

***Investment in
Pakistan***

KPMG Member Firms' Offices in Pakistan

Taseer Hadi Khalid & Co.

Chartered Accountants

Karachi

Syed Masoud Ali Naqvi
First Floor
Sheikh Sultan Trust Building No. 2
Beaumont Road
Karachi 75330, Pakistan
Telephone : +92 21 5685847
Telefax : +92 21 5685095

Lahore

Fariduddin Ahmad
J-8/99, St. John's Park
Lahore Cantonment, Lahore Pakistan
Telephone : +92 42 6662740, 6667394
Telefax : +92 42 6662546

Islamabad

Mian Safiullah
Sixth Floor, State Life Building Jinnah
Avenue P.O. Box 1323
Islamabad, Pakistan
Telephone : +92 51 2823558, 2825956
Telefax : +92 51 2822671

KPMG Consulting

Peat Marwick Taseer Hadi (Pvt.)
Limited

Karachi

Ahmed Saeed
Hannan Centre, 1st Floor
55, D.A.C.H.S. Block 7 & 8
Main Shahrah-e-Faisal
Karachi
Telephone : +92 21 4543335-7
Telefax : +92 21 4543741

Preface

Investment in Pakistan is a study, which provides information on corporate, financial, taxation and general aspects of Investment in Pakistan This study is based on information available up to 31 December 2003.

Disclaimer: This study contains information, which should be used for initial planning purposes only and advice should always be obtained before making any business decision.

Taseer Hadi Khalid & Co.

Karachi, Pakistan

March 2004

Contents

	Page
Pakistan Overview	8
Chapter 1 Pakistan in Brief	10
Historical Background	10
Area	10
Population	10
Climate	10
Languages	10
Economy	10
Agriculture	10
Industry	10
Transportation	11
Energy	12
Privatisation Programme	12
Capital Market	14
Chapter 2 Investment Policy, Procedures and Incentives	15
Background	15
Exchange Regulations Relating to Remittance of Royalty and Technical Fee	17
Indigenisation and Deletion Policy	17
Industry Specific Incentives	18
Fiscal (Tax Relief)	18
Tax Concession and Avoidance of Double Taxation	18
Protection to Domestic Manufacturing	19
Protection to Investment	19
Chapter 3 Foreign Exchange Regulations Applicable to Investment in Pakistan	21
Issuance of Share Certificates	21
Remittance of Dividend	21
Disinvestment Proceeds	21
Technical Fee and Royalty	21
Employment of Foreigners	21
Portfolio Investment	21
Special Convertible Rupee Account (SCRA)	21
Foreign Currency Borrowing for Plant and Machinery	21
Exchange Rate Fluctuation Risk	22
Exchange Companies	22
Other Foreign Private Loans – Any Purpose	22
Short Term Foreign Private Loans	22
Prepayments of Foreign Private Loans	22
Local Borrowings	22
Loans Against Guarantees of Non-residents or Against Collateral Held Outside Pakistan	23
Possession of Foreign Currency	23
Foreign Currency Accounts	24

Chapter 4	Export Processing Zones Authority	25
Chapter 5	Immigration Procedures	27
	Salient Features of Existing Visa Policy	27
	Additional Incentives	27
	Granting of Pakistan Citizenship to Foreign Nationals (Investors)	28
Chapter 6	Types of Business Entities	29
	Introduction	29
	Corporate Legislation	29
	Forms of Companies	29
	Formation of a Company	30
	Rules for Offering Capital to General Public	32
	Management	32
	Meetings	32
	Registered Office	32
	Filing Requirements	32
	Accounts and Audit	32
	Liquidation	33
	Stock Exchange Requirements	33
	Opening of Project/Branch/Liaison Offices of Foreign Firms	33
	Accounts of Branches / Liaison Offices	34
Chapter 7	Incentive Packages for Private Sector Power Generation and Transmission Projects	35
	Introduction	35
	Features of New Power Generation Policy	35
Chapter 8	Petroleum Sector	37
	Introduction	37
	Petroleum Exploration and Production Policy 2001	37
	Procedural and Regulatory Measures	37
	Incentives for Local Exploration and Production Companies	38
	On-shore Areas	39
	Off-shore Areas	40
	Miscellaneous	42
	Employment, Training and Welfare Programme	42
	Petroleum Policy 1997 - Incentives for Oil and Lube Refineries	43
	Incentives for Oil Marketing and Distribution	43
	Infrastructure Development	43
	Miscellaneous	43
Chapter 9	Mineral Policy	45
Chapter 10	Information Technology Policy and Incentives	46
	Introduction	46
	Pakistan Software Export Board (PSEB)	46
	Incentive Package for IT Sector	46
	Legislation and Regulations	47

Chapter 11 Tourism Policy	48
Introduction	48
National Tourism Policy 2001	48
Chapter 12 Securities and Non Bank Finance Companies	49
Capital Market	49
Major Institutional Developments	49
Automation of the Exchange	49
Performance of Karachi Stock Exchange	49
The Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003	50
Asset Management Companies	51
Housing Finance Companies (HFC)	51
Investment Companies and Investment Advisers	52
Investment Finance Companies	52
Leasing Companies	53
Venture Capital Companies and Venture Capital Funds	53
The Securities and Exchange Commission (Insurance) Rules, 2002	54
The Liased Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002	55
Code of Corporate Governance	55
Chapter 13 Banking and Insurance	57
Introduction	57
State Bank of Pakistan and Commercial Banks	57
Commercial Banks	57
Banking License	57
Reciprocity	57
Some Important Regulations Governing the Banking Companies in Pakistan	57
Prudential Supervision	58
Prudential Regulations	58
Modarabas	60
Insurance Ordinance, 2000	61
Code of Corporate Governance for Insurance Companies	62
Chapter 14 Labour Force and Employment	66
Background	66
Labour Policy	66
Labour Laws	67

Chapter 15 Income Tax

69

The System	69
Tax Year	69
Legal Status of The Tax Payer	69
Residency Test	69
Heads of Income	69
Salary	70
Income from Property	71
Income from Business	71
Capital Gains	76
Income from Other Sources	76
Modes of Payment of Tax	77
Filing of Income Tax Returns	79
Other Important Areas of The Ordinance	80
Taxation of Permanent Establishment of a Non-Resident	81
Taxation of Special Industries	81

Pakistan Overview

Name of the Country	: Islamic Republic of Pakistan
Geographical Location	: Between 23' and 37' North latitude and 61' and 76' East longitude
North	: China (Sinkiang) and Central Asian Republics
Northwest	: Afghanistan and Iran
East/South East	: India
South	: Arabian Sea
Area	: 796,095 Square Kilometres (76.61 million hectares)
Cultivated hectares	: 22.13 million
Forest hectares	: 3.81 million
Population	: 149.03 million (2003)
Population growth rate	: 2.1%
National Language	: Urdu
Official Language	: English / Urdu
Currency	: Rupee
Capital City	: Islamabad
Sea Ports	: Karachi, Mohammad Bin Qasim and Gawader
Dry Ports	: Lahore, Rawalpindi, Sambrial, Hyderabad, Multan, Faislabad, Peshawar and Quetta
Fish Harbours	: Karachi and Gawader
International Airports	: Karachi, Lahore, Islamabad, Peshawar and Quetta.
National Airline	: Pakistan International Airlines Corporation (PIA)
Rainfall	: 762 mm/annum
Literacy Rate	: 51.6% (Male 63%, Female 38%)

ECONOMIC INDICATORS

GNP growth rate	: 8.4%	Fiscal Indicators as a Percentage of GDP	
GDP growth rate	: 5.1%	Total Revenues	: 17.6%
Inflation (CPI)	: 3.3%	Tax Revenue	: 13.8%
Agriculture	: 4.1%	Non-Tax Revenue	: 3.8%
Manufacturing	: 7.7%	Total Expenditure	: 22.2%
Commodity Producing	: 4.8%	Current Expenditure	: 18.1%
Services	: 5.3%	Defence	: 3.9%
As a Percentage of GDP		Interest Payment	: 6.0%
Total Investment	: 15.5%	General Administration	: 2.5%
Fixed	: 13.1%	Development Expenditure	: 4.1%
Public	: 4.5%	Overall Deficit	: 4.6%
Private	: 8.6%	Money & Credit Growth Rate	
National Savings	: 19.5%	Monetary Assets	: 12.5%
Foreign Savings	: -3.7%	Domestic Assets	: -3.8%
Domestic Savings	: 14.7%	Balance of Payments Growth Rate	
GDP Deflator	: 4.5%	Exports (F.O.B)	: 16.6%
CPI (Growth %)	: 3.3%	Imports (F.O.B)	: 21.9%
		Trade Deficit	: 196.1%
		Private Transfers (net)	: 40.1%
		Worker's Remittances	: 98.6%
		Current Account Deficit	: 152.7%
OTHER FACTORS			
Per Capita Income:	Rs. 28,933 per annum.		
Exports:	US\$ 9,135 million		
Imports:	US\$ 10,340 million		
Major Crops:	Cotton, Wheat, Rice, Sugar cane, Other crops. Major		
Industries:	Textile, Cement, Fertilizer, Sugar, Leather Garments, Chemicals, Agro - based, Engineering and Electrical / Electronics Industries		

Source: Economic Survey of Pakistan, 2002-2003

Chapter - 1

PAKISTAN IN BRIEF

Pakistan is situated in Asia, forming part of sub-continent. Its borders are with China in the North, and towards West and Northwest are Iran and Afghanistan and towards East and South East its borders are with India. The coastline of Pakistan runs towards South along the Arabian Sea.

1. Historical Background

Pakistan gained independence on 14 August 1947 after a long struggle by Muslims of sub-continent for a separate homeland consisting of Muslim majority provinces of undivided India. The Islamic Republic of Pakistan comprises four provinces, Punjab, Sindh, the North West Frontier Province (NWFP) and Baluchistan, besides the Federal Capital and Federally Administered Tribal Areas.

2. Area

The country has an area of 796,095 square kilometres. The total cultivated area is 22.13 million hectares. The area under forest is 3.81 million hectares.

3. Population

According to the provisional results of 2002 census, Pakistan is the seventh most populous country in the world. The present population is estimated at 149.03 million (excluding Afghan refugees numbering 2.2 million in January 2001).

4. Climate

The climate is generally classified as tropical. The Southern (Sindh) and Western (Baluchistan) regions are relatively dry, whereas the Northern (Punjab) and North-Eastern (NWFP) parts receive greater rainfall, averaging 762 milli-meters per annum. The temperature varies greatly between seasons, and in the plains, it mostly ranges between a maximum of 49° centigrade in the summer to a minimum of 1° centigrade in the winter.

5. Languages

The national language is "URDU", which is gradually being introduced at all levels. It is written in the Persian script. Regional languages are Punjabi, Sindhi, Baluchi, Pushto etc. English is the official language and is widely spoken and understood in the country.

6. Economy

Pakistan's economy, ever since achieving independence, has witnessed an impressive transformation from purely an agrarian character to a semi-industrialized stage. Economic development since forties has taken place within the framework of successive Five Year Plans, which lay down the growth targets and sectional allocations for the period covered by each plan. In addition, annual development plans are also prepared indicating yearly break-up of investment and programme for economic development in the public and private sector.

The estimated per capita income of the country at current market prices is Rs. 28,933 per annum. The real GNP grew by 8.4% percentage in 2002-2003.

Gross Domestic Product (GDP) during 2002-2003 grew at 5.1 percent as compared to 2001-2002 when it grew at 3.4 percent.

The Pakistan Economy has shown a good performance especially over the last decade whereby GDP has increased on an average by 4.63% and the agriculture sector has grown at an average of 4.74% per annum between, 1995-1996 and 1999-2000. The performance of the manufacturing sector in general and large scale manufacturing in particular has been impressive in the year 2002-2003, with growth rates of 7.7% and 8.7% respectively.

7. Agriculture

The economy over the period has been predominantly reliant on agriculture, with income from this sector accounting for about 18% of export earnings and 24% of GDP and more than 48.4% of the labour force is employed in this sector. The agricultural sector has recorded a sharp revival in the growth of major crops from -1.8% in 2001-2002 to 15.1% in 2000-2001 and 5.80% in 2002-2003. Agriculture growth, suffered a severe setback during 2000-2001 due to the unprecedented drought situation and shortage of irrigation water to the extent of 40%, eventually causing a negative growth of 2.65%. However, growth improved to 6.1% in 2001-2002 and 4.1% in 2002-2003.

8. Industry

At its inception, Pakistan's industrial base was non-existent and value added in large-scale manufacturing accounted for a mere 14% of the

gross national product. Industrialization in Pakistan has passed from initial concentration on textiles and other agro-based industries to Cement, Engineering, Sugar and Steel Industries. The country has now substantial capacities in cotton textiles, sugar, cement, fertilizers, leather and leather products, carpets, vegetable ghee and some engineering goods. The sizable build up in this capacity has occurred largely due to strong incentives provided to the private sector along with a wide range of promotional activities undertaken by Government.

9. Transportation

■ *Roads*

The total length of roads in Pakistan is approximately 251,845 kilometres. This includes 7,112 kilometres of federalised roads, including nine National Highways and one Motorway (M-2). An investment of about Rs. 100 billion is earmarked for improvement of existing roads and construction of new highways and motorways during the 9th five-year plan.

National Highway Authority (NHA) was established in 1991 to plan, promote, organize, and implement programmes for construction, development, operation, repair and maintenance of national highways and major roads.

Following projects are in progress:

- a) Indus Highway Project (1,265 km): an alternate North-South route on the west bank of River Indus, which links Karachi and Peshawar;
- b) dualisation of National Highway (N.5) (1,762 km): a historical highway from Karachi to the Torkham border through Lahore;
- c) Pakistan Motorway Project: work on the second phase of the project, i.e., Peshawar – Islamabad Motorway (M-1) has been initiated. Two additional motorway projects, Pindi Bhattian - Faisalabad (M-3) and Karachi - Hyderabad (M-9) have been awarded on a Build-Operate-Transfer (BOT) basis; and
- d) main Karakoram Highway (N-35) (713 km): improvement to up-gradation of the road as per international standards.

In addition to these projects, NHA has also undertaken various projects for cross connecting some of the remote areas to these main highways and to construct some bridges of national importance.

The Federal Government has also constituted a National Mass Transit Authority (NMTA) on the lines of NHA, which has been entrusted with the job of planning and implementation of mass transit projects in major cities of Pakistan. The NMTA has devised plans and entered into agreement with private sector for establishment of Light Rail Transit Lines (LRT) in Karachi.

■ *Railways*

Pakistan Railways has a well-developed system connecting virtually the entire country from north to south and east to west, catering to the large-scale movement of freight as well as passenger traffic. The Pakistan Railways Network comprises 7791 kilometres of track, 737 stations, 577 locomotives, 23,939 freight wagons and 1,901 passenger coaches upto the end of March 2003.

The Government of Pakistan is actively encouraging private sector participation in the railway sector to operate passenger and freight trains by paying track access charges.

■ *Air transport*

Pakistan has 42 airports, 11 new terminals buildings, 3 new runways, and 2 new Hajj lounges. Karachi, the gateway of Pakistan, is an important port of call on the world air and sea routes. Karachi's airport has been expanded by the construction of most modern Jinnah Terminal, which is catering to the passenger requirements for the 21st century. Construction of Allama Iqbal International Airport, Lahore has also been completed whereas construction of new airport at Islamabad is under consideration on Build Own and Transfer basis. Ground breaking ceremony for Sialkot International Airport (SIAL) was performed in June 2002 and the construction is planned to be completed by August 2004. The major contribution towards raising this project is by the local businessmen who want to cut down their freight charges by developing their own airport of international standards. Government is also cooperating in various matters. The concept of SIAL is to attract investment and boost exports, as Sialkot is one of the major industrial areas, which had so far been using the

Lahore Airport. In addition to the national carrier PIA, two private carriers Shaheen Air International and Aero Asia are operating successfully on local and international routes.

■ *Ports*

Pakistan has two major operating ports namely Port of Karachi and Port Qasim serving 803,943 square kilometres of hinterland, besides offering services for land-locked Afghanistan.

The two ports are well served by the road and rail system, linked directly with the National Highways and Rail Services.

The Government has declared that the private sector investment in ports will be treated as investment in industries. The investment will enjoy the facility of repatriation of profits at the exchange rate prevalent at the time of repatriation and will be treated at par with investment in industries, in the matter of taxes and duties.

■ *Shipping*

The Pakistan National Shipping Corporation is a government managed Shipping Corporation with a fleet comprising 13 vessels. The Government has issued 35 licenses to private sector companies, but so far only two companies Tri-Star Shipping Company with one tanker and Millwala Shipping Company with only one small vessel have started operations. Although there are only two companies under the Pakistani national flag in the private sector, a number of companies are operating under flags of their own convenience.

Foreign shipping lines dominate the Pakistan shipping industry. Due to the small size and inadequate capacity, the national fleet presently ships approximately 10 percent of the regular cargo and 25 percent of the liquid bulk cargo.

10. Energy

The main source of energy in Pakistan include oil, gas, petroleum products, electric power and coal. Over the last decade, oil / petroleum consumption grew at an average annual rate of 7.1 percent during 1990-1995, but slowed to an average of 5.0% during 1996-2000. Average annual growth in gas consumption on the other hand remained negative during 1990-1995, however it grew at an average rate of 5.58% during 1996-2000. Average annual growth in electric power consumption during the

last decade was 4.76%. During the year 2001-2002, only electric power consumption grew at a rate of 6.6%, whereas the growth in consumption of other energy sources remained negative.

■ *Oil and gas*

The recoverable reserves of crude oil as on 1 April 2002 have been estimated at 310 million barrels in the country.

■ *Electric power*

The Water and Power Development Authority (WAPDA), Karachi Electric Supply Corporation (KESC), Karachi Nuclear Power Plant (KANUPP) and Chashma Nuclear Power Plant are the four main public sector organizations involved in power generation.

Electricity generation and transmission has been opened to private sector. Various incentives have been provided to the investors in this sector, which have been described later in this booklet. In order to facilitate the local and foreign investors, the Government has formed a Private Power infrastructure Board and has established a policy framework, which covers the procedural aspects and fiscal and monetary incentives available for investment in power generation and power transmission projects.

■ *Coal*

The estimated coal reserves of Pakistan are 185 billion tonnes, of which 175 billion tones are located in Thar, Sindh. To enhance the production of coal and other minerals, the Government has framed a mineral policy, which covers the procedural aspects and fiscal and monetary incentives available for investment in mineral extraction projects. The mineral policy has been discussed later in the booklet.

11. Privatisation Programme

The Government of Pakistan (GOP) attaches high priority to privatisation as part of its dynamic policy for restructuring and revitalization of the national economy. Recognizing the private sector as the engine for economic growth, the Government is conscious of the need to make privatisation in Pakistan both attractive and rewarding for potential investors.

The privatisation programme was launched in 1991 in order to minimize the governments' role in

commercial and business activities. In all approximately 160 public sector enterprises were intended to be privatised. By end of year 2000, the number stood at 106. Gross privatisation proceeds stood at about Rs 60.9 billion, or US\$ 1.8 billion based on the exchange rate prevailing at the time of the respective transactions. The telecom sector accounted for over half of all proceeds.

■ *Privatisation Commission Ordinance, 2000*

The Government has promulgated Privatisation Commission Ordinance, 2000 with the aims to ensure level playing field for existing and future entrants, protecting consumer and taxpayer interests and dealing with public employees in a fair manner. The Ordinance strives, inter alia to:

- a) ensure that the Government policies and objectives are met;
- b) ensure widest possible participation in privatisation;
- c) ensure that monopolies are not created in the process of privatisation; and
- d) strengthening of regulatory framework for independent and fair regulation.

The modes of privatisation that PC can opt for have been prescribed in the Ordinance as follows;

- a) sale of assets and business;
- b) sale of shares through public auction or tender;
- c) public offering of shares through a stock exchange;
- d) management or employees buyouts by the management or the employees of a state owned enterprise;
- e) lease, management or concession contracts; or
- f) any other method as may be prescribed.

The Ordinance requires PC to establish and maintain a distinct and separate Privatisation Fund in which all privatisation proceeds shall be deposited. The Federal Government is required to utilise privatisation proceeds received from the PC in a prescribed manner, i.e., 10% of such proceeds

for poverty alleviation and the remaining 90% for retirement of the Federal Government debt.

Under the Ordinance, PC has been required to publish by notice in the official Gazette specified information in respect of each of the privatisation transaction within 30 days of its completion.

The Ordinance provides one year period after completion of a privatisation transaction for any scrutiny or investigation by Federal Government or any of agencies in respect of such completed transaction. After the expiry of such period the Federal Government and any of its agencies shall not be empowered to carry out any scrutiny or investigation.

■ *Privatisation Policy and Objectives*

The main features of privatisation policy and objectives of the Government include:

- a) strategic assets will remain outside the programme;
- b) to ensure the benefits of privatisation are filtered to general public, the role of stock market to be considered in the process of privatisation;
- c) overseas Pakistanis are to be involved in the privatisation process;
- d) to ensure realisation of the highest price and assure transparency of privatisation process and fair play;
- e) protecting the interests of consumers and taxpayers and dealing with public employees in a fair manner;
- f) utilisation of privatisation proceeds to reduce expensive debts;
- g) using privatisation as a mean of broadening the ownership of assets, mobilising savings and strengthening capital market; and
- h) curtailing corruption in state owned organisation by privatising them to private sector

In addition to the above, the Policy has defined sector specific goals for banking, industry, oil and gas, power and telecommunication.

■ *Privatisation opportunities*

Following are the major upcoming privatisation opportunities as at 31 December 2003:

- a) Banking & Finance
 - i) Habib Bank Limited
 - ii) NIT
- b) Oil & Gas
 - i) Oil & Gas Development Company Limited
 - ii) Pakistan State Oil Limited
 - iii) Pakistan Petroleum Limited
 - iv) Sui Northern Gas Pipelines Limited
 - v) Sui Southern Gas Company Limited
 - vi) National Refinery Limited
- c) Power
 - i) Karachi Electric Supply Corporation
 - ii) Faisalabad Electric Supply Corporation
 - iii) Peshawar Electric Supply Company Limited
 - iv) Jamshoro Power Co. Ltd. (Genco 1)
- d) Real Estate
 - (i) Faletti's Hotel, Lahore

■ *Protection to economic reforms*

In order to provide legal protection to the process of Privatisation of public sector enterprises, the Government promulgated the Protection of Economic Reform Act in 1992, main features of the Act provides that the ownership, management and control of any company or business establishment transferred by the Government to any party shall not again be taken over by the Government for any reason.

12. Capital Market

The capital market in Pakistan consists of three stock exchanges located in three major cities, i.e. Karachi, Lahore and Islamabad. The principal security traded on these exchanges are ordinary shares. However other securities such as mutual fund certificates, modaraba certificates, government and corporate bonds, are also being traded. A number of listed companies have also offered Term Finance Certificates (TFC), a tradable non-interest bearing non-convertible debt instrument to general public for subscription.

The development of capital markets introduced a healthy trend of establishment of corporate brokerage houses. The local corporate brokerage houses have also attracted some of the leading international brokerage houses and investment banks and have established joint ventures and technical collaboration with them.

701 companies were listed at Karachi Stock Exchange (which is the main Stock Exchange) as at 31 December 2003.

Until 1994, trading was based on open out-cry system. With the advent of Central Depository Company, computerised stock trading has started for a large number of companies and the market is gradually moving towards a complete scrip based trading.

In order to facilitate corporate debt financing, the Government has taken a number of measures. Amongst them, the foremost being the framing of rules for the establishment of Credit Rating Agencies. The rules have facilitated the establishment of Credit Rating Agencies and presently, there are following two credit rating agencies in the country:

- a) Pakistan Credit Rating Agency (PACRA)
- b) JCR-VIS Credit Rating Company Limited

A company intending to issue any debt instrument to general public is required to obtain a credit rating from one of the approved credit rating companies.

The Government has also enacted Rules for the establishment and regulation of Non-Banking Finance Companies, which include Asset Management Companies, Discount Houses, Housing Finance Companies, Investment Advisers, Investment Finance Companies, Leasing Companies and Venture Capital Companies.

Chapter - 2

INVESTMENT POLICY, PROCEDURES AND INCENTIVES

1. Background

Pakistan's Investment Policy has been formulated to create an investor-friendly environment, with a focus on further opening up the economy and marketing the potential for direct foreign investment. Various incentives have been offered to attract foreign investments including full repatriation of capital, capital gains, dividend and profit except in the service sector where repatriation of profit has been restricted to 60% of total equity or profit.

■ *Policies*

Previously, only the manufacturing sector was open to foreign investment. Now, the Policy Regime is much more liberal with most other economic sectors also open for foreign investment and with significant efforts at mobilising domestic financial resources towards long term investment.

■ *Manufacturing / industrial sector*

- a) Foreign Investors are permitted to hold 100% of the equity of industrial projects without any permission of the Government.
- b) No Government sanction is required for setting up any industry in terms of field of activity, location, and size, except for the following:
 - i) Arms and Ammunitions;
 - ii) High Explosives;
 - iii) Radioactive Substances; and
 - iv) Security Printing, Currency and Mint.
- c) No new unit for the manufacture of alcoholic beverages or liquors will be allowed.
- d) There is no requirement for obtaining No Objection Certificates (NOC) from the Provincial Governments for locating the project anywhere in the country except in areas that are notified as negative areas.

■ *Non-Manufacturing Sectors*

Foreign investment on a repatriable basis is allowed in the Service, Infrastructure, Social and Agriculture Sectors subject to the conditions indicated against each. They will have to simply register their company with Security and Exchange Commission of Pakistan (SECP) under the Companies Ordinance, 1984 and to inform the State Bank of Pakistan, provided the relevant conditionalities are fulfilled.

■ *Other Sectors*

a) Tourism

Tourism has been given the status of Industry.

b) Housing and Construction

i) The Housing and Construction sector has also been declared as Industry.

ii) Local and Foreign Companies involved in real estate projects will not market these projects unless the title of the property is transferred in the name of a locally incorporated company and the "Commencement of Business" certificate is issued by the Security Exchange Commission of Pakistan (SECP) to the firm.

c) Information Technology

i) Computer Software and Information Technology (IT) have been declared as Industry.

ii) Custom duty exemption is available on import of machinery & equipment used in the field of IT.

iii) Computer software and other items related to IT can also be imported at zero rate of import duty.

d) Fiscal Incentives

0% customs duty on import of agriculture machinery, equipment and implements (not manufactured Locally) new or used.

■ *Services sector*

a) *Activities*

Foreign direct investment in services sector is allowed in all activities subject to the condition that services which require prior permission or licence from concerned agencies continue to get the same treatment and the provision of the respective sectoral policies.

b) *Conditions*

- i) The investors may henceforth simply register themselves with the Securities & Exchange Commission of Pakistan (SECP) and the State Bank of Pakistan for the purpose of repatriation of profits / dividends and disinvestment proceeds and royalties abroad;
- ii) The benchmark level of foreign investment in services sectors has been reduced from \$0.5 million to \$0.3 million. The mandatory period for the induction of local equity, i.e., minimum of 40% of total equity, in these enterprises has been increased from 3 to 5 years subject to the condition that the repatriation of profit during the mandatory period will be restricted to a maximum of 60% of total equity or profit; and
- iii) The much-debated proposal to allow remittance of franchise, royalty and technical fee to non-manufacturing enterprises such as the international food chains has now been approved and these chains will now be able to remit the above mentioned types of fee to their home countries.

■ *Infrastructure sector*

a) *Activities*

Infrastructure Projects including the development of Industrial Zones.

b) *Conditions*

- i) The amount of foreign equity investment in the company / project shall be at least US\$ 0.3 million; and

- ii) 100% foreign equity is allowed on a repatriable basis

■ *Social sector*

a) *Activities*

- iii) Education, Technical/Vocational Training, Human Resource Development (HRD), Hospitals, Medical and Diagnostic Services.

b) *Conditions*

- i) The amount of foreign equity investment in the company / project shall be at least US\$ 0.3 million; and
- ii) 100% foreign equity is allowed.

■ *Corporate Agriculture Farming (CAF)*

a) *Activities*

Land Development / Reclamation of Barren Land, Desert and Hilly Areas for Agriculture Purposes and Crop Farming, Reclamation of Water Front Areas / Creeks, Crops, Fruits, Vegetables, Flowers, Farming / Integrated Agriculture (Cultivation and Processing of Crops), Modernisation and Development of Irrigation Facilities and Water Management, on farm construction of wheat / grain storage and construction of cold storage for captive use (not on commercial basis). CAF has been declared as industry, henceforth it would be eligible for all the incentives and facilities available to industries in the country.

b) *Conditions*

According to the CAF policy, such local and foreign companies would be entitled to become CAF legal entity that are locally incorporated under the Companies Ordinance 1984. In case of foreign companies, 60% foreign equity is allowed with minimum investment of US\$ 0.3 m.

■ *Value added and export industries*

The units which export minimum 50% (average) of their annual production for ten years or have minimum value-addition of 40% of production value (which may be specified from time to

time) will be treated as Value-Added or Export Industry respectively.

The criteria for granting the benefit of Value Added to industries has been reviewed and a comprehensive positive list of such industries has been approved. The list covers sectors like Ceramic Products, Articles of Iron and Steel, Chemicals and Allied Industries, Engineering and Allied, Textiles, Pharmaceuticals, Photographic or Cinematographic goods and other miscellaneous industries.

2. Exchange Regulations Relating to Remittance of Royalty and Technical Fee

■ *Royalty*

Royalty is a fee paid by a local firm to the foreign collaborator in consideration of license to use the foreign manufacturers' patent / brand name for marketing the product(s).

■ *Technical fee*

It is a fee paid by the local firm to the foreign collaborator in consideration of:-

- a) Engineering and Technical Services including assistance on manufacturing process, testing and quality control, assistance by way of making available patented process and / or secret know-how and rights to avail technical / confidential information resulting from continuous technical research and development, etc.; and
- b) Technical training of local personnel.

No technical fee is allowed for simple conventional process goods, which are being produced in the country without foreign technical collaboration.

Payment of Royalty, Franchise / Technical Fee by the non-manufacturing sectors opened for Foreign Direct Investment like International Food Franchises is permissible, subject to the maximum limit of \$100,000 on the initial lumpsum payment, irrespective of number of outlets, and maximum 5% of net sales. The initial period for which such fees will be allowed, should not exceed five years. Subsequent extension in time period will be considered, provided these projects also make investment in allied upstream projects.

Remittance of Royalty/Franchise and Technical Fee or commission/service charges for the financial sector may be allowed by the State Bank, on case to case basis, in respect of foreign collaborators branded financial products/services. The one-time lumpsum upfront Royalty/Technical Fee/Franchise fee should not exceed \$500,000. Continuing payments should not exceed 0.25% of customers billing.

The State Bank of Pakistan has laid down certain conditions for remittance of Royalty and Technical Fee to facilitate the execution of agreements for transfer of technology. The conditions for remittance of royalty and technical fee are as follows:

Upon execution of an agreement for transfer of technology with foreign collaborator, the local firm would designate any of the Authorised Dealers (Banks) in foreign exchange in Pakistan through whom payments under the agreement will be made and send an authenticated copy of the agreement to the State Bank of Pakistan through the designated bank within 30 days from the date of its execution. The State Bank will record the agreement, if it conforms to the foregoing definitions of Royalty / Technical Fee.

Remittance of Royalty / Technical Fee would be allowed by the Authorised Dealer designated for the purpose, without the prior approval of the State Bank subject to the following:

- i) Application for remittance of Royalty / Technical Fee is submitted by the firm concerned in the prescribed form;
- ii) The correctness of the information furnished in the application must be certified by the Auditors of the firm;
- iii) Payment of income tax supported by a certificate from auditors of the paying firm. In case it is claimed that the payment is exempt from levy of income tax, then relevant exemption certificate from the competent tax authorities would be required; and
- iv) The applicant company must be incorporated and operating in Pakistan.

3. Indigenisation and Deletion Policy

The deletion policy of different products of engineering industry was formulated in 1980 with a

view to save foreign exchange, provide job opportunities, ensure transfer of technology, and development of engineering base in the country. The engineering industries sanctioned under this programme, were allowed to avail concessionary rate of duty for the import of components / sub-components and raw material to promote indigenisation. The deletion policy was further reviewed in 1995 and is under implementation with higher degree of transparency. The Industry Specific Deletion Programme (ISDP) for progressive manufacturing of Deep Freezer, Motorcycles and Tractors was also prepared during 1998 -1999 and implemented by CBR.

The deletion policy has attracted investment in many joint ventures and technical collaboration for local manufacturing in the country. Some industries obtained quality certification like ISO 9002.

However, recently the Government has principally decided, as exhibited by the new budget, to lower the duty rates and phase out all but the auto deletion programme in compliance with WTO rules. The priority of the new budget (June 2003) is to increase exports and to increase employment opportunities. Thus, the government has decided to continue with the auto deletion programme because this industry has impressive growth potential, is export oriented, and its manufacturers and assemblers have achieved their target of deletion programme (40 to 60 percent).

4. Industry Specific Incentives

The Government has also announced various allowances and reliefs in respect of import duties and taxes on import of plant and machinery and raw materials for certain specified industries. The industries eligible for these allowances and reliefs are:

Category A: Value Added or Export Industries;

Category B: Hi-Tech Industries;

Category C: Priority Industries (engineering and chemicals); and

Category D: Agro-based Industries.

5. Fiscal (Tax Relief)

■ *Incentives*

To keep Pakistan competitive in international markets and support the viability of

investments in the country, the following incentives are available to both foreign and local investors:

a) Initial Depreciation Allowance (IDA)

Under the provisions of sub-section (5) of Section 23 of the Income Tax Ordinance 2000, initial Depreciation Allowance at the rate of 50% is permissible on an "eligible depreciable asset" placed into service in Pakistan for the first time in a tax year. For the purposes of such allowance, "eligible depreciable asset" means plant and machinery excluding the following:

- i) any road transport vehicle unless the vehicle is plying for hire;
- ii) any furniture, including fittings;
- iii) any plant or machinery that is acquired second hand; or
- iv) any plant or machinery in relation to which a deduction has been allowed under another section of this Ordinance for the entire cost of the asset in the tax year in which the asset is acquired.

It should be noted that the classes of allowances by way of "First Year Allowance (FYA)", "Reinvestment Allowance (RA)" and "Industrial Building Allowance (IBA)" as were introduced through the Finance Act, 1998, at varying rates ranging from 20% to 80% have now been withdrawn under the New Ordinance.

b) Amortization

- i) Amortization of pre-commencement expenses is allowed at the rate of 20% annually.
- ii) Amortization of intangible assets is allowed over a period of ten years.

6. Tax Concession and Avoidance of Double Taxation

- a) The Federal Government may allow such concessions to industrial undertakings having foreign private investment as may be admissible under any law for the time being in force;

- b) Foreign private investment shall not be subject to other or more burdensome taxes on income than those applicable to investments made in similar circumstances by the citizens of Pakistan; and
- c) Foreign private investment shall be allowed all the tax concessions admissible on the basis of any agreement for avoidance of double taxation, which the Government of Pakistan may have entered into with the Government of the country of origin of such investment.

7. Protection to Domestic Manufacturing

The objective of keeping domestic manufacturing competitive will continue to be actively pursued through suitable adjustments in the tariff structure. Imported finished products will attract higher rates than imported raw materials / inputs. The incidence of duties and taxes on locally produced goods will be less than that on finished imported goods. Reasonable tariff protection will be available to domestic manufacturing depending upon value addition.

8. Protection to Investment

The economic policies and the existing legal cover for foreign and Pakistani investment will be extended to new areas and sectors. The benefits and incentives for investment provided by the Government shall continue to be in force and will not be reduced or altered to the disadvantage of investors. Accordingly, the Protection of Economic Reforms Act, 1992 was amended on December 16, 1999. The main features of existing Act are as follows:

- *Act to over-ride other laws*

The provisions of this Act shall have effect notwithstanding anything contained in the Foreign Exchange Regulation Act, 1947, the Customs Act, 1969, the Income Tax Ordinance, 2000 or any other law for the time being in force.

- *Freedom to bring, hold, sell and take out foreign currency*

All citizens of Pakistan resident in Pakistan or outside Pakistan and all other persons shall be entitled and free to bring, hold, sell, transfer and take out foreign exchange within or out of Pakistan in any form and shall not be required to make a foreign currency declaration at any

stage nor shall any one be questioned in regard to the same. However, under the foreign exchange regulations, there are certain restrictions on amount of foreign currency that can be taken out of the country.

- *Protection of fiscal incentives for setting-up of industries*

The fiscal incentives for investment provided by the Government through the statutory orders shall continue in force for the terms specified and shall not be altered to the disadvantage of the investors.

- *Protection of transfer of ownership to private sector*

The ownership, management and control of any banking, commercial, manufacturing or other company, establishment or enterprise transferred by the Government to any person under any law shall not again be compulsorily acquired or taken over by the Government for any reason whatsoever.

- *Protection of foreign investment*

No foreign, industrial or commercial enterprise established or owned in any form by a foreign or Pakistani investor for private gain in accordance with law, and no investment in share or equity of any company, firm, or enterprise, and no commercial bank or financial institution established, owned or acquired by any foreign or Pakistani investor shall be compulsorily acquired or taken over by the Government.

- *Secrecy of banking transactions*

Secrecy of bonafide banking transactions shall be strictly observed by all banks and financial institutions, by whosoever owned, controlled or managed.

- *Protection of financial obligation*

All financial obligations incurred, including those under any instrument, or any financial and contractual commitment made by or on behalf of the Government shall continue to remain in force, and shall not be altered to the disadvantage of the beneficiaries.

- *Equal treatment*

Industrial undertakings having foreign private investment shall be accorded the same treatment as accorded to similar industrial undertakings, having no such investment in the application of laws, rules and regulation, relating to import and export of goods.

Chapter - 3

FOREIGN EXCHANGE REGULATIONS APPLICABLE TO INVESTMENT IN PAKISTAN

Foreign investment in Pakistan enjoys full protection and repatriation facilities. The Foreign Private Investment (Promotion and Protection) Act, 1976 provides guarantees for repatriation of foreign investment to the extent of original investment, profits earned on such investment, and appreciation of capital.

The following are the important foreign exchange regulations pertaining to foreign investment:

1. Issuance of Share Certificates

Under a general exemption of the State Bank of Pakistan (SBP), shares can be issued to non-resident shareholders by companies in the manufacturing, social, agricultural and services sectors, provided the purchase price has been received in foreign currency through banking channels and the conditions pertaining to investment in that sector have been met. If foreign investment is made in the shape of plant and machinery, the SBP gives permission for issuance of shares after verifying the import documents.

In certain cases, where the proceeds of foreign equity are to be utilized for import of plant and machinery, SBP's permission can be obtained for retaining the funds in a foreign currency account in Pakistan or abroad.

Companies covered under the general exemption can also export the share certificates to the non-resident investors, without the SBP's prior approval.

2. Remittance of Dividend

Commercial banks are authorised to remit dividends to foreign investors net of taxes, if applicable.

3. Disinvestment Proceeds

Banks can remit disinvestment proceeds to the extent of market value less brokerage / commission on submission of Stock Broker's memo showing the particulars of sale, in case of listed companies and to the extent of break up value of shares, as certified by a practicing Chartered Accountant, in case of a private limited company or unlisted public limited company.

4. Technical Fee and Royalty

Payment of technical fee and royalty is allowed to foreign collaborators on manufacturing of goods (except simple conventional process goods, in agriculture, social, infrastructure and service sector projects and for Food Franchises as per policy detailed in Chapter 2.

The financial sector requires SBP permission to remit royalty / franchise and technical fee or commission / service charges to its foreign collaborators.

5. Employment of Foreigners

Employment of foreign technical and managerial personnel in the manufacturing, social, infrastructure and service sector projects do not require any approval from BOI. However, they require work visa. These foreign nationals are allowed to transfer their countries of domicile the difference between their salaries and estimated living expenses in Pakistan on monthly basis, through their banks.

Similarly no approval is required for employment of foreign experts and technicians for supervision of installation and commissioning of plant and training of local personnel for running the plant, and commercial banks are authorised to allow remittance of foreign exchange for this purpose.

6. Portfolio Investment

Foreigners can freely invest in shares traded on the Stock Exchange and can repatriate their disinvestment proceeds and dividend net of taxes through any bank. Such remittances do not require prior approval from any governmental authority.

7. Special Convertible Rupee Account (SCRA)

Funds available in such SCRA can be remitted out of Pakistan or credited to a foreign currency account maintained in Pakistan at any time with out prior approval of the SBP.

8. Foreign Currency Borrowing for Plant and Machinery

■ Private foreign currency loans

General permission has been granted to private sector entrepreneurs to obtain foreign currency

loans from banks / financial institutions abroad, parent companies of the multinationals and as suppliers credit including credit under PAYE Scheme, not involving government guarantee, for financing foreign currency cost of the projects covered by the government's industrial and investment policies. The repayment period of such loans / credit should not be less than five years. Loan agreement in respect of such private foreign currency loans including suppliers' credit under PAYE Scheme are required to be registered with SBP together with the repayment schedule thereof. Such registration allows remittance of interest and loan instalments after deduction of applicable tax without requiring prior approval.

■ *Pay-As-You-Earn (PAYE) Scheme*

Government instituted a scheme of Supplier's Credit, i.e., PAYE Scheme, in early 70s under which entrepreneurs in the private sector can obtain foreign currency loans for import of plant and equipment for specified export oriented industries either for establishment of new industrial units or for balancing, modernisation, replacement and expansion of existing export oriented units. Foreign private loans obtained under PAYE Scheme are subject to certain conditions relating to advance payment to supplier and utilisation of foreign exchange earnings from export for repayment of loan, etc.

9. Exchange Rate Fluctuation Risk

Authorised Dealers (Banks) provide forward cover for export, import, foreign private loans, repatriable foreign currency loans (excluding loans obtained by foreign contractors and branches of foreign companies) for any duration more than one month, in accordance with the conditions prevailing in the market.

10. Exchange Companies

A three stage procedure has been prescribed for establishment of Exchange Companies, starting from obtaining an NOC from the SBP, applying to the SECP for incorporation and obtaining licence for commencement of operations from the SBP. Foreign participation in exchange companies is permissible upto 50%. These companies can deal in foreign currency notes, coins, postal notes, money orders, bank drafts, travellers cheques and transfers. They can also open currency exchange booths at public places for dealing in foreign currency notes and coins and purchase of travellers cheques.

11. Other Foreign Private Loans - Any Purpose

Individuals, firms, companies resident in Pakistan including foreign controlled companies and branches of foreign companies but excluding banks may obtain foreign currency loans from abroad on repatriable basis for any purpose on the following terms and conditions:

- 1) No ceiling on amount of loan. The repayment period, however, should not be less than five years and the repayment should be made in equal instalments.
- 2) Interest payable in arrears on half yearly / yearly basis at a rate not exceeding the relevant LIBOR plus 1.5% and will be subject to Pakistan taxes as may be liveable.
- 3) Exchange rate fluctuation shall be borne by the borrower and no forward cover/ exchange risk coverage would be provided by the Authorised Dealers.
- 4) No bank guarantee for securing such loans would be provided from Pakistan.
- 5) The borrower must get the agreement registered with an Authorized Dealer who will handle all transactions there under and intimate the details after receipt of all disbursements to the SBP in prescribed form along with Proceeds Realisation Certificate showing encashment of loan into Pak Rupees. Thereafter, the Authorised Dealer would be free to remit the instalment of principal and interest on due date in terms of repayment schedule, after deduction of tax, if liveable thereon. No prepayment would be permissible.

12. Short Term Foreign Private Loans

■ *Short term loans from abroad by exporters*

Exporters who have valid firm commitments with foreign buyers for export of goods from Pakistan, can obtain short term foreign currency loans from abroad to the extent of value of such firm commitment. Authorised Dealers and borrowers are free to negotiate the interest rates and the maximum tenure of such loan shall be period generally fixed for repatriation of export proceeds plus 60 days. The exchange risk shall be borne by the borrower. However, the loan and the interest thereon has to be repaid out of the related export proceeds.

- *Repatriable foreign currency loans by foreign controlled companies for working capital*

Foreign controlled companies are allowed to contract foreign currency loans from banks/ financial institutions or from their Head Office or from other overseas branches/ associates abroad for meeting their working capital requirements, subject to the conditions that the repayment period should not exceed twelve months and the interest should not exceed 1% plus LIBOR. Such loans can be rolled over for further periods not exceeding twelve months each. Upon maturity of such loans, the Authorised Dealer will allow remittance of interest and principal after deduction of applicable tax, if liveable, based on the proceed realisation certificate for inward remittance of foreign exchange. Branches of foreign companies and foreign contractors are not allowed to pay interest on such loans.

Furthermore, foreign contractors are not allowed to pay interest on such loans. Repayment is subject to the condition of completion of contract and submission of clearance certificate from the tax authorities.

Foreign currency loans for working capital by Pakistani firms and companies Pakistani firms and companies functioning in Pakistan excluding banks may obtain foreign private loan on non-repatriable or repatriable basis for their working capital requirement, subject to the following conditions:

- *Non-repatriable basis*

These loans are treated as Rupee loans and neither principal nor interest/profit would be remittable abroad. Repayment of loans and interest would be made in Pakistan in Pak Rupees.

- *Repatriable basis*

- 1) The loan must be interest free and for a period not less than one year.
- 2) No bank guarantee for securing such loans would be provided from Pakistan.
- 3) No forward cover shall be provided.
- 4) The Government of Pakistan will not provide the facility of absorption of exchange risk in such cases.

The agreement on repatriable basis is required to be registered with SBP. Repayment schedule is also required to be registered with the SBP, where after, the Authorised Dealer is allowed to remit instalment of principal on due date.

13. Prepayments of Foreign Private Loans

The SBP allows prepayments of foreign private loans (other than the Government guaranteed loans), on a case to case basis. This facility can be availed by borrowers who have the rupee counterpart available with them or they have the capacity to generate rupee funds themselves.

14. Local Borrowings

- *Lending to foreign controlled companies for working capital*

Authorised Dealers are allowed to grant Rupee loans and credits to foreign controlled companies for meeting their working capital requirements.

- *Lending to foreign controlled companies for capital expenditure*

Foreign controlled companies engaged in manufacturing are allowed to obtain Rupee loans for meeting capital expenditure requirement from banks, development financial institutions and other financial institutions or by issuing Participation Term Certificates, etc. However, other foreign controlled companies require special permission to obtain medium and long term Rupee loans.

15. Loans Against Guarantees of Non-residents or Against Collateral Held Outside Pakistan

Authorised Dealers have general permission under the Foreign Exchange Regulations to grant Rupee loans to their clients (including foreign controlled companies) against guarantees of non-residents / guarantees received from banks functioning abroad.

16. Possession of Foreign Currency

There is no restriction on residents and non-residents on bringing in, and possessing foreign currency. However, there is a ceiling of US\$ 10,000 on taking foreign currency out of Pakistan. This ceiling is in addition to any amount released by any bank under the SBP's rules.

17. Foreign Currency Accounts

Following are allowed to open and maintain Foreign Currency Accounts (FCA) without prior approval from SBP:

- a) Pakistan nationals resident in or outside Pakistan, including those having a dual nationality.
- b) All foreign nationals, whether residing abroad or in Pakistan.
- c) Joint Account in the names of residents and non-residents.
- d) All diplomatic missions accredited to Pakistan, and their Diplomatic Officers.
- e) All International Organisations in Pakistan.
- f) Firms and companies established / incorporated and functioning in Pakistan, including those having foreign share-holdings except for certain specified types of foreign currency remittances, for which required procedure has been provided separately in the foreign exchange regulations.
- g) Charitable Trusts, Foundations, etc., which are exempted from income tax.
- h) Branches of foreign firms and companies in Pakistan;
- i) Non-resident Exchange Companies even if owned by a bank or financial institution.
- j) All foreign firms / corporations, other than banks and financial institutions owned by Banks, incorporated and operating abroad provided these are owned by persons who are otherwise eligible to open foreign currency accounts.

However, the facility is not available to airlines operating in / through Pakistan or collecting passage and freight in Pakistan and the investment banks, leasing companies and modaraba companies including those which have been granted licences to deal in foreign exchange.

FCAs can be fed subject to the specified conditions mainly in respect of nature of transactions effecting generation of foreign exchange, i.e., FCAs can not be fed through

proceeds of securities sold to non-residents, amount representing payments for exports of goods and services, any foreign exchange borrowed with the permission of SBP unless otherwise permitted and any foreign exchange purchased from a bank in Pakistan for any purpose. However, FCAs can be fed through remittance from abroad, travellers cheques issued from outside Pakistan, foreign currency notes and foreign exchange generated by the encashment of securities issued by the Government of Pakistan. Resident corporate bodies and legal entities cannot, however, generate funds from the kerb market for deposit in FCAs.

Foreign equity and foreign currency loan can be retained in a Special Foreign Currency Account opened with the special permission from SBP. The funds available in such foreign currency accounts can only be used for those purposes which are related to the business of the account holder or which are otherwise permitted under the foreign exchange regulations. Any unutilised amount of foreign currency in these accounts will be required to be converted into Rupee at the inter-bank market and no withdrawal will be allowed in the shape of foreign currency notes.

Those branches / liaison offices / representative offices of foreign companies which have been permitted to be established on the condition that they would meet their expenses out of funds received from their head office, are required to convert such funds, i.e., foreign currency into Rupees with a bank in Pakistan.

Chapter - 4

EXPORT PROCESSING ZONES AUTHORITY

Export Processing Zones Authority (EPZA) in Pakistan is a Government of Pakistan venture, which was formed with a vision to enhance and improve the exports of the country. The main objectives of EPZA are to boost industrialization and augment country's exports by creating facilities for investors to enable them to set up export oriented units which would, as a consequence, create job opportunities, bring in new technology and attract foreign investment. Established in 1980, EPZA is one of the fastest growing government projects in the country, having a state of the art infrastructure, based not only on the work efficiency but also the healthy environment in every aspect. It has a peaceful, secure and environmentally protected pollution free work area. All its zones are in the major cities of Pakistan so as to minimize any inconvenience of any sort.

EPZA is undertaking a very extensive program for setting up EPZs' in Pakistan. These EPZs' will be set up in close cooperation or under joint venture arrangement with the private sector.

■ *Facilities*

EPZA offers the following facilities to its clients:

- a) One window service and simplified procedure.
- b) All infra-structural facilities like water, electricity, gas, and telephone.
- c) Skilled & un-skilled labour.
- d) Sub-contracting without limit on variety and quantity both outside the zone as well as within the zone.
- e) The garment manufacturing units, located in EPZs' are eligible to participate in auction of quotas.
- f) GSP concessions given by various countries for imports from Pakistan are available to the manufacturers in the zone.
- g) Inter-unit transfer of finished goods among exporting units allowed.

■ *Incentives:*

The following incentives are offered to the investors:

- a) 100% ownership rights.
- b) 100% repatriation of capital & profits.
- c) No minimum or maximum limit for investment. Duty free imports of machinery, equipment and material.
- d) No sales tax on input goods including electricity & gas bills.
- e) Obsolete/old machinery can be sold in domestic market of Pakistan after payment of applicable duties & taxes.
- f) No excise or custom duty on cement, steel and any other material used in construction of buildings.
- g) Freedom from national import restrictions.
- h) Foreign Exchange control regulations of Pakistan not applicable.
- i) Defective goods/waste can be sold in domestic market after payment of applicable duties, maximum up to 3% of total value of export.
- j) Duty free vehicles allowed under certain conditions. After 5 years of use, vehicles can be disposed off in domestic market on payment of duty.
- k) Domestic market of Pakistan available on same conditions as for imports from other countries.
- l) Units operating in EPZs can undertake sub-contracting for units of tariff area subject to payment of duty and taxes on value addition only.
- m) Only EPZA is authorized to collect Presumptive Tax at the time of export of goods, which would be final tax liability.

- n) EPZ units allowed to supply goods to Custom manufacturing bonds.
- o) Production oriented labour laws to be solely regulated by EPZA.
- p) EPZ manufacturers will be treated at par with bonded manufacturers in tariff area for any future incentives to be announced for exporters.
- q) Relief from double taxation subject to bilateral agreement.

Chapter - 5

IMMIGRATION PROCEDURES

1. Salient Features of Existing Visa Policy

To facilitate travel to and staying in Pakistan for foreign business persons and investors, business visa policies have been considerably relaxed.

- a) Businesspersons and investors from the 45 countries (as listed in Board of Investment policy January, 2003) with substantial investment in Pakistan will be granted multiple entry visas valid for three years.
- b) Businesspersons and investors from any of the above 45 countries where there is no Pakistani Embassy will also be granted a thirty-day landing permit on arrival at the airport in Pakistan.
- c) Pakistani industrialists and businesspersons interested to invite foreign entrepreneurs from countries other than the above 45 countries, for promotion of trade and industrial cooperation, are allowed to sponsor, on their own guarantee, the granting of a visa for one month through the Chambers of Commerce and Industry at Lahore, Karachi, Peshawar, Quetta, Islamabad, and the Federation of Pakistan Chambers of Commerce and Industry.

2. Additional Incentives

■ *Work Visa Procedures*

- a) A uniform facility has now been in place and foreign technical and managerial personnel have been exempted from obtaining work permits in the newly opened sectors of the economy, viz. agriculture, service and social sectors. This was already enjoyed by such personnel for working in the manufacturing / industrial and infrastructure sectors. They are now only required to obtain work visas.
- b) Work visas will be granted to foreign technical and managerial personnel for the purpose of transferring skills and know-how. These visas will be granted subject to a constructive plan to train Pakistani personnel to take over the technical and managerial responsibilities over a reasonable period of time.

- c) A Committee under the Chairmanship of the Secretary of Board of Investment (BOI) periodically considers and decides the cases of granting or extending work visas to foreign personnel.
- d) The work visa will be issued for a period of upto 5 years or upto the date of expiry of the applicant's passport. The concerned Pakistani Mission abroad will grant work visas to the applicant whereas extension in work visa will be endorsed by the Regional Passport Office of the city where the expatriate is working upon authorisation by the Ministry of Interior.
- e) In case of multiple entry visas, the number of entries will not be restricted.

■ *Business Visa Conversion into Work Visa*

- a) For the purpose of changing the category of visa of foreign national employees and investors from business visa to work visa, the concerned expatriate is no more required to leave the country for this purpose. The Ministry of Interior will process such requests upon receiving verification from the BOI.
- b) Pakistani Missions abroad can issue multiple entry visas for upto 3 years to businesspersons and investors from the above 45 listed countries who bring in an amount of US\$ 200,000 or more.

■ *Registration of Foreigners with the Police*

- a) It has been decided to exempt all foreigners from registration with the police, except for nationals of countries on the negative list.
- b) Even in the case of countries on the negative list (except for Indians and foreigners of Indian origin), foreign nationals in the managerial category who are issued work permits/ visas will be exempted from police registration.

3. Granting of Pakistan Citizenship to Foreign Nationals (Investors)

Any person of a country recognized by Pakistan may obtain Pakistani Citizenship by investing a minimum of US\$ 0.75 million in tangible assets and \$0.25 million (or equivalent in major foreign currency) in cash on a non-repatriable basis, and by fulfilling the conditions of the Pakistan Citizenship Law. Investment on a non-repatriable basis means that the amount is brought to Pakistan through normal banking channels, converted into Rupees, and never remitted back through the free market.

Chapter - 6

TYPES OF BUSINESS ENTITIES

1. Introduction

Generally, there are no restrictions on the types of businesses that may be undertaken, except for the following:

- a) Arms and Ammunition
- b) High Explosives
- c) Radio Active Substances
- d) Security Printing, Currency and Mint.
- e) Manufacture of alcohol (except industrial alcohol)

For setting up an industry, not falling under the above categories, the sponsors do not need prior sanction.

Provincial Governments have already notified negative areas where industries cannot be established for security, defence and environmental reasons. If an entrepreneur is interested to establish an industry in these areas, he would have to obtain location clearance from the concerned Provincial Government.

Business activities may be carried on through a company, modaraba, branch, partnership or sole proprietorship. Companies incorporated in Pakistan and branches or liaison/representative offices of foreign companies are regulated by the Companies Ordinance, 1984, administered by Securities & Exchange Commission of Pakistan (SECP), formerly known as Corporate Law Authority. The Registrar of Companies operates under the SECP.

2. Corporate Legislation

Apart from Companies Ordinance, 1984, there are a host of other Corporate Legislations in force regulating different aspects of corporate entities. These are enumerated as follows:

- *Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance, 1970*

The Monopolies Ordinance provides measures against “concentration of economic power,” “growth of unreasonable monopoly power” and “unreasonable restrictive trade practices”, which are injurious to economic well-being, growth and development of the country.

A company is required to get itself registered with the Monopoly Control Authority under specified conditions as given in the Ordinance.

- *Banking Companies Ordinance, 1962*

The main law governing the establishment and operations of banking companies in Pakistan is the Banking Companies Ordinance, 1962.

In addition to banks, other financial institutions such as Modarabas, Leasing Companies, Housing Finance Companies, Investment Banks and Insurance Companies (general and life) have also been allowed to be formed in to private sector, details of which are discussed later in chapters 12 and 13.

- *Modaraba Companies and Modarabas (Floatation and Control) Ordinance, 1980*

No Modaraba can be floated unless an authorisation is obtained by the Registrar Modaraba Companies under the provisions of Modaraba Companies and Modarabas (Floatation and Control) Ordinance, 1980.

- *Securities and Exchange Ordinance, 1969*

The main law relating to the Stock Exchanges, Brokerage Houses, Mutual Funds, Central Depository and Credit Rating Agencies in Pakistan is the Securities and Exchange Ordinance, 1969 which regulates and governs the establishment and running of these entities in Pakistan.

3. Forms of Companies

The Companies Ordinance, 1984 provides for various types of company structures but the most common are:

- a) Companies Limited by Shares: Where the personal liability of the shareholders is limited

to the amount (if any) unpaid on their shares. Effectively, the shareholder's liability does not exceed the amount he is committed to, when taking up the shares in the company.

- b) **Company Limited by Guarantee:** A company having the liability of its members limited by memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its winding up. The company Limited by Guarantee is usually formed on a 'no profit basis'.
- c) **Unlimited Company:** The law also allows for an unlimited company to be formed.

From a practical point of view, the limited liability company with a share capital would be the type of company contemplated by a non-resident interested in investing in Pakistan.

A company incorporated in Pakistan, limited by shares may either be a "Public limited" (public company) or a "Private limited" (private company). A public limited company is generally one, which eventually may desire to raise capital from the public and this type of company includes all those whose shares are listed on the stock exchanges in Pakistan.

A private limited company is generally one, which has no need to obtain capital from public, in fact, it is prohibited from doing so. This type of company by its constitution (Articles of Association) restricts the rights of its members to transfer shares, limit its membership to fifty and prohibits any invitation to the public to subscribe for shares or to invite deposits from Public.

- d) **The Companies (Single Member Private Limited Companies) Rules, 2003**

Consequent upon promulgation of Companies Amendment Ordinance, 2002 the SECP released rules for single member company (SMC) in 2003. The salient features of the said rules are as follows:

- a) A private company may be formed by / with a single member as an "SMC";
- b) The SMC shall cease to be a single member company in the following cases:
 - i) Number of members increases to more than one
 - ii) Transfer of shares

- iii) Further allotment of shares
 - iv) Death of a single member
 - v) Operation of law or for any other reason;
- c) A Private Limited Co. having two or more members can change its status to SMC by passing special resolution, altering its articles of association & obtaining approval from the SECP; and
 - d) Every single member company shall write "SMC" in addition to Private Limited with its name.

The SMC Rules also cover provisions regarding directors' meeting, general meeting, authentication of balance sheet and the appointment of company secretary.

In addition to the above, business may also be conducted by means of partnership agreement between two or more persons or corporations carrying on a common business. Partnerships are generally limited in size to twenty partners.

For taxation purposes, partnership firms are classified into:

- 1) Registered firms; and
- 2) Unregistered firms

The income of the registered firm is subject to Super Tax, before distribution to the partners and the individual income of the partners is subject to income tax at the usual rates.

For unregistered firms, income tax is levied on the income of the partnership and the partners are not liable to pay tax on the share of profit received from the unregistered firm(s).

4. Formation of a Company

The Companies Ordinance, 1984 and Rules framed there under prescribe, various formalities to be complied with, for the formation of a limited liability company. The formalities relates to:

- a) Company's name

The promoters of any proposed company have to obtain confirmation from the company's registration office that the proposed name of

the company intended to be set up is available and is not identical with the name of any existing company or the proposed name is not deceptive, inappropriate, etc. Online query is also possible.

b) Memorandum and Articles of Association

A company is governed by its Memorandum and Articles of Association, which specify its objectives, purpose and location of its registered office.

c) Share Capital

A private company should have a minimum of one issued share and a public limited company a minimum of three. The par value of each share of a company should not be less than Rs. 10/-. There are no restrictions as to maximum capital for any form of company.

d) Registration Fees

Registration fee is paid in accordance with the provision of Sixth Schedule of the Companies Ordinance, 1984.

e) Membership

To form a private and a public limited company, there is a minimum requirement of one and three members respectively.

The number of members of a private company shall not exceed fifty. There is no such restriction for a public company.

f) Directors

A private limited company has a minimum of one director and a public company three directors. All the directors must be natural persons.

g) Registration of a Company

Three or more persons associated for any lawful purpose may subscribe their names to a Memorandum and Articles of Association of the company and complying with the requirements of the Ordinance in respect of the registration, form a public limited company, and any one or more persons, form a private limited company.

The promoters of the following types of companies having special businesses are required to obtain the letter of intent / permission from Ministries / Departments indicated below against each category:

Company	Permission from Ministries
Banking company	Ministry of Finance (Investment Wing) / State Bank of Pakistan.
Insurance company	Securities & Exchange Commission of Pakistan
Provident society	Securities & Exchange Commission of Pakistan
Investment company	Ministry of Finance / Securities & Exchange Commission of Pakistan
Leasing company	Securities & Exchange Commission of Pakistan

All manufacturing concerns, employing more than 10 persons, are required to register with the respective Provincial Chief Inspector of Industries under the Factories Act, 1984.

Companies are required to register with the concerned income tax department and obtain a National Tax Number (NTN).

5. Rules for Offering Capital to General Public

The SECP has issued rules for compliance by the companies offering capital to the general public and listed companies. The Stock Exchanges have been entrusted the function of monitoring compliance. The rules prescribe various conditions to be complied with by the issuers under the following categories:

- Public offering by loan based projects;
- Public offering by wholly equity based projects;
- Issue of shares on premium;
- Issue of right shares by listed companies;
- Issue of bonus shares by listed companies;
- Offer for sale of shares by privatised companies;

- g) Offer for sale by persons holding ten percent or more of share capital of a company; and
- h) Issue of shares for consideration other than cash.

Under the Code of Corporate Governance (CCG), every company proposed to be listed on the stock exchanges shall offer to the public not less than Rs. 100 million or 20% of the share capital whichever is higher. However, stock exchange may relax the limit with the approval of SECP.

6. Management

The management of companies is vested in the Board of Directors, and they may exercise such powers as are specified in the Articles of Association and the Ordinance. The Ordinance has vested in members certain powers, which cannot be exercised by the directors. The first directors are appointed by the subscribers to the Memorandum, and thereafter, by the members for a period of three years from the date of first Annual General Meeting (AGM). The first Chief Executive is appointed within 15 days of the appointment of the directors.

The CCG has specified the qualification, roles and responsibilities of directors, Board of Directors in case of listed companies.

7. Meetings

First AGM of the members (shareholders) is required to be held not later than eighteen months from the date of incorporation and subsequently, once in every calendar year within a period of four months following the close of its financial year.

The shareholders or directors may also requisition an extra ordinary general meeting of shareholders.

The Companies Ordinance, 1984 prescribes notice period to be given to shareholders in respect of all general meetings.

8. Registered Office

Every company is required to have a registered office to which all notices should be addressed and at which various documents / books are required to be maintained as prescribed under the Ordinance.

9. Filing Requirements

The Companies Ordinance, 1984, requires companies incorporated in Pakistan to file various

statutory returns relating to meetings of members, issue and allotment of shares, appointment and change in directors and chief executive, annual audited accounts, annual list of members etc. with the Registrar within the prescribed time limits.

Similarly, foreign companies are also required to file various statutory returns relating to their incorporation, principal place of business and particulars of Directors and Principal Officer, etc.

10. Accounts and Audit

Some of the important provisions of the Ordinance relating to Accounts and Audit are summarised as follows:

- a) Every company is required to keep proper books of account with respect to all sums of money received or expended by the company, all purchases and sales by the company, and assets and liabilities of the company;
- b) Every company under the tax laws is required to have its accounting year end at 30 June, unless an exemption is obtained from Central Board of Revenue. The mandated financial year end for manufacturers of sugar and cotton textiles is 30 September;
- c) Every company is required to prepare annual accounts including balance sheet, profit and loss account, cash flow statement and notes. These financial statements are required to comply with the disclosure requirements.
 - i) Which are more elaborate for listed companies as compared to public unlisted and private Companies.
- d) In case of listed companies and public unlisted companies, annual audited financial statements, together with information regarding shareholders and directors, is required to be filed with Registrar of Companies within forty five days of the annual shareholders' meeting.
- e) Under CCG, listed companies are required to publish and circulate quarterly unaudited financial statements along with Directors' review. Listed companies are also required to ensure before publication and circulation that half yearly financial statements have been subjected to limited review by the statutory auditors. Moreover, listed companies shall ensure that annual audited financial

statements are circulated not later than four months from the close of the financial year.

- f) In case of a private limited company, there is no requirement to submit annual financial statements to Registrar of Companies, however, information relating to directors and shareholders is required to be submitted to Registrar of Companies within 30 days of the AGM. Further, every company is also required to attach the audited accounts of its subsidiaries with certain specific details.
- g) Every listed company is required to submit a report semi-annually (including accounts) to Registrar of Companies and its members. The semi-annual report is required to be submitted within two months of the close of the half-year, and the annual report is due within 4 months of the accounting yearend.
- h) Every listed company is required to submit within one month of the close of every quarter of its year of account, its quarterly accounts to the members, stock exchanges on which it is listed, Registrar and SECP.
- i) Every company in Pakistan is required to have its accounts audited. A public company and a private company, which is a subsidiary of a public company or having a paid-up capital of Rs. 3 million or more, is required to have its accounts audited by a Chartered Accountant or a Chartered Accountants Firm. Further, the Income Tax Ordinance, 2000 requires that accounts of a private company (definition in Income Tax Ordinance) having a paid-up capital of Rs. 500,000 or more, should be audited either by a Chartered Accountant or a Cost and Management Accountant. However, the recently issued Code of Corporate Governance by SECP imposed additional conditions for appointment of auditors for listed companies.
- j) A directors' report to the shareholders on the company's state of affairs, recommendation for dividends, and other matters should be attached to the financial statements but these need not to be audited. Public company and a private company, that is a subsidiary of a public company, is also required to give additional matters in the Directors' report like qualification in auditor's report, etc., and also communicate with it information about pattern of shareholdings.

11. Liquidation

A company may under certain conditions be wound up voluntarily by a special resolution of its members. A liquidator will then be appointed by the members to realise the company's assets, discharge its liabilities and to distribute any surplus assets to the shareholders. A company may also be involuntarily wound up by the court, if inter alia it is unable to pay its debts on statutory demand by a creditor.

12. Stock Exchange Requirements

A company which seeks to offer its shares to the public and wishes to apply for a listing on the Stock Exchange must comply with the listing requirements of the Exchange in addition to compliance with the provisions of the Companies Ordinance, 1984.

The requirements of the Exchange relate to management and company procedures, disclosures, provisions concerning the issue of prospectus for the issue of shares to the public, distribution of financial statements and other matters to keep the public and the exchange(s) adequately informed on all aspects of the affairs of the company, which may affect the market value of its shares.

13. Opening of Project / Branch / Liaison Offices by Foreign Firms

- a) Foreign companies that wish to open their branch / liaison and representative office in Pakistan, may apply to Board of Investment (BOI) for permission on prescribed form. The time limit for processing and a final response by the BOI is 6 - 8 weeks. Permission from BOI to establish a branch / liaison office is subject to clearance from the concerned Government agencies / departments. The details regarding request documentation, etc., are available at all offices of the BOI.
- b) Permission for opening of branch / liaison offices will be granted by the BOI for a period of 3 to 5 years. Further extensions will be granted by the BOI after reviewing and examining the past performance of foreign companies. Requests for renewal or extension will be processed by the BOI within 2 weeks, provided the requests are supported with complete documentation.

- c) Foreign companies that intend to undertake export activities in Pakistan will be registered without any formality.
- d) Permission to companies engaged in contractual obligations of contracts will be granted on production of valid documents, without circulating to government departments.
- e) Every foreign company within 30 days of establishment of place of business in Pakistan is required to file with the Registrar a copy of its Charter or Memorandum and Articles of Association, particulars of Directors and Principal Officer and address of principal office, etc. to register such place of business under the Companies Ordinance, 1984.
- f) A foreign company, which intends to establish a permanent place of business in Pakistan, but does not wish to undertake any revenue generating activity, may register a liaison office under the Companies Ordinance, 1984, after getting prior approval of BOI. A liaison office must finance all its expenses in Pakistan by remittance from abroad, through normal banking channels.

14. Accounts of Branches / Liaison Offices

The requirements relating to preparation of accounts, audit and submission of accounts to Registrar of Companies are also applicable to the branch / liaison office of a foreign company. The accounts will have to comply with the disclosure requirements as contained in the Fifth Schedule of the Companies Ordinance, 1984.

A branch / liaison office of a foreign company is not only required to file annual audited accounts of Pakistan Branch, but also its global audited accounts within 45 days of incorporation or within 6 months of the end of accounting year, whichever is earlier.

Chapter - 7

INCENTIVE PACKAGES FOR PRIVATE SECTOR POWER GENERATION AND TRANSMISSION PROJECTS

1. Introduction

Pakistan has two vertically integrated public sector electric utilities-Pakistan Water and Power Development Authority (WAPDA) and the Karachi Electric Supply Corporation (KESC). WAPDA supplies power to all of Pakistan, except to the metropolitan city of Karachi, which is supplied by KESC. The system of WAPDA and KESC are interconnected through 220kv double circuit transmission line. The total installed capacity of power generation presently is 17,772 MW, which is insufficient to meet the demand on a year around basis. Out of which, 9,884 MW is owned by WAPDA, 1,756 MW by KESC, 137 MW and 325 by Karachi Nuclear Power Plant and Chashma Nuclear Plant, respectively and 5,670 MW by private power generators.

The total power demand in the country is expected to range between 19,000 and 25,500 MW by July 2008. The existing generation units and already committed additions to the capacity in both public and private sector are expected to meet all the increases in the future demand up to the year 2002 / 2003. The shortfall in the capacity by July 2008 is expected to range between 5,000 and 8,500 MW.

Significant growth in demand of electricity in Pakistan over the last three decades, provides an ideal opportunity for expansion of sales of electricity. In view of the positive response from the private sector in thermal based power generation under the 1994 Private Power Policy Framework, the Government announced a separate policy framework for hydel power in May 1995. Both of these policy frameworks were based on an up-front tariff. Recently, the Economic Co-ordination Committee (ECC) has approved the 'Power Generation Policy 2002' to offset power shortage of around 400-500 megawatts by 2005, and to encourage and promote investment in private power generation. Further, the new policy promotes hydel power, coal and gas based projects to reduce dependence on expensive furnace oil.

The scope of policy covers private sector projects, public sector projects, public-private partnership and projects developed by the public sector and then divested. The Government has constituted a Private Power and Infrastructure Board (PPIB) to

facilitate the development of private power projects by one window operation.

National Electric Power Regulatory Authority (NEPRA) has been established as an autonomous, independent regulatory authority, to promote the establishment of a competitive and efficient power sector while safeguarding the interest of both electricity consumers and power sector investors.

2. Features of New Power Generation Policy

The objectives of the policy are:

- a) To provide sufficient capacity for power generation at the least cost and to avoid capacity shortfalls;
- b) To encourage and ensure exploitation of indigenous resources including renewable energy resources, human resources, participation of local engineering and manufacturing capabilities;
- c) To create a win-win situation for all stakeholders; and
- d) To attune it to safeguarding the environment.

■ *Financial Regime*

This policy offers the following set of financial incentives:

- a) Permission for power generation companies to issue corporate registered bonds.
- b) Permission to issue shares at discounted price to enable venture capitalists to be provided higher rates of return proportionate to the risk.
- c) Permission for foreign banks to underwrite the issue of shares and bonds by the private power companies to the extent allowed under the laws of Pakistan.
- d) Non-residents are allowed to purchase securities issued by Pakistani companies without the SBP's permission and subject to the prescribed rules and regulations.

- e) Abolition of 5% limit on investment of equity in associated undertakings.
- f) Independent rating agencies are operating in Pakistan to facilitate investors in making informed decisions about the risk and profitability of the project company's Bonds/TFCs.

■ *Fiscal Regime*

This policy offers the following set of fiscal incentives:

- a) Customs duty at the rate of 5% on the import of plant and equipment not manufactured locally.
- b) No levy of sales tax on such plant, machinery and equipment, as the same will be used in production of taxable electricity.
- c) Exemption is already available from income tax including turnover rate tax and withholding tax on imports; provided that no exemption of income tax on oil-fired power plants.
- d) Repatriation of equity along with dividends is freely allowed, subject to the prescribed rules and regulation.
- e) Parties may raise local and foreign finance in accordance with regulations applicable to industry in general. GOP approval may be required in accordance with such regulations.
- f) Maximum indigenization shall be promoted in accordance with GOP policy.
- g) Non-Muslims and Non Residents shall be exempted from payment of Zakat on dividends paid by the company.

The above incentives will be equally applicable to private, public-private and public sector projects.

Chapter - 8

PETROLEUM SECTOR

1. Introduction

The current exploratory efforts in Pakistan has varied between 13 and 34 wells per year over the 5 fiscal years between 1994-95 and 1998-99, which resulted in a significant discoveries. This level of exploration and exploration commitments was not considered adequate to achieve the stated policy objective of the Government, which is to minimize the oil import bill through import substitution and thus ease pressure on balance of payments. Indigenous oil production has registered downward trend, which needs not only to be arrested but also reversed to achieve policy objectives.

It is considered that a major portion of the use of imported fuel oil in industrial and power sectors can be replaced by gas. Gas supply and demand projections indicate that the recent discoveries can replace most imported fuel oil by 2005, but thereafter production from existing reserves will decline and by the year 2010 gas supplies would be insufficient to meet increased domestic, commercial, industrial and power generation requirements. There is also a requirement for major infrastructure development in the coming decade in order to transport the additional gas supply expected from new discoveries.

The present Government has undertaken extensive review of policy terms in consultation with the petroleum industry in order to offer incentives, which are attractive relative to petroleum investment opportunities elsewhere. Such incentives are expected to create an investor friendly climate and attract exploration investment in the country. The present Government issued Petroleum Exploration and Production Policy, 2001 which supersedes previous Petroleum Policies to the extent applicable to Exploration and Production sector only without effecting the rights that may have accrued under the superseded policies.

The Petroleum Policy 1997 offers major incentives in the upstream and downstream petroleum sectors including a package based on production sharing arrangement for offshore areas. However, the Petroleum Policy 1997 has been superseded by the Petroleum Exploration and Production Policy, 2001 to the extent applicable to Exploration and Production sector only.

2. Petroleum Exploration and Production Policy 2001

■ *Block Award Process*

The existing Block Award Process (BAP) has been continued which is on the basis of competitive bidding for a Work Programme (WP). The pre-requisite of the BAP is that the standard Model Agreements are followed by all the applicants.

Application may be made for a block in accordance with the laid down grid system and the rules, without a Work Programme (WP). The first applicant and other interested Exploration and Production (E&P) companies must submit sealed bids specifying the WP and minimum financial obligation in US Dollars. Offers from the other interested E&P companies will be invited through press within specified time of receipt of first application. The Block will be awarded on the basis of best WP and related financial commitment offered. The first applicant company in Zones 0 (offshore) & I (West Baluchistan, Pashin and Potowar Basins) may be given the option to match the best offer. Application for the Exploration License will be given preference over the application for Reconnaissance Permit. All applications for exploration licenses will be decided within 60 to 120 days.

The 100% Government of Pakistan (GOP) owned Holding Company - Government Holdings (Pvt.) Ltd. (GHPL) will continue to look after the GOP's working interests in various joint ventures and remain independent of the GOP's regulatory functions. The potential GOP participation in new joint ventures will be handled through this company subject to conditions specified in respect of minimum local company's working interests on full participation basis in a joint venture with a foreign company.

3. Procedural and Regulatory Measures

■ *Expeditious disposal of applications*

- a) Procedure for clearances by Provincial Governments and security through a predefined "White and Green Area Map" will continue. No area clearance would be required for concession blocks falling inside white/green areas.

- b) All applications for Exploration Licenses will be decided within 60 to 120 days. Applications, which are contested, may take up to 120 days but no more.
- c) The Government will accept parent company's guarantees from companies of international repute and bank guarantees from others. The Government will also consider accepting the deposits in escrow accounts on a case to case basis. For the locally incorporated companies the GOP may consider suitable proposal for security against default.

4. Incentives for Local Exploration and Production Companies

The following incentives have been provided to local E&P companies with a view to develop a strong indigenous base in exploration and production and to minimise foreign exchange outlays:

- a) Such E&P companies will be encouraged to establish joint ventures with foreign companies as well as to operate exploration block with 100% ownership. In joint ventures where such local company(ies) holds at least the required minimum Pakistani working interest on a full participation basis, there would be no direct GOP participation through GHPL. The required minimum Pakistani working interest will be 15% for Zone I, 20% for Zone II and 25% for Zone III. Such companies will contribute their share of expenditure in Pak Rupees for required minimum Pakistani interest. However, if such E&P companies subsequently intend to reduce their working interest below the required minimum Pakistani working interest, GHPL will have the right to unconditional assignment of the remaining interest on full participation basis. Such assignment shall be at no cost to GHPL which shall participate on a point forward basis from the date of participation as per the Joint Operating Agreement (JOA).
- b) Where insufficient interest is expressed by E&P companies incorporated in Pakistan with respect to the minimum required Pakistani working interest, GHPL shall have the option to "make up" the remaining interest on a full participation basis.
- c) The foreign E&P companies shall be deemed to have fulfilled their obligation with respect to the minimum Pakistani participation if

Pakistani incorporated companies and/or GHPL do not take any interest fully or partially.

- d) Consortia of foreign companies not meeting the minimum required Pakistani working interest can still be granted an exploration licence provided such companies advertise in the press within 15 days of the grant, inviting Pakistani Incorporated Companies to participate in the joint venture on the full participation basis under standard JOA. The Pakistani incorporated companies shall have the option to participate in the joint venture within 30 days and another 30 days for GHPL to "make up" for any difference between the interest taken up by the Pakistani incorporated companies and the minimum required Pakistani working interest.

- e) Local E&P companies will, on a case to case basis, be entitled during the exploration phase to receive foreign exchange against payment in Pak Rupees to meet their day to day obligations under Permits, Licences and PCAs. After commercial discovery, local E&P companies would be paid upto 30% of their sale proceeds in foreign currency to meet their day to day operational requirements. For project financing after commercial discovery, local E&P companies will be required to make their own foreign exchange arrangements.

■ *Pipeline construction and operation*

E&P companies operating in Pakistan will be allowed to construct and operate pipelines for local requirements and for export of their share of petroleum which shall be regulated by the concerned regulator in accordance with applicable laws, rules and regulations based on an open-access regime. The E&P companies constructing such pipelines may be allowed priority access based on a firm utilisation plan.

■ *Gas allocation and sale*

- a) E&P companies operating in Pakistan will be allowed to contract with gas transmission and distribution companies and third parties, other than residential and commercial consumers, for sale of their share of gas in Pakistan at negotiated prices in accordance with applicable law, rules and regulations.
- b) Subject to the consideration of internal requirements, national emergencies and specified conditions, E&P companies will be allowed to export their share of crude

oil and condensate as well as their share of gas based on export licenses to be granted the concerned regulator.

- c) In case where foreign E&P companies sell gas to third parties in Pakistan and want to remit sale proceeds in foreign currency abroad, GOP shall allow these companies to freely remit a “guaranteed percentage” of their sale proceeds, subject to the specified conditions in respect of the prices and the percentage of total gross revenue.
- d) At the request of E&P companies, GOP shall purchase their share of pipeline specification gas through a nominated buyer which is effectively controlled by GOP by acceptable daily, monthly and yearly volumes to meet the internal demand in an economic manner at a price calculated in the specified manner.
- e) In case where the Government nominated buyer agrees in principle to purchase gas, the gas producer shall construct and operate gas pipeline connecting the field to the delivery point for which transmission tariff will be payable as approved by the concerned regulator in accordance with the applicable laws, rules and regulations.
- f) Consumer gas prices will be adjusted biannually to synchronise with the changes in producer prices.

5. On-shore Areas

An economic package has been defined and fixed for the following three defined on-shore geological Zones (I, II and III) on the basis of prospectively and corresponding financial and economic parameters.

Zone I: West Balochistan, Pasin and Potowar basins

Zone II: Kirthar, East Balochistan, Punjab platform and Suleman basins

Zone III: Lower Indus basins

The economic package will be reviewed from time to time in the light of additional information and may be subsequently adjusted to maintain international competitiveness.

■ *Import duties, taxes, fee*

Incentives in respect of Import Duties / Taxes and Fees for the E&P companies and the “service companies” has been provided by the Federal Government under Notification S.R.O. No. 400/(I)/97. Under the Notification the machinery, equipment, material, specialised vehicles, accessories, spares, chemicals and consumables, as are not manufactured locally, if imported by E&P companies including OGDC, their contractors and sub-contractors and services companies for defined phases of specified projects have been exempted from Custom Duties including regulatory duty and Sales Tax subject to the following conditions:

- a) Only such machinery, equipment, materials, specialized vehicles, accessories, spares, chemicals and consumable shall be entitled to the exemption, as are recommended by the relevant Regulatory Authority from time to time.
- b) Exemption available shall be admissible only to such E&P companies who hold permits, licenses, leases and who enter into supplemental agreements with the Government of Pakistan.
- c) In respect of goods imported, the respective E&P Company shall pay to the Collector of Customs on an annual deferred basis a consolidated fee equal to 3% of the total invoice value as determined by the Collector of Customs at the time of import of the equipment, materials, specialized vehicles, accessories, spares, chemicals and consumables imported by it, its contractors and sub-contractors.
- d) Items imported by Service Companies free of customs duties and sales tax if sold to E&P companies as part of their services which are rendered after first commercial discovery in a concession area, will be included in the total invoice value for calculation of the fee payable as aforesaid.
- e) The companies availing benefits under this notification shall furnish to the Collector of Customs an Indemnity Bond to the extent of customs duties and sales tax exempted on the import of items.

- f) The Indemnity Bond shall be discharged on production of a certificate issued by the Assistant Collector of Customs and Central Excise that items imported under this notification have been duly installed, consumed, used or have been scrapped in the prescribed manner or continue to be held in project inventory of the company or have been transferred to another company.
- g) In the event that an emergency condition occurs in connection with operation by E&P Company which seriously endangers life or property or the operation of the project, the company shall be allowed to import any item or items considered necessary by the said company to deal with the emergency under intimation to the Regulatory Authority and Collector of Custom without fulfilling such formalities as are likely to cause delay and such formalities will be attended to thereafter as soon as practicable.
- h) Items imported free of customs duties and sales tax, which become surplus, scrap, junk, obsolete or otherwise required to be disposed of shall be disposed of in the manner specified in the policy.

■ *Royalties & Income Tax, Windfall price levy*

- a) Royalties will be payable at the rate of 12.5 % of the fair market value at the field gate. The gas transport cost will be given consideration based on tariffs approved by the concerned regulators in order to determine the value on the field gate.
- b) Tax on income will be payable at the rate of 40% of profit or gains in accordance with the Fifth Schedule of the Income Tax Ordinance, 1979. However royalties will be treated as expense for the purpose of determination of income tax liability.
- c) A provision shall be made for windfall levy on crude oil/condensate using the specified formula.

■ *Producer pricing*

The criteria for pricing of the Crude Oil, Condensate, Non-Associated Gas, Associated Gas and Liquefied Petroleum Gas has been defined in

the policy, based on the prices of products in the international market.

■ *Production bonuses*

Production bonuses will be payable on a Concession Area basis and will be expended on infrastructure development in and around the Concession Area. Local E&P companies will pay their share of production bonuses in Pak Rupees.

■ *Conversion incentives*

All E&P companies can propose to GOP on a case to case basis for conversion of their existing exploration licences and applicable PCAs to new terms prior to end of 2001 without any change in the effective date subject to the specified conditions. The conversion policy will be applicable to the licences in which no discovery has been made and will be adopted as a package except that the participation interest of GHPL will remain unchanged.

6. Off-shore Areas

The economic package for this Zone (Zone '0') has been prepared based on production sharing arrangement. This off-shore package will apply to all new grants in off-shore areas. The E&P companies which hold exploration licenses in off-shore areas and are presently governed by Zone-I terms can apply to GOP for conversion to production sharing arrangement as per specified criteria. Otherwise they will continue to be governed by Zone-1 terms as per PCAs. This offshore package will apply to E&P companies who are granted Exploration Licenses during a period of 5 years from the enforcement of the this new package.

■ *Incentives*

- a) Following royalty schedule will be followed:
 - i) First 4 years of after commencement of commercial production - 0% of value
 - ii) 5th year after commencement of commercial production - 5% of value
 - iii) 6th year after commencement of commercial production - 10% of value

- iv) Thereafter - 10.5% of value
- b) Corporate income tax is capped at 40%.
- c) The following depreciation rates will apply:
 - i) On successful exploration wells - 25% (Straight Line Method)
 - ii) On facilities and offshore platforms 20% (Declining Balance Method)

Carry forward of any unabsorbed depreciation is allowed until such depreciation is fully absorbed.
- d) Sliding scale production sharing arrangement instead of direct Government participation.
- e) The production sharing agreement would be executed by the contractor with Government Holdings who will be granted the Exploration Licence. This company will, therefore, initially receive the profit oil and profit gas shares and will be responsible for the management of the production sharing agreements.
- f) A provision has been made in the Model Production Sharing Agreement (PSA) for windfall price levy @ 50% beyond specified oil and gas prices, which would increase by an specified amount for each contract year anniversary starting from the Contract year immediately following the grant of first lease in Contract Area.
- g) Cost limit is 85% including the royalty of 12.5%. The contractors can recover 100% of the costs up to a limit of 85% of the gross revenues.
- h) The profit split is set on the basis of a sliding scale for shallow, deep and ultra deep grid areas, which is based on cumulative production permitting a rapid recovery of investments and a higher net present value.
- i) Production bonuses will be as follows:
 - i) US \$1 million within 90 days of start of commercial production
 - ii) US \$2 million upon reaching 200 million cubic feet per day or 33,000 BOE
 - iii) US \$5 million upon reaching 600 million cubic feet per day or 100,000 BOE
- j) A relatively simple and non-discretionary conversion policy has been proposed which would allow all current holders of concessions to convert to the PSA.
- k) For the purpose of smooth discharge of work obligations under the PSA the work programme shall be carried out on the basis of work units.
- l) Import duties and taxes on import of equipment and material shall be 0% for exploration and 3% after the first commercial discovery in the Contract Area.
- m) A marine research fee will be applicable as per the following schedule:
 - i) US\$ 50,000 per year till first discovery
 - ii) US\$ 100,000 per year thereafter till first commercial discovery
 - iii) US \$250,000 per year during development phase
 - iv) US \$500,000 per year during production phase
- n) Training fee will be applicable as follows:
 - i) US \$20,000 per year - Exploration phase
 - ii) US \$100,000 per year - Development and Production phases
- o) Oil, gas, LPG and condensate producer price will be as per GOP policy applicable for Zone-I of onshore areas or "Arms' Length Sales Value" which ever is less.
- p) Exploration period will consist of an initial term of 5 years and two subsequent renewals of two-years each, for a total exploration period of 9 years.

- q) A maximum period of 10 years will be considered on a case to case basis to enable the companies to evaluate commercial aspects of the discovery and to make market arrangements for disposal of discovered gas.
- r) Total term of the contract will be upto 44 years, which will also cover the retention period and the longer exploration period.
- s) A new block system based on latitude and longitudes as defined in the policy will be followed for grants and relinquishments of all offshore acreage.
- t) The Contractor has to return 20% of the Original Contract Area prior to the termination of initial term, 30% of the Original Contract Area prior to the termination of the first renewal and another 30% of the Original Contract Area prior to the termination of the second renewal.
- u) Modest acreage rentals of \$50,000 plus \$10 per square kilometre will be applicable.

7. Miscellaneous

■ *Regulatory Authority*

The relevant Regulatory Authority shall notify the Central Board of Revenue (CBR) from time to time of the list of machinery, equipment, material, accessories, specialised vehicles, spares, chemicals and consumables required to be imported by the petroleum sector. This list will be subject to amendment by addition or deletion from time to time as considered appropriate by the relevant regulatory authority.

■ *Energy conservation, environment and safety control*

New environment and safety regulation shall be applicable to all companies. A standing task force has been established to address the problems of the oil and gas companies and to oversee and coordinate safety hazards at the oil/gas fields and other oil and gas installation.

■ *Contingency plans*

In view of the petroleum sector's lack of flexibility to adjust with the crises situation due to infrastructural

constraints, alternative plans/fall back positions will be formulated.

■ *Other measures*

- a) The system of Security Clearances of expatriates has been streamlined. The companies are required to provide the relevant particulars of expatriates, schedule of areas to be visited to Ministry of Petroleum and Natural Resources for onward transmission to the agencies concerned. Government will issue a temporary clearance for a period of three months.
- b) Declaration of a discovery as commercial in the on-shore areas can be accepted even on the basis of one well, subject to justification, current rules and regulations.
- c) In case of significant discovery by an E&P company, the joint venture will be allowed, in accordance with the relevant rules to retain petroleum rights under the exploration licence for a period of upto five years, subject to the specified conditions. Before the end of five years, the joint venture is required to submit a Development Plan and application for grant of a Development and Production Lease with an assessment of market potential and a plan for infrastructure development.
- d) Licence holders can be permitted to undertake early production schemes before finalisation and approval of Development Plan.

8. Employment, Training and Welfare Programme

Foreign and local E&P companies are required to expend the prescribed amounts during Pre-commercial Production and Post-commercial Production stages on training and welfare programmes. Employment programmes for Pakistani nationals will be agreed upon with the relevant Regulatory Authority on an annual basis as per guidelines issued from time to time. The amount of social welfare funds pledged by the companies in their respective agreements must be utilised to give lasting benefit to the communities.

9. Petroleum Policy 1997 - Incentives for Oil and Lube Refineries

The following incentives are offered in the Policy to attract private investment for the development of refining centres.

■ *Oil refineries*

- a) No permission is required for setting up new refineries or for expanding the existing ones.
- b) Import parity price formula for new oil refinery projects has been linked to a market related mechanism of refined products prices based on Singapore Mean FOB spot price along with all applicable local charges. There will be no minimum rate of return guarantee for new refinery projects
- c) Other income earned from non-refinery operations can be retained by the refineries.
- d) Import of crude oil will be permitted from any source subject to price economics after upliftment of local crude oil, if so allocated.
- e) Export of surplus products will be allowed freely.
- f) GOP will not give any product of offtake right guarantee. Refineries shall be allowed to sell products to any marketing company or they can set-up their own companies.
- g) Custom / relevant authorities will accept instructions for release of equipment on the basis of the recommendations of Regulatory Authorities. Import duties and taxes will be payable as per applicable Statutory Rules and Orders (SROs).

■ *Lube refineries*

- a) Lube products will remain free from price control.
- b) No permission will be required for establishing lube, grease and wax plants.

- c) Refineries are permitted to procure raw materials from both local and foreign sources.
- d) Used lubricating oil will only be sold to registered reclamation plants.
- e) Refineries shall establish adequate testing facilities.

10. Incentives for Oil Marketing and Distribution

- a) The commission of the Oil Marketing Companies (OMCs) and dealers will be reviewed and adjusted annually by the GOP, if necessary to enable them to invest in the construction of commercial Petroleum Oil & Lubricant (POL) storages, logistics and allied facilities for which a specified linkage would be stipulated. Improved margins and infrastructure will also help to eliminate short measurements, adulteration and other malpractices.
- b) Development of retail outlets will be left to the OMCs subject to environmental and safety rules.
- c) Anti-Adulteration Law will be introduced for strict quality control and enforcement.
- d) Import duties and taxes will be payable as per applicable SROs.

11. Infrastructure Development

Tariff for new white / black oil pipeline projects will be determined based on competing options of transporting the products by road or rail.

A storage surcharge of Rs. 0.10 per litre will be imposed on POL products for construction of strategic storages through NLC or OMCs for a 45 days cover.

Import duties and taxes will be payable as per applicable SROs.

12. Miscellaneous

■ *Import of domestic appliances*

Imports of domestic appliances like room air-conditioners, fridges, freezers etc. and saloon vehicles will not be allowed. Specialized vehicles will be allowed to be imported. The

Regulatory Authority will certify whether any vehicle qualifies as a specialized vehicle.

■ *Foreign employees and consultants*

Foreign employees and consultants of petroleum sector companies and foreign employees of such companies contractors and sub-contractors will be entitled to import as per applicable SROs used and bonafide personal and household effects, excluding passenger vehicles, provided that the effects were acquired or were in such person's possession before his arrival in Pakistan or were imported within 6 months of such arrival. Such personal and household effects may thereafter be freely exported free of Export Duties and Fees. Such articles shall not be sold or disposed off or transferred in Pakistan except with the prior permission of the Regulatory Authority and on a payment of Import Duties at the rate and value operating on the date the goods were first imported into Pakistan on the declared value of the goods at the time of import less depreciation @ 10% per annum.

■ *Inter-company transfers*

The relevant Regulatory Authority is authorized to allow the inter-company transfer of machinery, equipment, materials, accessories, specialized vehicles spares, consumables and chemicals where both are petroleum sector companies enjoying similar duty concessions under the Policy. Where the petroleum sector companies are subject to different rates of duty the Regulatory Authority may allow the transfer under intimation to Central Board of Revenue (CBR) on payment of differential rate of duty.

■ *Protection of investment*

Foreign investors whether on their own or in association with the local investors will enjoy the benefits under the Private Investment (Promotion and Protection) Act, 1976 and the Protection of Economic Reforms Act, 1992.

■ *Disinvestment / Privatisation*

Disinvestment / Privatisation of Public Sector companies / corporations, such as Sui Northern Gas Pipelines Limited, Sui Southern Gas Company Limited and Oil & Gas Development Corporation is under consideration of the Privatisation Commission. Efforts are in hand to expedite this process.

Chapter - 9

MINERAL POLICY

The first ever mineral policy was announced in September 1995 by the Government of Pakistan with a view to facilitate private sector investment in the mineral sector. This has been overridden by a modified National Mineral Policy launched in December 2003. This modified policy aims at increasing the mineral contribution to economic growth from the present 0.4 percent (\$500 million) of GDP to 3 percent (\$2 billion) of GDP.

With Pakistan becoming an exporter of copper and gold, there was a need for this amended policy. It has been prepared under the guidance of World Bank and based on World Bank recommendations, the government would introduce a mining rule and regulation, revise its mining fiscal regime and improve infrastructure and institutional arrangements.

The development of Pakistan's mineral resources has been limited to quarries producing limestone, rock salt, marble, and gypsum for industrial use and coal for internal power generation. The private sector however has been conspicuous by its absence as the environment has not been conducive for global investment. So, one of the aims of this policy is to create an environment attractive enough to lure private foreign investment in this sector.

■ *The main features of the policy are:*

- a) Corporate merger of small-scale mine operators will be encouraged.
- b) A Geodata Centre of Pakistan (GDCP) will be established as an autonomous body of the Ministry of Petroleum and Natural Resources. Its function would be to collect, store, update, and manage geodata of the whole country.
- c) Grants by the Federal and Provincial Governments will be provided to corporations for the promotional tasks on priority minerals or priority areas.
- d) The Mining Concession Rules will provide for four types of mineral titles: Reconnaissance License, Exploration License, Mineral Deposit Retention License, and Mining License.

■ *Main incentives offered in the policy are:*

- a) Mining and Value Added Mineral Processing placed in Category 'A' industry.
- b) 5% customs duty on import of plant, machinery and equipment (which is not manufactured locally).
- c) No provincial or local levies or taxes imposed on minerals or mining operations except for royalty.
- d) No sales tax will be imposed on minerals that are exported.

Chapter - 10

INFORMATION TECHNOLOGY POLICY AND INCENTIVES

1. Introduction

Information technology (IT) has assumed an unprecedented importance in the global economic arena. In Pakistan, the Government is setting a very high priority to this sector. One of the prerequisites for ensuring sustained growth of the industry and the economy is the provision of a definite framework consisting of policy, legislative and financial, and operational guidelines, which can provide a stable umbrella for growth.

The vision of the Government's IT Policy is to harness the potential of Information Technology as a key contributor to the development of the country. The guiding theme of the IT Policy is that the "Government shall be the facilitator and enabler to encourage the private sector to drive the development of IT and Telecommunication". The IT Policy includes Action Plan which is to be prepared on year on basis to provide a framework for implementation of the IT Policy. The Action Plan includes the priority areas, specific projects that can be conceptualised, formulated, assessed, prioritised and implemented. The Government has committed Rs. 5 billion for the IT and Telecommunication sector in the Public Sector Development Programme of year 2000-2001. The main allocation of funds has been foreseen for training, retraining, HR Development and provisioning of enabling infrastructure. Establishment of IT and Telecommunication Division, which will be the apex body having for coordination and controlling of the sector. The Division will be the single government agency to guide the IT industry and to perform regulatory function instead of too many IT Departments and agencies by the Government.

The Government of Pakistan announced the establishment of Private Software Export Board (PSEB) in May 1995. The PSEB is essentially responsible for formulating and implementation of the national policy framework for the Software Industry.

Following are the features of IT Industry in Pakistan:

- a) Internet access in 588 cities
- b) Bandwidth connection at monthly rate of only US\$ 3,000/mbps

- c) 155 MBPS backbone connectivity
- d) Expected orbit of the PAKSAT satellite in mid 2003
- e) Over 85% of telecommunication infrastructure using fibre optic cables
- f) Currently, over 350 software houses developing and exporting software from Pakistan
- g) Annual wage rate for IT professionals much less than the neighbouring countries, such as, China and India
- h) Domestic IT labour force is expected to be more than double by 2006, offering a resource pool of 1.5 million techno-literate individuals.

2. Pakistan Software Export Board (PSEB)

The PSEB functions under the Ministry of Science and Technology, and is responsible for assisting and guiding the Software Companies. Major functions of the Board include:

- a) Provide one-window facilities to the Software Companies for establishment and business facilitation.
- b) Plan, develop and execute a "Technical Assistance Program" for training institutions.
- c) Plan, develop and execute the "Software Technology Parks (STP) Scheme".
- d) Establish a Computer Training Institute, in collaboration with Export Promotion Bureau.
- e) Promote local Software Companies and Software Houses for access to potential clients
- f) Arrange technical assistance programmes in collaboration with international donor abroad agencies for development of Pakistani Software Industry.
- g) Facilitate projects between the Pakistani educational institutions and the computer industry to bridge the gap between academia and the industry.

3. Incentive Package for IT Sector

- a) The Government will play the role of a moderator, facilitator and an enabler, rather than a director, in the local IT industry's development.
- b) Computer Software and Information Technology (IT) have been declared as Industry and placed in Category 'B' of Industries.

- c) Zero percent customs duty on import of IT related machinery and equipment as listed at.
- d) Tax relief: Initial Depreciation (IDA) allowance @ 50% of machinery cost (50% on equipment for IT services).
- e) The rate of depreciation on computer equipment is 30%.
- f) Information Technology (IT) enjoys the status of "industry".
- g) The cost of Internet bandwidth has been drastically reduced by 65%.
- h) To facilitate the private sector IT telecom industry and to enhance the investor's confidence in the Government, processing period for license applications in the deregulated sector has been reduced to 7 days.
- i) In order to deliver efficient IT infrastructure, PTCL, would now provide international bandwidth and Internet connectivity to the ISPs and other corporate customers within 4 to 8 weeks.
- j) As a first step towards, Electronic Commerce, the "State Bank of Pakistan (SBP) has allowed banks to open Internet Merchant Accounts within Pakistan.
- k) Internet delivery on Cable TV has been permitted which would result in substantial increase in the Internet usage.
- l) Universal Access to the Internet even to non connected areas at the cost of a local using the unique '131' Universal Internet Numbers of ISPs has been extended.
- m) Call Centers, which are important potential source of foreign exchange earnings and employment creation, have been allowed to establish in the private sector.
- n) Computer networking and majority of IT equipment has been exempted from custom duties.
- o) Income tax holiday for the IT Training Institutions has been extended by another five years.
- p) Income of computer training institutions set up to 30-6-2005 is exempt from Income Tax.
- q) Banks are allowed to invest in the form of equity in dedicated venture.
- r) Software companies are allowed to retain 35% of their export earning in foreign exchange to meet the expenditure on purchase of hardware/software foreign travel, marketing and hiring of consultants.

- s) Tax exemption on export of software for 15 years.

4. Legislation and Regulations

To provide protection and enhance the confidence of users, providers, and facilitators of information services, legislation based on the recommendations of the Working Group Comprising IT and legal experts would be framed. The IT Policy recommended that the action should be taken on priority basis in the areas of Digital Signature Act, Computer Crime Act, Tele Medicine Act, Intellectual Property & Copyright Act and the Consumer Protection Act. The Government should seek legislative approval of changes to statutes that will encourage e-commerce and revise that mandate a paper-based or manual process.

A regulatory framework is essential to avoid violating policy goals and direction. It would be ensured that excessive regulations do not stifle industry investment and growth. In devising a useful regulatory framework, the focus would be on creating a fair, equitable and competitive environment based on the principles of free market and open access.

Chapter - 11

TOURISM POLICY

1. Introduction

Tourism has been recognized as an essential component of the economy. Its impact on the creation of jobs, income distribution and resource mobilization is gaining increasing importance. Pakistan has immense tourist resources including historical and cultural legacy, coupled with northern mountain heritage makes it a unique destination.

A National Tourism Policy was adopted in 1990, which aided to achieve investment of Rs 6 billion in tourism related projects. However, it failed to achieve the policy targets of 1.0 million foreign tourists and US\$ 1.0 billion as earnings by the year 2000. Many factors contributed to this, including political instability, inconsistency in the grant of incentives and concessions, and the continuation of stifling rules and regulations by the governing authorities.

The failure of previous policy to exploit the tourism potential fully persuaded the Federal Government to initiate and activate the formulation of a Tourism Master Plan, which identified various impediments adversely affecting the tourism sector in the country. In view of the above, the Government announced a new National Tourism Policy in May 2001.

2. National Tourism Policy- 2001

The features of the new Policy are as follows:

- a) Tourism shall continue to be treated as an industry, contributing more aggressively towards socio-economic growth.
- b) A paradigm shift from promoting seasonal tourism to year round tourism.
- c) A qualitative improvement/development in environment, human resources, tourist services and the tourist product.
- d) Federal and Provincial Governments to bring all legislation in consonance with demands of the tourist industry.
- e) Stimulate private sector involvement in tourism through provision of industry support constructs.

■ *Goals and Targets*

- a) To increase the number of tourists from 0.42 million in year 2000 by 6.5% annually over the next five years.
- b) To increase foreign exchange earnings from US\$ 385 million in year 2000 to US\$ 500 million over the next three years.

■ *Incentives*

- a) 10% customs duty on import of plant, machinery and equipment.
- b) Tax relief: First year allowance @ 75% of machinery cost.
- c) Tourism Projects to be allowed the status of industry.
- d) 50% income tax exemption be allowed to tour operations who bring in at least 500 inbound tourists in the form of group tours in that calendar year.
- e) Number of taxes covering the Hospitality Sector will be restricted to a maximum of six or seven taxes at the federal and provincial levels.
- f) On the recommendations of the Ministry of Tourism, land for hotels, motels, recreation parks, fun lands, athletic clubs, cultural centers etc., to be provided on non-commercial rates and on long lease basis by the development authorities at the Federal and Provincial levels.

Chapter - 12

SECURITIES AND NON BANK FINANCE COMPANIES

1. Capital Market

The country has three stock exchanges located in Karachi, Lahore and Islamabad. The stock exchanges have been registered with fixed numbers of members. A person / institution desirous of becoming a member of a stock exchange would have to acquire membership from an existing member.

Until 1990, membership of stock exchanges was only allowed to a sole proprietor or a partnership. However, corporate membership was allowed through an amendment in the Rules and Regulations of the stock exchanges. Since the amendment, a number of corporate brokerage houses have been established and some of these have also got themselves listed on the stock exchanges.

The principal security traded on the stock exchanges is ordinary shares of listed companies. However, other securities such as Mutual Fund certificates, Modaraba certificates, Term Finance Certificates, Corporate bonds, Government debt instruments, etc., are also quoted / traded.

The stock exchanges are governed under the Securities and Exchange Ordinance, 1969. The Ordinance prohibits the dealing in listed securities outside the stock exchange by any person and transaction in securities listed on the stock exchange by a person, other than a member of the stock exchange.

The members are prohibited to:

- a) extend or maintain credit, or arrange for extension or maintenance of credit to or for any person for the purpose of purchasing or carrying any security; or
- b) borrow on any security or lend or arrange for lending of any security carried for on account of a customer; or
- c) pledge or arrange for pledging of any security carried for the account of any customer.

2. Major Institutional Developments

The major developments of the capital market in Pakistan were; (i) establishment of Central Depository System; (ii) automation of trade in all the three stock exchanges and; (iii) establishment of Credit Rating Agencies. With the help of the Asian Development Bank, a new system design has been prepared having features of Rolling Settlement on T + 3 cycle on the basis of continuous net settlement. Securities & Exchange Commission of Pakistan (SECP) has streamlined its procedure governing issuance of Fixed Income Securities. A number of policy decisions have been taken to liberalise investment procedures and encourage capital formation through stock exchanges. Some of the significant developments in the corporate sector which have vastly enlarged the size and depth of the capital market include: permission for companies to buy back their own shares, assets securitisation, rehabilitation of sick industrial units, etc. The SECP has established the legal frame-work for securitisation of assets. By introduction of this concept, Pakistan has entered in an era where financial markets could reap the advantages of this mode from which the developed markets have benefited to a great extent.

3. Automation of the Exchange

The open-out cry system has been abolished and an automated trading system KATS is in place. It has been completed in a very short span of time.

Another major achievement was the transformation of physical settlement to on-line, real time book entry settlement of securities i.e. Central Depository System (CDS). This has eliminated the chances of forgery and fraud and delays in transfer. A large number of companies have moved to the scrip less system while others are being encouraged to switch over as well.

The CDS is managed by the Central Depository Company of Pakistan Limited, which has been established with the association of leading financial institutions and the three stock exchanges of the country.

4. Performance of Karachi Stock Exchange

The Karachi stock Exchange (KSE) retained its pre-eminent position in Pakistan during the financial year ended 2003 (FY03) by accounting for over 60 percent of shares traded by volume and majority of

debt and equity listings. During FY03, KSE was one of the best performing indices of the world. The benchmark KSE-100 Index continued its upward trend and peaked at a new all-time high of 4606 points in September 2003 before closing at 4472 points on 31 December 2003.

5. The Non-Banking Finance Companies (Establishment And Regulation) Rules, 2003

The SECP has promulgated the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003 (NBFC Rules) effective April 01, 2003. Non-Banking Finance Companies (NBFC) include:

- a) Asset Management Companies
- b) Discount Houses
- c) Housing Finance Companies
- d) Investment Advisers
- e) Investment Finance Companies
- f) Leasing Companies
- g) Venture Capital Companies.

The rules contain detailed procedures for establishment, licensing and operations for the above activities. Given below are some of the key areas relating to the initial phases of NBFCs.

- a) A NBFC may be established, if each of its sponsors, proposed directors, chief executive and chairman of the Board of Directors meet the prescribed eligibility criteria and terms and conditions.
- b) Permission would be required from the SECP before incorporation of a NBFC on the prescribed format along with prescribed documents and fee.
- c) The NBFC would be incorporated as a public limited company within a period of six months from the date of permission, extendable for a further period of three months.
- d) The Company after fulfilling the prescribed conditions would be required to obtain a separate license to commence business operations for each of the above-referred

category. However, for investment advisory and asset management services, a single licence would be required.

- e) Initially license would be issued for a period of one year, which would be renewable annually. The minimum paid up capital requirement for each category is given below and at least fifteen percent (15%) thereof to be allotted to the promoters:

Investment finance services	Rs. 300 Million
Discounting services	Rs. 200 Million
Leasing companies	Rs. 200 Million
Housing finance companies	Rs. 100 Million
Investment advisory & asset management services	Rs. 30 Million
Venture capital investment.	Rs. 5 Million (for a venture capital company)

■ *The NBFC Rules prescribes the following conditions which shall be applicable to a NBFC:*

- a) Financial and record keeping, preparation of accounts, insurance and risk management.
- b) Board composition and senior management positions e.g. chief executive, chief financial officer, etc. including restrictions on their dealings with and relating to the NBFCs.
- c) Operational matters such as opening of branches, bar on acquiring controlling interests, resource mobilization, and terms and conditions for each of the prescribed activities viz.; leasing, investment finance services, housing finance services, venture capital company and fund, investment advisory services – for acting as investment advisor and investment company - closed end funds, asset management services – open end fund.

- d) Transitional provisions - existing companies that fall under the above-referred categories were required to apply for fresh license under the new NBFC Rules by 15 May 2003 and also to meet the capital requirements mentioned above by December 31, 2003. Till issuance of the new licenses, the original licenses would remain valid.
- e) With the promulgation of the rules, the rules that existed for leasing companies (2000), investment companies and investment advisers (1971), venture capital companies and venture capital fund (2001) were repealed. However, licenses issued under the repealed rules would continue to remain valid, subject to compliance with the requirement to obtain fresh licenses.
- f) The rules also contain formats of various forms, applications, licenses etc. and information and documents required to be submitted to the SECP, disclosure requirements in financials and offering / constituent documents.

6. Asset Management Companies

An open-end mutual fund has been referred to as a "scheme" in these rules and means: "a unit trust scheme constituted by way of a trust deed which continuously offers for sale, securities which entitles the holder of such security on demand to receive his proportionate share of the net assets of the security."

The NBFC Rules 2003 relating to asset management services inter alia cover the following areas:

- *Restrictions on the business of asset management company*
- *Obligations of asset management company*
- *Remuneration payable to the asset management company*
- *Authorisation of a scheme*
- *Investment policy of a scheme*
- *Limitations and prohibitions on a scheme*
- *Appointment of trustees and conditions applicable*
- *Obligations of the trustee*

- *Annual fee*
- *Transaction with connected persons*
- *Pricing, issue and redemption of units*

7. Housing Finance Companies (HFC)

A NBFC licensed by the Commission to undertake housing finance services may undertake the following activities or functions provided that its memorandum and articles of association permits it to do so, subject to the conditions mentioned below and any other conditions that may be specified by the Commission from time to time, namely;

- a) provide long term finance for the purpose of constructing, purchasing or making any additions, alterations or improvement to or in any property;
- b) lease and rent on hire purchase basis buildings for residential and commercial purposes;
- c) establish and manage housing schemes without engaging in real estate business or work as subsidiary or holding company or as joint venture of construction business;
- d) carry out surveys and valuations of land and properties;
- e) arrange for the insurance of pledged property from the present approved insurance companies;
- f) manage mortgage investments as agents;
- g) manage public or private sector projects, in the housing and urban development sectors;
- h) make loans and advances for house building or non-residential properties to individuals, corporate, projects and housing companies;
- i) financing against existing property by way of mortgage, provided that the same property shall not be accepted as security unless the facility extended is settled;
- j) raise funds, in addition to share capital from:
 - i) commercial paper, any security and deposits of not less than thirty days maturity approved by the 'Commission;

- ii) foreign debentures both short and long term;
- iii) issuance of redeemable capital (participation term certificates or term finance certificates, etc.);
- iv) lines of credit;
- v) re-discount facilities;
- vi) loans on mark up to other NBFCs providing housing finance services; and
- vii) make investment in government securities, approved securities and such other approved modes as may be allowed to NBFCs from time to time.

■ *Limit on individual exposures*

The NBFC providing housing finance services may extend loans on commercial terms up to sixty per cent of the total cost of the project in the case of residential or non-residential property.

8. Investment Companies and Investment Advisers

■ *Investment companies (closed end mutual funds)*

Following is the summary of significant provisions of the NBFC Rules 2003 relating to the Investment Companies and Investment Advisers:

a) Eligibility for Registration

A company proposing to commence or continue business as an investment company shall be eligible for registration if it is registered as a public company under the Companies Ordinance 1984 and it is to function as a closed-end fund with equity of not less than one hundred million rupees. The Rules provides the criteria for registration as an Investment Company, which cover provisions relating to minimum capital, directors experience and qualification, etc.

b) Investment policy and diversification

The Rules provide that the investment policy of an investment company shall be clearly stated in its Memorandum and Articles of Association and public offer

documents. The Rules also provide for limits of investment in any security and prohibits certain kinds of transactions to be undertaken by the investment company.

c) Transactions with connected person

There are restrictions on transactions with such persons.

d) Amount distributable to shareholders

The Rules provide that not less than ninety percent of the profits of the investment company, as defined in the Rules reduced by such expenses as chargeable to company under the Rules including remuneration payable to the investment adviser, shall be distributed by way of dividends to the shareholders.

e) Custody of securities

The Rules provide that securities owned or held by an investment company, shall be placed with a custodian, appointed with the prior approval of SECP.

■ *Investment advisor*

The Rules provide for appointment of an Investment Advisor under a contract for specified duration, approved by SECP.

No person shall commence the business of investment advisor, unless registered with SECP. The criteria for registration as an Investment Advisor among other matters provides for minimum capital, directors experience and qualification, etc.

9. Investment Finance Companies

Investment Banks are allowed to engage in normal investment and merchant banking activities including medium term, long term and other types of financing. The Investment Banks are not allowed to open checking accounts but may accept deposits and borrow from local and foreign banks, and from the financial markets, etc.

The objects and functions of an investment bank have been specified in detail in the relevant notification. An investment bank can engage in money and capital market operations, project financing activities, corporate financial services

and any other investment finance business specifically allowed.

- a) An Investment Bank is required to comply with various conditions prescribed by the SECP, for the grant of permission and license.

10. Leasing Companies

Following is the summary of significant provisions of the NBFC Rules 2003 relating to the companies undertaking leasing business:

■ *The NBFC shall, -*

- a) invest at least seventy per cent of its assets in the business of leasing, unless it is duly licensed by the Commission to undertake any other form of business in addition to leasing, provided that cash and bank balances and investment in government securities shall be excluded to calculate investment in leasing business for purposes of this definition;
- b) provide facilities amounting to at least five per cent of its fund based facilities to small entrepreneurs; and
- c) acquire and maintain membership of Leasing Association of Pakistan and follow the code of conduct prescribed by the said Association.

11. Venture Capital Companies and Venture Capital Funds

A "Venture Capital Company" means a company which is engaged in financing of any venture project through equity or other instruments whether convertible into equity or not and provides managerial or technical expertise to venture projects, or acts as a management company for management of venture capital fund.

A "Venture Capital Fund" means a company, which is managed by a venture capital company and raises funds through private placement of equity and other securities, as specified in these rules and invests its resources in venture projects.

Some of the important provisions of the NBFC rules in respect of the venture capital investment and venture capital funds are briefly described below.

■ *Venture Capital Investment*

- a) Terms and conditions of operation

A NBFC licensed by SECP to undertake venture capital investment shall:

- i) not expose more than forty percent of its equity attributable to venture capital investment segment to any single person or group of companies; and
 - ii) disclose in its accounts all investments in companies and group of companies exceeding 10% of paid up capital of the NBFC attributable to the venture capital investment segment.
- b) Private placement

In addition to its equity attributable to the venture capital investment segment, a NBFC may receive funds for investment in venture projects through private placement of such securities as may be notified by SECP from time to time.

- c) Placement memorandum

A NBFC duly licensed by the SECP to operate as a venture capital company shall, before soliciting placement of its securities, file with the SECP a placement memorandum which shall inter alia give details of the terms subject to which monies are proposed to be raised from such placements.

■ *Venture Capital Fund*

- a) Eligibility conditions for grant of license

- i) A venture capital fund is required to comply with the certain conditions in order to be eligible for grant of license. The major conditions in this respect includes:

- it is incorporated as a company under the Companies Ordinance, 1984;
- it is not engaged in any business other than that of investment in venture projects; and

- it has a minimum equity of rupees fifty million raised through private placement;
- ii) The board of venture capital fund shall not have a director, who is on the board of any venture project being financed by the fund.

b) Terms and Conditions of Operation

A venture capital fund shall:

- not expose more than forty percent of its equity to any single person or group of companies;
- disclose in its accounts all investments in companies and group of companies exceeding 10% of paid up capital of venture capital fund;
- ensure that the maximum exposure of the venture capital company to its directors, affiliated companies and companies in which any of the directors and their family members hold controlling interest shall not exceed ten percent of the overall portfolio of venture capital; and
- not accept any investment from any investor which is less than rupees one million.

c) Private placement

A venture capital fund shall raise and receive funds for investment in venture projects through private placement of such securities as may be notified by SECP, from time to time.

d) Placement memorandum

A venture capital fund shall, before soliciting placement of its securities, file with the SECP a placement memorandum which shall inter alia give details of the terms subject to which monies are proposed to be raised from such placements.

12. The Securities and Exchange Commission (Insurance) Rules, 2002

In exercise of powers conferred by the Insurance Ordinance, 2000, the SECP issued the Insurance Rules 2002 effective December 12, 2002. These Rules contain detail operational and reporting guidance and procedures. The following is a list of certain key areas that have been covered in the said Rules:

- a) Procedure for registration
- b) Qualifications of actuaries
- c) Restricted classes of insurance business
- d) Conversion of policies
- e) Minimum statutory deposit levels
- f) Admissibility of assets
- g) Minimum required assets in statutory fund
- h) Solvency of non-life insurer
- i) Loans to employees and agents
- j) Requirement to effect and maintain reinsurance arrangements
- k) Fees for special audit
- l) Financial condition report
- m) Minimum valuation basis
- n) Financial statements of life insurance companies
- o) Amalgamation and transfer of life insurance business
- p) Compliance visiting
- q) Disqualification of agents & insurer
- r) Qualifications required of insurance agents
- s) Misrepresentation by life insurers
- t) Authorisation of insurance brokers

- u) Liability for insurance advice
- v) Unit valuations
- w) Insurers duties when claim denied

13. The Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002

The above-referred Ordinance was promulgated on 29 October 2002 to provide for a fair and equal treatment to all the investors as well as a transparent and efficient system for substantial acquisition of voting shares and takeovers of listed companies and matters ancillary thereto or connected therewith. Following is a summary of some important sections of the Ordinance:

■ *Ordinance not to apply to certain transactions*

This Ordinance not to apply to various transactions as mentioned therein e.g. increase in holding on account of right issue, transmission, result of arrangement / scheme, public issue, in ordinary course of business, sale of shares in consequence privatization, existing shareholdings, etc.

■ *Acquisition of more than ten per cent voting shares of a company but up to 25%*

Any person who acquires voting shares in a listed company as a result of which his aggregate holding exceeds 10% of the voting shares, must disclose the aggregate shareholding to the said company and to the stock exchange on which those shares are listed within two working days of the acquisition.

Any additional acquisition by the above person during the next 12 months need not be disclosed until such time as the shareholding does not cross 25%.

- a) Simply, the disclosure is triggered on crossing the 10% voting rights threshold. Any further purchases in the 12 months thereafter, up to 25% of the voting rights need not be disclosed.

■ *Additional acquisition of voting shares – beyond 25% (substantial acquisition)*

When the acquirer plans to cross the 25% threshold or gain control of a listed company, he is required to make a public announcement of

offer to acquire additional voting shares or control of such company. Before making announcement such person shall make requisite disclosures as mentioned above.

■ *Consolidation of holdings*

If an acquirer has crossed the 25% threshold and proceeds to increase his holding further, up to 51%, he is required make a public announcement of offer to acquire additional voting shares or control. This is not required as the additional acquisition is within 12 months from the date of the previous announcement.

■ *Other provisions*

The Ordinance also contains provision relating to appointment of manager to the offer, timing of public announcement, modalities of public announcement, contents of the public offering document, offer price, obligations of the acquirer, obligations of the board of directors of the target company, obligations of the manager to the offer, and other procedural matters, including penal provisions, reporting requirements, and powers of the SECP in the area of substantial acquisitions.

14. Code of Corporate Governance

In March 2002, SECP issued Code of Corporate Governance (CCG), which was later incorporated in listing regulations by all the Stock Exchanges in the country. CCG is amid to establish a framework of good corporate governance for the listed companies. The areas addressed in the CCG in respect of corporate governance include:

■ *Directors*

- a) Constitution of Board of Directors;
- b) Qualification and tenure of directors;
- c) Responsibility, powers and functions of Board of Directors;
- d) Meetings of the Board;
- e) Key information to be placed for decision by Board of Directors; and
- f) Orientation course for directors about their duties and responsibilities.

■ *Chief Financial Officer (CFO) and Company Secretary*

- a) Appointment, remuneration, terms and conditions of employment of CFO, Company Secretary and head of internal audit.
- b) Removal of CFO and Company Secretary.
- c) Qualification of CFO and Company Secretary.
- d) Requirement to attend Board meetings by CFO and Company Secretary.
- e) Corporate and Financial Reporting Framework. The Director's report to Shareholders.
- f) Frequency of Financial Reporting.
- g) Responsibility for Financial Reporting and Corporate Compliance.
- h) Disclosure of interest by a Director holding Company's Shares.

■ *Capital structure*

- a) Auditors not to hold shares;
- b) Corporate ownership structure; and
- c) Divestiture of shares by sponsors / controlling interest.

■ *Audit Committee*

- a) Composition of Audit Committee;
- b) Frequency of meetings of Audit Committee;
- c) Attendance of meetings;
- d) Terms of reference of Audit Committee; and
- e) Reporting procedure.

■ *Audit*

- a) Requirements of Internal Audit; and
- b) Requirements for External Audit

■ *Compliance with CCG*

- a) Every listed company to provide statement of compliance with CCG along with their annual report;
- b) Statutory Auditors to certify statement of compliance with CCG; and
- c) SECP may relax any required compliance on the basis of non-practicability.

Chapter - 13

BANKING AND INSURANCE

1. Introduction

Pakistan's financial sector consists of public, private and foreign commercial banks, development financial institutions, investment banks, leasing companies, mutual funds and Islamic venture capital fund companies ("Modaraba" companies).

2. State Bank of Pakistan

The State Bank of Pakistan (SBP), the Central Bank of the country was established in 1948. In addition to SBP monitoring, the implementation of Banking Companies Ordinance 1962, specifies regulations relating to the monetary system, credit and banking policy and supervises their implementation.

3. Commercial Banks

The commercial banks in addition to providing working capital and long-term financing to the investors, offer a range of vital services, such as, remittances of profits / dividends, currency accounts, etc. The specialised development institutions provide credit for investment in various sectors.

The main law governing the Banking Companies in Pakistan is the Banking Companies Ordinance, 1962 that regulates and governs the establishment and running of banking companies in Pakistan in addition to business of commercial banking. The Ordinance also specifies the types of businesses that a banking company may be engaged.

4. Banking License

The setting up of a bank (including opening of branches by a foreign bank) requires a banking license from SBP. An application containing prescribed information is required to be submitted in accordance with the provisions of the Banking Companies Ordinance, 1962 for obtaining a Banking License.

5. Reciprocity

Before granting a license to a foreign banking company to operate in Pakistan, the SBP may require to be satisfied that the Government or law of the country in which the banking company is incorporated, provides the same facilities to banking companies registered in Pakistan, as the

Government or law of Pakistan grants to foreign banking companies.

6. Some Important Regulations Governing the Banking Companies in Pakistan

The Banking Companies Ordinance, 1962 and State Bank of Pakistan Act, 1956 specify various regulations, some of which are specified below:

■ *Capital and reserves requirements*

At present, all banks operating in Pakistan are required to maintain a minimum paid up capital (net of losses) of Rs. 1000million. Additionally, they are also required to maintain capital and unencumbered general reserves, the value of which is not less than 8% of their risk weighted assets both on consolidated as well as stand alone basis.

■ *Cash reserve*

Banks are required to maintain a cash reserve of a percentage of their demand and time liabilities excluding the paid-up capital, reserves and balance in the profit and loss accounts with SBP. The ratio is changed in accordance with the demands of the monetary policy and currently stands at a weekly average balance of 5% subject to a daily minimum of 4%. No interest / profit is paid by the SBP on these funds.

■ *Liquid assets*

Banks are required to maintain liquid assets consist of unencumbered approved securities at a specified ratio to their demand and time liabilities. The existing ratio is 20% and it includes the cash reserve requirement.

■ *Assets outside Pakistan*

Banks are required to maintain assets of not more than 20% of the total time and demand liabilities outside Pakistan.

■ *Annual accounts and audit*

Under the Banking Companies Ordinance, a banking company is required to maintain the calendar year as its financial year, and its financial statements are required to be audited in accordance with 2nd Schedule of the Banking Companies Ordinance, 1962. The audited

financial statements along with auditors' report are required to be published in the prescribed manner and copies of accounts are also required to be submitted to SBP within 3 months of the financial year-end.

■ *Remittance of profits*

Foreign Banks operating in Pakistan are allowed to remit the net profit earned in Pakistan, subject to approval of SBP, after fully providing for classified assets and tax liabilities.

■ *Number of branches*

As per the Branch Licensing Policy issued by SBP, there is no restriction on the number of branches to be opened by any scheduled bank operating in Pakistan subject to fulfilment of the SBP criteria. The Policy require that each bank shall submit their Annual Branch Expansion Plan (ABEP) 30 days before the commencement of each calendar year during which it plans to open new branches. The eligibility of a bank to open a new place of business will be decided by SBP based on the specified criteria.

7. **Prudential Supervision**

■ *Statutory framework*

The Banking Companies Ordinance empowers the SBP to investigate the financial position of a particular bank and its adherence to applicable laws and regulations in the conduct of its business. The SBP conducts regular inspection of all banks operating in Pakistan.

■ *Supervisory systems*

The Banking Supervision Department and Banking Inspection Department of the SBP are responsible for supervision of banks operating in Pakistan. The Banking Supervision Department frames policies and carries out the regular monitoring of the activities of the banks and their compliance with local statutory regulations. The Banking Inspection Department carries out regular inspections of the commercial banks through SBP Inspectors.

■ *Powers of SBP after inspection*

In case where an inspection reveals that the operations of a particular bank are not being carried out in accordance with the applicable rules and regulations, SBP has powers to initiate

corrective action. In such situations, SBP can order the bank to follow specific instructions.

8. **Prudential Regulations**

The SBP has introduced specific Prudential Regulations for Corporate / Commercial Banks, Small and Medium Term Enterprises Financing, Consumer Financing and Micro Finance Banks / Institutions.

■ *Corporate / Commercial Banking*

Following are the important conditions prescribed in these regulations:

- a) Limits on bank's exposure to a single person.
- b) Limits on bank's exposure against contingent liabilities.
- c) Limits on bank's exposure against unsecured advances.
- d) Linkage between a borrower's equity and total borrowing from banks.
- e) Maintenance of debt equity ratio of the borrowers.
- f) Margin requirements for financing facilities against shares.
- g) Restrictions on dealing with directors, major shareholders and employees of the banks.
- h) Requirements for classification of loans and advances and making provisions for loan losses against advances classified as "other assets especially mentioned", "sub-standard", "doubtful" and "loss".
- i) Holding of office by Directors and Chief Executives, subject to certain conditions, and certain restrictions applicable on remuneration to members of Board of Directors.
- j) Bank charges – Maximum limits on bank charges in respect of services provided to constituents.
- k) Rates of bank charges to be fixed on half-yearly basis in advance.

- l) Restrictions on Opening of Accounts and prevention of criminal use of banking channels for money laundering and other unlawful trades.
- m) Payment of dividend by bank, subject to fulfilment of certain conditions.
- n) Restriction on Bank Operations outside bank's authorised place of business.
- o) Prohibition of practice of Window Dressing.
- p) Asset management and financial and investment advisory services.
- q) Credit rating of the financial institutions.

■ *Small and Medium Enterprises Financing*

Following are the important conditions prescribed in these regulations:

- a) Sources and capacity of repayment and cash flow backed lending.
- b) Personal guarantees.
- c) Clean facilities.
- d) Securities.
- e) Margin requirements.
- f) Per party exposure limit.
- g) Aggregate exposure of a bank / DFI on SME sector.
- h) Minimum conditions for taking exposure.
- i) Proper utilization of loan.
- j) Restriction on facilities to related parties.
- k) Classification and provisioning for assets.

■ *Consumer Financing*

- a) Facilities to related persons
- b) Exposure against total consumer financing

- c) Total financing facilities to be commensurate with the income
- d) General reserve against consumer finance
- e) Bar on transfer of facilities from one category to another to void classification
- f) Margin requirements
- g) Credit cards

Further detailed regulations has been issued for the following:

- a) Auto loans
- b) Housing finance
- c) Personal loans including loans
- d) For the purchase of consumer durables

■ *Micro Finance Banks / Institutions*

- a) Minimum Capital Requirements
- b) Exposure against Contingent Liabilities
- c) Statutory Reserve
- d) Depositors' Protection Fund
- e) Restriction on certain types of transactions
- f) Maximum Loan Size
- g) Maximum Exposure of a borrower from MFBs/MFIs/Other Financial
- h) Institutions / NGOs
- i) Classification of Assets And Provisioning Requirements
- j) Rescheduling / Restructuring of loans
- k) Writing-off Non-Performing Loans (NPLs)
- l) Pricing of MF Products and Services
- m) Investment in shares of any body corporate

- n) Prevention of Criminal Use of MFB/MFI Channels for the Purposes of Money Laundering and other unlawful trade
- o) Undertaking of cash payments outside the MFB's/MFI's authorized place of business
- p) Reconciliation of inter-branch accounts and settlement of suspense account entries
- q) Audit and submission of accounts
- r) Internal Audit
- s) Operational Policies
- t) Restriction on Election and Appointment of Directors

9. **Modarabas**

Modaraba as defined in "The Modaraba Companies and Modaraba (Floatation & Control) Ordinance, 1980" means "a business in which a person participates with his money and another with his efforts or skill or both his efforts and skill and shall include unit trusts and Mutual Funds by whatever name called".

A Modaraba Company is defined as a company engaged in the business of floating and managing Modaraba, and "Modaraba Fund" means fund raised through floatation of Modarabas.

"Modaraba" is an Islamic Mode of financing and has become popular in recent years as a means of providing Islamic modes of finance for investment in stock exchange and trade and industry.

■ *Types of modarabas*

Modarabas may be of two types namely:

- a) Multipurpose modaraba
This may have more than one specific purpose or objective.
- b) Specific purpose modaraba.
This may have one specific purpose or objective.

Further, Modarabas may be either for a fixed period or for an indefinite period (i.e. perpetual).

The majority of Modarabas presently quoted on the stock markets are Multipurpose Perpetual Modarabas.

A Modaraba cannot engage in business activities, which are opposed to injunctions of Islam and a Modaraba before being floated requires a certificate from the "Religious Board" that the proposed Modaraba is not a business opposed to the injunctions of Islam.

c) Eligibility for registration

A company shall be eligible for registration as a Modaraba Company if it fulfils certain specified conditions including the minimum capital requirement (which stands at Rs. 2.5 million at present if it is managing only Modaraba and Rs. 7.5 million if it is conducting any other business), qualification and experience of the directors, etc.

d) Floatation of modaraba

A Modaraba Company after being registered can float any number of modarabas. For this purpose business plan, prospectus being incorporating document and feasibility study is required to be submitted along with other prescribed information to Registrar Modaraba and shall have to be cleared from the Religious Board.

The management of a Modaraba rests in Modaraba Management company which is required to subscribe in each Modaraba floated by it not less than 10% of Modaraba Certificates offered for subscription contribute. A Modaraba Company is entitled to a maximum of 10% of the annual profits as management fee.

In the case of a Modaraba applying for listing on the stock exchange, 30% of the total paid up capital shall be subscribed by the sponsors or their associates or friends, relatives and associated undertakings and the balance 70% shall be offered to the general public.

e) Limits on exposure

Liabilities, including contingent liabilities of a Modaraba for the first two years of its operation shall not exceed seven times of its equity. In the subsequent years the liabilities shall not exceed ten times of the equity of its Modaraba.

f) Limit on modaraba exposure

i) The total exposure of a Modaraba to any single person or group shall not at any point of time exceed 20 percent of the equity of the Modaraba; provided that this limit may be enhanced on a case to case basis with the approval of Registrar Modaraba.

ii) In arriving at per party exposure, 90% of the following shall be deducted:

- Certificates of Deposit/Certificates of Investment/ Certificates of Musharaka of the borrower under lien with the Modaraba;
- face value of FIBs lodged by the borrower as collateral; and
- repayment guarantees issued by a bank, with investment grade rating not lower than BBB.

g) Conditions for granting facilities

While granting any facilities, Modarabas shall ensure that the total facilities availed by any borrower from Modarabas, Leasing Companies, Non-Bank Financial Institutions and Banks do not exceed ten times of the capital and reserves (free of losses) of the borrower as disclosed in its accounts.

h) Restriction on certain types of transactions

No Modaraba shall allow facilities of any kind to its Modaraba Company or any of its chief executive, directors or their spouses or relatives or major shareholders. No Modaraba shall allow facilities to individuals, firms or

companies in which the above referred persons are interested as guarantors, partners, directors, chief executive or major shareholder of the investee concerns without the approval of the majority of the directors of the Modaraba excluding the directors having interest as illustrated above.

i) Taxability of a modaraba

Information regarding taxability of Modarabas are covered in Chapter – 15 “Income Tax”.

10. Insurance Ordinance, 2000

The Insurance Act, 1938 has been replaced by the Insurance Ordinance, 2000 and after the commencement of this Ordinance, no person other than:

- a) a public company or
- b) a body corporate incorporated under the laws of Pakistan (not being a private company or the subsidiary of a private company)

shall start any insurance business in Pakistan.

The Ordinance has divided insurance business into life and non-life insurance businesses and no company would be registered to carry on both of the classes of insurance business.

■ *Conditions imposed on registered insurers*

An insurer registered under this Ordinance shall at all times ensure that the provisions of this Ordinance relating to:

- a) Minimum paid-up share capital requirements are complied with;
- b) Minimum statutory deposits have been complied with;
- c) Minimum solvency requirements are complied with;
- d) The obtaining of reinsurance arrangements are complied with;
- e) The insurer is, and is likely to continue to be, able to meet its liabilities; and

- f) The insurer meets, and is likely to continue to meet, criteria for sound and prudent management including without limitation those set out in Section 12 of the Insurance Ordinance, 2000.

■ *Paid-up capital*

The insurers registered under this Ordinance to carry on life and non-life insurance business are required to have a minimum paid-up capital of not less than Rs. 150 million in case of life insurance and Rs. 80 million in case of non-life insurance or any other higher amount as may be prescribed by the Federal Government. However, an amount of reduced minimum required paid up capital at commencement date has been prescribed and such reduction is time barred. An insurer, not having a share capital, is not required to comply with the above minimum capital requirements.

■ *Deposits*

- a) Every insurer shall, in respect of the insurance business carried on by him in Pakistan, deposit and keep deposited with the SBP, in one of the offices in Pakistan of the SBP for and on behalf of the Federal Government the required minimum amount specified.
- b) For the purposes of this section the required minimum amount is, either:
- i) The higher of ten million rupees and ten percent (10%) of the insurer's paid-up capital; or
 - ii) Such amount as may be prescribed by the Commission (SECP).

Provided that SECP may, subject to achievement of level of solvency as required by this Ordinance, abolish the requirement for deposits specified above by reducing the required minimum amount to zero.

11. Code of Corporate Governance for Insurance Companies

The Securities & Exchange Commission of Pakistan had issued Code of Corporate Governance (the Code) for both listed and non-listed Insurance Companies. The purpose of the Code is to establish a framework of good corporate governance whereby an insurance company is managed in

compliance with best practices. The SECP has directed that all the insurance companies, shall, with effect from March 01, 2003 follow the Code. A brief summary of these codes in respect of listed and non-listed insurance companies is given below:

■ *Listed Insurance Companies*

Board of Directors

- a) Responsibilities, Powers and Functions of Board of Directors inter alia include:
- i) Vision / mission statement
 - ii) Corporate Strategy
 - iii) Formulation of significant policies which may include:
 - Level of administrative expenses
 - Appointment & remuneration of agents
 - Remuneration of directors and other senior management staff
- b) Establishment of sound internal control system which covers the following aspects:
- i) Policies & procedures for checks & balances for separation of critical functions like risk management, underwriting, investments, claims handling, internal audit etc.
 - ii) Division of responsibilities between the board and / or members of the board and third party service providers
 - iii) Custody or other arrangements to safeguard the assets of the company and review it time to time
 - iv) Compliance issues at each Board meeting
 - v) Systems and controls to maintain a sound and verifiable system of international reporting to its head office in Pakistan

- vi) Signing authorities and bank mandates regarding the assets of the company
- c) Annual reviews and compliance procedures with regards to:
 - i) Strategic Objectives
 - ii) Key operational risks
 - iii) Declaration of conflict of interest from the managers & directors

Auditors & Actuaries

- a) Partners of the audit firm, their spouses and minor children not to hold, purchase, sell or take position in the insurance company or any of its associated companies or undertakings. This provision is also applicable to actuaries.
- b) Appointment of actuary is subject to prescribed qualifications.

Committees

- a) Underwriting committee
- b) Claim settlement committee
- c) Reinsurance settlement committee & co-insurance

Compliance with the Code of Corporate Governance

- a) Status of Compliance with the Code should be confirmed in a statement along with the annual report
- b) External auditor to review & certify the statement of compliance before publication
- c) SECP may relax certain provisions due to practical difficulties in compliance.

■ *Non-Listed Insurance Companies*

Board of directors:

- a) All insurance companies must ensure effective representation of independent non-executive directors including those

- representing minority interests, on their board.
- b) The board must include atleast one independent director representing institutional equity interest of financial institution(s).
- c) Number of whole time working (executive) directors must not exceed 75 percent of the elected directors, except if relaxed by the SECP Qualification and eligibility to act as Director.
 - i) Should not be a director of 10 or more listed companies.
 - ii) Must be a tax payer (except if he or she is non-resident).
 - iii) Not been convicted by a court as a defaulter in payment of loan to any bank or financial institution(s).
- d) Tenure of office of directors shall be 3 years; casual vacancy must be filled within 30 days.
- e) Responsibilities, powers and functions of the board of directors:
 - i) Exercise their powers and carry out fiduciary duties with sense of objective and independence in best interests of the company.
 - ii) Preparation & circulation of statement of ethics & business practice and ownership by directors and employees through signing the same.
 - iii) Formulation of significant policies, which may include areas such as risk management, human resource management, procurement of goods and services, other operational, financial and commercial areas as specified in the code.
 - iv) Develop a vision / mission statement.
 - v) Establish / implement sound internal control system.
 - vi) Write-offs of bad debts etc.

- vii) Determination of terms & conditions for the employment of chief executive & other executive directors.
- f) Conduct of meeting of the Board of Directors.
 - i) Meeting must be at least once a quarter.
 - ii) Minutes to be circulated within 30 days.
 - iii) Note of a dissenting director may be appended to minutes, if required by the Directors.
- g) Significant issues to be placed for decision by the Board of Directors.
 - i) Business plan, forecasts etc.
 - ii) Annual budgets.
 - iii) Quarterly / periodical accounts.
 - iv) Internal audit reports.
 - v) Management letter issued by external auditors.
 - vi) Significant issues, legal cases, labour disputes etc.
- h) Orientation courses for directors must be arranged by the insurance companies.
- i) Appointment, remuneration and terms and conditions of employment of chief financial officer (CFO), head of internal audit and company secretary must be determined by the board of directors.
- j) CFO or company secretary cannot be removed except by the CEO with the approval of the board of directors.
- k) The code also prescribes the qualification of CFO and company secretary.
- l) The CFO and company secretary must attend the meetings of the board; but neither shall be deemed to be a director or cast vote at the meeting, unless they are elected as director.

Corporate and Financial Reporting Frame work

- a) The directors' report to shareholders inter alia must include, apart from financial statements, statement of confirmation regarding a host of matters relating to financial and accounting matters, internal control system, no departure from best practices of corporate governance, no doubts about going concern etc. The directors' report shall also include the following, where necessary:
 - i) Reasons for significant deviation from last year's operating results etc.
 - ii) Six year summary of key operating and financial data
 - iii) Reasons for not declaring dividends or bonus
 - iv) Reasons for outstanding / overdue payments in respect of Government dues etc and amount involved
 - v) Statement of value of investment of retirement funds
 - vi) Number of board meetings and attendance record

Frequency of financial reporting

- a) Quarterly accounts with directors report
- b) Limited scope review of half yearly accounts
- c) Circulation of annual audited financial statements within 4 month of close of financial year
- d) Annual reviews and compliance procedures by the board of directors: covering strategic objectives, key operational risks conflicts of interests.

Responsibility for financial reporting and corporate compliance

- a) CEO and CFO must endorse financial statements before circulation to board of directors for consideration and approval

- b) Company secretary must furnish a secretarial compliance certificate as part of annual report
- c) Auditors & actuaries not to hold the shares of the insurance company
- d) The code define the functions of Underwriting Committee, Claim Settlement Committee and Reinsurance Committee & Co-Insurance.

Audit Committee

- a) Must comprise at least three members including chairman; names to be disclosed in the annual report.
- b) Chairman must preferably be a non-executive director.
- c) Must meet at least once in a quarter.
- d) Must be attended by CFO, head of internal audit and representative of external auditor if issues relating to audit and accounts are discussed.
- e) Terms of reference must be developed by the board; the code prescribes the matters to be included in the terms of reference.
- f) Secretary to the audit committee would be responsible for circulation of minutes within a fortnight.

Internal Audit

- a) There must be an internal audit function in every company.
- b) Head of Internal Audit must have access to the Chairman of Audit Committee.

External Auditors

- a) Auditors should have quality control satisfactory rating under ICAP QCR programme.
- b) Auditors should be compliant with IFAC code of Ethics adopted by ICAP. Rotations of audit firm every 5 years, if impracticable rotation of partner in-charge, after SECP's approval.

Actuary

- a) Eligibility criteria for the appointment of actuary have been prescribed.

Compliance with the Code of Corporate Governance

- a) Status of Compliance with the Code should be confirmed in a statement along with the annual report.
- b) Statutory / external auditor to review the statement of compliance by the company.
- c) SECP may relax certain provisions due to practical difficulties in compliance.

Chapter - 14

LABOUR FORCE AND EMPLOYMENT

1. Background

The estimated labour force in Pakistan in mid-year 2003 is 42.75 million, out of which 29.69 million is rural and 13.06 million is urban. The annual growth rate in 2003 was 3.34%. An estimated 3.34 million of the labour force was unemployed in the year 2003 compared to 3.27 million in 2002. Unemployment rate in 2003 was 7.82%.

2. Labour Policy

■ *The Principles, Aims and Objectives of the Labour Policy 2002 are:*

- a) Bilateralism
- b) Bilateral Codes of Conduct
- c) Consolidation of Labour Laws
- d) Promotion of Healthy Trade Unionism
- e) Strengthening Social Dialogue Mechanism
- f) Labour Judiciary
- g) Social Safety Net
- h) Elimination of Gender Discrimination
- i) Workers' Children Education
- j) Elimination of Child Labour and Bonded Labour
- k) Workers in the Agriculture Sector
- l) Informal Sector and Home-based Workers
- m) Seasonal Workers
- n) Regulation of Contract Work
- o) Rights of Workers in the Event of Privatisation
- p) Challenge of Globalization

- q) Labour Welfare Levies
- r) Human Resource Development
- s) Occupational Safety and Health
- t) Labour Research
- u) Labour Market Information System (LMIS)

■ *Action Plan*

The Labour Policy 2002 gives an action plan in for the following areas:

- a) Industrial Relations
- b) Consolidation and Rationalisation of Labour Laws
- c) Labour Judiciary
- d) Conditions of Employment
- e) Wages
- f) Occupational Safety and Health
- g) Transport Workers
- h) Human Resource Development
- i) Social Insurance
- j) Model Schools for Workers' Children
- k) Merit Scholarship/Stipend Scheme
- l) Welfare of Mine Workers
- m) Institutional Improvement
- n) Labour Welfare Measure by Employers
- o) Inspection Services
- p) Labour Market Information System
- q) Research and Training

3. Labour laws

In addition to the Labour Policy, different laws have been promulgated for the benefit of labour force. Some of these laws are briefly discussed below:

■ *Companies Profits (Workers' Participation) Act, 1968*

A company engaged in industrial undertaking, if the number of workers employed at any time during a year is 50, or more, or the paid up capital as on the last day of the accounting year is Rs. 2 million or more or the value of fixed assets as on the last day of the accounting year is Rs. 4 million or more, is required to establish a Workers' Profit Participation Fund and pay to it, 5% of its profits every year. The workers' share in the fund depends on the category of his average monthly salary, subject to a maximum of Rs. 5,000.

■ *Industrial Relations Ordinance, 1969*

This Ordinance relates to the formation of trade unions, the regulation of relations between employers and workmen and the avoidance and settlement of any differences or disputes arising between them or related matters. Besides, the Ordinance also deals with the Registration of trade unions, Collective Bargaining Agents, Worker's Council, Management Board, etc.

■ *The Factories Act, 1934*

The Factories Act is applicable to almost all the industries. According to the Act, "Factory" means any "premises" or "Precincts" thereof, where ten or more workers are or were working, in which a manufacturing process is being ordinarily carried on with or without the aid of power. The Act deals with following aspects relating to working conditions for workers:

- a) Daily and weekly working hours
- b) Intervals for rest
- c) Weekly holidays
- d) Compensatory holidays
- e) Extra pay for overtime
- f) Annual holidays

- g) Casual leave or sick leave
- h) Special provisions for adolescents and children
- i) Health and safety measures, etc.

■ *Employees' Cost of Living (Relief) Act, 1973*

Employees Cost of Living (Relief) Act, 1973 provides for the payment of cost of living allowance to employees getting wages not exceeding four thousand and sixty Rupees per month. The Act is applicable to an establishment to which West Pakistan Shops and Establishment Ordinance, 1969 applies.

The amount of cost of living allowance vary based on the wage level of employees. The amount of allowance has been increased from time to time through amendments in the Act.

■ *West Pakistan Shops and Establishment Ordinance, 1969*

The Ordinance provides for the maintenance of statutory records of wages, leave, holidays, working hours, overtime, etc. It applies to all shops and establishment where any workman is employed.

■ *Employee's Old Age Benefits Act, 1976*

The Act is applicable to every industry or establishment employing ten or more persons. The employer is required to insure the workers who draw wages up to Rs. 3,000 per month. However, in case where an employer opts for self assessment scheme, the maximum wage limit of the employees required to be insured under this Act is Rs. 5,000. The contribution is made @ 5% of workers' wages by the employer and such contribution cannot be recovered in any manner from the employee.

■ *West Pakistan Industrial and Commercial Employment (Standing Orders) Ordinance, 1968*

Every industrial or commercial establishment where 20 or more workmen are employed is required to comply with the conditions of employment of workmen and other incidental matters contained in the standing orders. An industrial or commercial establishment includes, all kinds of commercial establishments, such as, advertising agency, hotel, restaurant, bank, insurance company, etc.,

and industrial establishment includes factory, mine, construction industry, etc.

The standing orders cover the following matters relating to employment of workmen:

- a) Classification of workmen into permanent, temporary, probationers, etc.
- b) Terms and conditions of service to be given in writing.
- c) Publication of working time and holidays.
- d) Details as to shift working, terms of attendance, leave, terms of wages, group incentive schemes.
- e) Compulsory group insurance of permanent workmen against death injury or disability not covered by Workmen Compensation Act, 1923.
- f) Terms and conditions governing stoppage of work, and closure of establishment, and terms relating to termination of employment, governing payment of gratuity or other termination benefits.

■ *Workers' Welfare Fund Ordinance, 1971*

Under the Ordinance, any industrial establishment as defined in the Ordinance, whose total income is not less than Rs. 100,000, is required to pay 2% of so much of its total income as is assessable under the Income Tax provisions, to the Workers' Welfare Fund.

■ *Workmen's Compensation Act, 1923*

Under this Act, the employer is liable to pay compensation to workers for accidents arising out of and during the course of employment. The rates for compensation for death, permanent total disablement, permanent partial disablement and temporary disablement have been given in the Act.

■ *Provincial Employees Social Security Ordinance, 1965*

This Ordinance is applicable only to such areas, classes of persons, industries or establishments with regard to such benefits as the Government may specify from time to time in this behalf. The

benefits provided by this scheme are medical care, maternity benefit, death grant, pre-natal and post-natal care, injury benefit, disablement pension, disablement gratuity, Survivor's pension, etc. The benefits under the scheme are available to the workers drawing wages up to Rs. 5,000. The employer is liable to pay contribution at such rates and subject to such conditions as may be specified.

Chapter - 15

THE SYSTEM

The Income Tax Ordinance, 2001 (hereinafter referred to as "the Ordinance") is the tax code of Pakistan w.e.f. 01 July 2002, which governs the taxation of income. The procedures thereof are mainly contained in the Income Tax Rules, 2002. The financial policies and taxation measures are annually announced in accordance with the policies of Government and a Finance Act to this effect is promulgated.

The Ordinance extends to the whole of Pakistan however, in terms of Article 247 of the Constitution of Pakistan, the Ordinance is not applicable to Federally Administered Tribal Areas and Provincially Administered Tribal Areas.

1. Tax Year

"Tax Year" means the period of twelve months ending on 30 June in respect of which assessment of income will be made. Where the accounting period (income year) of a person is different from the normal tax year or has been allowed by the Commissioner of Income Tax to use a period of 12 months other than the normal tax year, such a tax year will be called "Special Tax Year" and will be denoted by the calendar year in which the closing date of the special tax year falls.

2. Legal Status of The Tax Payer

A taxpayer under the Ordinance may have any of the following status for charge of tax:

- *Individual*
- *Company or Association of Persons (AOP)*
- *Federal Government, Foreign Government, a political sub-division of a foreign Government or Public International Organization.*

The term "Association of Persons" includes a firm, a Hindu undivided family, any artificial juridical person and any body of persons formed under a foreign law.

The Ordinance does not provide for any legal status of a "Joint Venture", however, the Central Board of Revenue through a circular has clarified that parties to following types of Joint Venture shall be allowed to be taxed on their respective share of income from

the Joint Venture at the rates applicable to each Joint Venturer:

- *Where the Joint Ventures includes Government and a foreign enterprise; or*
- *Where Joint Venture includes at least one foreign enterprise and one or more local enterprises.*

3. Residency Test

The total income chargeable to tax under the Ordinance is determined with reference to the residential status of the tax payer.

- *An individual is considered to be a resident in respect of a tax year if his aggregate stay in Pakistan is 182 days or more during that tax year; or he is a Federal Government or Provincial Government employee or official, posted abroad for in the tax year.*
- *A company is considered resident for a tax year if it is incorporated or formed by or under any law for the time being in Pakistan or the control and management of its affairs is situated wholly in Pakistan at any time in the year or if it is a Provincial Government or local authority in Pakistan.*
- *An association of persons is considered resident for a tax year if the control and management of its affairs is situated wholly or partly in Pakistan at any time in the year.*
- *The total income chargeable to tax in the case of resident and non-resident is determined as follows:*
 - a) **A resident person** is chargeable to tax in Pakistan for both his Pakistan source income and his foreign source income.
 - b) **A nonresident** is chargeable to tax in Pakistan only to the extent of his Pakistan source income.

4. Heads of Income

Total income of a taxpayer can be charged to tax under any of the following heads.

- *Salary*
- *Income from property*
- *Income from business*

- *Capital gains*
- *Income from other sources*

It is mandatory that income should be classified under any one of the head mentioned above. The nature of deductions / allowances available against gross income differ from one head to another and a number of limitations have been specified for such allowances / deductions. The Ordinance, in general, permits the deduction of all such expenses of a revenue nature incurred wholly and exclusively in the earning of such income. Where an expenditure has been incurred in deriving income covered under more than one head of income mentioned above then such expenditure shall be apportioned on a reasonable basis taking into account the relative nature and size of activities to which they relate.

5. Salary

Provisions relating to the taxation of salary income as contained in the Ordinance and Rules are summarized below:

- *Allowances, perquisites and benefits*

The taxation of allowances, perquisites and benefits (paid in cash or kind) depend on the salary levels.

The Income Tax Rules contain provisions for taxation of perquisites / benefits, however, the Ordinance restricts the exemption and relief while computing income under the head salary, where the taxable salary income after allowing for all the reliefs and benefits exceeds the threshold to Rs. 600,000 in which case all the perquisites and allowances will be taxed subject to the condition laid down in rules.

The rates of income tax for tax year 2004 are given below:

**Range of Total Tax rates
income inclusive
of perquisites and
allowances**

- | | |
|---|--|
| a) Up to the total income of Rs. 80,000 | 0% |
| b) from Rs. 80,000 to Rs. 150,000 | 7.5% of the amount exceeding Rs. 80,000. |

- | | |
|------------------------------------|---|
| c) from Rs. 150,001 to Rs. 300,000 | Rs. 5,250 plus 12.5% of the amount exceeding Rs.150,000 |
| d) from Rs. 300,001 to Rs. 400,000 | Rs. 24,000 plus 20% of the amount exceeding Rs.300,000 |
| e) from Rs. 400,001 to Rs. 700,000 | Rs. 44,000 plus 25% of the amount exceeding Rs.400,000 |
| f) over Rs. 700,001 | Rs. 119,000 plus 35% of the amount exceeding Rs.700,000 |

The income tax liability for salaried taxpayers, where any income chargeable under the head 'salary' exceeds 50% of total income shall be reduced in the following manner:

Income Parameters	Reduction in tax liability
Rs. 60,001 to Rs. 80,000	70%
Rs. 80,001 to Rs. 100,000	60%
Rs. 100,001 to Rs. 150,000	50%
Rs. 150,001 to Rs. 200,000	40%
Rs. 200,001 to Rs. 300,000	30%
Rs. 300,001 to Rs. 500,000	20%
Rs. 500,001 to Rs. 1,000,000	10%
Rs. 1,000,001 or more	5%

In addition, full time teachers and researchers, employed in a non profit education or research institution including government training and research institution duly recognized by a Board of Education or a University or the University Grants Commission, have been allowed a further reduction of tax equal to 50% of tax payable after allowing for applicable reduction as per the table above.

- *Foreign expatriate*

If an expatriate, due to his employment becomes resident in Pakistan and whose presence in Pakistan is for a period or periods not exceeding three years, his foreign income will not be taxed unless the income is derived from a business

established in Pakistan or it is brought or received in Pakistan.

■ *Employee share scheme*

If on exercise of an option or right to acquire shares, an employer issues shares to an employee under employee share scheme, differential of the fair market value of the share at the date of issue and consideration given by the employee to acquire the shares shall be chargeable to tax.

■ *Expatriates returning to Pakistan*

Foreign source income of a resident, who is a citizen of Pakistan and who was not been a resident in the preceding four years, would enjoy tax exemption for two years i.e. in the tax year when he becomes resident and the following tax year.

6. Income From Property

Income from property includes rent received or receivable by the owner of land or a building as a consideration for the use or occupation of the said property. Tax liability under the income from property is computed after deducting the allowable expenses which includes repair to building, insurance premium, local rate, tax or cess on property etc.

7. Income From Business

Income from business or profession is taxed under the following regimes:

- 1) Normal Tax Regime
- 2) Presumptive Tax Regime

■ *Normal Tax Regime*

Under the normal tax regime, taxable income of the taxpayer is determined after reducing the related allowable expenses out of which some of the important allowable expenses are discussed below

Depreciation Allowance

The Ordinance provides for the allowability of depreciation allowance on the assets used in a business during a tax year. No depreciation is allowed in the year of disposal of the asset. If the asset is not used for the whole tax year,

depreciation shall be charged only for the months in which the asset was in use. A transfer or export of the asset out of Pakistan shall be treated as a disposal of that assets and the cost of the asset shall be deemed to be the consideration received for that asset.

The depreciation rates provided are as follows:

Class of asset.	Description.	Rate percent of the written down value.
<u>Buildings</u>		
I	Building (not otherwise specified).	5
II	Factory, workshop, cinema, hotel, hospital.	10
III	Residential quarters for labour.	10
<u>Furniture</u>		
IV	Furniture (including fittings).	10
<u>Machinery and plant</u>		
V	Machinery and plant (not otherwise specified).	10
VI	Computer hardware, including printer, monitor and allied items.	30
VII	Technical or professional books.	20
VIII	Ships.	
(i)	New.	5
(ii)	Second hand.	

	Age at time of purchase:	
	(a) Not more than ten years.	10
	(b) Ten or more years.	20
IX	Motor vehicles (all types)	20
X	Aircraft, aero-engines and aerial photographic apparatus.	30
XI	Below ground installations in mineral oil concerns	100
XII	Below ground installations, including but not limited to the cost of drilling, casing, cementing, logging and testing of wells, in offshore mineral oil	100
XIII	Offshore platforms and production installation in mineral oil concerns	20

Initial Allowance

An asset, which has been placed into service in Pakistan for the first time in a tax year, a deduction namely "initial allowance" is allowable, provided the asset is wholly and exclusively used in deriving income from business.

A uniform rate of 50% is applicable to certain classes of assets referred to in the ordinance as "eligible depreciable asset". "Eligible depreciable assets" include all assets except for the following:

- a) Road transport vehicle not plying for hire
- b) Furniture and fittings
- c) Plant or machinery that has been used previously in Pakistan.

Intangibles

An amortisation deduction is allowed for the cost of intangibles having useful life of more than one year, used wholly or partly for deriving income from business. In case of part use of the intangible for business purpose, the deduction shall be allowed proportionately and no deduction is allowed in the year of disposal of the intangible.

Where the intangible has been disposed off, which was subject to the aforesaid deduction, the difference between the tax written down value and the sale proceeds is treated as an addition to or deduction from taxable profits for that tax year.

The Ordinance also specifies the basis of recognition of cost and the circumstances in which the intangible shall be deemed to be disposed off.

Tax Liability

Tax liability is computed by applying the following tax rates on the taxable income.

Tax Year	Banking Company	Public Listed and Majority Govt. owned. Company	Other Companies including foreign & unlisted public company
2003	47	35	43
2004	44	35	41
2005	41	35	39
2006	38	35	37
2007	35	35	35

In addition to the above benefit, further benefit in the form of reduction as a special tax rebate @ 50 % of tax payable is allowable in case where the age of taxpayer, on the first day of income year age 65 years or more and his earning is upto Rs. 200,000.

Further, the taxpayer is also entitled to claim benefit of tax credits and rebates available under various provisions of the Ordinance.

■ *Presumptive Tax Regime*

Under the Presumptive Tax Regime (PTR), the tax deducted or collected at source is deemed to be final tax in respect of income from sources chargeable under PTR. The following principles need to be remembered in respect of income chargeable to tax under the PTR.

- a) Tax imposed is the final tax on the income and constitutes full and final discharge of the tax liability to the extent of these incomes.
- b) The income shall not be chargeable to tax under any other head in computing taxable income of the person.
- c) The amount chargeable to tax on gross receipt basis cannot be reduced by:
 - i) Any deductible allowance; or
 - ii) Set off of any loss.
- d) Tax deducted or collected shall not be reduced by any tax credits available under the Ordinance.
- e) Tax deducted or collected shall not be refunded unless it is in excess of the amount chargeable under the Ordinance.

Where the income of a person for a tax year is covered under PTR and hence subject to final tax, the person is not required to furnish a return of income instead he is required to file a statement containing prescribed particulars relating to income of the person for the tax year.

Following is a brief overview of the sources of income, which are chargeable to tax under PTR.

■ *Dividends paid by a company*

Every person who receives dividend from a company is chargeable to tax on gross receipt basis unless the dividend is exempt from tax.

■ *Payment of 'Royalty' and 'Fee for Technical Service'*

Where a non-resident person receives any Pakistan-source royalty or fee for technical services, tax at the rate of 15% shall be charged on the gross amount of royalty or technical fee. However, the following receipts are not chargeable under this section:

- a) Any royalty, where the property or right giving rise to the royalty is effectively connected to a permanent establishment in Pakistan of the non-resident person;
- b) Any fee for technical services, where the services giving rise to the fee are rendered through a permanent establishment in Pakistan of the non-resident person;
- c) Any royalty or fee for technical services, which is exempt under the Ordinance.

Any Pakistan source royalty or fee for technical services received by a non-resident person to whom presumptive taxation does not apply will be treated as "Income from Business" attributed to the permanent establishment in Pakistan of the non-resident person.

■ *Shipping and Air-transport income of non-residents*

Every non-resident person carrying on the business of operating ships or aircraft as the owner or charterer is chargeable to tax, unless the income is exempt from tax, in respect of:

- a) Gross amount received or receivable (whether in or out of Pakistan) for the carriage of passengers, livestock, mail or goods embarked in Pakistan; and
- b) The gross amount received or receivable in Pakistan for the carriage of passengers, livestock, mail or goods embarked outside Pakistan.

The rate of tax is as under:

- a) In case of shipping income, 8% of the gross amount received or receivable; or
- b) In case of air transport income, 3% of the gross amount received or receivable.

The Ordinance provides that returns are to be filed on prescribed format and manner by these non-residents.

■ *Tax on income of certain importers*

The Ordinance provides for collection of advance tax at import stage by Collector of Customs from every importer of goods @ 6% of the value of goods as determined under the Customs Act, 1969. The tax collected shall be final tax on income of importer arising from

imports except where goods are imported by an industrial undertaking as raw material, plant, machinery and equipment for own use. Further, when tax has been collected at import stage from resident importer of goods into Pakistan and treated as final tax, no tax shall be withheld at the time of supply of these goods locally.

Where edible oils are imported tax is required to be collected @ 3% which shall be treated as minimum amount of tax payable by the person and not final tax. If the final tax liability of the person exceeds the amount collected, the tax collected shall be credited against the final tax liability.

Under the new law the Commissioner has powers to issue exemption certificate or a reduced rates certificate from collection of tax at import stage in case of a manufacturer cum importer, importing goods as raw material exclusively for his own use, subject to certain conditions.

Tax is not required to be collected in case of import of following petroleum products.

- a) Motor spirit
- b) Furnace oil
- c) JP - 1 and
- d) MTBE

■ *Payments for sale of goods and execution of contracts*

The Ordinance provides that a person making following payments in full or in part including advance payment is required to deduct tax therefrom at the specified rates. The tax deducted shall be final tax on income of person arising from the following transactions.

- a) Where the recipient is a resident.
 - i) Payment on account of sale of rice, cotton, cotton seed and edible oils @ 1.5%.
 - ii) Payment on account of sale of any other goods @ 3.5%.
 - iii) Payment on account of execution of contracts, other than a contract for the sale of goods or the rendering of services:

- where the value of contract does not exceed 30 million rupees @ 5% of the amount of payment.
- where the value of contract exceeds 30 million rupees @ 6% of amount of payment.

b) Where the recipient is a non-resident on execution of:

- i) a turnkey contracts @ 8%.
- ii) contracts or sub-contracts for design, construction or supply of plant or equipment under the hydel power project or a transmission line project @ 5%.
- iii) contracts or sub-contracts for design, construction or supply of plant or equipment under any other power project or a transmission line project @ 4%.

iv) contracts other than above:

- where the value of contract is up to Rs. 30 million @ 5%
- where the value of contract exceeds Rs. 30 million @ 6%

Manufacturer despite having the status of resident do not fall under PTR as mentioned in para (a) above, unless they have opted for PTR by filing a written declaration within three months of the commencement of tax year and the declaration so filed shall remain irrevocable for subsequent three years.

Similarly non-resident contractors shall be subject to taxation under PTR if an irrevocable option has been filed within three months of commencement of tax year, which shall remain in force for three years. It is worth-mentioning that applicability of PTR to a permanent establishment of non-resident is an interpretational issue.

■ *Non-resident Operations and Maintenance (O&M) Contractors of Private Power Sector Projects*

The Ordinance provides a concessional tax rate for a non-resident O&M Contractor. Payments received by a non-resident O&M Contractor for operation and maintenance of a private sector

power project and transmission line project, approved by the Federal Government, shall be charged to tax @ 5% for a period of three years beginning with the commencement of company's operations, which shall constitute the final discharge of the tax liability of the O&M Contractor in respect of said project.

■ *Tax on the income of exporters*

The Ordinance provides that tax shall be deducted or collected at specified rates in the following cases as final tax on the income arising from export or sale to an exporter.

- a) By every authorised foreign exchange dealer at the time of realisation of export proceeds of an exporter.
- b) By every banking company at the time of realisation of proceeds on account of sale of goods to an exporter under an inland back to back letter of credit or any other arrangement as may be prescribed.
- c) By Export Processing Zone Authority at the time of export of goods by an industrial undertaking located in the Export Processing Zone.
- d) By every direct exporter and an export house registered under the Duty and Tax Remission for Exports Rules, 2001 at the time of making payment for a firm contract to an in direct exporter.

The rates specified for deduction or collection are as follows:

Where income pertains to exports covered under

- | | | |
|-----|----------------------------------|----------------------------|
| (a) | Part I of the Seventh Schedule | @ 0.75% of export proceeds |
| (b) | Part II of the Seventh Schedule | @ 1.00% of export proceeds |
| (c) | Part III of the Seventh Schedule | @ 1.25% of export proceeds |

■ *Tax on income from prizes and winnings*

Every prize on a prize bond, winning from a raffle, lottery, prize on winning a quiz, prize offered by companies for promotion of sale, or cross word puzzle is subject to withholding tax @ 10% of the gross amount which is treated as final tax. Where prize is not in cash, tax shall be collected @ 10% of the fair market value of the prize.

■ *Tax on transport business*

The tax collected at the time of collecting motor vehicle tax shall be final tax on the income of the owner of the goods transport vehicle from plying, or hiring out of such vehicle.

Tax shall be collected at following rates for goods transport vehicles:

	Registered laden weight	Tax (Rupees)
(a)	Less than 2,030 kilograms	1,200
(b)	2,030 kilograms or more but less than 8,120 kilograms	7,200
(c)	8,120 kilograms or more but less than 15,000 kilograms	12,000
(d)	15,000 kilograms or more but less than 30,000 kilograms	18,000
(e)	30,000 kilograms or more but less than 45,000 kilograms	24,000
(f)	45,000 kilograms or more but less than 60,000 kilograms	30,000
(g)	60,000 kilograms or more	36,000

After a period of ten years from the date of first registration of goods transport vehicle in Pakistan, advance tax shall be collected as follows:

Registered laden weights of less than 8,120 kilograms	No tax
Registered laden weights of 8,120 kilograms or more	1,200

- *Apportionment of expenses for calculating income under NTR and PTR*

The rules provide that expenditure incurred for a particular class of income can only be allocated to that class. Further any common expenditure incurred for deriving more than one head of income shall be allocated to each class in the proportion which the gross receipts from that class of income bear to the total gross receipts from all classes of income.

- *Minimum tax based on turnover*

If no tax is payable or paid by the company for a tax year or the tax payable or paid by the company for a tax year is less than 0.5% percent of the amount representing the company's turnover from all sources (i.e. income covered under the presumptive tax regime and income chargeable to tax under normal law) for that year, the aggregate of the company's turnover for the tax year, shall be treated as the income of the company and shall be taxed as follows:

Where no tax is payable or paid	An amount equal to 0.5% of turnover
---------------------------------	-------------------------------------

Where tax payable or paid is less than 0.5% of turnover.	An amount representing the difference between tax payable or paid and 0.5% of turnover.
--	---

Exemptions have been provided to certain companies from the applicability of minimum tax.

- *Treatment of previous year's losses*

Losses under head of income except speculation losses and capital losses can be set off against income under any other head only for that year in which loss was sustained. In case of a business loss, which cannot be fully set off in a tax year, can be carried forward upto six tax years immediately succeeding the tax year in which the loss was first computed. Foreign losses can be setoff only against foreign income.

In case of a banking company, unabsorbed business losses can be carried forward upto ten years subject to the following conditions:

- Wholly owned by the federal government as on 01st June 2002.
- Loss sustained relates to tax years from 01st July 1995 to 30th June 2001.
- Approved by the State Bank of Pakistan.

The accumulated loss under the head "Income from Business" of an amalgamating company, shall be set off or carried forward against business profits / gains of the amalgamated company upto a period of six tax years immediately succeeding the tax year in which the loss was first computed in case of the amalgamating company.

Unabsorbed tax depreciation, initial allowance & amortization can be carried forward to succeeding years until completely set off.

In case of speculation and / or capital losses, unabsorbed losses can be carried forward upto six tax years and only be adjusted against income from the same head in which the loss was sustained and not against income under any other head.

8. Capital Gains

Under the head income capital gains includes gain arising on the disposal of capital asset by a person in a tax year other than a gain that is exempt from tax under the Income Tax Ordinance, 2001.

For the purpose of this head of income "Capital asset" means property of any kind but does not include stock in trade, consumable stores, raw materials, property on which depreciation or amortization is allowed, immovable property or any movable property excluding some specified capital assets.

9. Income From Other Sources

Income in a tax year if not included in any other head, shall be chargeable to tax under the head Income from Other Sources. Some of the income included under this head are dividend, royalty, profit on debt, ground rent etc.

In computing income from other sources, a deduction shall be allowed for any expenditure paid by the person in the year to the extent to which the expenditure is paid in deriving income chargeable to tax under this head.

10. Modes of Payment of Tax

A taxpayer makes payment of tax at four stages, i.e.:

- a) deduction at source (withholding tax);
- b) advance payment of tax;
- c) payment of tax with the return of total income;
- d) payment of tax on demand;

■ Withholding of Taxes

Under the Ordinance, virtually every amount received by a person is subject to withholding tax. Such withholding tax is treated as a prepayment of final tax liability in cases where income is chargeable under the normal law and as a full and final discharge of tax liability, where the income falls under PTR.

Prescribed persons are treated as withholding tax agents who are required to withhold tax from specified payment.

The following is a summarized position of various types of payments and rates on which withholding is required except where exempted:

S. No.	Nature of payment	Section	Rates of Withholding			
1.	Salary	149	At average rate of tax			
2.	Payment on imports	148	6% in case of imports other than edible oils. 3% in case of imports of edible oil.			
3.	Profit on debt	151	10%- Post office saving account or if investment in NSC is made after 30 June 2001 or instalment in Mahana Amdani			
				4.	Certain payments to non-residents except payment on account of salary, dividend, supply of goods, rendering of services or execution of contract, rent of property and prizes and winning.	152
				5.	Payments for supply of goods, rendering of services or execution of contracts.	153
						In case of non-residents not having a permanent establishment in Pakistan 15% - Royalty 15% - Fee for technical services 30% - Other payments
						a) Payment made to a resident or permanent establishment of non-resident on account of:

account exceeds Rs. 4,000 per months.
10%- Profit on an account or deposit maintained.
20%- Profit payment on other securities issued by Federal or Provincial government or a local authority.
10%- Profit payment to a person other than a financial institution or any bond, certificate, debenture, security or instruments of any kind.

<ul style="list-style-type: none"> ▪ Execution of contract where value does not exceed Rs. 30 million @ 5%. ▪ Execution of contract where value exceeds Rs. 30 million @ 6%. ▪ Supply of rice, cotton, cotton seed or edible oils @ 1.5% ▪ Supply of goods other than those specified above @3.5% ▪ Services rendered other than transport services @ 5% ▪ Transport services @ 2.1% 		<ul style="list-style-type: none"> ▪ Execution of any other contract for construction or services rendered other than a contract to which section 152 applies @ 5% where value of contract does not exceed Rs. 30 million while @6% in case of contract where its value exceeds Rs. 30 million
<p>b) Payments made to non-residents on account of:</p>	<p>6. Payment of dividend 150</p>	<p>5% If recipient is a public company or insurance company</p>
<ul style="list-style-type: none"> ▪ Execution of turnkey contract - 8% of the amount of payment ▪ Execution of contractor or sub -contracts for designing, construction or supply of plant and equipment of power projects (other than hydel power projects or a transmission line projects @ 5%) @4% of the amount of payment 		<p>7.5% If recipient by a non-resident company from a company engaged exclusively in mining operation other than petroleum.</p> <p>7.5% if paid by a purchaser of a power project privatised by WAPDA.</p> <p>10% In all other cases.</p>
	<p>7. Export proceeds. 154</p> <p>Commission received by indenting commission agent. 154</p>	<p>0.75%, 1% or 1.25% of exports listed in part I, II or III of Seventh schedule.</p> <p>5%</p>

- d) Every person who is member of club where the monthly subscription exceeds five hundred rupees or admission fee exceeds twenty five thousand rupees.
- e) Every person who subscribes to a mobile phone.
- f) Every person who claims a loss under the Ordinance.
- g) Every pensioner.

In addition to the above every person is required to file wealth statement along with return, irrespective of the fact that his total income exceeds 200,000 or not.

12. Other Important Areas of The Ordinance

■ *Avoidance of double taxation and unilateral relief*

Pakistan has entered into agreements for avoidance of double taxation with a number of countries including those where the conventions are restricted to the taxation of income from international air / shipping traffic.

When the Ordinance and any Treaty are in conflict, the Ordinance provides for the treaty provisions to override in such cases.

A resident taxpayer shall be entitled to tax credit in respect of foreign source income chargeable to tax in Pakistan if foreign income tax, has been paid in respect of foreign source income equal to the lesser of –

- (a) the foreign income tax paid; or
- (b) average rate of Pakistan income tax applicable to the taxpayer the taxpayer's net foreign source income.

A credit shall be allowed under this provision only if the foreign income tax is paid within two years after the end of the tax year in which the foreign income to which the tax relates was derived by the resident tax payer.

■ *List of countries with whom Pakistan has signed avoidance of double taxation treaties*

- | | |
|---------------|------------------|
| 1 Austria | 28. Malaysia |
| 2 Azerbaijan | 29. Malta |
| 3 Bangladesh | 30. Mauritius |
| 4 Belgium | 31. Nigeria |
| 5 Canada | 32. Norway |
| 6 China | 33. Oman |
| 7 Denmark | 34. Philippines |
| 8 Egypt | 35. Poland |
| 9 France | 36. Qatar |
| 10 Finland | 37. Romania |
| 11 Germany | 38. Saudi Arabia |
| 12 Greece | 39. Singapore |
| 13 Holland | 40. Sri Lanka |
| 14 Hungary | 41. Sweden |
| 15 India | 42. Switzerland |
| 16 Indonesia | 43. Thailand |
| 17 Iran | 44. Turkey |
| 18 Ireland | 45. Turkmenistan |
| 19 Italy | 46. Tunisia |
| 20 Japan | 47. U.K. |
| 21 Jordan | 48. U.A.E |
| 22 Kazakhstan | 49. USA |
| 23 Kenya | 50. Uzbekistan |
| 24 Kuwait | |
| 25 Korea | |
| 26 Lebanon | |
| 27 Libya | |

■ *Anti avoidance*

Transfer Pricing

In order to avoid erosion of revenue through techniques of transfer pricing, revenue authorities in Pakistan introduced new provisions, empowering Commissioner of Income Tax to stop that illicit exercises. Following is the summary of those provisions:

- a) For realisation of arm length transaction, Commissioner may distribute or allocate income or tax credit between associate in the manner he deems fit.
- b) Reclassify transaction between related parties by applying the appropriate

methods for tax avoidance or following the criteria of substance over form.

- c) Ignore transactions having no substantial impact.

Thin Capitalisation

The concept of thin capitalisation has been brought in Pakistan tax legislation so as to refrain foreign companies from injecting debt instead of equity in their subsidiaries formed in Pakistan. Thin capitalisation rules apply to Foreign Controlled Resident Company (FCRC) is a resident company in which 50% or more of the underlying ownership is held by a non-resident person either alone or together with an associate) other than the financial institution or banking company.

Where foreign debt to foreign equity ratio of a FCRC exceeds at any time during a tax year profit on debt paid by the company in that year on the part of the debt exceeding 3:1 ratio will not be allowed as deduction while computing income of the FCRC.

■ *Advance ruling*

The Central Board of Revenue may, on application in writing by a non-resident taxpayer, issue to the taxpayer an advance ruling setting out the Commissioner's position regarding the application of this Ordinance, to the transaction proposed or entered into by the taxpayer.

Where the taxpayer has made a full and true disclosure of the nature all aspects of the transaction relevant to the ruling and the transaction has proceeded in all material aspects as described in the taxpayer's application for the ruling, the ruling is binding on the Commissioner with respect to the application of transaction.

Where there is any inconsistency between a circular and an advance ruling, priority shall be given to the terms of the advance ruling.

13. Taxation of Permanent Establishment of A Non-Resident

Permanent Establishment (PE) means a place of business through which the business of person is wholly or partially carried on and includes a wide range of places where business activities are carried

on. Income from business of a PE is determined on the basis of following principles:

- a) Profit is computed on the basis that PE is a distinct and separate person from the non-resident of which it is a PE.
- b) Any expenditure incurred for the purpose of business activities shall be allowed as a deduction.
- c) No deduction is allowed for amounts paid or payable by the PE to its head office or to another permanent establishment of the non-resident, other than actual reimbursement to third parties by the non-resident, by way of:
 - i) Royalties, fees or other payments for the use of any tangible or intangible asset by the permanent establishment;
 - ii) Compensation for any services including management services performed for the permanent establishment; or
 - iii) Profit on debts on money lent to the permanent establishment, except in connection with a banking business.

Similarly, income charged by the PE to the head office to another PE of the non-resident in respect of any of abovementioned heads will not be taken into account for tax purposes.

The Ordinance provides relief to permanent establishment of non-resident for expenditure incurred in the nature of Head Office Expenditure. Head Office Expenditure means "executive and general administration expenses" and includes salary and travelling expenses of employees employed by head office outside Pakistan and rent and other expenses for any premises outside Pakistan used for the purpose of business of permanent establishment in Pakistan.

The deduction on this account is allowed in the same proportion of Head Office Expenditure as the turnover of the permanent establishment in Pakistan bears to the world turnover of the non-resident.

14. Taxation of Special Industries

The Ordinance contains special provisions for determination of total income of insurance business, oil, natural gas and other mineral deposits, irrespective of the residential status of the taxpayer as follows:

- a) The profits and gains of any business of insurance shall be computed as per the rules for computation of total income from these businesses given in the Fourth Schedule to the Ordinance. In case of general insurance business, the allowances and expenditure in excess of the limits prescribed by the Insurance Ordinance, 2000 shall be approved by the Securities and Exchange Commission of Pakistan in order for them to be allowed.

- b) The profits and gains from the exploration and production of petroleum including natural gas and from refineries setup at Dhodak and Bobi fields, pipeline operations of exploration and production companies, and manufacture and sale of liquefied petroleum gas (LPG) and compressed natural gas (CNG) shall be computed in accordance with the rules in Part I of the Fifth Schedule to the Ordinance. A business undertaking in any of these categories qualify to be taxed separately from other business operations if such business undertaking is carried out as a result of an agreement with the Government.