OICCI TAXATION PROPOSALS 2014-2015

PROVINCIAL TAXES AND LEVIES

April, 2014

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EXECUTIVE SUMMARY

INTRODUCTION

The Overseas Investors Chamber of Commerce and Industry (OICCI) has always endeavored to contribute to Pakistan's tax reforms by providing input to revenue authorities on various tax and revenue related issues.

As an important stakeholder in the tax reforms process 196 OICCI members paid Rs. 700 billion as taxes to the Federal and Provincial Revenue Authorities, representing over one third of the revenue collections in the country, in the last fiscal year.

OICCI has already forwarded the Taxation Proposals to the FBR for the National Budget 2014-15, and to other relevant stakeholders.

We are now enclosing the Taxation Proposals for the Punjab Provincial Budget and would like to discuss/ explain these proposals to all the relevant Punjab government officials, so that the same can be incorporated in the Punjab Budget for 2014-2015.

All Revenue Collections Under One Ministry/Body

1. Integration of all Revenue Collections

For ease of doing business OICCI recommends that all divisions of revenue collection should be merged under one Ministry/Body. The existing revenue collecting authorities/boards are as follows:

- Punjab Revenue Authority (PRA)
- Excise & Taxation
- Board of Revenue (Punjab)

Tax Broadening Measures

2. Agricultural Income Tax

As per the constitution of Pakistan, right of taxing income lies with the federal government except income from agriculture which is taxable under provincial laws.

Agriculture related activities contribute around 20 percent of GDP, however, the collection of agricultural income tax is estimated to be even less than 1% of total collection of Federal and Provincial taxes.

The government should take all possible measures to increase revenue collection to ensure a proper balance between revenue and necessary expenditure, including financing of development projects to improve physical and administrative infrastructure of the province and enhancing energy capacities.

Additional taxes should not be raised from those who are already paying taxes honestly and diligently but the increase in tax collections should be made from those entities and individuals whose income has so far either been exempted from taxes or who have avoided paying their due share of taxes.

The biggest exempted sector is agriculture which hardly contributes to the national or provincial exchequers, despite the fact that over 65% of Pakistan's population is directly or indirectly linked with the agricultural sector. The original rationale of keeping agriculture out of tax net was to facilitate the small agriculturists. However due to non-implementation of land reforms the benefit of the tax exemption is being availed by big landowners earning huge incomes. Furthermore, income and wealth is also transferred by unscrupulous elements to businesses fronting as agriculture sector.

Main issues related to agriculture income are identified as follows:

- **Principle of Non-Discrimination:** In principle, income from all sources, including agriculture, if exceeding the minimum threshold applicable for other sources of income should be taxed without any discrimination.
- **Determination Basis:** Determination of net taxable income from agriculture is a difficult task, therefore an easily applicable manner of determining such income should be designed.
- **Flexible Income Based System:** At present, the Agricultural Income Tax has effectively become a land tax, based on land holding, that leads to the perception that there is no tax on agricultural activities.
- **Identification and Linkage with National Tax Number:** There is no identification of agricultural income taxpayer and the same is totally divorced from national tax number system

- **Administration:** There is no apparent effective manner of recovery. This reflects the very low importance being given to the recovery of agriculture tax.

Recommendation

In light of the above, following proposals are made:

a) <u>Income Based System:</u> At present, the tax is payable on 'land holding' or 'net income' whichever is higher. However, the manner of determination of net income is complicated and therefore in almost 100% of the cases tax is received on land holding basis. This discourages the taxation on net income basis. It is therefore suggested that in case of land holdings exceeding a certain size, the taxability of income on land holding be abolished and in all such cases, taxes should be collected on 'net income basis';

b) <u>Adjustable withholding tax:</u> A system of withholding tax at source should be introduced on supply/sale of agricultural produce such as sugar cane, wheat, cotton and others. There are very few agencies and enterprises which acquire such crops. The amount withheld should be adjustable against net income tax payable on net income basis. Rates of withholding and the threshold for the same are to be determined principally in line with other products – for example any payment exceeding Rs 25,000 should be subject to withholding at the rate of 1 to 3 percent as the case may be. Federal taxation system may be used for such collection on behalf of the provincial government in the same manner as is being done in other cases by the provincial government.

c) <u>Link and Interface with the National Tax Number:</u> All persons holding land exceeding the minimum threshold prescribed in the law should be required to have a Tax Number. For example National Tax Number (NTN) system maintained by FBR may be used with appropriate modification, adding one or two digits so as to identify that source of income is agriculture. [PRAL facilities may be used for such purposes in coordination with NADRA].

d) <u>Definition of Agricultural Activity:</u> Definition of agricultural income should be amended to include all agricultural activities like dairy farming and poultry etc.

e) <u>Rent for the Use of Agricultural Land:</u> Under the specific provision, the rent for use of agricultural land, which is general practice especially for large landowners, is an agriculture income. In common terms this is called 'Patta". All receipts from such sources represent agricultural income. There is effectively no mechanism to ensure completeness of recovery of taxes from such receipts. Such rent income should be subject to same rate of tax as is currently in vogue on property income under the FBR system.

SALES TAX ON SERVICES

3. Coordination Between Provincial Sales Tax Authorities

After the promulgation of provincial legislations the taxability of services continues to be a dilemma. Both the Provincial revenue collectors of Punjab and Sindh have been pursuing the taxpayers with regard to deposit of tax/duty within their respective jurisdiction, creating undue hardship for taxpayers.

Recommendation

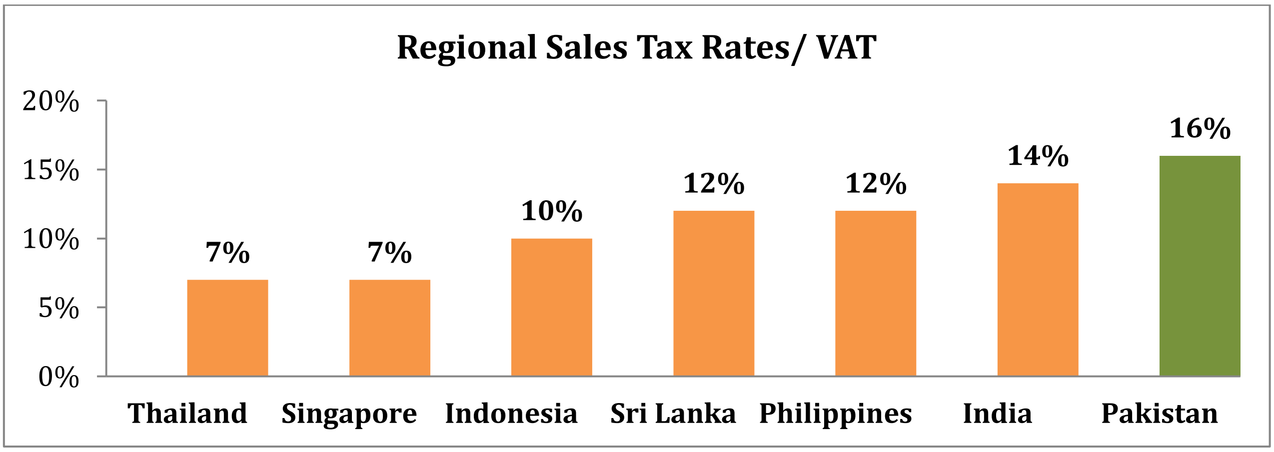
The provincial revenue boards should agree on jurisdictions so that issues of 'origin' and 'consumption' on services are settled, including basis of apportionment of revenues.

Rationale or Benefit

Duplicate taxation is causing hardships to taxpayers and has given rise to unnecessary litigations.

4. Reduction In Sales Tax Rate

Sales tax rate in Pakistan is very high as compared to Global tax rates. Sales tax rate should be reduced to 12.5% in order to reduce the already soaring cost of doing business in Pakistan.



Recommendation

Tax rate should be reduced to 12.5% in the next coming budget and should further be gradually reduced to 10% over the next three years for registered entities whilst the current rate should be maintained for unregistered entities. This reduced rate will encourage the registration of the unregistered taxpayers to avail the benefits of input adjustment.

5. Admissibility of Input Sales Tax

[Section 19, Chapter III of Punjab Sales Tax Act, 2012]

The section states that input tax may not be claimed by a registered person on the goods in respect of which sales tax has not been deposited in the Government treasury by the respective supplier. It is an unreasonable expectation by tax authorities from the buyer to ensure the deposit of the sales tax into Government Treasury by the seller, as the buyer does not have any enforcement power over the seller.

Recommendation

Section 19 should be suitably amended in-line with section 4 of chapter 1 of Punjab Sales Tax Act 2012, to exclude the taxpayers falling under Large Tax Payers Unit who are already subject to greater scrutiny and tax audits.

Rationale or Benefit

This will remove the undue pressure on legitimate taxpayers, as it is not the responsibility, neither the jurisdiction of the service recipient to ensure that the supplier has deposited output tax. Furthermore, legitimate taxpayers will not face harassment from tax authorities.

6. Use of technical knowhow/ information for manufacturing be eliminated from the definition of "Franchise services" and Input Tax adjustment be allowed against Franchise Services

The definition of "Franchise Services" is very broad and generic that covers technology transfers being made through use of technical knowhow/ information for manufacturing in Pakistan, which generates employment, saves foreign cash outflows for imports and contributes to society.

Recommendation

Use of product knowledge, technical know-how/ information for manufacturing should not be included in the definition of "Franchise Services".

7. Claim of Input Tax

As per rule 2 sub rule 3 of the adjustment of tax rules to the Punjab Sales Tax on Service Act, 2012 the input tax has to be claimed within next four months from the relevant tax period.

Recommendation

It is recommended that claim/adjustment period of input tax should be increased to six succeeding tax periods.

8. Definition of registered person is not concrete

2(33) "registered person" means a person who is registered or is liable to be registered under the Act but the person liable to be registered and has not registered shall not be entitled to any benefit available to a registered person under any of the provisions of the Act or the rules;

Recommendation

Definition proposed as, "registered person" means a person who is registered under this Act or any other person or class of persons notified by the Board in the official Gazette.

For PRA, only the person registered under PSTSA should be considered as registered person and not otherwise.

Rationale or Benefit

These words make the definition very vast. Especially when applying withholding sales tax, banks cannot determine a registered person, who is liable to be registered.

9. Exemption/Reduction of Withholding Agents from deducting Sales Tax from payments to unregistered persons

At present under Punjab Sales Tax on Services (Withholding) Rules 2012), where a service is provided by an unregistered person, the liability to pay the tax shall be on the person receiving the service.

As per Rule 5, in case of services obtained from registered or unregistered person (other than Company) whole amount of tax would be withheld.

Recommendation

Withholding agents should be exempted from deducting Sales Tax from payments to unregistered persons.

OR

Sales Tax @1% should be deducted from payments to unregistered persons (as applicable under Federal Sales Tax Act 1990)

Rationale or Benefit

The withholding agents are unnecessarily burdened with deduction of sales tax which is not claimable as input tax and is thus resulting in increasing their cost of doing business. Similar matters have already been decided by the courts in case of sales tax withholding rules of FBR and PRA. The ultimate objective of the taxpayer is that indirect tax should not increase its cost of doing business. Moreover these enforcement measures have negative bearing on the regulated sector only.

10. Input of sales tax should be allowed as whole and not for the assets exclusively used in a province.

(Punjab Sales Tax on Services (Adjustment of Tax) Rules 2012)

Currently input tax can be claimed on the supplies which are only related to the services provided for the province of Punjab, and which have been used exclusively for rendering of services. (Rule 4)

Recommendation

Input tax claim should be allowed, on the basis of gross sales tax paid in proportion of taxable services provided, including the capital goods as work in process.

Further province wise segregation should not be required, and inter provinces tax payments should also be allowed for input claim.

Rationale or Benefit

In case of Banks most of the major purchases are made centrally through the Head Office (HO), and systems and HO setups are used to provide the services to the entire Bank. Input regarding Sales tax should be allowed for the entire sales tax paid, whether used exclusively or not, credit can be allowed in proportion of taxable services for each province.

WORKERS PROFIT PARTICIPATION FUNDS (WPPF)/ WORKERS WELFARE FUND (WWF)

11. Workers Profit Participation Fund / Workers Welfare Fund

Under the present rules, WPPF has to be paid to the workers by a company @5% of its' accounting profit. WPPF is not allocated in full to the workers of the company due to salaries of most workers being more than the thresholds mentioned in the WPPF laws for entitlement. Consequently, significant portion of the WPPF contribution by the company, which remains unallocated, is deposited in the Government Treasury as WWF. In addition WWF @2% of taxable income has to be paid to the government at the time of the annual filing of tax return. It is pertinent to state that the workers of a company do not receive any direct benefit from the amount deposited by the companies in WWF. Large corporations have been paying billions of rupees towards WPPF/WWF over the years with no consequential relief for their workers.

Recommendation

Upper slab of workers' salary be removed, so that all the workers are entitled to enjoy distribution of WPPF, irrespective of their salary. Alternatively, utilization of WPPF by the company itself should be allowed through creation of a fund, for the interest of their own workers who contributed towards the generation of the profit.

Moreover, fund contributing companies should be allowed to utilize the excess allocation of WPPF for the benefit of their workers (instead of depositing the excess in WWF) or at least be allowed to retain a certain percentage of the excess amount for the benefit of their workers such as building schools, hospitals and so on.

Rationale or benefit

Benefit of the WPPF should go directly to the workers. Utilization of WPPF by the company itself through a fund for the interest of their own workers will help ensure that the money is being utilized for the direct benefit of the employees. It will also improve the cost of doing business, ultimately increasing the profitability of the company.

12. Interest on delayed payment of WPPF

The section 2 (e) schedule scheme clause 2 'Investment in fund' states that

'The Company shall pay to the Fund in respect of the amount in the Fund available to it for its business operation as aforesaid at the rate of 2.5 percent above the bank rate or 75 percent of the rate at which dividend is declared on its ordinary shares whichever is higher'

Recommendation

It is proposed to link the mark-up rate with KIBOR only.

Furthermore, due date for payment of WPPF to the fund to be within 60 days after the close of financial year so that the companies are able to make an accurate judgment of their WPPF liability and instances of over/ under payment to the fund may be avoided.

Rationale or benefit

It will avoid the undue pressure on the tax payers