OVERSEAS INVESTORS CHAMBER OF COMMERCE & INDUSTRY

OICCI TAXATION PROPOSALS 2017-2018

PUNJAB PROVINCIAL TAXES AND LEVIES

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INTRODUCTION

The Overseas Investors Chamber of Commerce and Industry (OICCI), is the collective voice of members, representing nearly all the largest foreign investors in Pakistan, who contribute, annually, over one third of the revenue collections in the country by the Federal and Provincial revenue authorities. OICCI is the largest chamber in terms of economic contribution and CSR initiatives by its members.

A few facts, which are part of the **OICCI profile**, are being mentioned below for an appropriate appreciation of the role played by the Chamber in the country's economy, including social inclusion activities:

- **Representing 195 Foreign Investors**
  - Shareholders from 35 countries / Representation in 14 business sectors
  - 57 listed on Pakistan Stock Exchange/ 50 associates of 2016 Global Fortune 500
  - companies
- **Major contributor to the Economy of Pakistan**
  - Approximately one-third of government taxes/levies collected from OICCI members
  - OICCI members invested USD 1.7 billion, in new capital expenditure, in 2015.
  - Members provide employment to around one million people
  - CSR activities of members benefit over 20 million underprivileged sections of society.
- **Tax Environment in Punjab Province**
  - We appreciate the positive attitude of the PRA in the quick and smooth resolution of the issue which had arisen last year, due to disallowance by FBR of input sales tax on services paid to provincial revenue boards. We urge all the revenue authorities to continue this effective engagement in proactively resolving all other issues including synchronization of the policies, standard tax rates and removal of all anomalies/ conflicts between the laws of the different revenue boards. Policy makers should always bear in mind that foreign investors, have invested in Pakistan and not in any particular province and therefore should not be made to suffer pending resolution of inter-governmental issues/conflict.
  - OICCI members are law abiding tax payers and share the concerns of the government on the very low tax to GDP ratio, which is primarily due to the fact that a significant portion of the economy is not documented and outside the tax net.

The views of the Chamber and operating experience of its members in Pakistan is closely followed by many stakeholders, including various international business chambers, diplomatic missions based in Pakistan and visiting foreign business delegations who come to get firsthand information of the business environment for potential foreign investors, and other groups looking for a stake in the growing economic potential of the country/region. OICCI avails these regular interactions to highlight the business potential and various tax and fiscal incentives available to foreign investors, as well as success stories of member companies in Pakistan.

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. The provincial government can devise an in house mechanism to share the revenue of the above three bodies through intra-government fund transfer.

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 Pakistan has fallen from 75 in 2010 to 144 in 2017, in the World Bank – EODB survey.

TAX BROADENING MEASURES

2. Agricultural Income Tax

As per the statistics mentioned in the Government of Punjab "White Paper – Budget 2015-16" employment of 45% of the population of the province is dependent upon agriculture and the sector accounts for 21% of the overall national production. "However, the collection of agricultural income tax is estimated to be even less than 1% of total collection of Federal and Provincial taxes."

The above disparities in tax levies between different incomes segments need to be addressed. It is recommended that the Punjab government and revenue authorities take all possible measures to increase revenue collection from the agriculture 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, as per common perception, by big landowners earning huge incomes. Furthermore, income and wealth is also transferred by unscrupulous elements to businesses fronting as agriculture sector.

Some of the key 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:** A transparent, easily understandable and 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

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, in almost 100% of the case, tax is received on land holding basis. This discourages the taxation on net income basis. Therefore, taxability of income on land holding should be abolished and taxes collected on 'net income basis'.

b) <u>Adjustable withholding tax:</u> Advance tax should be introduced on 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 advance tax should be adjustable against income tax payable on net income basis. Rates of withholding and the threshold for the same should be aligned with other products – for example any payment exceeding Rs 25,000 should be subject to advance tax 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 governments.

c) <u>Link and Interface with the National Tax Number:</u> All persons holding land should be required to obtain a National Tax Number (NTN), like the one maintained by FBR, and may be modified by 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 non-corporate 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. 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 (FBR, PRA, SRB, KPRA and BRA) 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.

As an example, a service provider registered in Sindh providing taxable services to recipient in Punjab is liable to pay sales tax in Sindh whereas the withholding agent (recipient of service) is registered in Punjab and is liable to withhold sales tax and pay the same to Government of Punjab.

Although, we have noted some improvement in the coordination between the revenue authorities, investors' concerns continue, for e.g. the issue of levy of sales tax at 'origination' and 'termination' of service in both the provincial legislations on services has still not been resolved.

Recommendation

A policy board comprising of the Chairmen of the Federal and Provincial revenue authorities should be formed to ensure synchronization of the policies, standard tax rates, basis of apportionment of revenues and removal of all anomalies/ conflicts between the laws of the different revenue boards (for example issues of jurisdiction, sales tax on toll manufacturing, clarity on jurisdiction and deductibility of WPPF/WWF expenses paid to the provinces).

The following possible alternatives may be looked into:

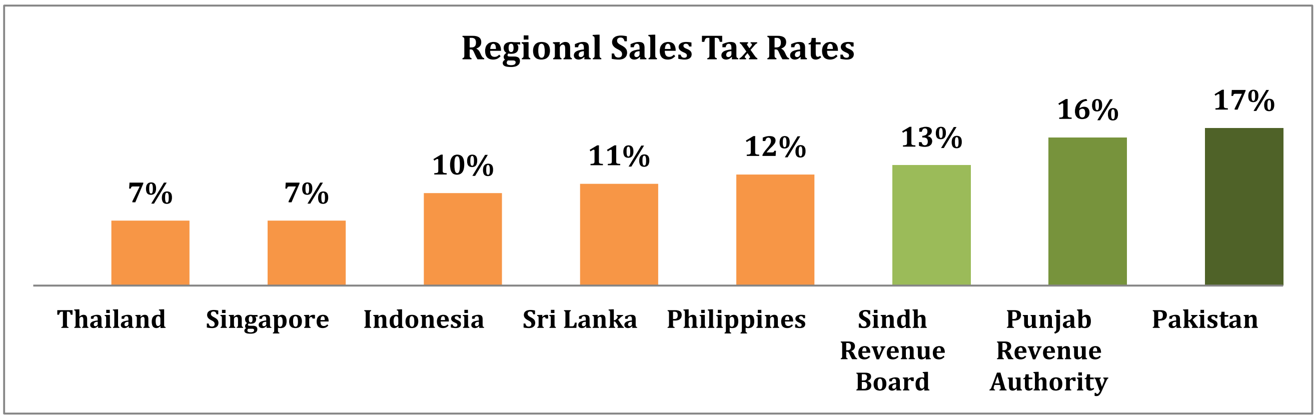
- **Taxability of service needs to be linked either with origination of service or termination thereof. Both the basis should not be simultaneously applied;**
  OR
- **Provincial revenue authorities, e.g. PRA, KPRA, BRA and SRB, along with FBR should devise a mechanism for uniform taxation of services involving all the Provinces without engaging the taxpayers in any unnecessary legal controversy.**

Rationale or Benefit

Duplicate taxation is causing hardships to taxpayers and has given rise to unnecessary litigations and is one of the deterrents in attracting FDI in Pakistan.

4. Reduction in Sales Tax Rate

OICCI commends the PRA for a number of steps introduced over the last few 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 other provinces: lower by 3%, in the province of Sindh and by 1% in the provinces of KPRA and BRA.



Recommendation

- **As a first the PRA sales tax rates on services should be aligned with the Sindh sales tax rate on services which is 13% and gradually reduced to 10% over the next three years, whilst the current rate should be maintained for unregistered entities. This reduction in rate will encourage the registration of the unregistered taxpayers to avail the benefits of input adjustment and will enhance documentation.**
- **Subsequently, a study of the rates in the regional countries, with comparable economic parameters should also be done and sales tax rates be made more competitive.**
  (A similar recommendation has also been given in the OICCI Taxation Proposals 2017-18, submitted to FBR in respective of Federal Sales Tax)

5. Admissibility of Input Adjustment on Franchise Fee

Under notification No. SO(Tax)1-1/2015-16 (Vol.II) dated Jan, 11 2016, rate of sales tax on franchise fee has been reduced to 10% from normal rate of 16%. Due to this change in the law, the manufacturers, registered with FBR are now unable to claim input tax credit because of the bar imposed in section 8(1)(J) of the Sales Tax Act 1990 read with rule 4(vii) of the adjustment of tax rules of PRA Act, 2012.

This is a clear case of hardship and disparity for the manufacturers operating in Punjab Province, as the input tax adjustment on franchise fee is admissible for the companies (manufacturers) operating in the province of Sindh, if they opt to pay the tax at the normal rate.

Recommendation

It is recommended that input tax adjustment should be allowed as it is causing disparity with the laws of other provinces. This will bring harmonization for the manufacturers registered with federation and facing undue cost pressures because of bar on input claims, in the province of Punjab.

Rationale or Benefit

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

6. Reduction In Sales Tax On Telecom Services

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

Recommendation

The current sales tax rate on telecommunication services of 19.5% should be brought at par with the general sales tax rate on all other service es in order to harmonize all sales tax on all services.

Rationale or Benefit

This will not only harmonize the tax rates and may also increase the tax collections by helping telecom operators tap lower income population of Pakistan.

7. Admissibility of Input Sales Tax

As per Section 19, Chapter III of Punjab Sales Tax Act, 2012, input tax cannot 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

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 need not face harassment from tax authorities.

8. Admissibility of Input Sales Tax on Advertisement

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 the tax is 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. Furthermore this rule is against the VAT mode of taxation.

9. Zero Rating 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.

Rationale or Benefit

Since pharmaceuticals prices are controlled, sales tax paid on inputs can neither be added to the selling price nor separately charged.

10. Zero Rating for Exports

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. All services provided to foreign companies outside Pakistan which result in inflow of foreign exchange should be exempt from Punjab Sales Tax.

Rationale or Benefit

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.

11. 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.

12. 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

In order to introduce clarity, the definition should be amended as follows:

"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".

Only the person registered under Punjab Sales Tax on Services Act, (PSTSA), should be considered as registered person and not otherwise.

Rationale or Benefit

The current definition of "registered person" is ambiguous and when applying withholding sales tax, banks cannot determine a "registered person, or is liable to be registered".

13. 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

Large Taxpayers registered with FBR or assessed under large taxpayer Unit should be exempted from deducting Sales Tax from payments to unregistered persons.

Alternatively, the rate of withholding sales tax against the invoices of unregistered persons should be reduced to 1% in line with the FBR's Withholding Sales Tax regime as applicable under SRO.660 (I)/2007.

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. Moreover these enforcement measures have negative bearing on the regulated sector only.

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

As per Punjab Sales Tax on Services (Adjustment of Tax) Rules 2012, 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.

Furthermore 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.

15. Common Sales Tax Return Filing Portal

Requirement specification for FBR, PRA, SRB, KPRA & BRA should be same for filing of monthly sales tax return rather than submitting same return at different portals, one portal accessible 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.

16. Provincial Sales Tax on 'toll manufacturing'

Punjab and Sindh provincial governments are treating toll manufacturing activity as a 'service' and PRA has 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. "Reverse charge mechanism" and subsequent recovery by the payer.

Throughout the world payment of sales or service tax is in VAT mode i.e. it is charged and recovered at every stage of sale until passed on to the final consumer. In case of IPP's all sales tax on goods and provincial sales tax on services are recovered except the taxes paid on reverse charge mechanism.

Under the provincial sales tax laws the service provider charge, collect and deposit provincial sales tax on behalf of the service recipient. However where services are being provided by a nonresident, then the recipient of the service is required to pay such taxes from its own pocket on reverse charge basis. The summary of reverse charge mechanism in Pakistan sales tax on services are as follows:

	Reverse charge mechanism Defined and Explained	**Adjustability of sales tax paid on Reverse Charge Basis**
Punjab Sales Tax on Services Act, 2012 [PSTS Act]	Reverse charge mechanism is defined under section 4(5) of the PSTS Act where rendering of taxable service originates from outside Pakistan but is received or terminated in Punjab, the recipient of such service shall be liable to pay the sales tax to the PRA.	Under Rule 6 of the Punjab Sales Tax on Services (Adjustment of Tax) Rules, 2012 No input tax adjustment is allowed which is paid under reverse charge mechanism.

Recommendation

Adjustment should be allowed for output tax deposited by the tax payer as reverse charge under the Punjab Sale tax Law

Rationale or Benefit

The disallowance under the PSTS is not in accordance with the general concept of VAT and is an additional cost to the IPP.s.

18. Deduction of Sales Tax by Bank on remittance of franchise services

As per rule 59 of Chapter XII (Franchise services) of Punjab Sale Tax Services Rules, where a remittance is made through a bank on account off franchise fee, technical fee, royalty fee or other fee of similar nature and bank has satisfied that franchisee/ franchisor has not paid the sales tax @ 16% the bank should deduct the sale tax from remittance.

Recommendation

This rule should be deleted as it is the responsibility of Franchisee/Franchisor to pay sales tax on such services.

Rationale or Benefit

It is not possible for banks to ensure the nature of payment and identify an entity as franchisee / Franchisor. Secondly no such list of franchisee is available with PRA.

19. Punjab Sales Tax On Services Rules 2012 - Chapter XII Franchise Fee

Recommendation

Companies should be given an option to pay sales tax on franchise fee at the nominal rate (same as offered by SRB)

Rationale or Benefit

Lower rate of sales tax on franchise fee renders the sales tax as inadmissible, hence increases the cost of doing business for most MNCs in Punjab which pay royalty fee for technology/brands brought into the country.

20. Labour and Manpower Service

“Labor and Manpower Services' have become an essential need of modern business. This business is operated with very low margins. Generally, service charge is based on percentage of salary / wage reimbursement of per hour of labour. These services are taxable at the rate of 16% in Punjab and 13% in Sindh. However, Sindh Sales Tax Law has provided special procedure for charging sales tax on these services. Under the Sindh law, sales tax is only applicable on services charges and reimbursement is excluded from the taxable value. As a result, recipient of service is not overburdened and effect of sales tax remains low.

However, under the Punjab sales tax law, these services are chargeable to tax at the rate of 16% and taxable value is not allowed to exclude reimbursement of salary/ wage component. As a result, a very high cost is to be borne by the recipient. Salary/ Wage being a reimbursement cost is also taxed which is against the spirit of the law.

Recommendation

It is suggested to amend the Punjab sales tax law in order to cater the aforesaid situation and to harmonize the law with the other provinces. Special procedure should be introduced for chargeability of sales tax on the services of 'labour and manpower'. These services are highly essential for conducting business and very strong support for enhancing employment opportunity in the province. Reimbursement is not revenue for service provider in any manner.

It will also resolve the disparity of cost of doing business in Sindh and Punjab.

OTHER LEVIES

21. Worker Welfare Fund / Workers Profit Participation Fund

Subsequent to 18th amendment provincial authorities are entitled to legislate on the workers welfare subjects including collection of dues from companies under Workers Welfare Fund (WWF) and Workers Profit Participation Fund (WPPF). Uptill now WWF and WPPF have only been legislated in the province of Sindh and the province of Punjab is yet to legislate on the subject.

Companies have been paying WWF / WPPF to the Federal Government, however subsequent to 18^{th} amendment the collection of these dues fall under the jurisdiction of provincial authorities. Absence of provincial legislation, clarity & lack of co-ordination between Federal & Provincial Governments has resulted in confusion and pressure for tax payers.

Recommendation

- **Federal & Provincial Governments should co-ordinate to provide clear directive/clarity regarding jurisdiction of WWF and WPPF.**
- **The Provincial government should take up with the FBR for necessary amendments in IT Ordinance, to enable taxpayers to claim WPPF and WWF charges for Income Tax purposes.**