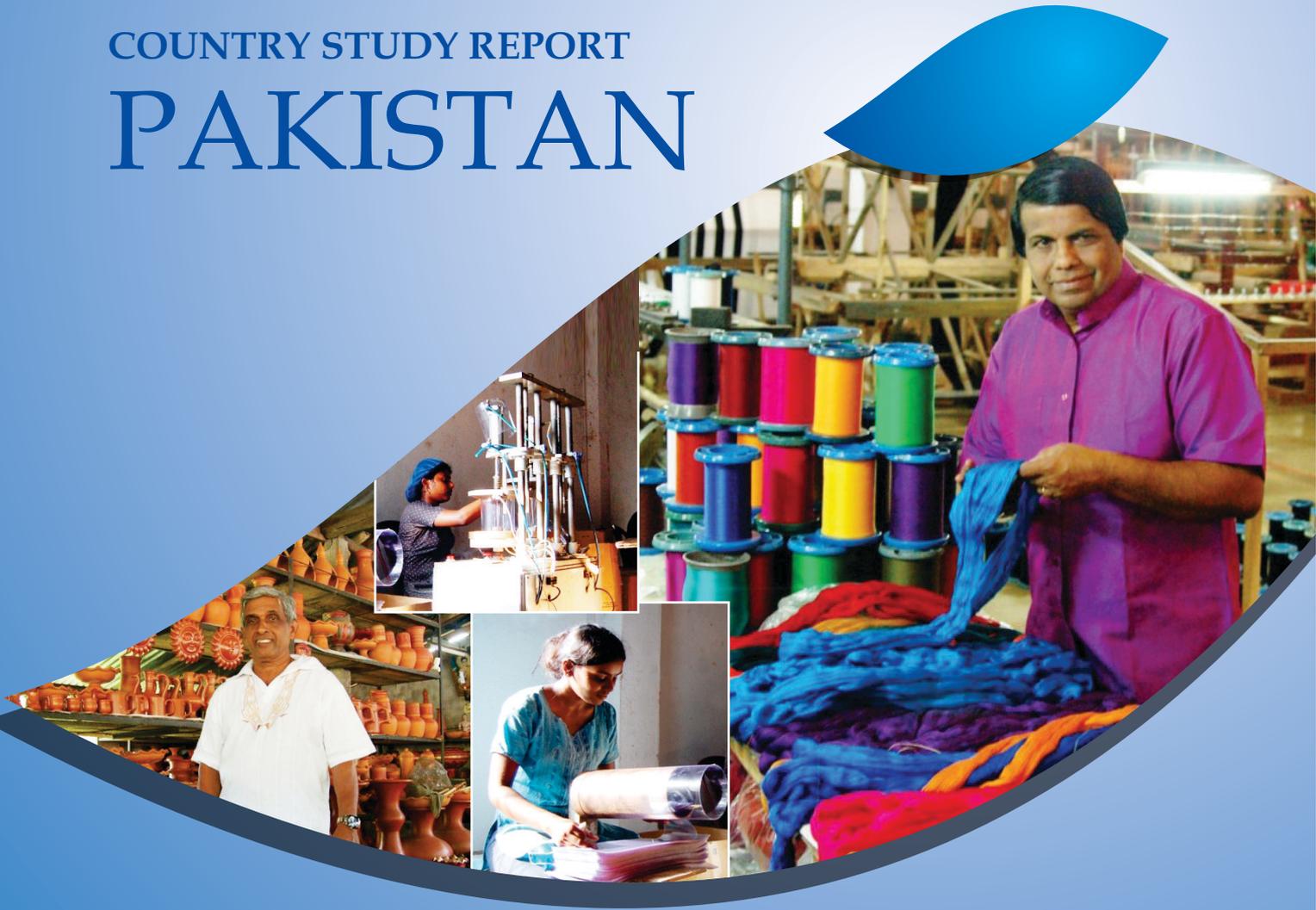


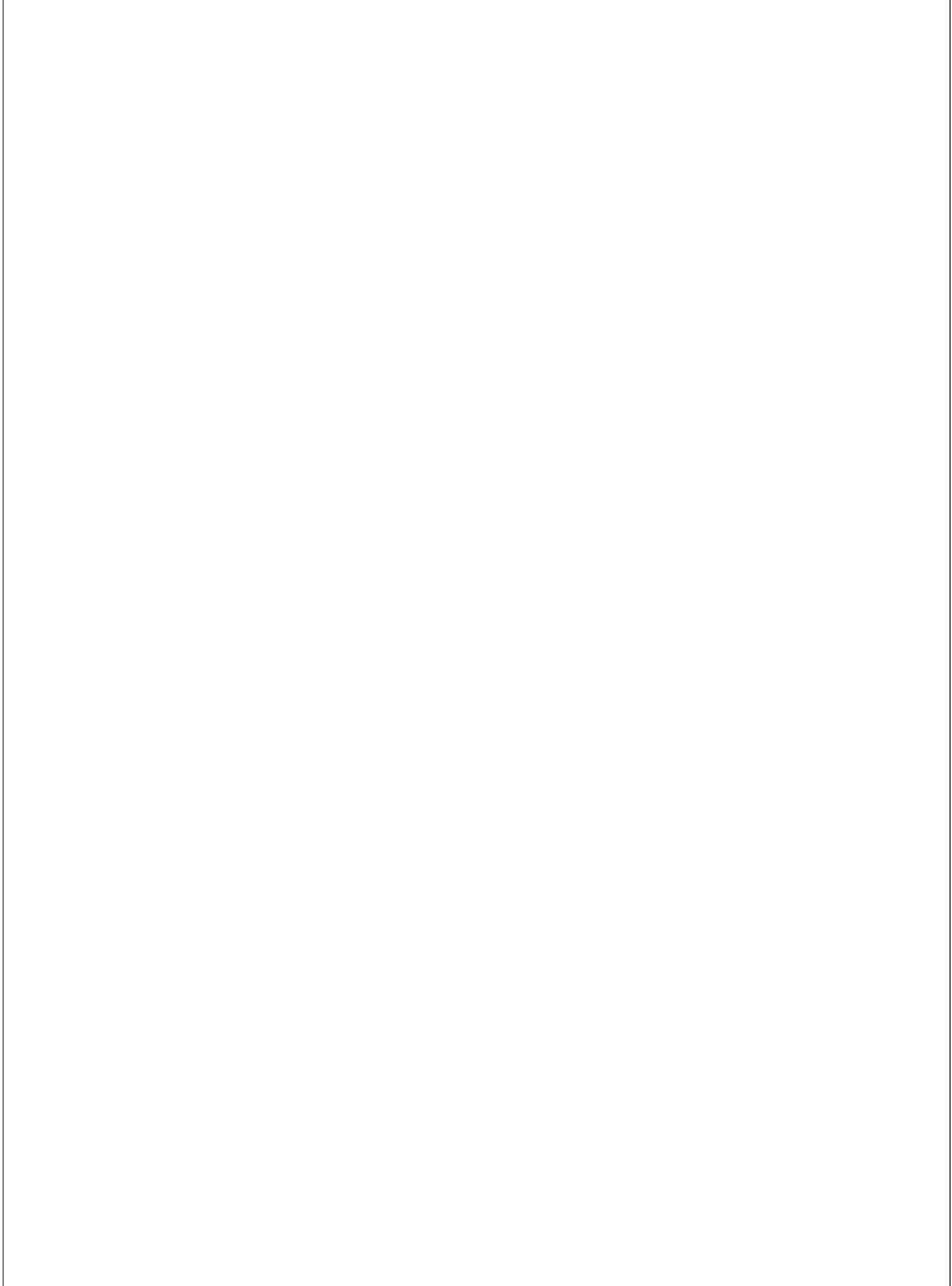


COUNTRY STUDY REPORT
PAKISTAN



Tax Policy and Enterprise
 Development in South Asia





COUNTRY STUDY REPORT
PAKISTAN

TAX POLICY AND ENTERPRISE
DEVELOPMENT IN SOUTH ASIA



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ISBN 978-969-7514-06-9

“This work was carried out with the aid of a grant from the
International Development Research Centre (IDRC), Ottawa, Canada.”

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About the Research

This research examines the impacts of property tax, value-added taxes, and tax exemptions and concessions on small enterprise development in South Asia. The goal is to provide decision-makers with data and insights to support more informed policy formulation and implementation for inclusive growth, productive employment, and enterprise development. The research also aims to examine the issues as they affect women entrepreneurs, to promote positive learning experiences among the countries, build fruitful exchanges, and foster effective policy discussions in a regional context.

The targeted outcomes include 5 Country Study Reports as well as a regional report based on Meta analysis. The reports are published and widely disseminated at the policy engagement workshops. Other project outcomes are policy workshops in all five countries and workshop reports, as well as an interactive website to support research and advocacy.

About BNU

Beaconhouse National University is the first Liberal Arts University of Pakistan. Chartered by the Government of Punjab, the BNU was established in 2003 for the purpose of imparting education with modern and rational course content while ensuring that the history and culture of Pakistani society are respected. BNU is planned as a non-profit, private university disseminating learning and encouraging research in diverse areas where the essential focus of the programs offered has been determined by the type of the work force identified for the future economic, business, academic, cultural and technological advancement of the country.

BNU has established the Institute of Public Policy, within the School of Social Sciences, and aims to develop this think tank as a pivotal centre of excellence in applied economics and social research.

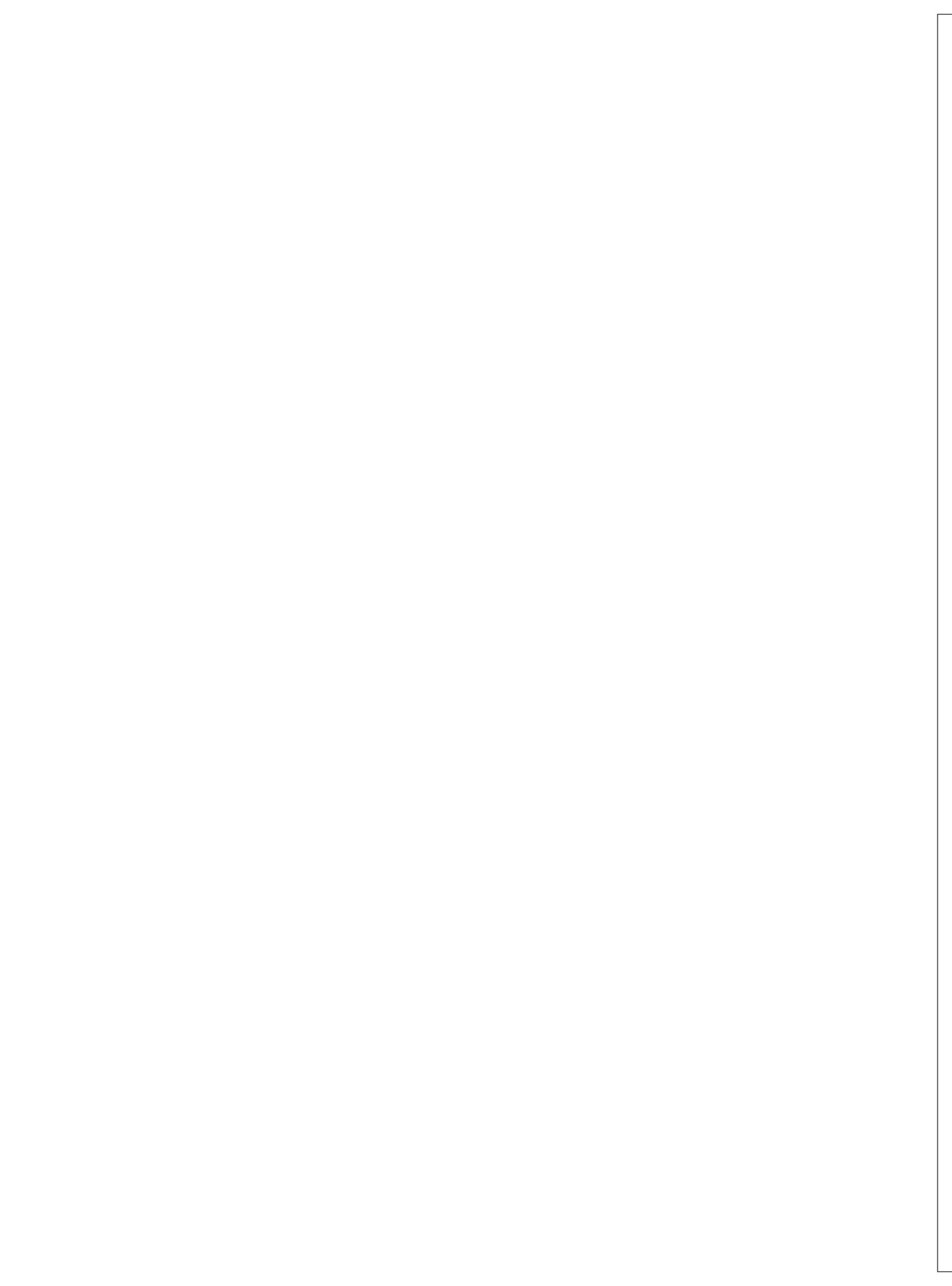


Table of Contents

List of Abbreviations & Acronyms	VIII
List of Tables	IX
List of Figures	XII
List of Boxes	XII
Executive Summary	1
Section I: Literature Review	3
1.1 <i>Characteristics of Small and Medium Enterprises in Pakistan</i>	3
1.2 <i>Tax Exemptions / Concessions and Enterprise Development</i>	6
1.3 <i>Value Added Tax (VAT) and Enterprise Development</i>	11
1.4 <i>Property Tax and Enterprise Development</i>	10
1.5 <i>Taxation/other Measures In 2013-14</i>	12
Section II: Methodology and Analytical Framework	15
2.1 <i>Impact of Tax Exemptions and Concessions on Enterprise Development</i>	15
2.2 <i>Impact of VAT on Enterprise Development</i>	16
2.3 <i>Impact of Property Tax on Enterprise Development</i>	16
Section III: Results and Findings	19
3.1 <i>Results of the Survey</i>	19
3.2 <i>Results of Key Informant Interviews</i>	64
3.3 <i>Results of Case Studies</i>	68
Section IV: Policy Implications and Recommendations	73
Section V: Limitations and Further Research	75
5.1 <i>Limitations</i>	75
5.2 <i>Research Questions</i>	75
Section VI: Conclusion	77
References	79

List of Abbreviations & Acronyms

SME	Small and Medium Enterprise Sector
VAT	Value-Added-Tax
OEM	Original Equipment Manufacturer
GST	General Sales Tax
GARV	Gross Annual Rental Value
ARV	Annual Rental Value
AOP	Association of Persons
PBS	Pakistan Bureau of Statistics
FBR	Federal Board of Revenue
RGST	Reformed General Sales Tax
SMEDA	Small & Medium Enterprises Development Authority
GDP	Gross Domestic Product
SEZ	Special Economic Zone

List of Tables

Table 1.1:	Number of Small and Medium-sized Establishments in Pakistan, Economic Census 2005
Table 1.2:	Number of Small Establishments by Industry
Table 1.3:	Rate of Setting up of New Small Establishments
Table 1.4:	Sectoral Distribution of Employment in Small Enterprises
Table 3.1:	Distribution of Sample by Location, Employment and Turnover
Table 3.2:	Percentage Distribution of Legal Status
Table 3.3:	Average Value of Assets and Turnover
Table 3.4:	Growth Rate of Assets and Turnover over Last Year
Table 3.5:	Sales Mix in terms of Domestic Sale Vs Exports
Table 3.6:	Average Number of Staff Employed
Table 3.7:	Percentage Distribution by Nature of Business Place
Table 3.8:	Percentage Distribution of Nature of the Land used for Business Purpose
Table 3.9:	Has Enterprise taken Loan in Last 5 Years
Table 3.10:	Percentage Distribution of Loan by type of Financing Source
Table 3.11:	Percentage Distribution of the reasons not applying for loan
Table 3.12:	Percentage Distribution of the Outcome of the most Recent Application
Table 3.13:	Percentage Distribution of Paid Taxes
Table 3.14:	Reasons for not Paying Tax
Table 3.15:	Various Federal Taxes Paid by Units
Table 3.16:	Multiplicity of all taxes Paid
Table 3.17:	Perception about too many Taxes
Table 3.18:	Perception about Complexity of Tax Laws and Procedure
Table 3.19:	Perception if Tax Collecting Agencies have Competent Officers
Table 3.20:	Perception about Tax Staff's Behavior with SMEs
Table 3.21:	Frequency of the Main Problems caused because of Multiplicity of Taxes

Table 3.22:	Perception about Harassment by the Tax Officials
Table 3.23:	Top 5 Challenges/Problems created by Taxes
Table 3.24:	Firms Registered with the Tax Authorities
Table 3.25:	Distribution of the Units not Interested to get Tax Benefits due to Problems
Table 3.26:	Percentage Distribution of Problems for Tax Benefits
Table 3.27:	Distribution of Units getting any Tax Concession
Table 3.28:	Frequency Distribution of the Difficulties faced by Firms while Applying for the Exemptions
Table 3.29:	Impact of Tax Exemptions and Concessions on Sales, Productivity and Competitiveness
Table 3.30:	Did Establishment get any Tax Holiday?
Table 3.31:	Major causes of Non-Compliance
Table 3.32:	Tax Related Government Assistance for Growth of Business
Table 3.33:	Percentage Distribution of RGST Compliance
Table 3.34:	Frequency Distribution of Year from which Firm became RGST Compliant
Table 3.35:	Major Reasons behind SMEs not being RGST Compliant
Table 3.36:	Has the Enterprise faced Difficulties in obtaining RGST Refunds
Table 3.37:	Perception about Performance of RGST Officials
Table 3.38:	Perceptions about the Friendliness of RGST Regulations towards SMEs
Table 3.39:	Frequency of Tax Officials Visits to the your firm
Table 3.40:	RGST Regulatory Authorities are less Administrative Friendly when it comes to dealing with Woman
Table 3.41:	Enterprise Pay Tax by the Land used for Business Purpose
Table 3.42:	Criteria used for Imposition of Property Tax
Table 3.43:	Type of Property Tax by Firms
Table 3.44:	Average property Tax Rate and Annual Property Tax Paid by Firm
Table 3.45:	Degree of Enforcement in Collection of Property Tax
Table 3.46:	Property Tax Plays Important Role in Selecting Location for Business
Table 3.47:	Does Property Tax affect your Decision to expand the Business

Table 3.48:	Reasons for not owning the Land of your Business Site
Table 3.49:	Complying of Land Acquisition Procedure
Table 3.50:	Incidence of Corruption in Land Acquisition
Table 3.51:	Ranking of the Top 5 Problems Land Markets created for your Business
Table 3.52:	Accounting Procedure and Documentation
Table 3.53:	Employment to Population Ratio
Table 3.54:	General Biases and their Impact on Enterprises owned by Women Entrepreneurs

List of Figures

Figure 2.1: Conceptual Framework of the Study

Figure 3.1: Sampling Strategy

List of Boxes

Box 2.1: Differential in Tax Treatment of Small and Large Enterprises Income Tax (prior to Finance Bill of 2013)

Executive Summary

In rising South Asia, Small and Medium Enterprises (SMEs) have been playing their due role in keeping the economy growing. The very grassroots of labor-intensive South Asian economies have witnessed a strong SME contribution towards expansion of industrial manufacturing through adoption of innovation, and balancing of income distribution by absorption and skill-enhancement of labor. Various aspects of state policies have influenced the trajectory that the SMEs have taken, of which an important tool is taxation.

The Institute of Public Policy (IPP), at the Beaconhouse National University (BNU), Lahore, became part of a regional initiative by GINI, to study the impact of tax policy on enterprise development, with a dedicated focus on SMEs. Working parallel to four other policy institutes in four other South Asian countries, IPP has conducted intensive research in Pakistan, contributing towards the regional study. Within the larger framework of tax policy and enterprise development, the aims of the research included highlighting the outreach of tax concessions and exemptions to SMEs and the benefits therein, and the disproportionate impact of taxes incurred due to varying outreach of these tax relaxations. Another objective was to register whether SMEs have had to physically relocate due to these disproportions in taxation, and how this, along with other factors, had an impact on their productivity and expansion.

Laying down the basis to build this study upon, a thorough secondary research was conducted on tax policy in Pakistan and how it had affected the performance and growth of SMEs in various sectors in the past. By doing so, certain knowledge gaps were identified in the existing literature and efforts were made to fill them through primary research. As a first step into the field, perception surveys were conducted with around 200 individuals holding positions of influence in the SME sector of Pakistan's manufacturing industry. Furthermore, key-informant interviews were also conducted with tax regulators, tax collecting officials, and tax-paying entrepreneurs, to gather their perception of the existing tax regime, the policy direction that it follows, and how could it be made more effective yet more supportive of SMEs. Figuring out a missing link in the research, case studies were included on women entrepreneurs as there was only a scarce representation of them in perception surveys and interviews. The specific purpose of these case studies was to understand the differing dynamics for women in the SME sector, and how taxation policies and filing procedures were impacting their businesses as compared to male counterparts.

It was found through the surveys that almost 80% of SMEs in Pakistan are working

formally, as they are registered with one authority or another. However, only a half of them were registered with Pakistan's tax-collecting body, the Federal Board of Revenue (FBR). Interviews revealed that those who aren't registered with the FBR find little intensive in doing so as they find the tax regime to be biased towards large enterprises, and taxation procedures to incur a compliance cost that either they cannot afford to bear, or offset the benefits entailed in filing returns. It was also voiced that Reformed General Sales Tax (RGST) should be made void of double-incidence of taxation on tax-compliant entrepreneurs working in informal value chains, by making the returns-claiming procedure simpler and more transparent. Both of these issues are augmented by the malpractices of tax officials who indulge in rent-seeking, increasing compliance cost, and making procedure more complex and time consuming. The women entrepreneurs, who made their mark through the case studies, expressed concern regarding the difficulty of handling male labor in the South Asian society, where males enjoy an unjust societal pedestal over females regardless of their varying economic statures. Another concern expressed felt by entrepreneurs of both genders was the complexity of availing formal credit line through financial institutions, which makes them depend on informal sources of credit charging heavy amounts of interest, eventually stunting the growth of their enterprises. Also, the development of enterprises is hindered by higher property tax and utility rates in commercial area, which forces enterprises to operate in residential areas, missing out on the benefits of commercial clustering.

Pondering upon the issues brought to limelight by surveys, interviews, and case studies, a set of recommendations have been provided to assist Pakistani government with policy regulation and implementation. Broadly, policies have been suggested that would rid the taxation procedures of their complexity, reduce the compliance cost, make relocation to commercial heartlands viable, and grant formal credit options to entrepreneurs. Implementing these policies would transform the SME perception of taxation from a punitive tool to an assistant in growth, and further enhance the contribution of small and medium enterprises in accentuating the South Asian economies.

SECTION-I

Literature Review

1.1 Characteristics of Small and Medium Enterprises in Pakistan

The Economic Census of 2005 carried out by the Pakistan Bureau of Statistics undertook the enumeration of all establishments throughout Pakistan. An establishment is defined as follows:

‘An establishment is an economic unit under single ownership or control, viz: under a single legal entity, which produces goods or services. It is generally a single physical location and is engaged in one or predominantly one type of economic activity. Examples of an establishment are a factory, a retail store, an office, a bank etc. The kind of activity unit, although different from the establishment, for this census is treated as establishment. Unlike the establishment, the kind of activity unit is not restricted in respect of the geographical area in which the given type of activity is carried out by a single legal entity. In cases such as construction, transportation and communication, a single legal entity will carry out the same kind of activity over a wide geographic.’

1.1.1 Number of Establishments

In Pakistan, small establishments are defined as units with employment of up to 10 persons. The number of such establishments is given in Table 1.1. In addition, establishments with employment of 11 to 50 persons are characterized as medium-sized units. The total number of SMEs is 5.8 million. Excluding agriculture, it is 2.9 million. According to the Census, the total number of small units in urban areas, excluding agriculture, is 2.4 million. Bulk of the small units is either owned by individuals or in the form of partnerships. Among non-agricultural small production units, the largest presence is in the sectors of manufacturing, wholesale and retail trade and community, social and personal services.

Table 1.1: Number of Small and Medium-Sized Establishments in Pakistan, Economic Census 2005 (000s)

	Small (1-10 persons)	Medium (11-50 persons)	Total
Agriculture	2930	26	2958
Mining and Quarrying	1	N	1
Manufacturing	569	12	583
Electricity, Gas & water	N	N	n
Construction	1	N	1
Wholesale & Retail Trade	1565	2	1567
Transport & Communication	51	N	52
Financing and Insurance	48	1	49
Community, Social and Personal Services	648	11	659
Total	5813	52	5870

The distribution of small establishments within manufacturing by major industry group is given in Table 1.2. The largest concentration of small establishments is in textile, wearing apparel and leather and food, beverages and tobacco industries. Net of exits, the number of new small establishments' increase by about 2.5 percent per annum. Projected at this rate, the number of small establishments outside agriculture is estimated at 2.8 million in 2011.

Table 1.2: Number of Small Establishments by Industry (employment upto 10 persons) (000s)

	Number	Percent
Food, beverages and tobacco	49	20.9
Textile, Wearing Apparel and Leather	246	43.2
Wood & Wood Products, including Furniture	63	11.1
Paper & Paper Products, including publishing	10	1.7
Chemical, Rubber & Plastic Products	5	0.9
Non-metallic Mineral Products	12	2.1
Basic Metals	4	0.7
Fabricated Metal Products	57	10.0
Others	53	9.3
Total	569	100.0

Table 1.3: Rate * of Setting up of New Small Establishments (000s)

	Number	Percent
Last 4 years	564	9.7
5 to 9 years	1171	20.1
10 years to 15 years	753	13.0
Over 15 years	3382	57.2
Total	5870	100.0

*net of closures.

1.1.2 Employment in Small Enterprises

The Labor Force Survey carried out annually by the Pakistan Bureau of Statistics includes all small enterprises, outside agriculture, with employment of less than 10 workers as part of the 'informal sector'. The distribution of non-agricultural employment is 26.2 percent in the formal sector and 73.8 percent in the informal sector. The implied distribution by economic sector is given in Table 1.4.

Table 1.4: Sectoral Distribution of Employment in Small Enterprises (Non-Agricultural) (000)

	Total	Small - Units	Share in Sector (%)
Manufacturing	7376	4864	65.9
Construction	3769	3511	93.2
Wholesale & Retail Trade	8722	8485	97.3
Transport & Communications	2745	2334	85.0
Community, Social & Personal Services	5815	2181	37.5
Others	1131	438	38.7
Total	29558	21813	73.8

Sectors where employment is largely concentrated in small units include construction (93 percent), wholesale and retail trade (97 percent) and transport and communications (85 percent). In manufacturing and community, social and personal services the shares are 66 percent and 39 percent respectively.

In terms of distribution by sector of employment in small units the largest sector is wholesale and retail trade sector with employment of 8.5 million, followed by manufacturing with 4.9 million workers and construction with 3.5 million workers. Total non-agricultural employment is estimated at almost 22 million. Therefore, labor absorption in the economy hinges largely on the rate of growth of small enterprises. It

appears that, given the number of small units, the employment per unit an average is about 8 persons.

1.1.3 Distribution by Paid Up Capital

The Securities and Exchange Commission registers companies under different Acts. Small companies, with paid up capital of up to Rs 100,000 only (equivalent to \$1100 approximately) are 22500 in 2011 out of the total number of companies of 57,830. It is clear that a large number of small enterprises do not have formal legal status and are operated/ owned by individuals or partnerships.

Therefore, the predominant form of production organization is small enterprises. There are over 2.8 million such enterprises in the country today operating outside agriculture, mostly in the informal and service sectors.

1.2 Tax Exemptions/Concessions and Enterprise Development

There is limited existing literature on the impact of fiscal exemptions and concessions on the development of small and medium enterprises in the sector. However, some literature exists on the overall impact of the fiscal regime, which highlights that enterprise development is affected by the fiscal policy depending on the policy objectives. A summary review of literature is presented below.

Hyder & Ahmed (2001) discuss the reasons for declining private investment in Pakistan. Pakistan has a lower rate of investment to GDP ratio as compared to India and Bangladesh. The purpose of the paper was to analyze the decline in private investment, which is the main cause of deceleration in the growth momentum of Pakistan's economy. Due to lack of investor confidence, private investment has reached its lowest point in the recent economic history of the private sector led growth phase in Pakistan. The paper argues that economic (increased real interest rate, lack of capital and infrastructural investment) as well as non-economic factors are responsible for this declining investment.

Economic policies are formulated in such a manner that the short-term objectives of lowering the fiscal and trade deficits were to some extent achieved but overall economic performance and investment were ignored. In order to control external trade deficits, a policy of devaluation increased the cost of production through an increase in prices of imported raw material especially of plant and machinery. Higher real interest rates due to

excessive public borrowing that were due to the failure in reducing fiscal deficits has resulted in financial crowding out and has eroded the savings that might be used to finance private investment. Certain non-economic factors also affected private investment like the sanctions which were imposed after the nuclear blast, events following that initial shock including the freezing of foreign currency accounts, the military coup, the harassment of the partially successful accountability drive of the military government, the 9/11 incident, the Afghan war and tensions on the Pak-India border.

The authors recommend an alternative economic package with long term positive affects for private investment by increasing investor confidence including duty free imports of machinery for investors, public investment in infrastructure, provision of subsidized loans conditional on improvement in the quality of product to increase export competitiveness and further development of a secondary debt market. Though the focus of the paper was not the SME sector, the recommendations are likely to give a boost to the overall manufacturing sector.

Shah (2003) bases his paper on the need for fiscal incentives and strong government policy to attract foreign direct investment in a highly globalized competitive world. Using the Jorgenson's Neo-classical Investment Model the cost of capital is computed after considering the taxation policy and the treatment of invested capital. The paper shows that the cost of capital is an important consideration apart from location advantages for foreign investors. The paper elaborated on the fiscal provisions including the fiscal incentives in place for rural industrialization, industrial estates and incentives for export processing zones, and their implications on the investment environment, specifically focusing on foreign investment in Pakistan. The computed results show consistent and significant impact of the cost of capital on FDI inflows. A principal objective of the study was to undertake a realistic and in depth investigation of the tax concessions and the response of investors. The paper argues that if the government intends to continuously attract and retain foreign investment it must provide the requisite fiscal incentives such as tax concessions & infrastructure such as strong judicial system and a liberalized rather than protected policy regime.

Pasha and Bengali (1985), in this paper analyze the fiscal incentives for industrialization of the backward regions Pakistan with particular focus of Hub Chowki in Baluchistan. As the inequalities of income and opportunities between regions are increasing, governments in different countries are adding regional development goals in the national plans. Monetary and fiscal policies have emerged as the primary policy tools to induce faster growth of the backward regions. To measure the impact of the development in the area if Hub Chowki the methodology used is to compare the Net Present Value (NPV) of the project in the underdeveloped area with the NPV of the project in the developed area. The

values are compared after taking out the variation in the recurring costs and capital between the two areas. The methodology analyzes the impact of fiscal incentives in the form of customs duty exemption on imported machinery and a five year tax holiday on profits. The results of the analysis show that the incentives are successful in diverting investment rather than generating new investments. Also the incentives create a pattern of high degree of capital and import intensity with a low regional multiplier. Moreover, the negative impact of the incentives increases the welfare cost on the economy. In the end, as a policy implication, an alternative three tier differential incentive scheme is proposed.

Masood & Ahsan (1997) explore the efficacy of tax concession policy in generating investment in underdeveloped areas in Pakistan. Taking a case-study of an industrial state, Gadoon-Ama- Zai located in KPK province, the authors find that no new investment has been generated in the areas because of the tax concessions. Most investment is diverted investment that would have taken place in another area in the country had the concession not been in place. Specifically, the analysis shows that the tax holidays at a micro level have been unsuccessful in raising investment in backward areas. This result is consistent with previous studies: Pasha and Bengali (1985); Pasha and Ismail (1988) and Azhar and Sharif (1975).

The results also show that the depreciation allowances are more effective in increasing the present value than the tax holidays concession. These results indicate that if the government wants to increase investment level in the underdeveloped areas, the tax laws should be amended in such a way to allow the acceleration of depreciation allowances in the tax holidays areas.

Ghaus-Pasha (2010) explores the reason why Pakistan has seen a downward trend in its tax-GDP ratio. Looking at the trend since the early 1990s she shows how the tax to GDP ratio declined by 4 percentage points because of the liberalization of the tariff regime. Though tax reforms were introduced, especially an increase in sales and direct taxes, Pakistan was unable to offset this loss completely. The author finds that the tax-to-GDP ratio of Pakistan has not been held back by slow growing tax bases but more by a policy of reduction in statutory tax rates and/or by exemptions and concessions on existing tax bases. Thus, despite the growth momentum in the early to mid 2000s and increase in foreign investment in Pakistan within the telecommunication sector, food industry, energy sector etc, Pakistan was unable to capitalize on it and increase its tax-GDP ratio as it exempted from taxes these sectors to attract investment. The author makes recommendations to improve the situation, including bringing the exempted sectors within the tax base, improving tax administration and the need for political will and leadership for a better tax system in Pakistan.

1.3 Value Added Tax (VAT) and Enterprise Development

Literature on the impact of VAT or General Sales Tax (GST) as it is called in Pakistan, on SME development does not exist largely because they are exempt and little focus has been given to research on VAT taxation on inputs in exempt sectors. As the following summary indicates, the focus has been more on the revenue mobilization from the tax.

Sales Tax (GST) is one of the leading sources of federal tax receipts. It contributes around 40 percent of the total net revenue collection. Revenue collection was Rs 841 billion in 2012-13. Sales tax in Pakistan is collected on domestic production and on imports. The major revenue spinners of domestic sales tax collection, accounting for 85 percent of gross collection are: POL products, telecom services, natural gas, sugar, cigarettes, electrical energy, services, cement, beverages and tea. The most important contributor is the petroleum sector.

Sales taxes on imports contribute about 46 percent to the total collection. Out of fifteen major commodity groups, a double-digit growth has been recorded in GST collection from tea & Coffee, edible oil, Iron & Steel, paper & paper board, Plastic & resins, and organic chemicals etc. The composition of sales tax on imports reveals that around 39 percent of collection originates from POL products.

The additional net revenues from replacement of GST and an expansion of VAT to services not covered under the GST regime could yield an additional Rs. 82 billion, in 2010-11, equivalent of 0.5 percent of the GDP (Institute of Public Policy, 2010).

Ahmed & Rider (2008) suggest that to increase revenues governments often take actions in forms of increasing tax rates and efforts related to enforcement. Such actions may further distort the tax compliances and thus fail to impact revenue mobilization in a positive manner. This dilemma exists in many developing countries because of large informal sectors and low tax compliance. Pakistan's huge informal sector is due to large portion of out of tax net business activities, and this includes significant portion of services (Federal Board of Revenue, January – March 2009). There are more serious non-compliance issues with direct taxes than indirect taxes. This is one of the reasons why many countries are shifting to the indirect taxes, particularly the value added taxes.

The case for value added taxes in Pakistan is based on the ground of high buoyancy and share of the services sector including wholesale and retail trade telecommunication and transport, most of which have a low taxable component. In case of retail and wholesale trade the individuals are in general from middle income group, and have greater scope of

escaping from detection of non-payment of tax. This is also because the system of third-party reporting is relatively weak in developing countries compared to developed countries.

1.4 Property Tax and Enterprise Development

Literature on property taxation examination of issues in tax collection and administration is substantial in Pakistan. However, when it comes to the informal land markets or the impact of property taxation on enterprise development in the informal sector, research is almost non-existent. A summary of some literature is presented below.

World Bank (2006) highlights that property taxes have long history in Indo-Pak sub-continent. Lands were taxed by the way of land revenue. Property taxes were considered suitable way of collecting taxes. Though Pakistan has a comparatively long experience of collecting property taxes yet tax collection is very limited. The property tax has essentially been the provincial tax; however the house tax was administered by the Local Bodies like Municipal Committees etc.

Pasha & Ghaus (1989) draw attention to persistently low yield of real property tax in Pakistan. Uncertain fiscal policy about the role of property tax, narrow tax-base, generously large and distorting exemptions, ineffective tax administration, and inadequate collection records are major factors responsible for low yields of real property taxes (*The World Bank, 2006*). The role of real property taxes is important in the overall improvement of tax-to-GDP ratio, because it is one of the taxes which are progressive.

Proper valuation of each property is very difficult, especially where real estate market is not well established. According to (*The World Bank, 2006*), banded system which is used in many developing countries, measures property tax based on quality, location and size. It is considered relatively efficient. Banded system works on the principle that properties within same band pay the same property tax, and detailed discrete valuations of each property is not required. But in case of Pakistan this system does not pay off, because of generously given exemptions, reductions and rent control; as these cause distortions in the tax base.

This system is based on the Annual Rental Value tables, based on the quality, location and size. *Nabi & Shaikh, (2011)* suspect that for tax evasion purposes there is undervaluation of properties on large scale. The formula based valuation does not account for different

income brackets, quality and location and often results in over-taxing the poor and under taxing the rich. Therefore the equity dimension of this form of tax is lost. Broadening the tax base and updating GARVs is critically important. This will allow inclusion of new residential areas, along with revised ARV unit value according to commercial activity and level of development. On the other hand ARV values can be adjusted by accounting for inflation. Eliminating unnecessary obstacles to registering and transferring property is also of great importance in overall improvement in tax base, as it reduces transaction costs and helps to formalize property titles. Simple procedures to register property are also associated with greater perceived security of property rights and less corruption (The World Bank, 2010).

Ghaus, (1889) the inability to achieve economies of scale raises costs of collection with respect to revenues generated and weakens the case for investments in tax administration. Consequently, according to Pasha (1995) in most small municipal governments departmental collection is fragmented and ineffective. Fiscal effort varies considerably among the provinces and the smaller provinces in particular have potential for higher revenues which they are currently not exploiting Hussain & Pasha, (2010).

Further, *Aziz and Haider (2014)* argue that exemptions extended to the UIPT taxpayers are hurting the provincial revenue generation badly apart from outdated property valuation rolls. They estimated that approximately 1207 million PKR are being lost annually in Punjab provinces due to various exemptions esp. the exemption of 5 Marla residential houses.

In theory, consistent with The World Bank, (2006), governments can estimate desired revenue yields from property taxes to cover their local service costs, and set the appropriate tax rate against the known tax base to achieve their revenue targets. In practice, however, the historic tax base and tax rate limit the freedom that governments have to introduce significant changes in either the tax base or rate. If there are less reductions and exemptions in the tax base rather than rate preferences, then it would be easier to administer, and more effective. The growth in revenues from a particular tax is crucially dependent on the buoyancy of its tax base. According to Ghaus & Pasha, (1988), if the latter is growing rapidly then even in the absence of periodic enhancements in tax rates, there is likely to be corresponding fast growth in tax revenues. Alternatively, if the tax base is stagnant, then the growth in revenues is constrained.

The devolution plan of 2001 led to the transfer of number of functions from provincial to local governments. Along with others this includes the taxes/fees chargeable at different levels - district, tehsil and union - of local governments. (Social Policy and Development Centre, 2007) The principal source of revenue for TMAs is expected to be the property tax

on annual rental value of buildings and lands and the tax on transfer of property. Union administrations have limited fiscal powers beyond the levy of some small fees. However, following the restoration of democracy, according to Nabi & Shaikh, (2011) proper devolution of the property tax is coupled with the broader issue of local government reform.

1.5 Taxation/Other Measures in 2013-14

In the research and analytical framework submitted earlier, we had identified certain tax policy measures, exemptions and concessions, which constitute tax expenditures and have a significant impact on the SME sector also. The budget of 2013-14 includes some major changes of policy in these measures which are identified below.

In its Fiscal Budget, of 2013-14, the government has announced a number of measures that can potentially have a significant bearing on the SME sector in Pakistan.

Income Tax

The salient features of the measures relating to income tax which have a positive impact on the profitability and growth of the SME sector include:

- The rates of tax for business individuals are proposed to be revised to support the middle income earners. The existing five slabs for business individuals and AOPs are proposed to be increased to seven slabs which will bring progressivity in the rates of tax.
- To remove the discrimination against the non-corporate sector the facility of carry forward of unadjusted minimum tax is to be extended to Individuals and AOPs which was restricted to the corporate sector.
- Current reduction in minimum tax is restricted to the distributors of cigarettes in corporate sector. Being discriminatory to small taxpayers of this sector working in the status of AOPs and Individuals, reduced rate of minimum tax is to be extended to the individuals and AOPs.
- Currently the goods transport vehicles are subject to withholding tax at the time of payment of provincial motor vehicle tax and this tax is the final tax on their income. The goods transport vehicles are also subject to withholding tax @ 2% on providing transport services which is the minimum tax. To facilitate the transport sector the withholding tax on payment of provincial vehicle tax is proposed to be made adjustable.

- To rationalize the taxation of large companies, the rate of initial depreciation to be reduced from 50% to 25% for Plant and Machinery.

However, there are also certain measures the implications of which may be detrimental for the SME sector. Clearly, for example, relief to the corporate sector in terms of tax relief is likely to compromise the competitive position of the SMEs vis-a-vis the large scale sector.

These are as follows:

- Currently Corporate Income Tax Holiday for a period of 5 years is available to projects in Special Economic Zones. To promote industrialization and investment in the country, the period of holiday is to be extended to 10 years.
- To provide relief to the corporate sector, the rate of tax for non banking companies is being reduced from 35% to 34%, with the target eventually of 30%.
- Minimum Tax @ 0.5% of turnover is payable by companies, certain individuals and AOPs in case of declared losses or if the tax payable on the declared income is less than the Minimum Tax. The rate reduced from 1% to 0.5% through Finance Act 2012 to be restored to 1%.
- Contribution of the wholesale and retail sector towards the tax revenue is not commensurate with share of this sector in the GDP. To ensure documentation of the economy and to bring the traders into the tax net all manufacturers were made liable to collect adjustable withholding tax from distributors, dealers and wholesalers through the Finance Act 2012. To remove hardship this withholding tax is being restricted to the Electronics, Sugar, Cement, Fertilizers, Iron & Steel Products, Motorcycles, Pesticides, Cigarettes, Glass, Textile, Beverages, Paints & Foam sectors and the rate is being reduced to 0.1%. The scope of withholding tax is also being extended to retailers. Withholding tax @ 0.5 % by the distributors, manufacturers or commercial importers from the retailers is proposed.
- Separate rates of withholding tax to be introduced for corporate and non corporate sectors with the objective to encourage corporatization and to enhance revenue and to ensure effective enforcement of fiscal codes.

Over and above these, the Prime Minister of Pakistan has announced on November 29, 2013 an incentive-cum-amnesty package to revive the economy, which includes an investment package, facilities for tax payers etc. As for the investment package, an investor would not be asked about or probed about his source of income in case the investment is between Rs 10 million and Rs 50 billion.

Also, in the case of tax returns, for an individual paying tax exceeding 25 percent of the previous payment, there will no audit. NTN holders would be exempt from penalties, default surcharges and audit if they paid a minimum tax of Rs 20000 per annum. Top 400 taxpayers will get taxpayers identification cards and will enjoy entitlements' like access to VIP lounges, fast track immigration, and higher baggage allowance. Clearly these measures favor larger taxpayers. Another measure which may deter new taxpayers is the withdrawal of the power of the chairman and members of FBR to access bank accounts of existing tax payers. Overall, the package is largely targeted towards 'big businesses'.

Revised General Sales Tax (RGST)

Some of the revenue measures taken in the budget of 2013-14 are as follows:

- Enhancement in standard rate of sales tax from 16% to 17%.
- Charging further tax @ 2% on taxable supplies to a person who has not obtained registration number.
- Charging sales tax @ 5% in addition to the standard of 16% on non-registered commercial and industrial consumers of electricity and gas having monthly bill in excess of Rs. 15,000.
- Expansion in list of items which are chargeable to sales tax on retail price.
- Withdrawing the concessions available to thirteen districts of Khyber Pakhtunkhwa, FATA and PATA on the pattern of Income Tax exemptions already withdrawn
- Substituting zero-rating with exemption on the items of non export oriented sectors.
- Expansion of scope of withholding regime for withholding of whole of amount of tax by withholding agents on purchases made from unregistered persons.

The measures listed above are focused on the informal economy likely to reduce the profitability and growth of the SME sector.

The salient feature of the measure relating to sales tax which has a positive impact on the profitability and growth of the SME sector include:

- Exclusion of finished consumer goods from the list of items chargeable to sales tax @ 2%.

Therefore, by and large the new Government in an effort to broaden the tax base may make business conditions more difficult for SMEs

SECTION-II

Methodology and Analytical Framework

The research methodology used includes secondary data analysis, in particular the budget and Finance Bills to identify government actions on taxation. A primary survey of 200 SMEs has also been conducted in three centers of SME activities in the country i.e. Faisalabad, Lahore and Karachi. The primary survey covers all three themes. Key Informant Interviews and case studies have also been conducted to supplement the secondary and primary data findings especially with regard to data on women entrepreneurs.

Research questions that the study poses are:

2.1 Impact of Tax Exemptions and Concessions on Enterprise Development

What is the extent to which small enterprises face biases in tax exemptions and incentives? (See Box 2.1)

What is the extent to which these biases disproportionately impact on small enterprises operated in the undocumented economy and/or those owned/ managed by women?

What are the impacts of the exemptions and concessions on entrepreneurs and SMEs in terms of enterprise performance and productivity?

What are the impacts of biased tax regimes on emigration of entrepreneurs and skilled labor?

2.2 Impact of VAT on Enterprise Development

What are the progressivity impacts of VAT burden on small enterprises (particularly those operating in the undocumented economy)? How do they affect enterprise performance and productivity?

How are small entrepreneurs treated by VAT administration in terms of compliance costs and taxpayer friendliness?

2.3 Impact of Property Tax on Enterprise Development

What are the weaknesses in property tax systems that create and/or sustain informal land markets?

What is the nature and magnitude of impacts of land informality on entrepreneurs of small enterprises operating in the undocumented economy?

The conceptual framework for the study is presented visually in Figure 2.1. 'Bottom-up' the relationships are as follows:

Box 2.1 Differential in Tax Treatment of Small and Large Enterprises Income Tax (prior to Finance Bill of 2013)

In favor of Small Enterprises

Exemption limit of Rs 400,000 annually including lower tax rates on property income

Flat rate of 25 % on income of a small company*as compared to 35% for large companies

Lower effective tax rates for particular economic activities like retail trade, transport services, etc, which are largely in informal economy.

Special investment allowance of up to Rs 1 million. **

No wealth statement required if income less than Rs 1 million.

Minimum tax on turnover not payable by individuals or AOPs with turnover below Rs 50 million.

In favor of Large Enterprises

Accelerated depreciation allowance on investment (of 50% in the first year)

Low presumptive tax on exports of 1 % on turnover

Tax credit for balancing, modernization and replacement (of 20%)

Tax credit for enlistment in the stock exchange (of 15%)

Tax holidays for particular sectors (energy generation) and locations (Special Economic Zones, backward and rural areas)

Lower fixed rate on industrial importers as compared to commercial importers (mostly imports for small enterprises)

Option to file a return and pay a lower fixed tax rate on supplies and exports (more likely to be availed by companies)

Tax credit on investment financed by equity

Lower withholding tax rate (as % of bill) on electricity bills

General Sales Tax

In favor of small companies

Exemption limit of up to Rs 7.5 million of turnover (in taxable supplies)

Sales tax on services exemption on many services in the informal economy including wholesale and retail trade, community, personal and social services

In favor of large companies

2 ½ % reduction in income tax liability if 90% sales to registered persons

Customs Duty

In favor of large Companies

Examples including the following :

SRO 565 (1) /2006: Exemption from customs duty on import of raw materials, sub-components, components, sub-assemblies, for manufacture of specified goods (Survey based)

SRO 567(1)/2006: Exemption from customs duty on import of specified goods (non-Survey based)

SRO 575(1)/2006: Exemption from customs duty on machinery and equipment

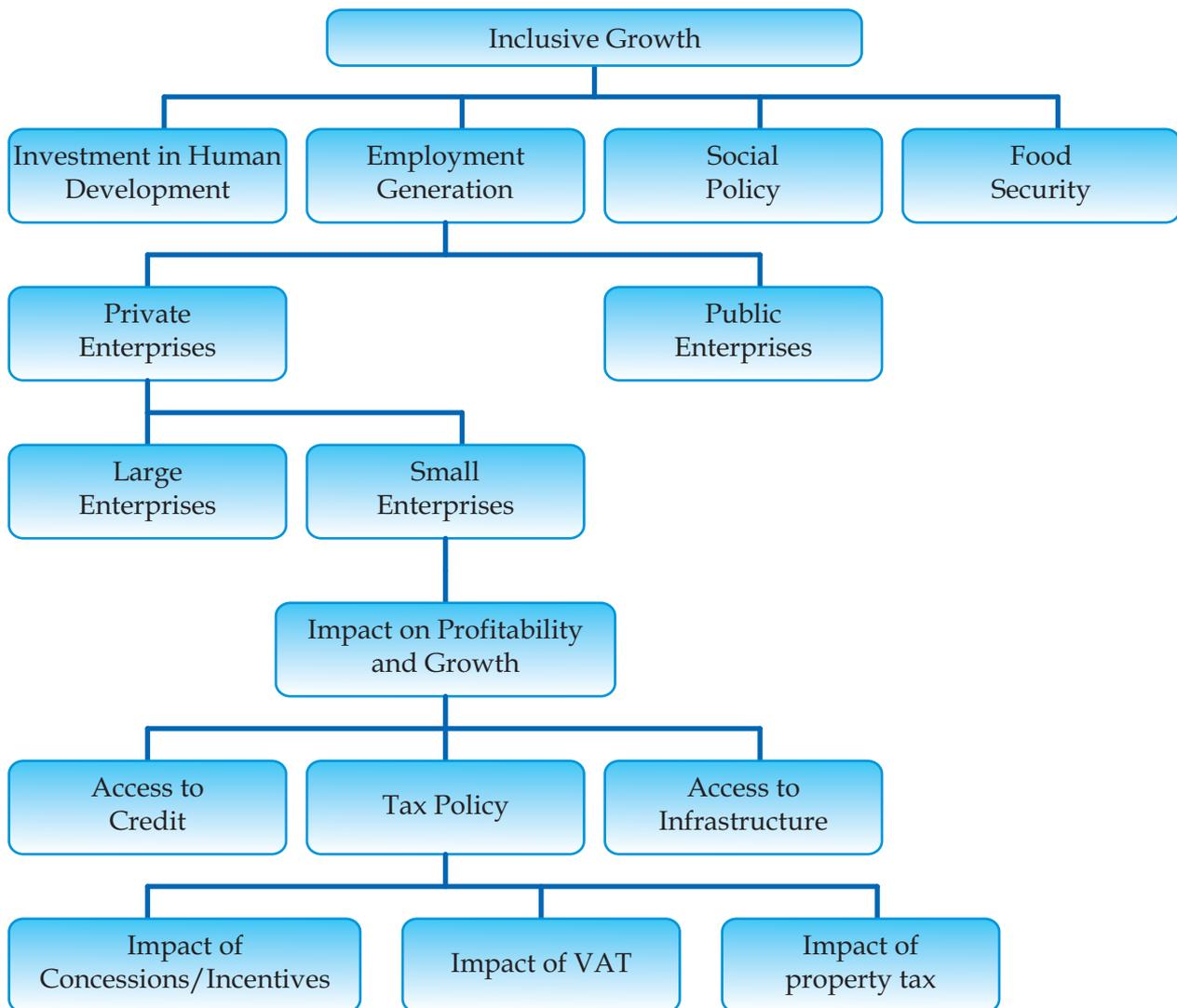
SRO 809(1)/2009: Exemption from custom duty to textile industry for import of machinery and equipment

SRO 666(1)/2006: Exemption from customs duty for OEMs in automobile Sector

** Under Companies Ordinance 1984, with paid up capital of less than Rs 25 million, 250 employees or less, and annual turnover not exceeding Rs 250 million*

*** Same limit for large companies*

The impact of key elements of tax policy, viz, differential in tax expenditures, the system of VAT and property taxation, on the performance, profitability and growth of small enterprises has implications on the growth of small enterprises and the resultant contribution of employment generation to the process of 'inclusive growth' in the economy.

Figure 2.1: Conceptual Framework of the Study

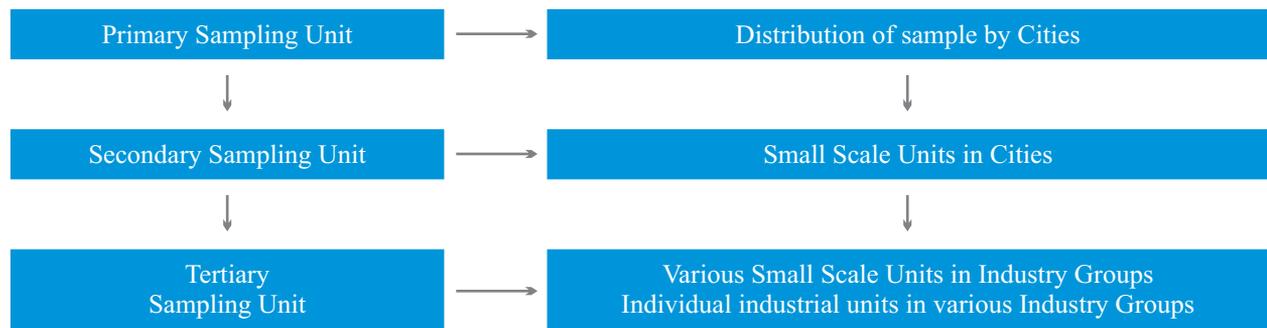
SECTION-III

Results and Findings

3.1 Results of the Survey

The primary instrument of data collection was a survey on a pre-designed and tested questionnaire of a stratified (by city, firm and industry group size) national random sample of industrial units (see Figure 3.1).

Figure 3.1: Sampling Strategy



The population of the industrial units was obtained from the Economic Census 2005, published by the Pakistan Bureau of Statistics (PBS). Once the sample distribution across cities was finalized, the individual sample units were selected from the population of units obtained from the Provincial Directories of Industries prepared by the respective Provincial industrial Departments. For each unit, the Provincial Directories give name, address, and year of registration and level of employment. The last variable enables the selection of small units. Table 3.1 shows the distribution of sample by city, by employment size and by annual turnover.

Table 3.1: Distribution of Sample by Location, Employment and Turnover

	Frequency	Percent
By City		
Faisalabad	65	32.5
Karachi	55	27.5
Lahore	80	40.0
By Employment		
10 Or Less	104	52.0
10 to 50	75	37.5
Above Than 50	21	10.5
By Turnover		
Less Than 5 Million	84	42.0
5 TO 10 Million	25	12.5
10 to 20 Million	27	13.5
20 And Above	64	32.0
Total	200	100.0

3.1.1 Registration Status

Almost 82 percent of the firms are registered under different agencies. Share of registered firms increase as the size of firm increases (See table 3.2). Almost half of the sample units said they are registered with Federal Board of Revenue (FBR).

Table 3.2: Percentage Distribution of Legal Status (%)

	Registered Firm	Non Registered
By City		
Faisalabad	78.5	21.5
Karachi	69.1	30.9
Lahore	93.8	6.3
By Employment		
10 Or Less	65.4	34.6
10 to 50	100.0	0.0
Above Than 50	100.0	0.0
By Turnover		
Less Than 5 Million	57.1	42.9
5 TO 10 Million	100.0	0.0
10 to 20 Million	100.0	0.0
20 And Above	100.0	0.0
Total	82.0	18.0

3.1.2 Turnover and Assets

Table 3.3 gives the average value of assets and turnover of the units. The assets and turnover increase by the size of firm. The average value of the fixed assets of the firm as of December 2012 is Rs 18.6 million almost and turnover is Rs 102 million.

Table 3.3: Average Value of Assets and Turnover (Million Rs)

	Fixed Capital, as Of Dec 12	Land, as of Dec 12	Building, as Of Dec 12	Plant and Machinery, as Of Dec 12	Annual Turn Over, as of Dec 12
By City					
Lahore	27.86	2.66	3.10	22.10	54.21
Faisalabad	6.79	2.92	2.10	1.78	7.19
Karachi	18.91	6.77	8.73	3.41	44.41
By Employment					
10 Or Less	5.27	1.96	1.80	1.51	3.61
10 to 50	24.95	4.42	5.66	14.87	39.20
Above Than 50	61.45	11.40	12.02	38.02	187.19
By Turnover					
Less Than 5 Million	4.49	1.70	1.44	1.36	2.35
5 TO 10 Million	16.62	2.88	3.01	10.73	6.53
10 to 20 Million	21.36	2.33	3.60	15.44	13.88
20 And Above	36.57	7.77	8.93	19.87	101.74
Total	18.55	3.87	4.32	10.35	36.23

Table 3.4: Growth Rate of Assets and Turnover Over Last Year (%)

	Fixed Capital	Land	Building	Plant and Machinery	Annual Turn Over
By City					
Lahore	3.86	1.05	4.91	3.29	6.14
Faisalabad	10.95	10.50	13.06	13.34	19.19
Karachi	11.87	9.97	13.33	7.72	22.27
By Employment					
10 Or Less	10.65	7.35	13.09	10.50	16.46
10 to 50	6.00	5.41	7.35	5.45	12.84
Above Than 50	5.51	6.88	7.09	3.64	15.22
By Turnover					
Less Than 5 Million	10.36	6.37	12.99	10.58	15.73
5 TO 10 Million	9.79	7.18	11.55	14.78	14.92
10 to 20 Million	7.36	7.41	8.88	4.20	16.84
20 And Above	5.62	6.25	6.96	3.28	13.16
Total	8.37	6.57	10.23	7.85	14.95

3.1.3 Assets and Turnover Growth

Table 3.4 presents the growth rate of the assets and sales in 2012 as compared to 2011. On average the Fixed Capital grew by 8.4 per cent where sales grew at almost 15 per cent.

Table 3.5: Sales Mix in Terms of Domestic Sale Vs Exports (Million Rs)

	Domestic Sale	Exports
By City		
Lahore	38.7	15.5
Faisalabad	6.5	0.6
Karachi	25.2	19.2
By Employment		
10 Or Less	3.5	0.1
10 to 50	33.6	5.6
Above Than 50	96.7	90.5
By Turnover		
Less Than 5 Million	2.4	0.0
5 TO 10 Million	6.2	0.3
10 to 20 Million	12.6	1.3
20 And Above	65.9	35.8
Total	24.6	11.7

3.1.5 Share of Exports

The share of exports in total sales for the firms with employment above 50 is almost 50 per cent. Overall, the share of exports in total sales is 32 per cent. (See table 3.5). Karachi-based units are more export-oriented. The smallest enterprises do not export.

3.1.6 Employment Growth

Table 3.6 shows the change in employment over time for the firms. Again the growth in employment is highest for large firms as compared to small firm. It shows that over the time large firms are able to expand their business in relation to small firms.

Table 3.6: Average Number of Staff Employed

	Initial Staff Employed	Current Staff Employed
By City		
Lahore	14	29
Faisalabad	6	11
Karachi	12	31
By Employment		
10 Or Less	4	6
10 to 50	13	25
Above Than 50	36	102
By Turnover		
Less Than 5 Million	4	6
5 TO 10 Million	8	14
10 to 20 Million	10	19
20 And Above	21	52
Total	11	23

3.1.7 Location

50 per cent of the sample units said they have a permanent establishment outside the market. The rate is higher for Lahore. Almost 50 per cent of the small firms (With employment less than 10 or with sales less than 5 million) said they have permanent establishment in a market. (See Table 3.7)

Table 3.7: Percentage Distribution by Nature of Business Place (%)

	Permanent Establishment Outside a Market	Permanent Establishment In a Market	Temporary Establishment In a Market
By City			
Lahore	80	13	8
Faisalabad	29	71	0
Karachi	31	58	11
By Employment			
10 Or Less	41	48	11
10 to 50	64	35	1
Above Than 50	43	57	0
By Turnover			
Less Than 5 Million	40	49	11
5 TO 10 Million	44	48	8
10 to 20 Million	59	37	4
20 And Above	61	39	0
Total	50	44	6

3.1.8 Land Ownership

Almost 51 per cent of the units are operating on their own land. The share of own land increases as the size of firm increases. 22 per cent of the units use privately leased land, 18 per cent use privately rented property and 10 per cent use government land (See Table 3.8).

Table 3.8: Percentage Distribution of Nature of the Land Used for Business Purpose

	Owned land	Leased private land	Land rented from local government	Privately rented property
By City				
Lahore	31	11	19	39
Faisalabad	43	52	5	0
Karachi	87	2	4	7
By Employment				
10 Or Less	39	32	12	17
10 to 50	63	12	5	20
Above Than 50	62	10	19	10
By Turnover				
Less Than 5 Million	32	35	14	19
5 TO 10 Million	52	20	4	24
10 to 20 Million	56	19	7	19
20 And Above	72	8	8	13
Total	51	22	10	18

3.1.9 Access to Credit

Only 36 per cent of the units have taken a loan in the last five years. Access to credit for these firms is very low, being 15 per cent higher for the large firms (with sale above than 20 million) as compared to small firms (with sale less than 5 million) (See table 3.9).

Table 3.9: Has Enterprise Take Loan in Last 5 Years (%)

	Yes	No
By City		
Lahore	45	55
Faisalabad	25	75
Karachi	36	64
By Employment		
10 Or Less	34	66
10 to 50	36	64
Above Than 50	48	52
By Turnover (Rs)		
Less Than 5 Million	30	70
5 TO 10 Million	32	68
10 to 20 Million	37	63
20 And Above	45	55
Total	36	64

Table 3.10 presents the various sources used by firm for financing. Almost 47 per cent units take loan from Commercial bank, 31 per cent self finance while 18 per cent use private financing companies. The access to the Micro Finance Banks is very low.

Table 3.10: Percentage Distribution of Loan by type of Financing Source

	Commercial Bank	Cooperatives	Pvt. Finance	Micro Finance	Self Finance
By City					
Lahore	45.0	0.0	0.0	5.0	50.0
Faisalabad	56.3	6.3	25.0	0.0	12.5
Karachi	42.9	0.0	47.6	0.0	9.5
By Employment					
10 Or Less	27.8	0.0	30.6	5.6	36.1
10 to 50	53.3	3.3	10.0	0.0	33.3
Above Than 50	90.9	0.0	0.0	0.0	9.1
By Turnover					
Less Than 5 Million	34.6	0.0	26.9	3.8	34.6
5 TO 10 Million	37.5	0.0	12.5	12.5	37.5
10 to 20 Million	20.0	10.0	50.0	0.0	20.0
20 And Above	66.7	0.0	3.0	0.0	30.3
Total	46.8	1.3	18.2	2.6	31.2

Table 3.11 gives the various reasons for not applying for loan. 67 per cent said there is no need for a loan. The second most frequently cited reason was unfavorable interest rates.

Table 3.11: Percentage Distribution of the reasons Not applying for loan

	No need for a loan	Application procedures were complex	Interest rates were not favorable	Collateral requirements were too high	Size of loan and maturity were insufficient	Did not think it would be approved	Application required formal registration of companyd be approved	Others
By City								
Lahore	47.7	8.1	28.8	7.2	1.8	3.6	1.8	0.9
Faisalabad	74.2	4.5	12.1	1.5	7.6	0.0	0.0	0.0
Karachi	100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
By Employment								
10 Or Less	65.0	5.8	18.3	5.8	3.3	0.8	0.8	0.0
10 to 50	66.7	4.6	19.5	1.1	3.4	2.3	1.1	1.1
Above Than 50	77.8	5.6	5.6	5.6	0.0	5.6	0.0	0.0
By Turnover								
Less Than 5 Million	66.7	6.1	15.2	7.1	3.0	1.0	1.0	0.0
5 TO 10 Million	56.3	6.3	28.1	3.1	3.1	3.1	0.0	0.0
10 to 20 Million	69.0	3.4	20.7	0.0	6.9	0.0	0.0	0.0
20 And Above	70.8	4.6	15.4	1.5	1.5	3.1	1.5	1.5
Total	66.7	5.3	17.8	4.0	3.1	1.8	0.9	0.4

Looking into future prospects, only 11 per cent of the units have recently applied for a loan. (See table 3.12) 55 per cent of the units said that their application was approved for loan and 32 per cent said application is still in process, 9 per cent said application was rejected and 5 per cent units said they don't know. Approval rate is almost 50 percent higher for large units. (See table 3.12).

Table 3.12: Percentage Distribution of the Outcome of the most recent application

	Application was approved	Application was rejected	Application still in process	don't know
By City				
Lahore	78	22	0	0
Faisalabad	50	0	50	0
Karachi	29	0	57	14
By Employment				
10 Or Less	22	22	44	11
10 to 50	83	0	17	0
Above Than 50	71	0	29	0
By Turnover				
Less Than 5 Million	29	14	43	14
5 TO 10 Million	50	50	0	0
10 to 20 Million	33	0	67	0
20 And Above	80	0	20	0
Total	55	9	32	5

Table 5.13: Percentage Distribution of Pay Taxes

	Registered Firm	Non Registered Firm
By City		
Lahore	94	6
Faisalabad	78	22
Karachi	76	24
By Employment		
10 Or Less	69	31
10 to 50	100	0
Above Than 50	100	0
By Turnover		
Less Than 5 Million	62	38
5 TO 10 Million	100	0
10 to 20 Million	100	0
20 And Above	100	0
Total	84	16

3.1.10 Tax Payment

Units were asked about whether they are paying taxes or not. 84 per cent of the units claimed that they paid taxes. (See Table 3.13) According to Table 3.14 the most frequent reason, 49 per cent, for nonpayment was the unit was below the exemption threshold and thereby not liable to pay taxes. The tax evaders justified it on grounds of either lack of service, difficulty in filing returns, lack of equity in the system or high tax rates (See Table 3.14).

Table 3.14: Reasons for Not Paying Taxes

Reasons	Number	Percentage
Turnover/Sales are below Exemption Level	32	49.2
No problem if Tax is not paid	7	10.8
See no need for paying Taxes	6	9.2
Tax Rates are too high	5	7.7
Tax Revenue is not fairly spent by the Government	5	7.7
No one comes to Collect Tax	4	6.2
Difficulty in filling the Tax Return	4	6.2
No benefit from taxes paid in Services from Government	2	3.1

Among those who are paying taxes, 71 per cent pay some tax on their incomes, 61 percent pay General Sales Tax (RGST), 17 percent the withholding tax, and 13 percent excise duty respectively. (See table 3.15)

Table 3.15: Various Federal Taxes Paid by Units (%)

	Income tax	Withholding Tax	GST	Excise duty	Other
By City					
Lahore	92	33	53	4	11
Faisalabad	25	0	53	2	2
Karachi	88	10	83	43	31
By Employment					
10 Or Less	50	14	25	1	0
10 to 50	83	19	84	15	13
Above Than 50	100	24	100	48	57
By Turnover					
Less Than 5 Million	46	19	0	0	0
5 TO 10 Million	64	16	84	0	0
10 to 20 Million	67	22	96	7	7
20 And Above	95	14	86	31	31
Total	71	17	61	13	13

**total is greater than 100 duty multiplicity of taxes.*

Table 3.16: Multiplicity of all taxes paid

No of Taxes	Frquency	Percent
One	1	0.5
Two	4	2.0
Three	8	4.0
Four	12	6.1
Five	13	6.6
Six	29	14.6
Seven	22	11.1
Eight	28	14.1
Nine	15	7.6
Ten	13	6.6
Eleven	8	4.0
Twelve	9	4.5
Thirteen	6	3.0
Fourteen	5	2.5
Fifteen	8	4.0
Sixteen	3	1.5
Seventeen	4	2.0
Eighteen	3	1.5
Nineteen	4	2.0
Twenty	2	1.0
Twenty one	1	0.5

3.1.11 Multiplicity of Taxes

The multiplicity of taxes/charges collected by the two tiers (federal and provincial) is highlighted by Table 3.16 which shows the frequency distribution of the different taxes in Pakistan. Almost 19 per cent of the firms are paying one to five taxes, 54 percent of the units are paying six to ten taxes, 18 per cent are paying eleven to fifteen taxes and 9 per cent are paying more than fifteen taxes.

When asked about their perception about multiplicity of taxes, 82 per cent of units 'agreed' that there are too many taxes. (See Table 3.17)

Table 3.17: Perception About Too Many Taxes (%)

	Strongly Agree	Agree	Disagree	Strongly Disagree	Don't Know
By City					
Lahore	45.0	47.5	1.3	0.0	6.3
Faisalabad	38.5	38.5	0.0	1.5	21.5
Karachi	40.0	32.7	3.6	0.0	23.6
By Employment					
10 Or Less	26.0	40.4	1.9	1.0	30.8
10 to 50	56.0	44.0	0.0	0.0	0.0
Above Than 50	66.7	28.6	4.8	0.0	0.0
By Turnover					
Less Than 5 Million	25.0	35.7	0.0	1.2	38.1
5 TO 10 Million	48.0	44.0	8.0	0.0	0.0
10 to 20 Million	37.0	59.3	3.7	0.0	0.0
20 And Above	62.5	37.5	0.0	0.0	0.0
Total	41.5	40.5	1.5	0.5	16.0

3.1.12 Complexity of Taxes

80 per cent of the units 'strongly agree' and 'agree' that tax laws and procedures are complex while 16 per cent said they don't know about complexity of tax laws and procedure. (See table 3.18).

Table 3.18: Perception about Complexity of Tax Laws and Procedure (%)

	Strongly Agree	Agree	Disagree	Strongly Disagree	Don't Know
By City					
Lahore	48.8	38.8	5.0	1.3	6.3
Faisalabad	33.8	43.1	1.5	0.0	21.5
Karachi	32.7	36.4	7.3	0.0	23.6
By Employment					
10 Or Less	31.7	32.7	4.8	0.0	30.8
10 to 50	45.3	50.7	4.0	0.0	0.0
Above Than 50	57.1	33.3	4.8	4.8	0.0
By Turnover					
Less Than 5 Million	27.4	32.1	2.4	0.0	38.1
5 TO 10 Million	48.0	44.0	8.0	0.0	0.0
10 to 20 Million	55.6	40.7	3.7	0.0	0.0
20 And Above	45.3	46.9	6.3	1.6	0.0
Total	39.5	39.5	4.5	0.5	16.0

3.1.13 Efficiency of FBR

Only 20 per cent of the sample perceives that the tax collecting agencies have competent officers. (See table 3.19)

Table 3.19: Perception if tax collecting agencies have competent officers (%)

	Strongly Agree	Agree	Disagree	Strongly Disagree	Neither Agree nor Disagree	Don't Know
By City						
Lahore	2.5	6.3	37.5	46.3	1.3	6.3
Faisalabad	6.2	21.5	29.2	20.0	1.5	21.5
Karachi	10.9	16.4	36.4	7.3	5.5	23.6
By Employment						
10 Or Less	5.8	12.5	26.9	21.2	2.9	30.8
10 to 50	5.3	17.3	38.7	36.0	2.7	0.0
Above Than 50	9.5	9.5	57.1	23.8	0.0	0.0
By Turnover						
Less Than 5 Million	4.8	8.3	25.0	21.4	21.4	38.1
5 TO 10 Million	16.0	20.0	32.0	28.0	28.0	0.0
10 to 20 Million	3.7	22.2	55.6	18.5	18.5	0.0
20 And Above	4.7	15.6	39.1	37.5	37.5	0.0
Total	6.0	14.0	34.5	27.0	27.0	16.0

3.1.14 Perceptions

Sample units were asked about their perception about tax staff's behavior with small business enterprises. 66 per cent said tax staff's behavior is unfair with SMEs. (See table 3.20).

Table 3.20 Perception about tax staff's behavior with SMEs (%)

	Strongly Agree	Agree	Disagree	Strongly Disagree	Neither Agree nor Disagree	Don't Know
By City						
Lahore	1.3	10.0	37.5	42.5	2.5	6.3
Faisalabad	3.1	4.6	46.2	24.6	0.0	21.5
Karachi	16.4	14.5	27.3	12.7	5.5	23.6
By Employment						
10 Or Less	2.9	8.7	34.6	21.2	1.9	30.8
10 to 50	5.3	6.7	42.7	42.7	2.7	0.0
Above Than 50	23.8	23.8	33.3	14.3	4.8	0.0
By Turnover						
Less Than 5 Million	2.4	8.3	28.6	20.2	2.4	38.1
5 TO 10 Million	8.0	8.0	56.0	28.0	0.0	0.0
10 to 20 Million	3.7	7.4	37.0	51.9	0.0	0.0
20 And Above	10.9	12.5	42.2	29.7	4.7	0.0
Total	6.0	9.5	37.5	28.5	2.5	16.0

3.1.15 Degree of Harassment

70 per cent of the sample units feel that they were harassed by tax officials while only 10 per cent did not feel any harassment by the tax officials. (See table 3.21)

Table 3.21: Frequency of The Main Problems Caused Because of Multiplicity Of Taxes

Problems	Number	Percent
High bribe rate in department	103	51.5
Bearing extra tax Burden	74	37.0
Complicated Tax System	61	30.5
It's a time wastage activity	59	29.5
Problem to maintain quality	48	24.0
It's a Tension	47	23.5
Inflation rate issue	42	21.0
Decrease Profit Margin	39	19.5
Blackmailing from various agencies	38	19.0
Documentation problem	29	14.5
Facing Higher production cost	26	13.0
Un necessary visits of tax Department	23	11.5
Non availability of information regarding Tax	20	10.0
Facing financial issues	20	10.0
Under invoice	18	9.0
Strikes	14	7.0
Regular visit to collect finished goods	12	6.0
No problem	10	5.0
Revenge policy	9	4.5
Increase in tax rate	8	4.0
Impose labor Law (No Child Labor)	7	3.5
Others	13	6.5

3.1.16 Problems

Sample units highlight some general problems and inconveniences created by multiplicity of taxes: bribes payment by 52 percent; extra tax burden for 37 percent of the respondents; complicated tax system for 31 per cent units; time consuming activity for 30 percent besides others indicated in Table 3.22.

Table 3.22: Perception About Harassment by The Tax Officials (%)

	Strongly Agree	Agree	Disagree	Strongly Disagree	Neither Agree nor Disagree	Don't Know
By City						
Lahore	10.0	66.3	16.3	1.3	0.0	6.3
Faisalabad	30.8	41.5	1.5	0.0	4.6	21.5
Karachi	23.6	32.7	9.1	1.8	7.3	25.5
By Employment						
10 Or Less	21.2	40.4	4.8	0.0	2.9	30.8
10 to 50	20.0	61.3	9.3	2.7	5.3	0.0
Above Than 50	19.0	47.6	33.3	0.0	0.0	0.0
By Turnover						
Less Than 5 Million	17.9	39.3	2.4	0.0	2.4	38.1
5 TO 10 Million	28.0	64.0	8.0	0.0	0.0	0.0
10 to 20 Million	29.6	55.6	7.4	0.0	7.4	0.0
20 And Above	17.2	53.1	20.3	3.1	4.7	0.0
Total	20.5	49.0	9.5	1.0	3.5	16.0

3.1.17 Impact of Taxation

Table 3.23 presents the top five challenges created by taxes for sample respondents: 71 percent have concerns about remaining competitive in market; 63 fear that reduction in profit margins may possibly compromise quality; 42 fear that taxes will lead to inflation, either inflationary trend or once and for all jump in prices; and, 38 percent are concerned about increase in the cost of production.

Table 3.23: Top 5 Challenges/Problems Created by Taxes

Ranking	Number	Percent
Competition in Market	143	71.5
Maintain quality of product	126	63.0
High inflation	84	42.0
Maintain price of commodity	76	38.0
Facing high production cost	74	37.0
Due to load shedding maintain production	71	35.5
Facing marketing problem	52	26.0
Corruption / bribe	45	22.5
Face Law and order situation	42	21.0
Facing extra burden of tax	29	14.5
Face Bhatta Ism	25	12.5
Mental disturbance	19	9.5
Facing Complicated tax system	16	8.0
Others	37	18.5

3.1.18 Compliance Costs

Turning next to costs associated with paying taxes, 84 per cent of the sample respondents said they are registered with tax authorities while all units with sale above 5 million said they are registered with tax authorities.

Table 3.24: Firms Registered with The Tax Authorities

	Yes	No
By City		
Lahore	94	6
Faisalabad	78	22
Karachi	75	25
By Employment		
10 Or Less	68	32
10 to 50	100	0
Above Than 50	100	0
By Turnover		
Less Than 5 Million	61	39
5 TO 10 Million	100	0
10 to 20 Million	100	0
20 And Above	100	0
Total	84	17

Those who are registered with tax authorities pay on an average Rs 57, 000 annually for their tax compliance which includes cost of registration, documentation and additional employees.

Half of the sample firms said they are not interested to getting tax benefits due to problems (See table 3.25) which include:

Table 3.25: Distribution of the Units Not Interested to Get Tax Benefits Due to Problems

	Yes	No
By City		
Lahore	55	45
Faisalabad	48	52
Karachi	49	51
By Employment		
10 Or Less	44	56
10 to 50	57	43
Above Than 50	62	38
By Turnover		
Less Than 5 Million	42	58
5 TO 10 Million	56	44
10 to 20 Million	70	30
20 And Above	53	47
Total	51	49

The biggest problems associated with tax benefits reported by units are compliance costs, complex rules and documentation requirements.

Table 3.26: Percentage distribution of Problems for tax benefits

	Cost	Complex rules and regulations	Documentation Requirements
By City			
Lahore	98	57	59
Faisalabad	71	84	84
Karachi	74	100	93
By Employment			
10 Or Less	85	65	70
10 to 50	84	86	81
Above Than 50	77	85	77
By Turnover			
Less Than 5 Million	91	60	71
5 TO 10 Million	71	71	86
10 to 20 Million	89	100	63
20 And Above	76	82	82
Total	83	76	75

3.1.19 Impact of Tax Exemptions and Concessions on Enterprise Development

This section presents finding on the impact of exemptions and concession on enterprise development in Pakistan. Table 3.27 shows that 16 per cent of the units are getting tax exemptions and concessions offered by tax agencies and 84 per cent of the units are not availing any tax concessions. 71 per cent of the large firms are getting concessions while only 7 per cent of the small units enjoy such concession primarily because they are exempt.

Table 3.27: Distribution of Units getting any tax concession (%)

	Yes	No
By City		
Lahore	11	89
Faisalabad	9	91
Karachi	31	69
By Employment		
10 Or Less	7	93
10 to 50	13	87
Above Than 50	71	29
By Turnover		
Less Than 5 Million	4	96
5 TO 10 Million	20	80
10 to 20 Million	11	89
20 And Above	33	67
Total	16	84

Table 3.28 shows the percentage distribution of the problems faced by the units in getting concessions. 41 percent units complained about the very long procedure, 36 percent high corruption rate, while 9 percent felt a bias against small units and tax authorities is the main difficulty faced by units.

Table 3.28: Frequency Distribution of the Difficulties Faced by Firms While Applying for the Exemptions

	Number	Percent
Very long procedure	9	41
High Corruption rate	11	50
Bias against	2	9

Table 3.29 shows units' perception about impact of tax exemption and concessions on sales, productivity and competitiveness of the firm. In case of sales 41 percent reported high impact, 25 per cent said medium impact, 19 per cent said low impact. 44 per cent said the impact of exemptions on productivity is medium and 28 said impact is high. 38 per cent said medium impact on competitiveness and 31 per cent said no effect.

Table 3.29: Impact of Tax Exemptions and Concessions on Sales, Productivity and Competitiveness (%)

	Sales	Productivity	Competitiveness
High	41	28	16
Medium	25	44	38
Low	19	16	16
No effect	16	13	31
Total	100	100	100

Only 5 per cent of the units said they received any tax exemptions at initial stages of establishment. Those who do get tax holidays they got it for 5 years. (See table 3.30) 39 per cent units said complex procedures for tax filing is the main reason for non-compliance by firms, 35 per cent said tax rates are too high and 21 per cent said they are never been requested to pay taxes by the government. (See table 3.31)

Table 5.30: Did Establishment Get any Tax Holiday? (%)

	Yes	No
By City		
Lahore	0	100
Faisalabad	0	100
Karachi	18	82
By Employment		
10 Or Less	1	99
10 to 50	4	96
Above Than 50	29	71
By Turnover		
Less Than 5 Million	1	99
5 TO 10 Million	0	100
10 to 20 Million	4	96
20 And Above	13	88
Total	5	95

Compared to others, the biggest assistance by government for growth of business is reducing tax said by 31 per cent of the units. 25 per cent of the units said there is a need to strengthen the services of tax authorities towards SMEs. Granting tax holidays and granting tax exemptions were each said by 22 per cent of the units as a source of business growth. (see table 3.32)

Table 3.31: Major causes of Non-Compliance (%)

Reasons	Percent
Tax rates are too high	35
The procedures for tax filing are too complicated	39
Never been requested to pay taxes by the government	21
Others	6
Total	100

Table 3.32: Tax Related Government Assistance for Growth of Business

Assistance by Government	Percent
Reducing tax rates	30.5
Granting tax holidays	22.1
Granting tax exemptions	22.3
Strengthen the services of tax authorities towards SMEs	25.1
Total	100

3.1.20 The Impact of RGST on Enterprise Development

In order to identify the impact of RGST (Pakistani counterpart of VAT), on enterprise development, there was a separate module in the questionnaire the findings of which are presented below. Table 3.33 shows that 51 per cent of the sample respondents are RGST compliant. Firms with sale below 5 million are exempt. Also, RGST compliance increases as the employment size increase.

Table 3.33: Percentage Distribution of RGST Compliance

	Yes	No
By City		
Lahore	50	50
Faisalabad	42	58
Karachi	64	36
By Employment		
10 Or Less	17	83
10 to 50	84	16
Above Than 50	100	0
By Turnover		
Less Than 5 Million	0	100
5 TO 10 Million	84	16
10 to 20 Million	96	4
20 And Above	86	14
Total	51	49

Over 44 percent of the sample units registered with tax authorities between 1996-2005 while 33 percent became tax compliant thereafter. This is because the current Sales tax legislation was introduced in 1990, but became fully effective in 1996. (See table 3.34).

Table 3.34: Frequency Distribution of Year from which Firm became RGST Compliant

Years	Number	Percent
1966-75	5	4.9
1976-85	7	6.9
1986-95	15	14.7
1996-2005	45	44.1
2006-12	30	29.4
Total	102	100.0

Sample units were asked to identify some major reasons for the low RGST compliance by SMEs: 69 per cent of the units said that there are no benefits associated with RGST compliance; 53 per cent said there is lack of awareness about the tax system; procedural complexities resulted in low compliance according to 44 per cent of the sample units; 33 per cent of the sample units said if they get identified there is possibility of future harassment by tax agencies; while behavior of tax officials was also reported as a reason why the SME sector has low compliance.(See Table 3.35)

Table 3.35: Major Reasons Behind SMEs not being RGST compliant

	Lack of Awareness	No Benefits	Procedural Complexity	Problematic Behavior of VAT Administration	Possibility of Future Harassment	Others
By City						
Lahore	48.8	56.3	31.3	1.3	7.5	0.0
Faisalabad	53.8	92.3	67.7	29.2	58.5	0.0
Karachi	56.4	60.0	34.5	40.0	38.2	1.8
By Employment						
10 Or Less	58.7	81.7	50.0	26.0	40.4	1.0
10 to 50	53.3	62.7	37.3	14.7	26.7	0.0
Above Than 50	19.0	28.6	38.1	19.0	14.3	0.0
By Turnover						
Less Than 5 Million	59.5	86.9	48.8	25.0	44.0	1.2
5 TO 10 Million	36.0	76.0	52.0	16.0	32.0	0.0
10 to 20 Million	59.3	59.3	44.4	25.9	22.2	0.0
20 And Above	46.9	46.9	34.4	15.6	21.9	0.0
Total	52.5	69.0	44.0	21.0	32.5	0.5

An important deterring factor is also the difficulty in getting tax refunds. According to Table 3.36 more than half of the sample respondents had problems getting refunds from FBR while 19 per cent said they did not have a problem.

Table 3.36: Has the Enterprise faced Difficulties in obtaining RGST Refunds

	Yes	No	Don't Know
By City			
Lahore	66	4	30
Faisalabad	46	32	22
Karachi	45	25	29
By Employment			
10 Or Less	38	20	41
10 to 50	65	20	15
Above Than 50	90	10	0
By Turnover			
Less Than 5 Million			
5 TO 10 Million	60	24	16
10 to 20 Million	63	33	4
20 And Above	72	14	14
Total	54	19	27

Sample respondents were asked about their perceptions about the performance of RGST officials. About three-fourth categorized it in “low” to “very low” category (see Table 3.37).

Table 3.37: Perception About Performance of RGST Official (%)

	Very Low	Low	Indifferent	High
By City				
Lahore	19	68	11	3
Faisalabad	14	62	9	15
Karachi	27	29	16	27
By Employment				
10 Or Less	21	53	13	13
10 to 50	16	64	12	8
Above Than 50	24	33	10	33
By Turnover				
Less Than 5 Million				
5 TO 10 Million	4	72	12	12
10 to 20 Million	30	44	15	11
20 And Above	17	53	13	17
Total	20	55	12	14

Sample Units perceptions' ranking about the friendliness of VAT regulation toward SMEs is: 34 per cent 'very low'; 46 per cent 'low'; 13 per cent 'indifferent'; and, 8 per cent 'high'. (Table 3.38). Large firms seem more satisfied as compared to small firm.

Table 3.38: Perceptions about the Friendliness of RGST Regulations Towards SMEs (%)

	Very Low	Low	Indifferent	High
By City				
Lahore	42.5	45.0	10.0	2.5
Faisalabad	27.7	52.3	15.4	4.6
Karachi	27.3	38.2	14.5	20.0
By Employment				
10 Or Less	40.4	42.3	11.5	5.8
10 to 50	28.0	54.7	12.0	5.3
Above Than 50	19.0	28.6	23.8	28.6
By Turnover				
5 TO 10 Million	40.0	40.0	16.0	4.0
10 to 20 Million	22.2	51.9	22.2	3.7
20 And Above	26.6	43.8	14.1	15.6
Total	33.5	45.5	13.0	8.0

When asked about the frequency of the visit by tax officials 41 per cent of the units said quarterly, 40 per cent annually, 13 per cent biannually and 6 per cent said monthly. (See table 2.43)

Table 3.39: Frequency of Tax Officials Visits to the firm (%)

	Monthly	Quarterly	Biannually	Annually
By City				
Lahore	0.0	20.0	5.0	75.0
Faisalabad	6.2	78.5	9.2	6.2
Karachi	14.5	27.3	29.1	29.1
By Employment				
10 Or Less	9.6	41.3	8.7	40.4
10 to 50	2.7	38.7	17.3	41.3
Above Than 50	0.0	47.6	19.0	33.3
By Turnover				
5 TO 10 Million	4.0	48.0	12.0	36.0
10 to 20 Million	3.7	48.1	18.5	29.6
20 And Above	3.1	39.1	17.2	40.6
Total	6.0	41.0	13.0	40.0

Inquiry whether RGST officials are discriminatory towards women led to a positive response in less than one-fourths of the respondents. 43 per cent reported no discrimination while about a third did not know. (see table 3.40).

Table 3.40: RGST Regulatory Authorities are less administrative friendly when it comes to dealing with woman (%)

	Yes	No	Don't Know
By City			
Lahore	39	36	25
Faisalabad	6	72	22
Karachi	22	18	60
By Employment			
10 Or Less	20	51	29
10 to 50	23	43	35
Above Than 50	43	5	52
By Turnover			
5 TO 10 Million	24	48	28
10 to 20 Million	26	37	37
20 And Above	25	30	45
Total	24	43	34

3.1.20 The Impact of Property Tax on Enterprise Development

This section presents the impact of property tax on enterprise development. Table 3.41 shows the percentage distribution of enterprises paying taxes on property by the use of land. Almost 52 per cent firms said they are paying property tax. Units using privately rented land or privately leased land are not paying property tax.

Table 3.41: Enterprise Pay Tax by the Land Used for Business Purpose (%)

	Yes	No
Owned land	96	4
Leased private land	5	95
Land rented from local government	25	75
Privately rented property	0	100
Total	52	48

Almost 38 per cent of the units said that value of land & building only is the criteria used for imposition of property tax, 23 per cent of the units said value of land is used as criteria and 21.2 percent said value of land, building & machinery is used as criteria. (See table 3.42).

Table 3.42: Criteria Used for Imposition of Property Tax (%)

	Value of land only	Value of land & building only	Value of land, building & machinery only	Annual fixed amount	Covered Area
By City					
Lahore	10.0	66.7	3.3	3.3	16.7
Faisalabad	11.5	42.3	0.0	38.5	7.7
Karachi	37.5	16.7	43.8	2.1	0.0
By Employment					
10 Or Less	31.6	36.8	15.8	13.2	2.6
10 to 50	21.3	42.6	14.9	14.9	6.4
Above Than 50	10.5	26.3	47.4	0.0	15.8
By Turnover					
Less Than 5 Million	30.4	30.4	17.4	17.4	4.3
5 TO 10 Million	7.7	69.2	7.7	7.7	7.7
10 to 20 Million	40.0	20.0	13.3	26.7	0.0
20 And Above	18.9	37.7	28.3	5.7	9.4
Total	23.1	37.5	21.2	11.5	6.7

Table 3.43 shows the percentage distribution of type of property tax paid by the firms. 72 per cent of the firms are paying Commercial Property tax, 26 per cent of the firms paying Residential property tax and only 2 per cent are paying industrial property tax. Results show an indication of wrongly specified property use by the units or the owners of land.

Table 3.43: Type of Property Tax by firms (%)

	Commercial Property Tax	Industrial Property Tax	Residential Property Tax
By City			
Lahore	60.0	3.3	36.7
Faisalabad	100.0	0.0	0.0
Karachi	64.6	2.1	33.3
By Employment			
10 Or Less	92.1	2.6	5.3
10 to 50	74.5	2.1	23.4
Above Than 50	26.3	0.0	73.7
By Turnover			
Less Than 5 Million	91.3	4.3	4.3
5 TO 10 Million	92.3	0.0	7.7
10 to 20 Million	93.3	0.0	6.7
20 And Above	52.8	1.9	45.3
Total	72.1	1.9	26.0

Table 3.44 gives average property tax rate and average annual tax paid by units. The average property tax rate is almost 5 Rs per square feet. On an average, a sample unit is paying Rs. 91000. As expected, the average annual Property tax increases with firm size.

Table 3.44: Average property tax rate and Annual Property Tax Paid by firm (Rs)

	Property Tax Rate	Average Tax
By City		
Lahore	5.23	71,597
Faisalabad	4.04	12,991
Karachi	4.71	145,917
By Employment		
10 Or Less	4.26	28,276
10 to 50	4.57	63,982
Above Than 50	5.84	284,632
By Turnover		
Less Than 5 Million	4.13	14,152
5 TO 10 Million	4.69	48,482
10 to 20 Million	4.27	48,533
20 And Above	5.06	147,281
Total	4.69	91,247

Sample units paying property tax were asked about the degree of enforcement in collection of property tax: 40 per cent reported it to be 'strong'; 14 per cent said 'somewhat strong' and 12 per cent said 'very strong'. Overall, sample units seem satisfied with enforcement of property tax. (See table 3.45).

Table 3.45: Degree of Enforcement in Collection of Property Tax (%)

	Very Poor	Poor	Somewhat Strong	Strong	Very Strong
By City					
Lahore	26.7	26.7	26.7	16.7	3.3
Faisalabad	3.8	0.0	3.8	69.2	23.1
Karachi	12.5	27.1	12.5	37.5	10.4
By Employment					
10 Or Less	10.5	18.4	2.6	55.3	13.2
10 to 50	23.4	19.1	21.3	25.5	10.6
Above Than 50	0.0	26.3	21.1	42.1	10.5
By Turnover					
Less Than 5 Million	8.7	17.4	4.3	52.2	17.4
5 TO 10 Million	23.1	7.7	0.0	61.5	7.7
10 to 20 Million	6.7	20.0	13.3	60.0	0.0
20 And Above	17.0	24.5	22.6	22.6	13.2
Total	14.4	20.2	14.4	39.4	11.5

Less than one-fourth of the sample units said 'Yes' to the question that property tax plays an important role in selecting business location. Results show that for small units, property tax rate is not important in selecting land for business. A major reason for this is that most of the small units do not have their own land and property tax is paid by owner of the land.

Table 3.46: Property Tax Plays Important Role in Selecting Location for Business (%)

	Yes	No
By City		
Lahore	23.3	76.7
Faisalabad	0.0	100.0
Karachi	37.5	62.5
By Employment		
10 Or Less	18.4	81.6
10 to 50	19.1	80.9
Above Than 50	47.4	52.6
By Turnover		
Less Than 5 Million	13.0	87.0
5 TO 10 Million	30.8	69.2
10 to 20 Million	13.3	86.7
20 And Above	30.2	69.8
Total	24.0	76.0

Only 5 per cent of the units said that property tax affects their decision to expand business. As such, most of the firms believe that property tax does not affect their decision about expansion. (See table 3.47).

Table 3.47: Does Property Tax affect your Decision to Expand the Business (%)

	Yes	No
By City		
Lahore	16.7	83.3
Faisalabad	0.0	100.0
Karachi	0.0	100.0
By Employment		
10 Or Less	2.6	97.4
10 to 50	6.4	93.6
Above Than 50	5.3	94.7
By Turnover		
Less Than 5 Million	0.0	100.0
5 TO 10 Million	7.7	92.3
10 to 20 Million	0.0	100.0
20 And Above	7.5	92.5
Total	4.8	95.2

As to why sample units preferred not have land for their business, the frequently cited reasons were: have no money to acquire land; cheap rental property available, and; property prices are too high and out of reach (See table 3.48)

Table 3.48: Reasons for Not Owning the Land of Business Site (%)

	Have no Money to acquire land	Cheap rental property available	Not available a place where required	Property is too costly and out of reach	Due to small business	Security problem	Easy to access
By City							
Lahore	96.4	32.7	9.1	29.1	0.0	7.3	7.3
Faisalabad	100.0	70.3	10.8	45.9	0.0	13.5	5.4
Karachi	100.0	57.1	0.0	71.4	14.3	0.0	14.3
By Employment							
10 Or Less	100.0	47.6	6.3	38.1	1.6	9.5	7.9
10 to 50	96.4	42.9	10.7	32.1	0.0	7.1	7.1
Above Than 50	87.5	75.0	25.0	62.5	0.0	12.5	0.0
By Turnover							
Less Than 5 Million	100.0	45.6	7.0	38.6	1.8	8.8	8.8
5 TO 10 Million	100.0	50.0	16.7	25.0	0.0	8.3	8.3
10 to 20 Million	100.0	58.3	8.3	41.7	0.0	8.3	0.0
20 And Above	88.9	50.0	11.1	44.4	0.0	11.1	5.6
Total	98.0	48.5	9.1	38.4	1.0	9.1	7.1

**total greater than 100 due to multiple responses*

In order to see the impact of land markets on enterprise development some questions were asked. Almost 88 per cent of the units believe that land acquisition procedures are complex. (See table 3.49)

Table 3.49: Complying with Land Acquisition Procedure (%)

	Yes	No	Don't Know
By City			
Lahore	90.9	0.0	9.1
Faisalabad	91.9	8.1	0.0
Karachi	42.9	57.1	0.0
By Employment			
10 Or Less	82.5	11.1	6.3
10 to 50	96.4	0.0	3.6
Above Than 50	100.0	0.0	0.0
By Turnover			
Less Than 5 Million	82.5	12.3	5.3
5 TO 10 Million	83.3	0.0	16.7
10 to 20 Million	100.0	0.0	0.0
20 And Above	100.0	0.0	0.0
Total	87.9	7.1	5.1

Units also believe that there is very high corruption in land acquisition. Almost 91 per cent units said corruption is rampant in land acquisition. (See table 3.50).

Table 3.50: Incidence of Corruption Is Rampant in Land Acquisition (%)

	Yes	No	Don't Know
By City			
Lahore	90.9	0.0	9.1
Faisalabad	94.6	0.0	5.4
Karachi	71.4	28.6	0.0
By Employment			
10 Or Less	88.9	3.2	7.9
10 to 50	92.9	0.0	7.1
Above Than 50	100.0	0.0	0.0
By Turnover			
Less Than 5 Million	89.5	3.5	7.0
5 TO 10 Million	83.3	0.0	16.7
10 to 20 Million	91.7	0.0	8.3
20 And Above	100.0	0.0	0.0
Total	90.9	2.0	7.1

Table 3.51 gives the five major problems created by land markets for sample units. 68 per cent said high bribe rate, 62 per cent said lack of proper record available, 64 per cent said too much documentation and 54 per cent said the existence of a powerful land mafia.

Table 3.51: Ranking of the top 5 problems land markets create for your business

	High value land	High value land	Available at worst place no infrastructure	High tax rate area	High cost accure to reach market	Powerful land Mafia	Double documentation	High bribe rate	Lot of visit to relevant Department	No proper land record available	Non availability of infrastructure	Patwari system, is the cause of monopoly	Lengthly legal requirement	Security issues
By City														
Lahore	15	4	7	49	27	67	73	62	9	71	4	40	69	4
Faisalabad	57	19	22	32	32	43	57	84	41	46	11	30	27	0
Karachi	57	57	57	86	57	0	29	29	14	43	0	29	43	0
By Employment														
10 Or Less	41	21	22	49	32	46	60	70	21	56	5	30	48	0
10 to 50	21	0	7	39	32	68	64	64	25	68	11	46	46	7
Above Than 50	13	0	0	38	25	63	88	63	13	63	0	38	100	0
By Turnover														
Less Than 5 Million	42	23	21	51	33	44	60	67	23	53	5	32	47	0
5 TO 10 Million	42	0	17	25	17	67	83	75	0	75	0	33	67	0
10 to 20 Million	25	0	17	42	25	75	50	83	25	75	17	25	42	0
20 And Above	6	0	0	44	39	61	72	56	28	61	6	56	61	11
Total	33	13	16	45	31	54	64	68	21	60	6	35	52	2

In the end some general question were asked from units. 78 per cent units said they maintain their books of account, 48 per cent said they submit documents to property tax authority and 36 per cent of the units hire professional for paying property tax. (See table 3.52)

Table 3.52: Accounting Procedure and Documentation

	Do you maintain any books of accounts and/or other documents?		Do you submit any document to the authority collecting property tax?		Do you hire any tax professional for paying property tax?	
	Yes	No	Yes	No	Yes	No
By City						
Lahore	76.7	23.3	6.7	93.3	6.7	93.3
Faisalabad	61.5	38.5	34.6	65.4	38.5	61.5
Karachi	87.5	12.5	81.3	18.8	52.1	47.9
By Employment						
10 Or Less	76.3	23.7	60.5	39.5	31.6	68.4
10 to 50	80.9	19.1	40.4	59.6	36.2	63.8
Above Than 50	73.7	26.3	42.1	57.9	42.1	57.9
By Turnover						
Less Than 5 Million	65.2	34.8	56.5	43.5	21.7	78.3
5 TO 10 Million	84.6	15.4	53.8	46.2	53.8	46.2
10 to 20 Million	80.0	20.0	46.7	53.3	53.3	46.7
20 And Above	81.1	18.9	43.4	56.6	32.1	67.9
Total	77.9	22.1	48.1	51.9	35.6	64.4

3.2 Results of Key Informant Interviews

To supplement the primary survey, the IPP team undertook interviews of some key informants also. The brief based on these interviews is presented below:

Taxation policies appear to be insensitive to the needs of SMEs. Large enterprises in Pakistan have influence on policy making. Apart from the tax liabilities of the SMEs there has never been significant effort to simplify their compliance requirements (e.g. simplified

tax calculations, permitting simplified accounts, less frequent filing) and thereby lower their tax compliance costs – that is lower the amount of time and resources required by firms to comply with the tax system.

Talking about the SMEs major issues related to tax compliance, CEO SMEDA, Sardar Ahmed Nawaz Sukhiara said “depending on the design and features of tax system, simplification measures may not only lower tax compliance costs; some measures can also enable small businesses to have additional cost savings. But unfortunately the number of taxes has been increasing over time which certainly is hurdle in SME creation as well as tax compliance.”

Respondents of Key Informant Interviews

No	Name	Designation	Address	Duration of Interview
1	Iftakhar Qutab	Chairman Punjab Revenue Authority	5-B Danepur Road, G.O.R-1, Lahore Office # 042-99205482	2 hours
2	Sardar Ahmed Nawaz Sukhiara	CEO SMEDA	4th Floor, 3rd Building, Aiwan-e-Iqbal Complex, Egerton Road, Lahore	1 hour
3	Shahid Ashraf Tarrer	Secretary Excise and Taxation		1 hour
4	Syed Dilshad Hussain	Manager of Association of Silk Products	Banarsi Silk Emporium Banaras Colony at Orangi Town	1 hour
5	Nadir Chippa	Manager of Association of Plastic Electric products	Bohra pir Old city Karachi	Half Hour
6	Muhammad Gulzar	Manager Manufacturing Motor Cycle Spare Parts	112- Tibat cebtre MA. Jinnah Road Karachi Phone # 021-32213639	Half Hour
7	Ali Hassan	Real Estate Agents	Plot no# 67/103 Buffer Zone Adjecent to Hydri Market North Nazimabad Karachi	Half Hour
8	Muhammad Kabeer	Real Estate Agents	R-79,Shop#4, Behind Zakia Palace Pak Kousar Town Karachi Phone # 0300-2152690	Half Hour
9	Muhammad Khan Samejo	Real Estate Agents	316-317, Faisal view apartment Korangi Road	Half Hour
10	Abdul Rasheed Memon	Real Estate Agents	Memon Estate Memon Goth	Half Hour

To change the tax policies for SMEs, government must devise policy by sector because SMEs are highly heterogeneous, some companies are very sensitive to the macroeconomic conditions while others are well established and could resist to the downturns. For the purpose of policy making Pakistani SMEs can be categorized sector wise and cluster wise. For example Industry located in Gujranwala is entirely different from that of Sialkot which is mostly related to sports.

There has to be some institutional setup for awareness among SMEs about incentives. For this purpose private information industry could play significant role. This is because Government, tax departments and tax officials are not trust worthy; because if tax officials approach to the SMEs and talks about providing incentives or other related measures, they would think they are trapping them. Therefore major issue with the tax system is that it is not efficient and trustworthy particularly the tax collectors that have interactions with the SMEs from time to time.

All over the world even in developed countries they have special treatments for SMEs. For example in China and India there are different tax slabs for SMEs. There is need to simplify the system according to the capacity of SMEs. Tax collection system has to be efficient and equitable according to international best practices.

FBR or any other organization does not have proper records and information regarding SMEs. Therefore government should have proper record on SMEs by conducting periodic censuses of establishments so that it can better formulate tax policies. For example the manufacturing capacity, turnovers related information would give better picture of the situation related to SMEs and help formulate policies. How can government know the proper rates of taxation of SME if there is no information in their growth, particularly on their profit margins? Pakistan had census on manufacturing industries 8 years ago. This needs to be updated.

There are three reasons for giving incentive to industries 1) 'infant industry' protection 2) technology transfer or 3) increase export surplus. Government must have studies for individual sectors based on which they must give incentives to particular industries.

Pakistan must have a proper development program for SMEs, we should first analyze the youth between the age of 18-25; what kind of skill they have and what kind of raw material is available, access to world market and loaning for investors must be handled by government, skill development must be designed with help of education and skill development institutions.

There can be three reasons for low tax to GDP ratio, either tax design is not right, tax

implementation is weak, or tax machinery is not working properly. To bring SMEs into tax net government should provide incentives in such a way that increase the tax collection. For example generally the managerial competencies of SMEs, particularly in the field of finance are inadequate, which is one of the main hurdles in the development of SME. Government should provide opportunity to all the SME owners to acquire the skills needed to help their firms survive the crisis, with particular incentives to the tax payers, not only to encourage participation in general managerial skills development but also bring SMEs into the tax net. Also competence building should increase the demand for financing among SMEs.

Property tax on industries is charged according to area and the rate is of residential property which is lowest property tax rate. Treating industrial property as residential property instead of commercial property itself is a huge incentive.

Property tax rates also have impact on land market to some extent but property related issues like title, building place, services and other issues increase the cost of acquiring property. Therefore, all of the departments related to acquiring and transfer of land and property must be integrated. There is no preferential treatment for SMEs in property tax apart from property tax rate of residential property which is enjoyed by all industries without any discrimination.

Lack of documentation has negative impact on property tax collection. Documentation must be incentivized, for instance by giving them soft loans but putting conditions of documentation.

Every year the tax officials pay visits to enquire the status of property whether it is rented or in self occupation so that it can be taxed accordingly. The calculation and methodology is based on survey which is being done now and till then they are taxed according to 2001's Annual Rental Values Table.

The large number of taxes put huge burden on business because it increases the cost of compliance. Talking about the efforts for simplification of property tax, Secretary Excise and Taxation, Shahid Ashraf Tarrer said "We are developing web based applications for calculations of tax liability and payment of taxes online. These applications would allow people to calculate their tax liability as well as provide information on dimensions of their property. Implementation in Five big cities will be finalized by the end of this calendar year."

3.3 Results of Case Studies

To supplement our findings on females, the IPP team undertook interviews of some female entrepreneurs. Responses are given below;

Last few decades have seen significant progress by women in all walks of life. Technological advancements along with socio-economic changes and to some extent the deteriorating economic condition of large section of middle income groups have forced women to stand in the public arena to participate and work side by side with men. In Pakistan there are two main factors that still hinder the women's participation in entrepreneurship and business: the cultural norms of pardah (veil) and the notion of izzat (honour). These rigid rules are deep-rooted, which limit women to homes, and draw their legitimacy from perpetuation of firm beliefs, traditional mind set and cultural values. The low level of female participation in labor market, manifested in Table 3.53 demonstrates this.

Table 3.53: Employment to Population Ratio

Pakistan (15+)	2000	2002	2004	2006	2007	2008	2009	2010	2011
Both sexes	46.8	46.5	47	49.7	49.8	49.9	50.3	50.7	50.4
Male	78.6	77.6	77.6	79.6	79.6	79.1	78.5	78.3	78
Female	13.7	13.6	15.6	19	19.4	19.9	21	21.9	22.2
15-24 years									
Both sexes	35.1	37.6	38.5	41.9	40.9	40.3	40.6	41.1	39.6
Male	61.6	61.8	62.7	66.1	64.2	62.3	61.4	61.3	59.5
Female	7.2	11.8	13.7	16.8	16.8	17.1	18.3	18.8	18.8
South Asia (15+)	2000		2004	2005	2006	2007	2008	2009	2010*
Both sexes	57.5		58.4	58.5	58.7	58.8	59	59	59.1
Male	79.6		79.8	79.8	79.7	79.5	79.6	79.2	79.1
Female	33.9		35.7	36	36.6	36.9	37.3	37.6	38
East Asia (15+)									
Both sexes	73.5		72.5	71.9	71.4	71	70.4	70	69.9
Male	79.2		78.4	77.8	77.2	76.8	76.1	75.7	75.6
Female	67.6		66.5	65.9	65.3	65	64.4	64.1	64

However, a change in the trend is emerging and there is some evidence of an increasing number of women stepping into the business and manufacturing environment. Over the last decade, the ratio of female employment to population has increased by over nine percentage points. It has increased from 13.7% in 2000 to 22.2 percent in 2011 with employment to population ratio of 18.8% for women aged between 15-24. But it is still very low compared to South Asian and East Asian employment-to-population ratio of 38% and 64% respectively for women aged above 15.

Table 3.54 shows the responses of women enterprises regarding general biases and their impact on enterprises owned by women entrepreneurs. Most of the time cultural and traditional norms suppress women from starting and running their own businesses. Along with lack of family support and encouragement, women have to face non-professional behavior from male entrepreneurs. Women generally also lack skills about business and knowledge about finance and management

Most of the business incentives do not reach the woman unless women enterprise is not backed by a man. Also ministries, chambers of commerce and other associations do not have room for women enterprises.

Table 3.54: General Biases and Their Impact on Enterprises owned by women entrepreneurs (%)

	Yes	No	Don't Know	Total
Most People are not cooperative towards women entrepreneurs	67	33	0	100
Non-professional behavior of male entrepreneurs towards women	56	33	11	100
Payment recovery is a problem (weak bargaining position) for women	44	44	11	100
It is a problem to attract customers in a women enterprise	11	78	11	100
Unfavorable market behavior with women	44	33	22	100
Finding market is a difficult job for women	44	44	11	100
Government departments were not cooperate with women	22	78	0	100
The costs of running a business are higher for women entrepreneurs	22	78	0	100
Access to finance/credit for women entrepreneurs is difficult	33	56	11	100
General attitude towards women entrepreneurs is improving over time	11	56	33	100
Are women business support networks increasing?	11	56	33	100
Lack of technical skills of women entrepreneurs is a hurdle in enterprise development	67	33	0	100

3.3.1 Case Studies of Successful Women Entrepreneurs

(a) *Ms Shubana* is a self-made entrepreneur who started earning through teaching in a school. She belonged to a traditional family where females do not have a lot of education, but she managed to earn Master's degree in Political Science. Therefore, it was relatively easy for her to get out and start teaching. But teaching never pleased her and she was rather fond of dress designing and used to design garments for her family as a regular home activity. She got married at the age of 26.

She continued teaching after getting married in order to share the burden with her husband who is also a teacher by profession. She left teaching seven years ago when she decided to run her own business of dress designing and stitching. She set up her business in 2004 with a cost of Rs 50,000, employing two stitching machines and two laborers. In the beginning the business grew slowly as there was lack of capital and number of customers was very low as she could only sell her clothes in her vicinity. Overtime as word spread gradually she got established and invested in more machines and laborers.

She said when she started her business she had problems managing raw material and labor related issues. Especially, the male workers are not easy to handle and most of the people with whom she had dealing at the start of her business were not cooperative towards women. Several times she had issues with hiring tailors, who started free riding using machines for their own work and stealing raw material and other machinery parts. According to her in male dominant society handling male labor is a difficult job for her. Despite these problems, she still prefers to hire male laborers.

Every day she starts at 8:00 am in the morning with little inspection of the machines in order to assure whether every machine is in working condition. By 9:00 the laborers start stitching and cutting activities. The stitching and designing activities in general are either according to customer's requirements or own designs and stitching. Once designs are approved, the laborers start sewing which generally takes 4 to 7 days depending on the type of design and requirements except the heavy bridal suits which may take more than 3 weeks.

Narrating her story she said, she did have good know-how of stitching and designing but not have any prior business experience and was unaware of the cost of inputs, but she learnt everything by doing it herself. In the initial stages maintaining the machines and keeping them in working conditions was also very difficult task for her as laborers sometimes intentionally damage the machines in order to find excuses to remain idle.

She did not avail any loan from a bank because she did not want to go through lengthy

requirements related to bank processes and procedures and more importantly she thought, it would be difficult to pay back timely as she had no experience. So the Rs 50,000 she invested to start her business was borrowed from some of her relatives which she managed to pay back in first two years.

When number of machines and laborers increased, she started selling clothes to the shopkeepers and retailers in the market on credit. However, most of the retailers exploited her weak bargaining position by denying or delaying payments. Most of the payments get stuck in the special events like during Eid days when the workload is at peak.

As time passed she managed to hire a good team of laborers and some good connections in the market that not only increased her business but also helped her in reducing costs. Because her work is being recognized as quality work and she can get some decent price without many negotiations. Though she did not have any marketing for her business, the number of customer grew over time only by the word of mouth. Now she had 25 machines including different types of stitching machines, and 50 laborers including dyers, embroiders.

She said her husband have always been very supportive in establishing her boutique. She now has 2 children, Alisha and Ali Ahmad, who are getting education at well-known private school and want to see his son as successful businessman. She is also very happy that her husband has been doing PhD abroad and she is managing all family chores and business.

Talking about tax related issues to women enterprises she said the number of taxes is too large and many tax officials from different departments pay visits and harass the women enterprises. Because women generally do not have true information on different kind of taxes and tax related rules and regulation, most of the time they end up paying bribes to the tax officials in order to get rid of the hassle.

Her aim is to become a regionally recognized brand name, moderate growth annual profitability, and maintain quality of work. As she has already started exporting garments but sales are generally with help of friends and relatives. Now she wants to start exporting at larger scale as exports offer greater margin of profit.

(b) Zil-e-Batol is well educated women entrepreneur and belongs to middle income family. She is running a jewelry designing and manufacturing business. She started her business for supporting her family. She was really fond of designing jewelry and wanted to

run own business from her early years of education. That is why she decided to have MS in jewelry designing. According to her, even after acquiring right kind of skills and knowledge about a particular business; women entrepreneurs still have to face a lot of problems in the business environment and government is not doing much to support the women entrepreneurs.

She started her business 3 years back by selling articles online, with only two laborers at the manufacturing unit in Karachi. Currently she is working with 7 employees but still selling jewelry in local market. In 3 years she worked hard to expand her business. But her business requires high cost raw material because the pearls and stones are too expensive. Therefore she started using artificial pearls and stones and her work is being appreciated by her customers but profit margin is not enough to reinvest and expand business.

Finding some ways to expand her business she attended many meetings and workshops at Chamber of Commerce and other organizations but did not get any support. Talking about the loans and other facilities she said, she applied for loans many times but was not able to get one. Over three years, she said, she could have achieved more with some help and support from concerned government departments.

According to her there are too many taxes and tax system is too complex when it comes to dealing with different departments of governments. Therefore she has to avail services of a tax lawyer once every year to work for all the tax related matters. She was not aware of any subsidies and exemptions available to the SMEs or women enterprises. According to her she avoids making contact with the tax officials; firstly, over 3 years of her business experience she never met a single tax official who helped her in any way. Secondly because they create complications in conducting business and would increase her cost by requiring her to change the way she does her business and maintaining all kinds of documents they need.

SECTION-IV

Policy Implications and Recommendations

An analysis of the impact of current policy and its implementation on all three themes, tax concessions and exemptions, RGST and Property tax, on the SMEs shows that Pakistan needs to do a lot more to promote the sector. The informal sector lacks willingness to join the formal sector and sees no benefit in changing its status. At the same time public policy is also not conducive. In this environment, it is important that some effort is made by the public sector to strengthen the SMEs, particularly given their role in employment generation, export promotion and contributing to inclusive growth.

The government has adopted some policy measures that were included in the initial theoretical and recommended policy framework, however, many remain. We suggest that the government may consider the following:

- Rationalizing tax expenditures and enhancing greater public investment, especially in power generation and distribution, gas supply, roads, etc. for small enterprises. As compared to tax expenditures it will improve the competitive position of the SMEs relative to the large scale sector and enhance their growth and profitability.
- Provide fiscal incentives for conversion from AOP to small company according to the Companies Ordinance. This will improve their competitive position and growth and profitability prospects

Besides, the government may consider reducing competitive advantage from tax expenditures to large companies by the following policy measures;

- Limiting the duration of tax holidays to a maximum of five years. The government has in fact extended it from 5 to 10 years for Special Economic Zones (SEZ), with its negative revenue consequences
- Reduction in the accelerated depreciation allowance on the acquisition of non-productive physical assets (like buildings) is likely to improve the competitive position of SMEs also. The Finance Bill 2013 has reduced the initial allowance from 50 % to 25%.
- Higher accelerated depreciation allowances on acquisition of locally manufactured machinery (50%) versus 25% on imported machinery
- Elimination of the presumptive tax differential between commercial importers (who

mostly supply small companies) and industrial importers. This has, in fact, been increased in the Finance Bill 2013. This is likely to adversely affect the SMEs

- Making the withholding tax rate on electricity bills proportionate to the size of the bill, in the Finance Bill 2013. There has introduced an additional sales tax at the rate of 5 per cent on non-registered commercial and industrial users of electricity and gas having monthly bill in excess of Rs 15000
- Introduction of incentives for higher compliance by small enterprises. The proposed scheme is described in Box 2.1.

RGST

- Allowing voluntary registration by small enterprises, which are below the exemption limit will have positive implications on their growth and competitiveness
- Simplifying the tax system with more tax payer friendly returns, less frequency in filing of returns for small enterprises and availability of forms in local languages. This will both improve revenues and improve tax compliance.

Property Tax

- Simplification of the method of assessment of tax liability and making a transition to a self-assessment system. This will increase compliance and revenues
- Computerization of property records, following a comprehensive survey to improve revenue collection, and compliance.
- Reducing tax differential between different types of properties to generate more revenues
- Rationalization of the overall tax incidence on property transactions to improve compliance
- Reduce the documentation requirements for small land transactions.

Transfer collection of property tax to large municipal governments to improve compliance by establishing a stronger link between taxation and benefits.

SECTION-V

Limitations and Further Research

5.1 Limitations

The research was based on a small sample of 200 and therefore the conclusions should be taken as indicative in character. The surveyors were fully trained, but inevitably there may be some response biases by the sample units, particularly in reporting of the level of tax compliance and problem faced.

5.2 Research Questions

This section will describe methodology and suggestions for conducting Meta analysis. We compare findings across countries, compare policy across countries and learn from each other experiences

5.2.1 Theme 1

What is the extent to which small enterprises face biases in tax exemptions and incentives?

What is the extent to which these biases disproportionately impact on small enterprises operated in the undocumented economy and/or those owned/managed by women?

What are the impacts of the exemptions and concessions on entrepreneurs and SMEs in terms of enterprise performance and productivity?

What are the impacts of biased tax regimes on emigration of entrepreneurs and skilled labor?

5.2.2 Theme 2

What are the progressivity impacts of VAT burden on small enterprises (particularly those operating in the undocumented economy)? How do they affect enterprise performance and productivity?

How are small entrepreneurs treated by VAT administration, against indicators of compliance costs and taxpayer friendliness?

5.2.3 Theme 3

What are the weaknesses in Property Tax systems that create and/or sustain informal land markets?

What is the nature and magnitude of impacts of land informality on entrepreneurs of small enterprises operating in the undocumented economy?

SECTION-VI

Conclusion

Development of SMEs in Pakistan remains an under-researched area reflective of the policy neglect. GINI/IDRC must be appreciated for initiating research on small enterprises, which can play an important role in achieving 'inclusive growth' in Asian economies.

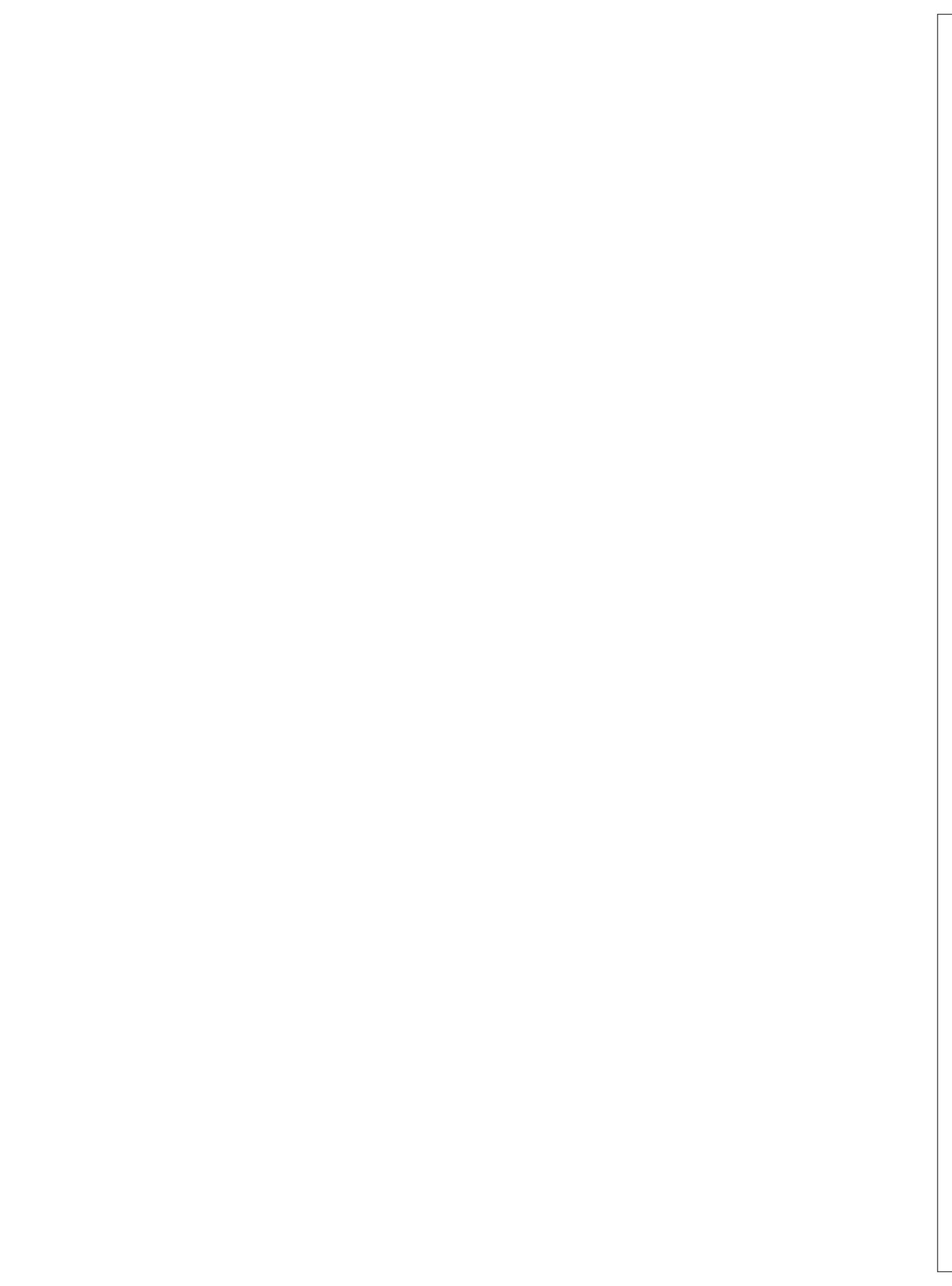
The primary conclusions are, first, that constraints to enterprise development relate more to the business environment and lack of access to credit, services (especially electricity and gas), markets, technology and skills.

Second, the taxation system does play a role, albeit a somewhat negative one. Recent changes, particularly in the granting of exemptions and concessions, reveal an anti-small enterprise bias and a visible orientation towards big business. This will aggravate further the competitive disadvantage of small enterprises.

The research undertaken demonstrates that to the extent that small enterprises fall in the net of taxes like income tax, GST (VAT) or property tax they do not enjoy any significant preferential treatment, except for the presence of exemption limits. In addition, the compliance costs are high, including bribes to tax officials.

The report recommends a reduction in the multiplicity of taxes and other charges, simplification of returns and reduction in documentation requirements. Also, compliance levels of small enterprises could increase if there is a stronger link with services provided.

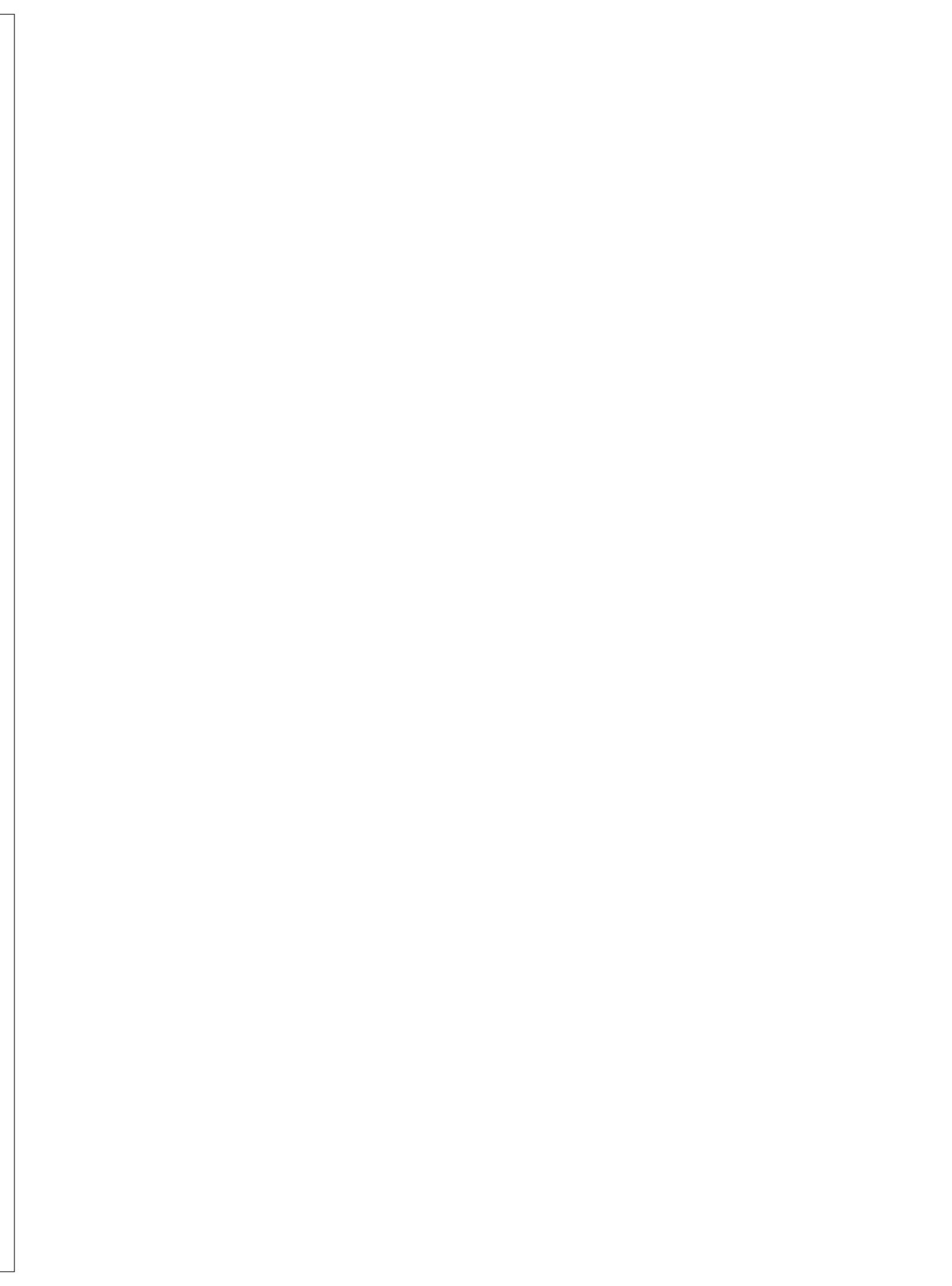
Overall, the Report has demonstrated the need for development of a comprehensive set of policies to promote SMEs. Such a framework should recognize the difference in constraints faced by small enterprises in different sectors. At the minimum, tax policy should not discriminate in favor of big business. This is essential if the growth process has to be made more inclusive and employment provided for the burgeoning youth population. The recently announced Prime Minister's Youth Program is very much a step in the right direction.



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