OICCI TAXATION PROPOSALS 2014-2015

PROVINCIAL TAXES AND LEVIES

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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 annually 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 upcoming Sindh Provincial Budget and would like to discuss/ explain these proposals to all the relevant Sindh government officials, so that the same can be incorporated in the Sindh Budget for 2014-2015.

MULTIPLE TAXES AND INCREASED COST OF DOING BUSINESS

The cost of doing business in Sindh has increased significantly on account of various levies, taxes and other costs which were not applicable in the recent past, including a very high expense outlay on security related matters as the law & order situation of the province has become a major concern for investors. Though the availability of a relatively better infrastructure, with port facilities, has attracted the investors to the province, the current energy crises, with consequent steep rise in energy costs, combined with the new levies and taxes has started de-motivating investors.

Currently following taxes and levies are collected by the provincial government which is contributing towards the increase in the cost of doing business;

1. **Sindh Sales Tax on Services**
2. **Stamp Duty**
3. **Sind Development & Maintenance of Infrastructure (SDMI)**
4. **Marking fee**
5. **Market Fee**
6. **Professional Fee**

All the above taxes impact the decisions of new investors. The Sindh Sales Tax on Services also includes provisions which adds to the cost of current entrepreneurs, especially when it is not levied in the true form of an indirect tax

OICCI strongly recommends taxes should be levied keeping in mind the cost of doing business not only in other parts of the country, but with other regional countries as well. Secondly, the taxes should be levied rationally, e.g. marking fee and stamp duty, are charged without any concrete rationale and without considering its negative impact on business. Furthermore, levying taxes/duties/fees without considering its impact on the business gives rise to litigation, which is neither beneficial to taxpayer nor for the collector. The consolidation of taxes will also make compliance easy for taxpayer. We also suggest that tax free zones should be set up in the province to attract FDI.

All Revenue Collections Under One Ministry/Body

1. Integration of all Revenue Collections

OICCI recommends that the following present division of revenue collections should be merged under one Ministry/Body.

- Ministry of Finance - Sindh Revenue Board (SRB)
- Ministry of Excise and Taxation and
- Sindh Board of Revenue (SBR)– responsible for taxes on all transactions related to immovable property, stamp duties and agriculture tax

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 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.

As mentioned at the very beginning, 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 and

- **Administration:** There is no effective manner of recovery. At present the collection is assigned to Sindh Board of Revenue. 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:

1. **<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';**
2. **<u>Adjustable withholding tax:</u> 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 many other cases by the provincial government.**
3. **<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].**
4. **<u>Definition of Agricultural Activity:</u> Definition of agricultural income should be amended to include all agricultural activities like dairy farming and poultry etc.**
5. **<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 Federal and Provincial revenue collectors (Sindh and Punjab) have been pursuing the taxpayers with regard to deposit of tax/ duty within their respective jurisdiction, creating undue hardship for taxpayers.

Recommendation

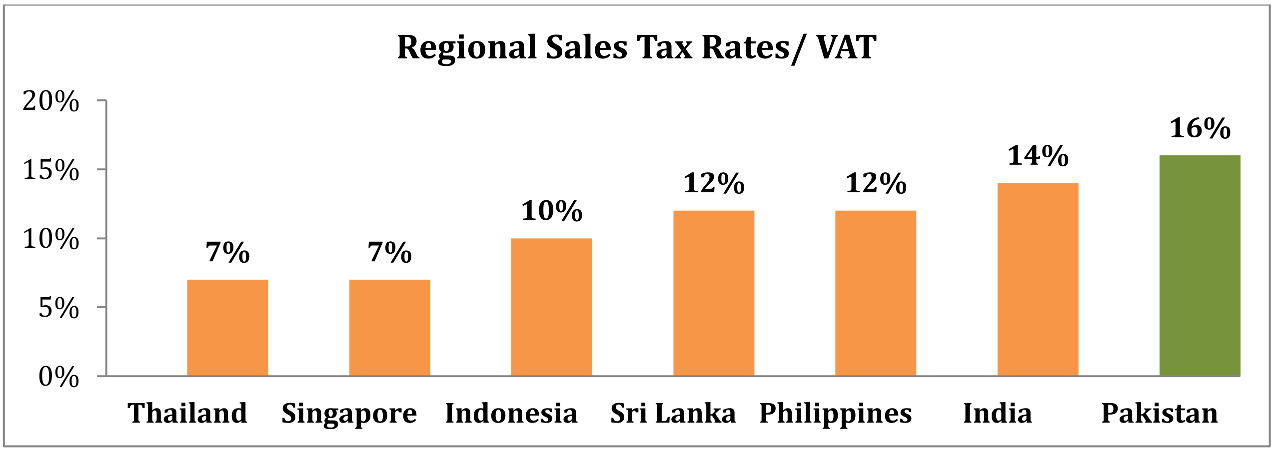
All the provincial revenue boards should agree on jurisdictions so that issues of 'origin' and 'consumption' on services are settled, including basis of apportionment of revenues. Secondly, the resolution should be facilitating for the taxpayer, rather than creating hardship in compliance. The tax allocation between the provinces should be done by the provinces themselves.

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. Clarity on Scope of Taxable Services

[Second Schedule to the Sindh Sales Tax on Services Act, 2011]: The services mentioned in the Second Schedule are not conclusive in nature which gives rise to disputes between service providers and revenue authorities. It may be noted that except for chapter 98 of the Custom Tariff, the international commentary issued by the World Custom Organization in the form of explanatory notes is available, which is used as a reference in resolving interpretational issues. Therefore, the chances of disagreement increase, because the Second Schedule is not conclusively drafted.

Recommendation

The description of services listed under Second Schedule should be precise and clear or further clarified so that over-lapping situation/ interpretational issues do not arise, e.g. services under PCT headings: 'Services provided and rendered by persons engaged in contractual execution of work or furnishing supplies' (9809.0000) and 'contractors of building, roads and bridges, electrical and mechanical works, horticultural works, multi-discipline works and similar other works' (9814.2000).

Rationale or Benefit

Once the above clarifications are done ambiguities and disputes in determination of taxability as well as withholding of tax by the service recipient will not arise.

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

At present under Section 9 of the Sindh Sales Tax on Services Act, where a service is provided by an unregistered person, the liability to pay the tax shall be on the person receiving the service.

Further, as per Sindh Sales Tax Special Procedure (Withholding) Rules, 2011, a withholding agent is required to deduct sales tax at applicable rate against any taxable services obtained from unregistered persons at gross value of the services.

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.

7. Admissibility of Input Sales Tax

[Section 18 Sindh Sales Tax on Services Act, 2011 read with rule 22A of the Sindh Sales Tax on Services Rules, 2011]

The rule 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 18 should be suitably amended 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.

8. Sales Tax On Royalty/ Technical Fee For Franchise Relationship

The franchise fee is chargeable on reduced rate under the Sindh Sales Tax on Services Act 2011 and is not allowed to be adjusted against the output tax liability; hence it is a cost to the franchisee.

Section 3(2) read with 9(2) of the Sindh Sales Tax on Services Act give rise to a situation where the taxable services received from a non-resident will be taxed in the hands of recipient. Further, the input tax on said services will not be available for adjustment. However, we understand that the said provisions will be applicable on the recipient of franchise service only.

Recommendation

We recommend that the franchise fee should be brought in VAT regime so that it can be adjusted against output tax liability. Further, a suitable process should be made for claiming input tax from a non-resident.

Clarity should be provided on the applicability of "reverse charge".

9. Use of technical knowhow/ information for manufacturing be eliminated from the definition of "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".

Rationale or Benefit

Taxpayers suffering from increase in cost of doing business even on account of technology transfers will get some relief and provide an incentive to foreign investors.

10. Threshold for exemptions

Threshold for exemptions described under Notification issued by SRB vide S.R.B.-3-4/3/2011 is not clear from the point of view of the withholding agent.

Recommendation

It needs to be clarified whether the threshold of Rs.50 million is applicable on the service providers engaged in contractual execution of work on the basis of the contract entered into with the withholding agent or this threshold is determined on the basis of total revenue of the contractor during the financial year involving various contracts.

Rationale or Benefit

Interpretational issues should not arise while determination of taxability as well as withholding tax by the service recipient.

11. Claim of Input Tax

The input tax can only be claimed if the same is paid rather than following the accrual method of accounting. Further, the input tax has to be claimed within next four months from the relevant tax period. This restriction will give rise to filing of refund which resultantly brings administrative hassle to taxpayer and tax collector.

Recommendation

It is recommended that claim/adjustment period of input tax should be increased to six months and adjustment should be allowed on payable basis rather than paid basis i.e. in line with the mechanism adopted by FBR.

12. Sales Tax on Services for Pharmaceutical Inputs

All pharmaceutical products are exempt from Sales Tax. Consequently any sales tax paid by pharmaceutical industry on goods or services purchased, can neither be passed on to the consumer nor can be claimed as input, and has to be absorbed by the manufacturers in their costs. It is resulting in increasing the cost of doing business, amidst already spiraling inflation, and frozen prices of finished products.

This is also against the philosophy of sales tax which is supposed to be borne by the consumer.

Recommendation

Services received by pharmaceutical industry should be zero rated.

13. Introduction of Zero-Rating

As per the Fifth Schedule to the Sales Tax Act 1990, exports made by a registered person are zero-rated. Presently, there is no concept of zero-rating in Provincial Sales Tax Acts. Resultantly, the companies providing services to foreign companies and bringing foreign exchange in Pakistan need to pay sales tax from their own account.

Recommendation

A separate schedule should be inserted in Provincial Sales Taxes Act for zero rating and exempt services.

14. Common Sales Tax Return Filing Portal

Requirement specification for FBR, SRB & PRA should be same for filing of monthly sales tax return rather than submitting same return at different portals, one portal accessable to all tax authorities should be there.

Recommendation

This would save operational cost of taxpayer as well better visibility for Federal and provincial tax authorities.

15. 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 to GOP from cellular industry.

Recommendation

Currently, telephone usage is subject to sales tax rate of 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, in order to harmonize all sales tax rates. This will increase the tax collection by helping telecom operators tap lower income population of Pakistan.

16. Provincial Sales Tax on 'toll manufacturing':

Punjab and Sindh provincial governments are treating toll manufacturing activity as a 'service' and have levied sales tax at the rate of 16 percent effective July 1, 2013. Notwithstanding the fact that toll manufacturing is not a 'service' and therefore outside the constitutional scope of Provinces to charge PST, such a levy has directly increased cost of doing business, especially for pharmaceuticals which are exempt from Federal Sales Tax. It may be noted that toll manufacturing activity, since inception of sales tax regime, has always been treated as 'a manufacturing activity'. Since pharmaceutical and some other supplies are exempt from sales tax under the FST Act, no Federal Sales Tax was leviable under the FST Act. The position is further aggravated owing to the fact that prices of pharmaceutical products are regulated by Drug Regulatory Authority of Pakistan; therefore effect of such levy has to be borne by pharmaceutical company itself.

Recommendation

"Toll manufacturing" should be deleted from the list of services.

Rationale or Benefit

It will bring practice in line with the norm besides reducing cost of doing business.

17. Chargable 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.

18. Party Wise Break-Up Of Output Tax

As per FBR law, SRO 530(I)/2008 dated June 11, 2008, utility companies such as electricity, gas, phone and mobile phone, etc. are not liable to submit monthly sales summary to the Sales Tax return. This relief was provided keeping in view the fact that such companies have a very large customer base (exceeding 30 million in most cases) and provision of customer wise information is not practicable. The relief was withdrawn through a similar SRO in 2009, however it should be noted that ordinary uploading mechanisms (such as Microsoft excel) support rows in thousands, rather than millions, and accordingly uploading of the complete information would require data in several files which may result in great time delays, errors or IT malfunctions / corruptions.

Recommendation

In view of the above, we recommend that an exemption in this regard should be available in the Sindh Sales tax Act since customer wise detail is not practically possible to be uploaded on SRB Web portal.

OTHER LEVIES

19. Stamp Duty

The definition of the term 'instrument' as contained within the Stamp Act 1889, applicable for the province of Sindh, was amended in 2006 to broaden its scope. Subsequently through an amendment in the Sindh Finance Act of 2009, the term Purchase Order (PO) was included to the stamp schedule for purposes of levy of the stamp duty on POs generated at the rate of 0.2% of the amount of the PO. The progressive nature of the tax is increasing the cost of doing business and further raises the issue of double taxation, in the presence of income and sales tax as direct and indirect taxes respectively. The levy is currently enforced only in Sindh and therefore causes serious hardships for corporate sector registered or carrying out business in Sindh Province as against other provinces.

Recommendation

It is recommended that the Stamp Duty on PO @ 0.2% should be eliminated as it is a tax on 'instrument' and not on a transaction. If it is not a transaction tax on purchase then there can't be a dual charge under the constitution on same nature of transaction.

Furthermore, Stamp Duty is payable on enforceable instruments. PO in commercial sense is a document only acknowledging the transaction that will be undertaken and the PO in the ordinary commercial sense does not fall within the ambit of Stamp Act.

20. Sindh Development & Maintenance Infrastructure Fee/ Cess

Sindh Finance Act, 1994 (as amended from time to time) levied Cess/ Fee for the maintenance and development of infrastructure on all imports.

Recommendation

It is proposed that Sindh Development & Maintenance Infrastructure Cess be withdrawn in its entirety.

Rationale or Benefit

We understand that this levy is adversely affecting in terms of increasing the cost of doing business in Sindh.

Elimination of the same will reduce unnecessary burden on importers through Sindh Province.

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

21. 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.

22. 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