THE INCOME TAX REGIME AND THE NON-PROFIT SECTOR
THE CASE OF PAKISTAN

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1 INTRODUCTION

The origins of charity lie in religious belief coupled to a moral responsibility on those who are well off to help those in need. Personal charity was initially directed to the poor as alms, but over time a fair portion was institutionalised. This took the form of institutionalised giving routed through the temples, firstly for the upkeep of the temples and their keepers, and secondly for operating free kitchens for the poor. With the passage of time this expanded into the establishments of public trusts and foundations and their expanded role in the distribution of charity, and for undertaking works of public interest. While this was largely voluntary and based on peer pressure, the advent of Islam saw the first codification of this responsibility. It introduced the concept of *Zakat* (a form of wealth tax), *Ushr* (a form of income tax), *Fitra*, as mandatory religious duties of the rich, and of *Sadaqa*, and *Khairat* as a voluntary act of charity, the first in recognition of the largesse of and bounty from Allah, and the latter as an additional sharing of wealth to redress poverty and suffering.

The transition from personal giving to institutionalised charity and philanthropy has been recognised by all governments. This is particularly so in developing countries where governments in general are faced with a paucity of resources and the existence of ossified and archaic systems and procedures which lead not only to institutionalised waste, but also to economic rent seeking behaviour by those in power. This has created a general realisation for

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greater cost-effectiveness and transparency in the delivery of services. This has been fortified by research and experiment, that the involvement of not for profit organisations (NPOs) in assuming some of the responsibility of government is more beneficial and ensures sustainability. As such governments throughout the world have encouraged such organisations by giving them special consideration where taxes are concerned. The giving of charity by donors has also been encouraged by allowing the amount donated as a tax write-off.

In 1988 the Government of Pakistan in concert with the provincial governments enunciated a uniform policy for the implementation of potable water and sanitation schemes for the rural areas of Pakistan. The Policy for the first time recognised the need for beneficiary participation in the development of the sector at each stage starting with planning and running through to the operation and maintenance of schemes. This principle was further expanded in the Social Action Programme (SAP) which was put together by the Government of Pakistan in 1991. A cornerstone of the governing policy parameters was the decentralisation of services and the involvement of communities, community based organisations (CBOs) and NGOs, in other words the non-profit sector organisations, in delivering services. This was reiterated more forcefully in the second phase of SAP. It has also become one of the major mechanisms for reducing poverty during the implementation of the Poverty Reduction Strategy. This development governance paradigm has been extended as part of the National Devolution Plan. Every local government is required to establish Citizen Community Board comprising of eminent citizens not elected to any public office locally through which not less than half its development budget is to be routed. Moreover the performance and operations of the local government departments are to be reported on by various Committees of Councillors. This paradigm is also an integral component of the Poverty Reduction Strategy

where the employment generation through public works and self-employment through micro-credit are to achieved through partnerships with NPOs and CBOs.

It would thus appear that the Government of Pakistan seems to be encouraging the non-profit sector. To this end it has initiated the process of revisiting the enabling environment legislation with respect to both, facilitation and regulation on the one hand, and the fiscal policy framework on the other. Changes in the fiscal policy framework were initiated in the 1998/99 federal government budget when it increased the share of income that could be donated to charitable organisations approved by the Income Tax Department. The earmarking of half the development budgets of local governments in 2001/02 to be spent only through the Citizen Community Boards was the next major step undertaken. The government of the day recognises that it is necessary to provide a more favourable enabling fiscal environment to further promote sustainable development of NPOs, specially to stimulate more local, sustainable funding from private and corporate sources.

This paper attempts to demystify the fiscal regime governing the not-for profit sector. Section 2 sets out the milieu within which the sector operates. Section 3 examines the Income Tax Ordinances and how they have changed with time. Section 4 first analyses the implications of the Ordinance with respect to any particular aspect and then suggests remedial measure for creating an enabling Income Tax environment to make the sector financially self-sustaining.

2 THE MILIEU : AN OVERVIEW

The sector organisations can be divided into four main categories. The first are the national level policy research and advocacy organisations largely funded by international donors. The

second are the umbrella or catalytic organisations which act as the change agents in the implementation of national or regional programmes, projects and schemes, or are foci or conduits for funding, establishing or assisting community-based organisations shift from welfare orientation alone to participatory development as well. The third are the Rural Support Programmes (RSPs) which aim to reduce poverty on the basis of self help. They are engaged largely in, one, providing technical and financial support in building village/community level physical infrastructure, two, providing micro-credit and assistance in establishing small and micro-enterprises, three, assisting in the development of and harnessing natural resources, four, supporting the development of the social sectors in poor communities, and five, empowering communities by harnessing their potential to help themselves to improve their quality of life. The fourth are the foot soldiers - the community based organisations who are engaged in actually implementing or operating projects and schemes at the neighbourhood, settlement or regional level. Very few operate at the provincial level.

The contribution of the non-profit sector organisations to the economy is substantial. Ghaus-Pasha, Jamal and Iqbal (2002) state that the sector consists of about 45,000 active organisations ranging from the unregistered neighbourhood/village community based organisations to the nation-wide organisations. The bulk of them (91 percent) are engaged in activities for the public benefit. Nearly half (46 percent) are engaged in education, and about 16 percent are engaged in advocacy and espousing the civil rights cause. Only 6 percent are involved in delivering health care. The study also states that the bulk (40.5 percent) are registered as societies, about 15 percent as social welfare agencies and about 6 percent as trusts. More than 38 percent of the sector organisations are unregistered of which only about a tenth have applied for registration. The sector organisations employ 476,000 persons

divided between paid employees (264,000), and volunteers (212,0000), accounting for over four percent of the non-agricultural employment. Over six million people contributed about Rs. 715 million to the sector organisations as membership fees in the fiscal year ending June 2000, that is about 4.4 percent of total revenue of the sector organisation. This is only marginally lower than what the government doled out as grants. However this is only a fraction of the contributions through philanthropy. According to this study local philanthropic contributions account for over 37 percent of revenues. While there is much-ado about institutionalised external (non-Pakistani) public and private funding, this accounts for less than 6 percent of cash revenues and marginally more than 2 percent of the in-kind contributions. All of the receipts are spent, thereby contributing marginally more than 0.5 percent to the Gross Domestic Product.

Having accepted the principle that sustainable development can be achieved best through the active participation of the beneficiaries in not only the development of infrastructure but also its subsequent maintenance, the Government of Pakistan has made this central to the implementation of both the Poverty Reduction and Social Development efforts, on the one hand, and also in the devolution of government and government functions to the grass roots level, on the other hand. To provide an enabling environment for the availability of resources to the partnering organisations and to others wishing to supplement publicly provided services, the government has recognised the need to create a fiscal environment supportive of this goal. The fiscal regime impacting on the non-profit sector organisations include not only the laws, rules and regulations of the federal and provincial governments, but also some of the utility charges levied by supplier organisations in the public domain. These include the Income Tax, the Sales Tax, and the Customs Duty laws, regulations and rules at the federal level. At the provincial level are the taxes and other levies on urban land and properties

owned by NPOs, the taxes on motor vehicles, and the stamp duties on instruments. The electricity distribution organisations also offer a special domestic rate rather than a commercial rate to recognised charitable organisations.

Barring the Income Tax Ordinance 2001[2], all of these are archaic. Each, including the Income Tax Ordinance 2001, is rife with discretion. The systems and procedures set out in the rules and regulations are cumbersome, prone to varying interpretation on a case to case basis and encourage the harvesting of economic rents by tax officials. While the development paradigm has changed, the preponderant share of the fiscal and regulatory environment has not. In no way can the regime be considered enabling for the sustained existence of the NPOs. Some of the stakeholders think that as the country's resources are limited and national savings are perhaps the lowest certainly in the region, the imperative for making the use of resources by all the players in the game, including the Citizen Sector Organization transparent, effective and efficient must be fully secured. At the same time the institutional arrangements for securing these objectives should be fair and document based. Based on these principles certain guiding principles have emerged. These form the basis of this review and the revisions to the Income Tax support regime. The principles, agreed to with the stakeholders, particularly the Ministry of Finance and the Central Board of Revenue are.

1 It will have to be recognized that for rapid and sustained transformation in the quality of life, resource mobilisation efforts have to be made at Federal, Provincial, Local and Community Organizations levels. Collection of funds by the Citizen Sector Organizations through donations, grants, contributions, subscriptions, membership fees and service charges should therefore be viewed as "Resource Mobilisation for Development."

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[2] Which is planned to come into effect from 1 July 2003

2 Citizen Sector Organizations replicating and expanding the network of tax financed social assets and public service have to be treated at par with Government agencies in fiscal treatment of receipts and expenditure. (All debts are in fact deferred domestic resource mobilization commitments for their servicing and repayment).

Having accepted the new development paradigm and the principles on which a supporting fiscal framework should rest, the Government of Pakistan has initiated the process and the provisions of the Ordinance 2001 with the Income Tax Rules 2002 governing the non-profit organisations clearly indicate this.

3 THE INCOME TAX LAW

The law of tax on incomes originates from after the invasion and colonisation of India by the British. At independence, Pakistan inherited the law from pre-partition India, the Income Tax Act 1922. The first major attempt to make the income tax regime consonant with modern day needs and practices was made in 1979. Each year thereafter, the governments introduced substantial changes to the Ordinance thereby creating a body of law which was cumbersome and not easily interpreted by even the tax practitioners and the tax authorities themselves. Conflicting opinions and judgements have resulted in substantial discretion in both interpretation and implementation. To remedy this, the law was changed to reflect these variations and to "modernise" it in line with "best practice" in 2001.

To the layman, the Income Tax law is a black box and to most practitioners, the law as applicable to the NPOs is a grey area. Many organisations assume that since they are non profit organisations, they are not liable to pay income tax and are, therefore, exempt from filing returns, even if they are recognised as charities by the Income Tax Department.

According to the Income Tax Ordinance, 1979[3], only some types of incomes of recognised NPOs were exempt. For instance, income of Trusts for religious and charitable purposes derived from investments in government securities were exempt. However, income derived from other investments, from the sale of services and of publications were exposed to the levy of a Withholding Tax. In such cases an annual return has to be filed which is then assessed for tax purposes. Even when organisations are granted a tax exempt status this return must be filed. The same situation continues to exist under the Income Tax Ordinance, 2002. However, the income of such organisations from all sources has been exempt, provided such income is used within Pakistan only for the declared objectives of the organisation.

3.1 Definitions

The Income Tax Ordinance of 1979 did not and that of 2001 does not distinguish between the various types of non-profit organisations, nor the legislation under which they may be registered. Each is, therefore, treated at par. Each application for exemption of income from taxation or for being recognised as a charitable organisation so that any donee is entitled to a rebate in tax liability is treated on a case by case basis. Neither the Ordinances, nor the Rules 1982, contain any criteria against which each application should be judged. Exemptions from taxation were governed by the definition of the term "*charitable purposes*". Section 2 sub-section 14 of the 1979 Ordinance defined this as :

> *"Charitable purpose includes relief of the poor, education, medical relief and the advancement of any other object of general public utility*"

[3] NGORC. 1991. NGO Registration Study. Volume 1. Policy Research Report. Aga Khan Foundation and NGORC, Karachi.

The Income Tax Ordinance, 2001 has for the first time introduced the term "*non-profit organisation*". The definition as contained in sub-section 36 of section 2 of the Ordinance and amended by the Finance Ordinance, 2002 states:

> *"non-profit organisation" means any person -*
>
> *(a) established for religious, charitable, educational, welfare or developmental purposes or for the promotion of amateur sport;*
>
> *(b) which is registered under any law as a non-profit organisation and in respect of which the Commissioner has issued a ruling certifying that the person is a non-profit organisation for the purposes of this Ordinance; and*
>
> *(c) none of the income or assets of the person confers, or may confer a private benefit on any other person.*"

Since the term "*charitable purposes*" had not been defined in the 2001 Ordinance, this was introduced through an amendment contained in the Finance Ordinance, 2002 by the addition of clause 11 (A) in Section 2 which reads

> *(11 A) "charitable purposes" includes relief of the poor, medical relief and the advancement of any other object of general public utility*".

The term "*person*"used in the context of an NPO has been defined in Section 80 of the 2001 Ordinance and covers all types of organisations ranging from the individual to a company. One hopes inadvertently, this Ordinance does not extend the recognition as a non-profit organisation to either a Society registered under the Societies Registration Act, 1860, or a Voluntary Social Welfare Agency (VSWA) registered under the Voluntary Social Welfare Agency (Control and Regulation) Ordinance, 1961. In other words, a Society and a VSWA are not eligible for being granted tax exemption. However, Section 4 of the 2001 Ordinance states that every "*person*" who has a "*taxable income*" shall pay Income Tax. Since all

Societies registered under the Societies Act and VSWAs under the 1961 Ordinance are not recognised as "*person*", then these are, therefore, exempt *ab initio*.

3.2 Registration for Exemptions

Exemption of income of an "organisation established for charitable purposes" from Income Tax were governed by Section 14 of the 1979 Ordinance and now by Section 53 of the 2001 Ordinance, both of which refer to the Second Schedule of the Ordinances. All applications were earlier made to the Regional/Zonal Commissioner of Income Tax under Rule 41A of the 1982 Rules. Rule 211 of the 2002 Rules requires that applications are submitted to the Commissioner of Income Tax having jurisdiction over the area in which the applicant organisation resides. The 1979 Ordinance required that all applications were mandatorily accompanied by all of the documentation submitted for registration, in addition to the registration certificate, a detailed report of the preceding three years' activities vis-a-vis the aims and objects, and the audited accounts, the tax returns and the assessment orders also for the preceding three years. The last two were required to establish the fact that the income of the organisation was limited to donations and grants from government and/or international aid organisations. All of these were anyway exempt income under international protocol (for the latter) and it was argued that grants from government are derived *ab initio* from resources accruing from taxation and, therefore, should not be taxed again, particularly as these were seen to be made for charitable purposes. The decision for approval or otherwise rested solely with the concerned Regional/Zonal Commissioner of Income Tax.

In the 2001 Ordinance all of the above documents are required mandatorily. However audited accounts, tax returns and assessments orders are required only for the year preceding the application year and the detailed report is to be prepared not by the organisation, but by

an independent authority to be established by the Government of Pakistan and failing that, the Central Board of Revenue. One major distinction between the 1979 and 2001 Ordinance is that the former exempted income through a process granting such exemption. The latter, on the other hand, recognises the organisation as a non-profit organisation and the exemption accrues automatically. This recognition not only exempts the income of the organisations, but also the donation given by any assessee to such organisations.

3.3 Exemption from Tax

Both the Ordinances have given exemptions to specific organisations or to special types of organisations. The first category contains organisations established by the Governments, the Aga Khan Development Network, the Armed Forces and such NPOs which have attained some repute for welfare activities particularly in the medical and educational arenas, such as the Fatimid Foundation, the Al-Shifa Trust, the Shaukat Khanum Memorial Trust, the BCCI FAST, all of which are listed in Clause 91 of the Second Schedule of the 1979 Ordinance and Clause 61 of the same schedule in the 2001 Ordinance. The second category exempts schools and universities provided they do not generate profits. A five year exemption from income tax has also been given for the operation of computer training institutes.

Clause 62 of the Second Schedule of the 1979 Ordinance exempts the income of any welfare institution or trust derived from donations, contributions, subscriptions, house property, investments in Federal Government securities and that part of income from business which is spent for carrying out welfare activities. This has been essentially repeated as Clause 58 of the Second Schedule of the 2001 Ordinance. The only addition to this Clause is its extension to include non-profit organisations. In addition Clause 59 also exempts "profit on debt from financial institutions, grant received from Federal Government or Provincial Government or

District Governments, foreign grants" used for "religious or charitable purposes and is actually applied or finally set apart for application thereto". Both Clauses contain a caveat that the exemption will bear the same ratio as the income from business, the latter sources and the income from securities of the Federal Government and house property is spent in Pakistan bears to that of the total income from these sources. In other words the exemption will be 100 percent if the amount spent in Pakistan is equal to the income from these sources. If, however, the share spent in Pakistan is lesser than only this share will be exempt and the rest attract tax.

Clause 60 of the Second Schedule also exempts that amount of voluntary contribution received by a religious or charitable institution which is spent for these purposes of the institution.

3.4 Exemptions to donors

Applications for enabling donors to claim a rebate in their individual tax liability in proportion to the donation (including articles and goods given) to their total income are governed by Section 47 of the 1979 Ordinance. All applications must be made by the organisation only and must be accompanied by the same set and quantum of documentation required for claiming exemption of income tax on the income of the charitable or religious institution. All applications were made to the CBR through the Income Tax Officer of the Circle in which the organisation is located. The decision for approval rested solely with the regional/Zonal Commissioner of Income Tax in charge of the concerned Income Tax Circle. Section 61 of the Ordinance 2001 continues to permit donation in cash and property only.

There is a limit on the amount of donations that either an individual or an organisation can claim relief on. The limits were revised in the 1998-99 Federal Budget. The Finance Act 1998 contained changes with respect to the kind and level of donations for charitable purposes. Changes to only Section 47 of the Income Tax Ordinance, 1979 have been included. The first notification was with respect to donation of articles or goods. The value and type of such articles or goods would be determined by the Central Board of Revenue. The cap on donations set in absolute terms was replaced finally by a share of income. The limit of 10 percent in the case of companies has been increased to 15 percent. In the case of all other assessees 30 percent of income can now be donated for charitable purposes. These limits have been carried forward in the 2001 Ordinance in Section 61.

3.5 Administrative Requirements: Applications and Audit

The procedure for approval, renewal and withdrawal of approval for the purpose of a comprehensive exemption available under clause(62) of the Second Schedule of the 1979 Ordinance is practised through Rule 41A of the Income Tax Rules 1982. Its counterpart in the 2001 Ordinance is sub-section 36 of section 2 and Chapter XVII (Rules 211 to 218) of the 2002 Rules.

Under the 1979 Ordinance audit reports had to be signed by a Chartered Accountant. The 2001 Ordinance has changed this to suit the size of the organisation. Thus audit reports and audited accounts signed as follows are acceptable:

a A retired officer of Government not below grade-18 or a Bank Manger, provided its receipts and expenditures pass through bank accounts, for non-profit organisations with annual receipts of upto Rs. 0.5 million

b A cost and management accountant for those with annual receipts of over Rs 0.5 million and upto Rs 3 million, or

c A chartered accountant for any amount of annual receipts

4 THE IMPLICATIONS OF THE INCOME TAX LAW

While the Income Tax Ordinance, 2001 and the Income Tax Rules, 2002 are more sympathetic to the sector, they continue to suffer from the discretion in interpretation. For instance, once again, no criteria for recognition has been specified. As a consequence of a lack of a set of criterion to establish the validity of the application and the very limited interpretation of the definition applied by the authorities, there is, therefore, substantial and unbridled discretion available to the sanctioning authority, the concerned Commissioner of Income Tax, who has jurisdiction over the area where the applicant's principal office is located.

4.1 *Definitions*

To be able to restrict the discretion in interpreting the term "*charitable purposes*" Pasha et.al. (1999) had recommended changes in the definition for inclusion in the Federal Budget 1998-99 to amend the Income Tax Ordinance, 1979. This had stated :

> "The definition of "charitable purpose" needs to be clear and more specific in view of the wider and more pronounced role of non-governmental organisations. A clear and specific definition creates confidence and transparency, and restricts the possibility of incorrect interpretation. The existing definition may, therefore, be replaced by the following:
>
> *"charitable purpose" includes*
>
> *(a) relief of poverty,*
>
> *(b) provision of humanitarian or disaster relief,*
>
> *(c) advancement of religion,*
>
> *(d) provision of education, training, or development of human resources by targeting the poor,*
>
> *(e) provision of health, nutrition, or family planning services,*
>
> *(f) advancement of culture or the arts,*

(g) non-commercial research, including scientific, technological, or social research, but not related to armaments or warfare,

(h) promotion of historical or cultural preservation,

(i) promotion of social or economic development primarily for the benefit of economically or socially disadvantaged individuals or groups, including micro-credit programmes,

(j) protection of human rights,

(k) protection or enhancement of the environment,

(l) elimination or reduction of discrimination, or

(m) any other object of general public utility.

Since the Ordinance 2001 has made no change in the definition of "charitable purposes", the earlier recommendation for change should be accepted.

Similarly the term "*public benefit non-governmental organisation*" has not been defined in Section 2. It is, therefore, proposed that a new sub-section be added after sub-section (36) as follows:

(36A) A "public benefit NGO" is any society registered under the Societies Registration Act, 1860, cooperative society registered under the Co-operative Societies Act, 1860, company registered under Section 42 of the Companies Ordinance, 1984, voluntary social welfare agency registered under the Voluntary Social Welfare Agencies (Registration and Control Ordinance, 1961), public and charitable trust registered under the Trust Act, 1882, or a waqf registered under the Mussalman Wakf Validating Act, 1913 and

(i) which is established in Pakistan primarily for the purpose of engaging in one or more charitable purposes, and

(ii) from which no net earnings, profits, or assets can be distributed during the life of the organisation or upon its termination to any member, founder, director, officer, or employee, or to any spouse or blood relative of such a person, and

(iii) that provisions similar to those of Sections 230, 234, 236, 241 and 242 of the Companies Ordinance, 1984 shall apply equally to all public benefit NGOs registered under any enabling law with respect to the maintenance and submission of accounts, and

(iv) that the provisions similar to those of Sections 252, 254, 255, 256 and 257 of the Companies Ordinance, 1984 shall apply equally to all public benefit NGOs registered under any enabling law with respect to the audit of the accounts of the public interest NGO."

4.2 Approvals

The conditions for according approval under the Ordinance 1979 rested on several very restrictive premises:

a that the institution has been formed for the purpose of establishing "hospitals or providing education or for community welfare". This is extremely restrictive unless the term "community welfare" is defined to include even those activities mandated for the proposed Citizen Community Boards under the several provincial Local Government Ordinances, 2000. During discussions with the Ministry of Finance, it has been conceded that taxing the NPOs is a zero sum game, especially if it is recognised that the multiplier effect of such tax exemptions is of the order of 10 to 3, that is a tax sacrifice of Rs 30 will trigger an investment of Rs 100, supplementing the national saving pool by Rs 70, and

b that "it has operated and functioned in Pakistan, at national level for a period of not less than three years". It would appear that this was designed to benefit only a few elite organisations. This excluded the vast majority of potential partners to government from the NPO community. There appears to be no rationale for forcing a good local NPO operating in a Province/region to operate country-wide before extending it some fiscal support. The condition

> should rather be that it has complied with minimum acceptable standards of internal governance, accountability, transparency and efficiency prescribed by law.

The rules make the Central Board of Revenue responsible for determining the qualification of an NPO for tax-exempt status and whether it has or will not be able to achieve its declared aims and objectives. In practice, the papers are sent by the CBR to the Zonal Commissioner of Income Tax who forwards them to either the Assistant or Deputy Commissioner in charge of the circle in whose tax jurisdictions the CSO operates. There has been loud complaint in all the parts of the country that it takes considerable time, effort and incurs informal costs, (there is no fee required with the application) before a recommendation goes back to the Zonal Commissioner. Apart form the multi-tier processing, the documents required in verification are demanded, piecemeal. The whole process of initial approval and annual renewals can take up to a few years initially and up to six months each time.

It is heartening to note that the 2002 Rules do not lay down any such conditions, and are in fact extremely liberal. The 2001 Ordinance speaks of an independent agency for data based investigation, verification, certification and the procedure is now more user-friendly. The 2002 Rules have introduced a time limit for decisions on any applications. Rule 216 states clearly that the decision must be finalised, either way, within **two months** of receipt of the application. Rule 212 of the 2002 Rules clearly stipulates that the life span of any approval would be only until the 31st of December of the year following the one in which approval has been given. With the proposed arrangement for verification, certification and rating, it should be possible for the CBR to grant renewals for 3 to 5 years depending on the rating of the applying organisation. Discussions with the Central Board of Revenue indicates that it is considering that renewals could be for three years in the future. The CBR should implement

this as it would not only foster the development of the Non Profit sector, but also reduce its administrative burden, and last, but not the least, improve its image and public relations with the citizens at large.

The cap placed on the time within which decisions should be taken (2 months from receipt of complete in order applications) should also be to the benefit of organisations applying for being given the status of a non-profit company by the CBR.

4.3 Exemptions

By widening the scope of the income which is tax free, the Government has provided an avenue to the NPOs to invest in securities which yield a higher return than the securities of the Federal Government. Further by specifying that grants from District Governments are also exempt, the government has recognised the need for public-private partnerships at this level for both infrastructure development and poverty reduction and has, therefore, developed an enabling environment for such partnerships to flourish through the fiscal regime.

4.4 Donations

Section 61 of the 2001 Ordinance (donations to approved organisations) is essentially the same as Section 47 of the 1979 Ordinance. The critical parametric change is that the "in kind" donations is restricted to only property. This is very limiting as, in fact, some of the non-profit organizations are receiving donations in the form of free services of experts for their projects with the donor bearing the pay-roll and related costs imvolved. It would, therefore, equitable to continue this "in kind" donation over to the new Ordinance and include "goods, articles and services" in Section 61.

4.5 Other Issues

NPOs, like all other organisations outside the public domain, are also tax collectors on behalf of the CBR. They are required to deduct income tax from suppliers of goods and services and from employees salaries and allowances and deposit these with the Treasury. While this is not too burdensome, it has placed a substantial cost on all organisations wishing to recruit and maintain staff of the highest calibre. This is particularly so for the policy research and development organisations in the non-profit sector. In 1996, the government introduced a tax on allowances in the pay package of employees, it provided some relief to those organisations who were paying tax free salaries or some portion of the tax to employees. In the past these taxes were added back to salaries and the gross was taxed until the gross reached a level where the employers liability of tax reached zero. As a consequence the non-profit policy research and development organisations were for the first time able to offer tax free salaries to staff. Unfortunately, the Income Tax Ordinance 2001 has re-introduced the concept of tax-on-tax through Section 12 (3), thereby reducing the ability of most, if not all, such organisations to retain their staff.

It would not be unrealistic to assume that such staff would fall into the highest tax bracket. In this instance the liability of the employers would increase by nearly 50 percent. While this may not be outside the affordable limit for profit-making organisations, it is certainly outside the levels of change that can be afforded by even the most well endowed policy research and development organisations in the non-profit sector. All such organisations will be the poorer, not only financially, but skill-wise also, for this provocative act on the part of the Ministry of Finance.

One wonders whether this was done deliberately in the pursuit of higher revenues. If so, then the result could well be counter-productive. The government would be well-advised to repeal this section from the law.

Another major irritant which has been introduced by the 2001 Ordinance is in Section 13 (7) which states in effect that interest free loans to employees would be treated as interest-bearing loans. The interest would be assumed to be that for government treasury bills, currently yielding over 8.5 percent annually. The section states that this would be treated as accrued income in the hands of the organisation. Since such interest income has not been exempted for NPOs, they would be liable to pay tax on this even though they are approved undertakings.

One fails to understand the logic of this act by the government. On the one hand they espouse the cause of a *riba*-free economy. On the other hand, they treat interest-free loans to employees contrarily. The government would gain substantial brownie points if they were to repeal this section.

5 CONCLUSION

In conclusion one can state that the government has begun making strides to create a truly enabling fiscal environment to ensure the financial sustainability for the non-profit sector organisations. It has made changes, some for the benefit of the sector, but it has also introduced some non-beneficial sections in the new law, perhaps inadvertently. On the whole, however, the regime is much more friendly to the sector.

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THE INCOME TAX REGIME AND THE NON-PROFIT SECTOR THE CASE OF PAKISTAN

BY

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