



OICCI TAXATION PROPOSALS 2015-2016



PUNJAB PROVINCIAL TAXES AND LEVIES

April, 2015

TABLE OF CONTENTS

Page Nos

Executive Summary 03

• All Collections Under One Ministry/Body 04

• Tax Broadening Measures 04

• Sales Tax on Services 06

EXECUTIVE SUMMARY

INTRODUCTION

The OICCI, a business chamber representing nearly 200 multi-national companies operating in Pakistan, is a major stakeholder in the economy of the country. OICCI members contribute over PKR 725 billion annually to the Federal and Provincial revenue authorities, representing over one third of the revenue collections in the country in fiscal year 2013-14. The voice of the Chamber resonates across the world as shareholding of member companies is from thirty five different countries of the world and they operate in fourteen major business sectors of the country, including the financial services, oil, gas, energy, pharmaceuticals, chemicals, fertilizers, pesticides, cement, food, consumer goods, engineering, trading and other areas. Fifty seven of the OICCI members are listed on the stock exchanges of Pakistan and fifty members are associates of the five hundred largest companies of the world listed by the Fortune magazine in 2014.

The OICCI has always endeavored to contribute to Pakistan's tax reforms by providing input to revenue authorities on various tax and revenue related issues and after submission of Taxation Proposals to the FBR for the National Budget 2015-16, we are now enclosing the Taxation Proposals for the Punjab Provincial Budget 2015-16.

OICCI 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 2015-2016.

All Revenue Collections Under One Ministry/Body

1. Integration of all Revenue Collections

Currently revenue collections of the Province of Punjab fall under the following Ministries/Bodies;

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

OICCI strongly recommends that all revenue collections should be merged under one Ministry/Body. This would add considerably to the ease of doing business (EODB), a matter which should be a priority for all policy makers in the country since the annual World Bank survey shows that Pakistan has fallen fifty three positions, from 75 in 2010 to 128 in 2015, in the WB EODB survey.

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 by the provinces – for Sindh under the Sindh Land and Agricultural Income Tax Act, 2000 and for other provinces under the respective 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 Sindh 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, enhancing energy capacities and creating employment opportunities.

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 to facilitate small agriculturists is not applicable, due to non-implementation of land reforms, and 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 even the small number of agricultural income taxpayer as they are not on the national tax number (NTN) system
- **Administration:** There is no effective manner of recovery. At present the collection is assigned to Sindh Board of Revenue. We understand that there is no Member in the SBR for Agriculture Tax. 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) **Income Based System:** 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) **Adjustable withholding tax:** A system of withholding tax at source should be introduced on supply of cash in return for sale of agricultural produce such as sugar cane, wheat, cotton and others. There are only around 10 to 15 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) **Link and Interface with the National Tax Number:** All persons holding land 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) **Definition of Agricultural Activity:** Definition of agricultural income should be amended to include all agricultural activities like dairy farming and poultry etc.
- e) **Rent for the Use of Agricultural Land:** 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 Federal/Inter-Provincial Sales Tax Authorities

After the promulgation of provincial legislations the taxability of services continues to be a dilemma. Both the Federal and Provincial revenue collectors (Sindh, Punjab and KPK) have been pursuing the taxpayers with regard to deposit of tax/ duty within their respective jurisdiction, as per the provincial/federal laws, creating undue hardship and double taxation claims for taxpayers.

Recommendation

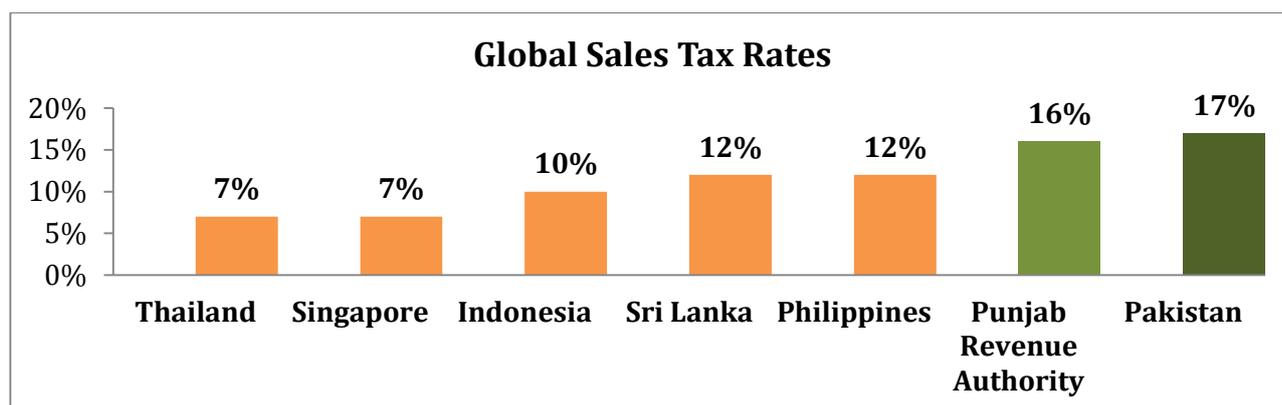
All the revenue boards should agree on jurisdictions and common rules so that issues of ‘origin’ and ‘consumption’ on services and claim of input taxes should be clarified in a simple and understandable manner, including basis of apportionment of revenues. Secondly, the resolution should be facilitating for the taxpayer, rather than creating hardship in compliance. The tax allocation should be done by the revenue authorities without creating hardship for the taxpayers.

Rationale or Benefit

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

4. Reduction In Sales Tax Rate

OICCI commends the PRA for a number of steps introduced over the last couple of years to streamline the sales tax on services structure, which has given a positive message to investors based in Punjab. However the sales tax rate continues to be very high – even in comparison to the sales tax rate on services in the province of Sindh, which is 1% lower than the Punjab province sales tax rate on services of 16%.



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. Reduction In Sales Tax On Telecom Services

The high growth rates of cellular Industry in Pakistan have slowed down due to various reasons which include higher taxation. Pakistan cellular industry is one of the highest taxed in the region. This relative decline in growth has resulted in decrease in revenue from cellular industry.

Recommendation

Currently, sales tax rate on telecommunication services is 19.5%. It is proposed that this should be brought at par with other services - sales tax on telecom services be equivalent to general Sales Tax rate on services, in order to harmonize all sales tax on services rates. This will increase the tax collections by helping telecom operators tap lower income population of Pakistan.

6. 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.

7. Admissibility of Input Sales Tax on Advertisement

Punjab revenue authority has disallowed input tax claim in respect of advertisement services.

As per Rule 13(2) of Punjab Sales tax on services (withholding) Rules, no adjustment or credit shall be admissible to the persons registered under the Act in case of the tax deducted or withheld and paid in respect of advertisement services”.

Recommendation

Rule 13(2) should be abolished from the withholding Rules by giving the legal right to claim of input tax to service provider in respect of advertisement services.

Rationale or Benefit

This is a legal right of the tax payer to claim input tax paid on providing taxable services also this rule is against the VAT mode.

8. Chargeable Services To Be Classified As Zero Rated Services

Presently exports of goods are charged to tax at the rate of zero percent (zero rated) under the Sales Tax Act, 1990. This facilitates the claim of input tax relating to such goods and encourages the economic development of the Country through improvement in inwards remittances and resultantly the balance of payments.

The amounts received by the Long Distance International License Holders including Pakistan Telecommunication Company Limited on international incoming calls under agreement with the foreign telecommunication companies are of similar nature and represent significant inwards remittance contributing to improvement of Rupee to Dollar parity.

Recommendation

We recommend that the above mentioned services should be classified as zero rated services. This will result in harmonization of tax laws in Pakistan and would ensure convenient compliance with tax laws through uniform systems across the country and would also contribute towards the economic development of the Country.

9. 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”.

10. 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.

11. 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.

12. 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.

13. 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.

14. FED on Franchise Services - Second Schedule

The rate of FED imposed on Franchise Services is 16% which is higher than rate of 10% imposed by Sindh Revenue Authority or Federal Board of Revenue

Recommendation

It is recommended that rate of FED in Punjab should be aligned with that of other region.

Rationale or benefit

Disparity in cost of doing business in various provinces will be reduced.