The Institute of Chartered Accountants of Pakistan

PROPOSALS FOR THE FEDERAL BUDGET 2013-14

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PRESIDENT'S NOTE

The Institute of Chartered Accountants of Pakistan (ICAP) is a leading national professional body working for the public interest in Pakistan. It is committed to work for building a prosperous tax culture that will help Pakistan to achieve sustained growth. ICAP's strength and knowledge is drawn from the expertise of its members having a world class qualification, knowledge and experience. Our members work in every sector of the economy, and they add value to their organizations and the national economy through their positive contribution.

The tax-to-GDP ratio in Pakistan has remained the lowest in the region, and is not sufficient for sustainable economic growth. The country is facing wide budgetary deficits and the Government is compelled to recourse to short term measures like Tax Amnesties and Exemptions which are not in the interest of the nation.

The corporate sector, which is the most documented segment in Pakistan, pays the highest amount of taxes as compared to the rest of the segments of the economy. The contribution of the Services and Agriculture sectors to the national exchequer is extremely low in comparison with the contribution made by the manufacturing sector while their combined contribution to GDP is three times higher than that of the manufacturing sector. Consequently, the industrial sector carries a greater burden of tax.

The decentralization of revenue collection through tax on services by provincial ordinances has created further complications for the genuine tax payers in particular and for the economy in general.

There is a dire need to immediately address these issues through proper long term planning and by building mutual consensus with all the stakeholders. It is hoped that ICAP's proposals will be given due consideration in the forthcoming budgetary process.

I would like to express my deepest appreciation for the efforts of Mr. Saqib Masood, the Chairman, and to the members of the Committee on Taxation for their valuable input. I would also like to acknowledge the assistance and support provided by the Technical Services Directorate, in developing these proposals.

Ahmad Saeed
President

FOREWORD

The feeling of despondency that had seized the whole nation for the last many years is at its climax. A part of media is already anticipating the upcoming budget as a make-or-break phenomenon; a turn in the right direction may prove to be a boon in the coming years.

Introducing tax reforms in an election year is indeed difficult, accentuated by the fact that the interim set-up has only one objective; elections. Many of us strongly believe that this is the time to take difficult decisions, but would such decisions be sustainable?

Balancing the wish-list received from the different stakeholders was difficult for the Committee on Taxation this year, but our focus was to bring tax reforms and to broaden the tax base. Our proposals also include suggestions to simplify the law and remove ambiguities in the taxation regulations particularly with reference to corporate tax policies and promoting investment in the country.

I must appreciate the hard work by the members of the Committee on Taxation, who have diligently worked in a very tight schedule to put up these recommendations. I am hopeful that our work would be given due consideration by the relevant authorities.

Saqib Masood
Chairman Committee on Taxation

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BROADENING TAX BASE

1.1 TAX AMNESTY SCHEMES AND PERMANENT WHITENING FACILITY

One of the incentives available for tax delinquents in our country is the frequent announcements of tax amnesty schemes and existence of permanent whitening facility, which on one hand encourages the tax evaders, and on the other hand let the honest taxpayers down who have diligently paid their due taxes. Government should focus on taking steps to make non-filers document their business and pay taxes. The tax amnesty and money whitening schemes are acts of betrayal and cheating both with the honest taxpayers and the nation.

It is strongly suggested that:

- The tax evaders must be dealt with strictly;
- Tax intelligence system and the process of survey and search should be effectively brought in place to point out the tax delinquents and bring them into the tax net in order to increase the tax base which will ultimately help in boosting the revenue collection;
- Section 120A should be removed from the statute book as it is a constant allurement for the tax delinquents to hide their income which ultimately overburdens the existing taxpayers for meeting the increasing tax revenue targets; and
- The application of Section 111(4)(a) should be made conditional with provision of particulars of the remitter, his/her relationship with the recipient of the remittance and the purpose for which remittance is coming.

1.2 ACCOUNTABILITY OF TAXATION OFFICERS

The taxation authorities, at the time of finalization of audit proceedings or amendment proceedings under section 177 and section 122 (5A) of the Ordinance respectively, makes unjustified additions to the income of the taxpayer creating exorbitant demand of tax that are entirely baseless. Such actions are reversed after undergoing the complete appellate process, creating burdens on both the tax payers and the department. In order to make the tax management system fair and transparent, it is suggested that an appropriate mechanism of accountability of the respective tax officials, who created bogus demands in the first place, should be introduced in the Ordinance. Accountability at the lower level would eventually decrease the work load at the Appellate Forum, who can then concentrate on genuine cases.

1.3 COMPUTERIZATION OF TAX DEPARTMENT

Income tax department should have one online system. Every tax officer should be provided with login ID and password. All notices and communications with tax payers should be made through that system. Every document generated from the system should be pre-numbered and dated, which could not be modified once it is sent to the tax payer. Each case should be assigned a unique number by the system and all proceedings should be recorded under that system; even the proceedings of the case finalized in the Supreme Court. The use of an effective information system can easily identify the performance of the tax officers, and reduce collusion of tax officers with the taxpayers. Further, there should be a monitoring body within the tax department to review internal records of assessments, whereby tax officers are called to explain any discrepancies in the proceedings.

1.4 IDENTIFICATION OF PROSPECTIVE TAX PAYERS

To increase the tax base, prospective tax payers cases should be selected on the basis of expenditure and assets. For example if the monthly electricity bill of a bungalow/shop is more than say Rs. 20,000, that person should be issued with income tax notice asking to furnish income tax return.

DIRECT TAXES

- Persons not enrolled in tax, maintain bank accounts and are engaged in sale and purchase of properties and vehicles, making air travels, paying utility bills, school fees, club memberships, and stay in hotels etc. for which they are required to produce their CNIC number.

  It is proposed that appropriate amendments be made in the relevant laws, including taxation laws, to make it mandatory to provide NTN / CNIC for specified transactions and such transactions be reported to the FBR to be matched with NTN data base to identify tax evaders. [2.2.2]

- The country is no doubt in dire need of foreign exchange. Accordingly, the tax laws were armed with section 111 providing immunity to the source of foreign remittances for tax purposes. However, it is generally believed that this facility has grossly been misused for whitening of untaxed income earned within Pakistan.

  It is proposed that appropriate checks and balances may be introduced, i.e. prescribing maximum immunity threshold, to discourage the trend of whitening of untaxed income under section 111. [2.1.8]

- Though agricultural income is exempt from income tax; trading in agricultural produce is not. The trading of agricultural produce is generally carried on by commission agents through various ‘mandis’ managed through market committees, who grants / renew licenses of these agents.

  To bring this segment into the tax net, it is proposed that Market Commission Agent registered with Market Committees, dealing in agricultural produce, be subject to tax. As a first step, fixed tax may be introduced, payable at the time of renewal of their licenses. [2.2.8]

INDIRECT TAXES

- Present rate of 16% Sales Tax is a bottle-neck in inducing people to come within tax net at one hand, and is also contributing to inflation on the other hand. Unlike all the developing countries of the world, Pakistan does not offer any substantial protection to its manufacturing / industrial sector. Consequently, businesses prefer to operate as traders and enjoy associated tax / duty benefits. To address the growing inflation, unemployment and shrinking business environment, not only the rate of indirect taxes needs to be reviewed but policies should be geared to make indigenously manufactured goods competitive against imported goods. (3.1.2)

- Services rendered, initiated or consumed in the Province of Sindh and Punjab are being taxed under the respective Provincial laws. There are certain overlapping situations under the Federal and provincial laws e.g. admissibility of Sindh / Punjab Sales tax on services for refund claim with FBR. It is proposed that FBR, Sindh Revenue Board and Punjab Revenue Authority should agree upon legal framework and thrash out the legal and procedural impediments. (3.1.3)

- Sales Tax regime, as adopted in Pakistan, basically adheres to the concept of Value Addition with the key objective to pass on the ultimate charge of tax through different value addition process to the end user of goods or services. Therefore in true spirit, there should not be any concept of monthly refunds except for exporters and in cases of reduced taxation. (3.1.4)

- Certain services being taxed under independent Provincial Sales Tax Laws in vogue in Sindh and Punjab, such services are still taxable under Federal Excise Act as well as under Punjab and Sindh Sales Tax Laws, which may result to double taxation. It is recommended that it should be made exempt from the scope of Federal Excise Act 2005 and allied rules.(3.1.5)

- Presumptive taxation, fixed tax regime, reduced rate regime curb documentation and effectively have been counter-productive in formalization of economy and development of tax base. It is therefore recommended that all Presumptive / Value Addition / Fixed Tax Schemes should be abolished and all such sectors / goods may be brought under the normal tax regime (3.1.6)

- Some extra incentive may be offered to the registered persons, if they deal only with registered and organised sectors. This may be in the shape of fixed or variable tax credit(s) at the end of the year. This may help in increasing the number of registered person. (3.1.8)

OTHERS

- Appeals at Appellate Tribunal are generally adjudicated by a Division Bench comprising of Judicial Member and Accountant Member. An officer of FBR is appointed as an Accountant Member for specific period. In order to provide professional resources, it is proposed that Chartered Accountants with at least 10 years of experience in tax practice be appointed as Accountant Member of the Appellate Tribunal [2.3.3]

- Penalty provisions on delay / failure to file return of income etc. contained in section 182 on the basis of tax liability instead of tax payable (i.e. tax liability reduced by tax payments already made) is creating hardship and an impediment in inducing non-taxpayers. Further, levy of penalty for not filing of withholding statements with reference to tax liability of a person is contradictory to law It is proposed that penalty for non filing of tax return be imposed on the basis of net tax payable and the explanation inserted vide the Finance Act 2011 should be abolished . It is also recommended that penalty for non filing of withholding statements u/s 165 existed before the Finance Act 2011 be restored. [2.4.12]

2.1 TAX POLICY

2.1.1 RATE OF CORPORATE TAX AND REGIONAL COMPARISON

The present Corporate Tax rate of 35 percent is the highest in the entire region. China, which provides reasonable opportunities for the establishment of manufacturing sector, operates with the rate of tax of around 15 to 20 percent. This is effectively a disincentive to multinational groups for locating their manufacturing base in Pakistan. India, Bangladesh, Malaysia and Thailand have also brought down their corporate rate of tax to around 30 percent.

There are, even, cases where the rate has been brought down to 25 to 28 percent. This level is by and large in line with almost all the OECD member countries where the rate of corporate tax is around 28 percent.

UAE presents another extreme where there is, effectively, nil corporate tax. The rate of corporate tax throughout the developed world has been brought down below 30 percent.

Pakistan is a place where income is taxed at a substantially higher rate than the rate applicable to head office of a multinational group. This is considered a bad omen for tax planning.

In Pakistan a reduced Corporate Tax rate of 25% is applicable for small companies and maximum rate of 25% for Association of Persons and Individuals. This differential is discouraging expansion of companies and conversion of businesses from association of persons and individual to an organized and documented corporate structure.

Recommendation:

The rate of corporate tax for Public and Private Companies in Pakistan should be gradually reduced to bring it at par with other competitive economies and to provide incentive for formation of organized and documented sector.

2.1.2 NON-SALARIED INDIVIDUALS' TAX RATE

Discrimination of salaried and non-salaried persons by providing separate tax rates is against the norms of personal taxation. This clearly indicates that the law itself admits that non-salaried persons understate their income.

It is very odd that where the income exceeds Rs. 2,500,000, a salaried person attracts the maximum tax rate of 20% as compared to a non-salaried person who attracts the maximum tax rate of 25%.

Recommendations:

Huge gap in maximum tax rate should be narrowed by expanding the non-salaried tax bands so that the maximum tax rate of 25% starts at least for income above Rs.5,000,000.

2.1.3 SALARY TAXATION - TAX CREDIT

The general rate of personal taxation has been brought down over the years, however, on account of abolition of exemption for non-taxable perquisites the effective rate has remained almost the same. Even in the past there were very few cases where effective rate exceeded the maximum rate of 20 percent.

All the progressive tax regimes provide possibilities for tax planning for personal taxation if the same is in line with the overall economic priorities of the government. Such opportunities are provided by way of:

- Availability of investment allowance for equity investment; and

- Tax credit for interest on house mortgage, etc.

However, this needs to be rationalized by providing incentives for certain personal expenditure. In Pakistan, there is a need to incorporate planning mechanism that simultaneously encourages documentation and assist in bringing untaxed services sector into tax net. This requires introduction of 'tax credit' against personal taxation on submission of evidences of expenses incurred on education of children and Utilities.

Such a credit will provide incentive for the user of such services in obtaining evidences for payments. That will in turn induce the recipient to be within the documented sector. Like other measures, this system had also been introduced in the past. However, due to procedural difficulties and lack of will by the tax executives, positive results could not be achieved.

Recommendation:

Tax Credit for personal expenditure on education of children and utilities should be introduced with the only condition of submission of evidence of payment with full particulars of the payee.

2.1.4 SMALL COMPANY DIVISION III, PART I, FIRST SCHEDULE

The concept of 'Small Company' was introduced in 2005 with a reduced rate of tax and exemption from being a withholding agent under section 153 of the Income Tax Ordinance, 2001 as applicable to the non-corporate sector, in order to provide an incentive for businesses conducted in the status of 'individual' and 'association of persons' to convert themselves into corporate structure and be a part of organized and documented sector without any tax burden.

Later, the exemption from being a withholding agent in case of small company was withdrawn and associations of persons / individual with turnover exceeding fifty million rupees were also made a withholding agent under section 153. As a result an individual and AOP with turnover upto Rs. 50,000,000 continues to be in an advantageous position as compared with a 'Small Company' having similar turnover.

Recommendation:

Small Company to be brought at par with an association of persons and individuals by providing the threshold of turnover of Rs. 50 million for the purposes of withholding agent under section 153.

2.1.5 PRESUMPTIVE TAXATION

Presumptive Taxation Regime (PTR) introduced in 1990 is another dogma that needs a serious policy review for a sustainable growth in tax base.

There is unanimity of the view that policy framework for PTR was in principle, introduced to cater for certain negative aspects of Pakistani tax culture. These aspects were:

- Effectively no tax contribution by certain sectors which resulted in a view that at least a minimum presumptive sum be taxed; and

- Withholding taxation with normal taxation necessarily requires refund, if the tax liability determined on net income basis is less than tax withheld. There were serious abuses of refund provisions. Accordingly, checks to that effect were introduced by way of PTR.

Nevertheless, this was not a sustainable model. It was a 'stop-gap' arrangement. There was a need to incorporate and institute provisions which would check aforesaid abuses. Over a period of more than two decades concrete measures have not been adopted to curb the abuses that led to introduction of PTR. Accordingly, PTR has continued and in certain cases it is being promoted.

An effective tax system can only work where there are identical tax procedures and processes for the same kind or nature of business activities. Furthermore, there has to be no discrimination in incidence by one sector over the other. PTR disturbs both these aspects. There is a need to review PTR in that context.

Through Finance Act, 2012 positive steps have been taken for opting out of presumptive tax regime in respect of Sale of goods, Import of goods and Export of goods, subject to certain conditions, which is highly appreciated. Similar positive steps are also required to be taken in respect of Execution of Contracts (U/S 153(1)(c)), Brokerage and Commission (U/S 233), Goods Transport Vehicles Plying for Hire (U/S 234) and CNG Stations (U/S 234A).

The amendments introduced through Finance Act, 2012 by insertion of clauses 41A, 41AA and 41AAA suggest that a person can opt of of final taxation on imports, exports, supply of goods and execution of contract if he opts out of the presumptive tax regime with a condition that the minimum tax liability under normal taxation regime would not be less than 60%. You would appreciate that normal taxation regime taxes income of taxable profit basis which can vary substantially from accounting profits. In the provisions are strictly interpreted it would appear that any person whose tax liability works out to less than 60% based on his declared profit and tax adjustment would not be able to avail this option while a person having a higher profit of 60% or more will be able to avail this option. This preposition appears to be unfair as the person who is making less profit will end up paying a high tax liability under presumptive regime. In our view this distortion may induce persons to distort their accounts to meet the minimum tax liability ceiling.

Recommendations:

- As a transitional measure, for all corporate taxpayers current final tax regime should be converted into minimum tax, with facility to carry forward such minimum tax for immediate five succeeding tax years to adjust against tax liability determined on taxable income.

- Alternatively, the corporate sector be given option to opt out from presumptive taxation.

- The benefit of opting out of presumptive tax regime be extended to Execution of Contracts (U/S 153(1)(c)), Brokerage and Commission (U/S 233), Goods Transport Vehicles Plying for Hire (U/S 234) and CNG Stations (U/S 234A) as well.

- The option should be available to all such persons who are ready to accept a minimum tax liability of 60% of the total taxes withheld on their imports, exports, supply of goods or execution of contracts irrespective of the fact if their actual tax liability based on profits works out to less than 60%.

2.1.6 TAX ON CAPITAL GAINS (SECURITIES) - NON-RESIDENT

There is a need to rationalize the regime for taxability of capital gains in case of a non-resident person. Tax on capital gain should be calculated after allowing indexation for devaluation of Pakistani Rupee, if any. Similar treatment is also provided in section 48 'Mode of computation' of Indian Income Tax Act 1961, as follows:

"The Income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely:

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto:

Provided that in the case of an assessee, who is a non-resident, capital gains arising from the Transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed *by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so however, that the aforesaid manner of computation of capital gains shall be application in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an India company……."*

Recommendation:

In case of a non-resident, tax on capital gain should be calculated after allowing indexation for devaluation of Pakistani Rupee, if any.

2.1.7 FOREIGN LOSSES - SECTION 104(2)

According to section 104(2) 'the foreign losses' are to be carried forward to the following tax year and set off against the foreign source of income chargeable to tax under that head in that year. As a result foreign loss sustained by resident taxpayer is not adjustable against the local income, which is un-realistic and against the concept of taxing global income.

In the repealed Income Tax Ordinance, 1979 there was no such restriction and foreign losses sustained by a resident could be set off against local income.

Recommendation:

The restriction of set off of foreign losses against subsequent foreign income needs to be removed.

2.1.8 INCENTIVES TO EVADE TAXES

Improvement of tax base essentially requires abolition of any discrimination between taxpayer with adequate penalties for the delinquents but in Pakistan the situation is on the contrary. There are two policy features favouring the delinquents:

- **Whitening the untaxed money by abusing the various provisions of the law such as 'inward foreign remittance'**

By virtue of clause (a) of sub-section (4) of Section 111 of the Income Tax Ordinance, 2001 a taxpayer does not have to offer explanation about the nature and source of any amount of foreign exchange remitted from outside Pakistan through normal banking channels.

The above-mentioned sub-section though promotes inflow of foreign exchange remittances towards the country; however, the same provision is being largely misused to incorporate the untaxed income. Moreover, the provision is also refraining persons from being enrolled/ included in the tax net and making true and fair declaration of income.

It will be appreciated that why would someone like to pay tax at the rate of 20% to 25% when this permanent route of amnesty is available at a cost of around 2%.

- **Regular and persistent system of official whitening of money by way of 'Tax Amnesty Schemes'**

Out of the turn announcement of tax amnesty schemes really erodes the spirit of the taxpayers who are duly complying the Tax laws and paying taxes on the single penny they earn in any tax year. Income tax Ordinance, 2001 has already provided a cushion for those to disclose undisclosed income on paying nominal amount of tax. In the presence of a scheme to disclose undisclosed income, such steps really dent the moral and confidence of taxpayers on the government.

Such schemes provide complete amnesty for all defaulted liabilities on payment of a very nominal sum. In the case of indirect taxes, there are almost regular amnesty schemes for delinquents. This places the taxpayer community in an embarrassing position.

The existence of section 120A on the statute book, granting a perpetual power to the Federal Board of Revenue to make such schemes, is a best remedy available and temptation for delinquent taxpayers and discouragement for compliant taxpayers.

These policies encourage the unorganized sector to continue with the present setup. In this situation, the documented and organized sector suffers both in financial terms as well as culturally for the reason that such measures reflect a sign that system will continue to prevail and there is no need for a positive shift.

Recommendations:

- Section 111(4)(a) of the Income Tax Ordinance, 2001 should be abolished or alternatively a maximum threshold of immunity may be at least be prescribed to stop unchecked whitening of funds;

- Section 120A of the Income Tax Ordinance, 2001 should be removed from the statute book; and

- Policy decision be taken that in future, no Tax Amnesty Schemes shall be offered.

2.1.9 ALTERNATIVE DISPUTE RESOLUTION - SECTION 134A(1)

Through Finance Act, 2009, the scope of cases which could be referred for Alternative Dispute Resolution (ADR) was restricted such that the cases where:

- Prosecution proceedings have been initiated; or

- Interpretation of question of law is involved having effect on other identical cases; cannot be referred for Alternative Dispute Resolution.

The Rules regarding Alternative Dispute Resolution already provides that "Any such resolution shall not be used as precedent, except as provided in the agreement".

Accordingly restricting the scope of cases that could be referred for Alternative Dispute Resolution is not justified.

Further, under the existing provisions the decision of the ADRC is subject to an overriding approval of the Federal Board of Revenue. Our members experience suggests that in most of the cases where the recommendations are towards relief to the taxpayers, the FBR does not ratify the decision of the committee, which is often done As a result the members of the ADRC who spend their valuable time and energy in finding amicable resolution of the disputes involved, feel disgruntled and are not motivated in becoming part of ADRC committees.

Recommendations:

- The position prior to the amendment made through Finance Act, 2009 should be restored.

- The decision of ADRC should be made binding on FBR and only in case of serious reservations and compelling reasons to be given in writing authority may be given to reject the ADRC orders after mandatorily obtaining written permission of the Chairman, FBR.

2.1.10 PAYMENTS FOR GOODS AND SERVICES - SECTION 153(3)(b)

Rendering of or providing of services subject to deduction of tax at source by the non-corporate sector has been excluded from the ambit of final tax and instead tax deducted at source has been made the minimum tax.

The initiative of restricting the presumptive tax/final tax regime is in line with the earlier recommendations of the Institute and is appreciated.

However, the concept of 'minimum tax' is against the norms of taxation of income and indirectly tantamount to the continuation of presumptive tax regime. This concept to secure the revenue, to start with, is understandable but also needs to be progressively phased out.

Professional service providers, who by their governing statutes are not allowed to get themselves incorporated, is a class of taxpayer for consideration for exclusion from the 'minimum tax' concept.

Recommendation:

Like corporate sector, professional service providers, who by their governing statutes are not allowed to get themselves incorporated, should also be excluded from the ambit of 'minimum tax' concept. Alternatively, such persons should be allowed to carry forward such minimum tax for next five tax years and adjust against their tax liability on taxable income.

2.1.11 INCOME FROM PROPERTY - SECTION 15, 155 AND 169 AND CLAUSE (a) OF DIVISION VI OF PART I OF FIRST SCHEDULE

2.1.11.1 Exclusion from fixed tax regime

The Institute is of a firm view that presumptive/final/fixed tax regimes are distortion to our taxation system.

Income from property is another area for active consideration of bringing back to the normal tax regime (i.e., prior to the amendments made through Finance Act, 2006 & 2010) and to start with organized and documented corporate sector is a best fit.

Recommendation:

Income from property of the corporate sector should be excluded from the presumptive / final / fixed tax regimes.

2.1.11.2 Exemption threshold - Section 15(7) and Division VI of Part I of First Schedule

Income from property with a gross rent not exceeding Rs. 150,000 is not chargeable to tax under section 15(7) in the hands of an individual or an association of persons where such taxpayer does not derive taxable income under any other head. This threshold of Rs. 150,000 was fixed when the "zero" tax rate threshold for individuals and association of persons was Rs. 100,000 after giving 50% margin for expenses against the gross rent.

Through Finance Act, 2012 the "Zero" tax rate threshold for individuals and association of persons was increased to Rs. 400,000. However, in sub-section (7) of section 15 and Division VI of Part I of First Schedule the corresponding change was not made which is an inadvertent anomaly.

Recommendation:

In clause (ii) of sub-section (7) of section 15 the figures "150,000" should be substituted with the figures "600,000".

2.1.11.3 "Zero" tax rate threshold - Division VI of Part I of First Schedule

The existing rate card for Income from property under clause (a) of Division VI of Part I of First

Schedule (applicable to an individual and association of persons) and section 15(7) are contradictory.

According to section 15(7), the exemption is available if the property income (gross rent) does not exceed Rs. 150,000 and the taxpayer has no other taxable income under any other head. Contrary to this under clause (a) of Division VI of Part I of First Schedule the exemption by way of "zero" tax rate is available even if the:

- property income exceeds Rs. 150,000; or
- taxpayer has taxable income under any other head and income from property (irrespective of the quantum of property income).

Recommendation:

The rate card under clause (a) of Division VI of Part I of First Schedule be substituted as under (subject to recommendation under the preceding Sub-Para):

S. No.	Gross amount of rent	Rate of tax	
		Where the taxpayer has no other taxable income under any other head	Where the taxpayer has taxable income under any other head
(1)	Where the gross amount of rent does not exceed Rs.150,000	Nil	5 per cent of the gross amount
(2)	Where the gross amount of rent exceeds Rs.150,000 but does not exceed Rs.400,000	5 per cent of the gross amount exceeding Rs.150,000	Rs.7,500 plus 5 percent of the gross amount exceeding Rs.150,000
(3)	Where the gross amount of rent exceeds Rs.400,000 but does not exceed Rs.1,000,000	Rs.12,500 plus 7.5 per cent of the gross amount exceeding Rs.400,000	Rs.20,000 plus 7.5 per cent of the gross amount exceeding Rs.400,000
(4)	Where the gross amount of rent exceeds Rs.1,000,000	Rs.57,500 plus 10 per cent of the gross amount exceeding Rs.1,000,000	Rs.65,000 plus 10 per cent of the gross amount exceeding Rs.1,000,000

2.1.12 EXPORT OF SERVICES

Exports whether of goods or services are the back bone of any economy and particular of developing economies. Pakistan is no exception to this fact and our policy thrust is to enhance the exports to its optimum levels.

Export of goods and export of services are for all practical purposes more or less the same. In both cases all the related activities of producing the goods and generating of services originate from Pakistan and earn valuable foreign exchange for the country.

Currently, only Information Technology related services are recognized by providing exemption of income from export of such services. However, there are number of other services in particular professional services by Architects, Engineers, Chartered Accountants, etc. also needs to be recognized for promoting export of such services.

Recommendation:

To promote, encourage and incentivize export of services, it is proposed that this should be exempted like IT enabled services or alternately brought at par with taxation of income from export of goods.

2.1.13 COMPENSATION TO WITHHOLDING AGENTS

Federal Board of Revenue has been availing the services of withholding agents free of charge for quite a long time. These withholding agents have been incurring heavy expenditure in the form of changes in their systems, hiring and training of their staff, storage for retention of withholding Tax records and similar operating expenses. They are also subject to tax audits of withholding taxes and then penalised for any default which at one hand puts thereon an additional cost.

Recommendation:

Withholding agents should be allowed to retain 10% of the amount of tax collected as service charges on the principle of natural justice.

2.1.14 EXEMPTION OF INCOME RECEIVED FROM ANNUITY OR ANNUITIES

Exemption of income received from annuity or annuities issued by a Life Insurance Companies registered under section 3 of the Insurance Ordinance were available through clause (21) of Part-I of second Schedule to the Income Tax Ordinance, 2001 which was withdrawn by Finance Act, 2008.

Pension received by an employee from its employer is exempt under clause (8), (9) and (12) of the Part-I of the Second Schedule to the Income Tax Ordinance, 2011. However, income received from an annuity, which is a kind of pension benefit remains chargeable to tax.

Logically, like pension, income received from an annuity should also be exempt from tax to safe guard the interest of senior citizens after reaching the retirement age.

Recommendation:

Income received from annuity upto Rs. 120,000 per annum after 60 years of age should be exempted from tax.

2.1.15 CONDONING OF TIME LIMIT BY THE BOARD – Section 214A

The Federal Board of Revenue is empowered to condone the time or period specified under any of the provisions of the Ordinance or rules made there-under within which any application is to be made or any act or thing is to be done, in any case or class of cases and permit such application to be made or such act or thing to be done within such time or period as it may consider appropriate.

The provisions of section 214A, prior to amendment made through Finance Act, 2012, was implied that this power can not be used detrimental to a taxpayer. However, by virtue of the amendment made through Finance Act, 2012 it has been specifically provided that this power to condone the time or period of an act or thing to be done by any of the Income Tax Authorities can also condoned.

This amendment is highly pre-judicial to the interest of taxpayers and indirectly gives a blanket power to the Federal Board of Revenue to override the statutory time limit or period of any act or thing to be done by the Income Tax Authorities.

Recommendation:

Amendments made in section 214A through Finance Act, 2012 should be withdrawn.

2.2 DOCUMENTATION, RESOURCE MOBILIZATION AND BROADENING OF TAX BASE

2.2.1 GENERAL

Un-documented, cash and parallel economy is a menace to our entire taxation system. The major chunk of the state revenue is generated by few sectors of the businesses owned by National and Multi-National companies and corporations. The transport, wholesale, retail and professional services sector of the business has a very low contribution in the tax revenue as compared to their share in GDP.

Our direct tax laws need a major shift to curb this situation. Following are the examples of our existing laws that do not support documentation and resultantly the increase in tax base and resource mobilization:

- Final tax regime;
- Fixed tax or separate block of income;
- A very extensive withholding tax regime coupled with final tax, which has converted direct tax into indirect tax;

Another very significant area for major shift is facilitation of compliant taxpayers and penalization of non-compliant taxpayers. All our direct tax laws are day by day burdening the existing and compliant taxpayers. No measures are being taken to enforce the tax laws on the non-compliant taxpayers.

With this background following measures are recommended.

2.2.2 USE OF CNIC NUMBER

Generally, people who have not obtained National Tax Number and do not pay due taxes, participate in documented economy to meet their needs and comforts e.g. opening and maintaining bank accounts, placement of money in profit based securities, sale and purchase of properties and vehicles, air travels, utility bills, club memberships, credit cards, stay in hotels etc. For such needs, they are generally required to produce their CNIC Number. However, due to non-availability of data or lack of access to the available data, they could not be brought to the tax net. Accessing and developing data base on the basis of CNIC number can provide an opportunity to identify the non-tax payers to bring them into the tax net.

Recommendation:

Appropriate amendments in the law should be made to make it mandatory to provide NTN on specified transactions e.g. transfer of property, transfer of vehicle, opening of bank account and to impose obligations on certain persons to provide periodical statements on the basis of CNIC Numbers e.g. air travel agents, hotels. Similarly, appropriate amendments could be made in banking laws to have access to the specified data of banks and financial institutions for the purpose of identifying non-taxpayers.

2.2.3 FINAL TAX, FIXED TAX AND SEPARATE BLOCK TAX REGIMES

In the last two years steps have been taken to reduce the scope of final tax, fixed tax and separate block tax regimes but a lot more needs to be done by abolishing and replacing the same with minimum tax concepts to start with. This will ensure documentation and payment of tax at the applicable rate on the consolidated taxable income instead of breaking in different regimes.

Income from property

The concept of taxing income from property as a separate block of taxable income should be done away. Deductions against the gross rent should be admissible only if actually incurred and that too subject to an overall threshold of 50% of the gross rent.

Income from business - Commercial Imports

Commercial imports should be excluded from the final tax regime and the tax collected at import stage should be converted into a minimum tax to start with.

Income from business - Sale of goods and execution of contracts

Sale of goods and execution of contracts should be excluded from the final tax regime and the tax deducted at source should be converted into a minimum tax to start with, with entitlement to carry forward and adjust such minimum tax in future tax years against tax liability on taxable income.

2.2.4 TAX CREDIT TO REGISTERED PERSONS - SECTION 65A

To provide incentive for documentation of economy and increase in the tax base, in 2009 tax credit to those manufacturers registered under the Sales Tax Act, 1990, making 90% of their sales to persons registered under the Sales Tax Act, 1990 and also provide details of such sales to the department was introduced. This needs to be extended beyond the manufacturers in particular the entire wholesale chain.

Recommendation:

This tax credit should be extended to all persons registered under the Sales Tax Act, 1990.

Note: The proposed change will not affect the tax liability of incomes falling under the presumptive tax regime, as tax credits are not admissible to such persons under section 169.

2.2.5 WITHHOLDING TAX ON INDUSTRIAL AND COMMERCIAL CONSUMERS

The withholding tax regime has been very effective in increasing the tax base in the country. The existing scheme covers almost all the segments of the economy.

At present a very large number of taxpayers comprising of small and medium sized industries and the entire wholesale and retail chain are not contributing to the tax revenue in the ratio of their contribution to the GDP. This situation will be further deteriorated with the increased 'zero' tax rate threshold increased to Rs. 400,000, which needs to be taken care of by taking appropriate actions well in time i.e.:

2.2.5.1 Imposition of withholding tax on industrial and commercial consumers of natural gas

Currently, natural gas consumption by CNG Stations is subject to withholding tax only. A large number of industrial and commercial consumers of natural gas are not paying any tax or paying a very little amount as compared to the volume of business on the basis of their consumption of natural gas. It will be appropriate to bring this sector of economy to contribute to the national exchequer by way of a withholding tax.

Recommendation

Withholding tax at the rate of at least 5% and 10% on natural gas consumption by industrial and commercial consumers respectively should be introduced with a maximum capping of tax amount of Rs.10,000 per month to take care of cash flow problems of large scale consumers.

2.2.5.2 Increase in the rate of withholding tax on commercial consumers of electricity

The current rate of withholding tax on electricity consumption by commercial consumers with bill amount upto Rs. 20,000 per month ranges from 6% to 23% whereas for bill amount exceeding Rs. 20,000 it is 10%. This needs to be increased and rationalized for the reasons stated above.

Recommendation:

The rate of withholding tax on electricity consumption by commercial consumers should be fixed at a flat rate of 25% of electricity consumption with a maximum capping of tax amount of Rs. 10,000 per month to take care of cash flow problems of large scale consumers.

2.2.6 WITHHOLDING TAX ON PASSENGER TRANSPORT VEHICLES PLYING FOR HIRE AND OTHER PRIVATE MOTOR CARS - SECTION 234 AND PARA (2) AND PARA (3) OF DIVISION III OF PART IV OF FIRST SCHEDULE

The current rate of advance tax collected along with the motor vehicle tax does not commensurate with the current margin of profit in case of passenger transport vehicles plying for hire and other operating cost of private cars. Further the reason for non compliance of the provision of clause (vi) of sub-section (1) of Section 114 is also due to the fact that the current advance tax rates are very nominal. In our society in order to improve compliance with tax laws and increasing the tax base the rate of advance tax should have a pinching effect in proportion to the income or cost of operating.

Recommendation:

The current rate of advance tax under Para (2) and (3) of Division III of Part IV of First Schedule should at least be doubled.

2.2.7 INCENTIVE TO THE COMPLIANT TAX PAYERS

Currently there is nothing in the Income tax to promote tax culture and provide incentives to compliant tax payers. There is a need to introduce appropriate measures to reward compliant tax payers.

Recommendation:

It is proposed to introduce a concept of furnishing annual sales summary along with NTN or CNIC of the customers with an incentive of 5% tax credit of the tax payable.

2.2.8 DEALERS/AGENTS OF AGRICULTURAL PRODUCE

The Federal Board of Revenue introduced an amendment in SRO 363 whereby the exemption available to the supplier of agricultural produce from provision of section 153 has been withdrawn and limited to actual grower/producer of agricultural products. We welcome this step as it will bring into the ambit of taxation a very large segment of the economy which were taxable under the provisions of Income Tax Ordinance but were out of the net on excuse of agricultural income. Under the Income Tax Ordinance, the exemption to agricultural income is restricted to the actual producer and grower of the land and not to the intermediaries who make the real income in the process. However, we feel that this change will only bring into net all those intermediaries who are making supplies to withholding tax agents. The persons who do business through market *(mandis)* will remain outside the net.

All businesses of agricultural produces both cash crops, fruits and vegetables are conducted through various *'mandis'* spread across the country which are managed through market committees. These market committees are governed under Provincial Act, e.g. Punjab Agricultural Marketing Ordinance 1978. Under this Act, in order to deal with the agricultural produces, they need to be registered as a working commission agent with the market committee under a formal licence which is renewed on annual basis. All Provincial Governments have reliable data available through market committees which can be used for taxation of their important segment and bring them into the tax net.

However, since the entire system works on cash basis, therefore, it would be difficult to start with taxation of real income and it would be more advisable to tax them on some fixed tax regime.

Recommendation:

- The market commission agent registered with market committees may be subject to fixed tax (excluding income subject to collection of tax at source under section 153) depending upon their category; we suggest the following fixed rates for each category:
  - Category - A Rs. 10,000 per annum
  - Category - B Rs. 7,500 per annum
  - Category – C Rs. 5,000 per annum
- The marketing committee should be made the withholding tax agent for collection of the above tax along with the annual fees and be required to submit annual statement to the tax department.
- The market committee should before granting renewal of licence to ensure that such person is a holder of National Tax Number.

2.3 PROCEDURES AND MISCELLANEOUS

2.3.1 GRANT OF STAY BY COMMISSIONER (APPEALS) Section 128(1A)

The inherent power of Commissioner (Appeals) to grant stay against recovery of tax in hardship cases (where an appeal is pending before him/her) has been given a legal cover and regulated by insertion of section 128(1A) by Finance Act, 2012. However, the aggregate period of stay that can be granted is only 30 days. In view of the ground realities (flimsy assessments and delay in deciding the appeals) this period of 30 days needs to be suitably increased and brought in line with the powers of the Appellate Tribunal.

Recommendation:

In section 128(1A), the period of "thirty days" should be substituted with "one hundred and eighty days".

2.3.2 PROCEDURE IN APPEAL - SECTION 128(4)

The power to set aside the assessment order in an appeal before the Commissioner (Appeals) contained in section 129(1)(a) was withdrawn through Finance Act, 2005. With this change the powers vested in the Commissioner (Appeals), under section 128(4) to cause further inquiry before disposing of an appeal to be made by the Commissioner, has attained a significant importance, in order to enable the Commissioner (Appeals) to give clear cut findings on the matters arising in the appeal before him.

Restricting the further enquiry to be made by the Commissioner alone against whose order an appeal has been preferred by the taxpayer is not fair and judicious, because the results of such inquiry will naturally be biased and tilt to support the order, the Commissioner has originally made (order under appeal).

Recommendation:

The powers of the Commissioner (Appeals), under section 128(4) to cause further inquiry by the Commissioner should be enlarged enabling the Commissioner (Appeals) to cause further inquiry by an expert or seek an expert opinion.

Consequently, section 222 of the Income Tax Ordinance, 2001 should also be amended, enabling the Commissioner (Appeals) as well to appoint an expert.

2.3.3 APPOINTMENT OF THE APPELLATE TRIBUNAL- SECTION 130(4)

Chartered Accountants in Practice can be of great value as Accountant Member of the Appellate Tribunal. This was recognized in the repealed Income Tax Ordinance, 1979 whereby the Federal Government could appoint Chartered Accountants with at least ten years of experience in practice as Accountant Member of the Appellate Tribunal, till June 2001.

Recommendation

Section 130(4) should be amended in order to provide for the appointment of Chartered Accountants with at least ten years of experience in tax practice, as Accountant Member of the Appellate Tribunal.

2.3.4 SECTION 177 READ WITH SECTION 214C

The powers of the Commissioner Inland Revenue as contained in section 177 of the Income Tax Ordinance, 2001 ("Ordinance") for selection of cases for tax audit has been the subject of controversy between the taxpayers and the tax collectors. The taxpayers have objected to the basis of selection of cases by the Commissioners and there are a number of Court decisions available on the subject.

The Finance Act, 2010 introduced section 214C in the Ordinance whereby the Federal Board of Revenue (FBR) has been empowered to select taxpayers for audit of income tax affairs through computer ballot random or parametric as it deem fit. Simultaneously, certain changes have also been brought about in the text of section 177 via the Finance Act, 2010. Through these amendments, sub-sections (1) and (2) have been substituted while sub-sections (3), (4) and (5) have been omitted. The crux of the amended section 177 of the Ordinance is that the Commissioner instead of selecting a taxpayer for tax audit; is now to call for the records of a taxpayer in order to conduct audit of the tax affairs of a taxpayer. It therefore, appears that after the FBR selects cases for tax audit through parametric or random computer balloting in terms of section 177 of the Ordinance, the Commissioner is now authorized to "conduct" the audit.

However, the tax authorities are of the view that even after the amendments introduced in section 177 as aforesaid, they are still empowered to "select" the cases for tax audit. They are of the view that these powers are in addition to the powers given in section 214C to the FBR and would therefore, operate separately.

Recommendation

To resolve this controversy, it is suggested that suitable amendments may be made in section 177 of the Ordinance to bring clarity in such provisions. This will smoothen the operation of section 177 of the Ordinance which will in turn eliminate the conflict prevailing among the taxpayers and the tax collectors.

2.3.5 REVAMPING OF INCOME TAX RULES

It has been observed that most of the Income Tax Rules are not aligned to Income Tax Ordinance, 2001.

Recommendation:

Income Tax Rules need to be revamped to avoid confusions.

2.4 REMOVAL OF HARDSHIPS

2.4.1 PERQUISITES - SECTION 13(7) AND EXEMPTION OF PERQUISITES - CLAUSE (53A) OF PART I OF SECOND SCHEDULE

2.4.1.1 Taxation of Notional Income

Under sub-section (7) of section 13 of the Income Tax Ordinance, 2001 the difference between the benchmark rate and the actual rate of interest charged (where actual rate of interest is less than the benchmark rate) by the employers on concessionary loans provided to the employees is treated as perquisite chargeable to tax.

This is not a significant source of revenue for the Government on the one hand and very rigid piece of legislation on the salaried taxpayer on the other hand who are hard hit by the present economic situation. The taxation of this notional income is highly unjust since it taxes the notional income of the salaried person which is against the basic principle of taxation since this notional income will never ever be received by the taxpayer. Similar notional income in the hands of employees of airline, transport, educational institutions, restaurants, hospitals, clinics etc. is already exempt under clause (53A) of Part I of Second Schedule.

Recommendations:

- The taxation of marginal income on loans obtained from the employer below Benchmark rate should be exempted by making necessary amendments in clause (53A) of the Part I of the Second Schedule and by deleting sub-section (7) of Section 13; or
- Alternatively the minimum threshold of the loan amount on which the provisions of Section 13(7) would not be attracted should be raised to at least Rs. 2,500,000 from the existing limit of Rs. 500,000.

2.4.1.2 Exemption of mortgage loans (Alternate to above)

The rationale underlying this proposal is that:

(a) Only mortgage loans will be exempted from the applicability of Section 13(7) of the Ordinance whereas all other concessionary loans like auto loans, personal loans will continue to be taxed on the difference between the actual and the benchmark rate;

(b) It will boast the housing industry since in today's economic situation and the presence of speculators in the property market it is next to impossible for a salaried employee to own a house on commercial mark up rates. Once this industry takes off there will be provision of cheap houses and there will be increase in tax revenue from housing and allied sector;

(c) it will contribute in enhancing the national economic activity by extending affordable loans and advances to middle class income group of society;

(d) It will remove detrimental financial ramifications due to incremental rate of interest on notional income for all other salaried persons, who are already facing a tough challenge to survive within their paltry resources- all legally declared and tax paid;

(e) The FBR is also cognizant of this fact by stating in Clause (53A) that "any other perquisite or benefit for which the employer does not have to bear any marginal cost; and the Circular Letter 4(8)IT-J/91 dated June 30, 1991 issued by then CBR opines that "…it is not desirable to tax such notional income…". The same principle should be applied in this situation.

Recommendation:

Alternatively at least the mortgage loans be exempted from the operation of section 13(7) of the Income Tax Ordinance, 2001.

2.4.2 SALARY TAX SLABS - CLAUSE (1A) DIVISION I, PART I OF THE FIRST SCHEDULE

Through the Finance Act, 2012, tax slabs of salary income were reduced from 17 to 6. From the perusal of existing law, it is clear that fixed tax factors (FTF) for slabs 4, 5 and 6 are not in line with the earlier slabs and are fixed at a higher amount of Rs. 95,000, Rs. 175,000 and Rs. 420,000. Instead, these slabs should be Rs. 92,500, Rs. 167,500 and Rs. 255,000 respectively. Further progressive rate of tax is applicable for persons with income ranging between Rs. 400,000 to Rs. 2,500,000 whereas flat rate @ 20% is applied after deducting the basic exemption of Rs. 400,000 for persons earning taxable income of Rs 2,500,000 and above.

Recommendation

It is suggested to revise the tax slabs number 4, 5 and 6 based on principles of progressive taxation, in light of the order of Federal Tax Ombudsman for removal of irregularities.

2.4.3 LIMIT OF EMPLOYER'S CONTRIBUTION TO PROVIDENT FUND - CLAUSE (3) PART I OF SIXTH SCHEDULE

Through Finance Act 2008, the employer's contribution in the recognized provident fund in excess of Rupees one hundred thousand (Rs.100,000) is deemed to be Income of the employee. This matter has importance since employer contribution, though a constructive receipt is not an actual receipt as the same is not at disposal of an employee and therefore tax incidence should not be levied at the time of contribution. Further, where such Fund is recognised under income tax laws, the payments from the fund to the employee (which include employer’s contribution) are exempt under clause 23 of Part I of Second Schedule to the Ordinance. Therefore, it is illogical that when an amount is ultimately exempt, it is taxed at the time of contribution. It is suggested that ceiling of rupees one hundred thousand may be withdrawn as in many case this is the only long term benefit.

Further taxation of salary income is permitted by section 12 on receipt basis only, therefore in the event that there is an excess contribution to an employee above Rs. 100,000 how would that be taxed in the hands of an employee as he would not be receiving that contribution rather the contribution will be credited to the Fund who will pay to an employee when he retires or resigns from service. Further, the employer's contribution can be withheld by the employer in the case if employee is charged with misconduct. Due to such eventuality, it is only at the time of retirement or resignation that one can say with certainty that the employer's contribution would be received by the employee.

Recommendation:

Due to multiple complications, the ceiling of Rs. 100,000 should be withdrawn.

2.4.4 GROUP TAXATION - SECTION 59B

Section 59B seeks to provide group relief in the form of adjustment of losses between holding and subsidiary or subsidiary to subsidiary if they fulfil the minimum holding criteria. The required holding is 55% if one of the companies in the group is a listed company and 75% if none of the companies in the group is listed company. The law further prescribes certain conditions that the group companies have to fulfil in case they avail the facility of group relief. The conditions are set out in sub section (2) of section 59(B). One of the conditions under sub-section 2(c) of section 59(B) is as follows:

"…..holding company, being a private limited company with seventy-five percent of ownership of share capital gets itself listed within three years from the year in which loss is claimed."

Recommendation:

The Institute is of the view that requiring holding company to get itself listed within three years from the year in which loss is claimed should be removed and instead there should be a condition that at least one company within the group should get itself listed. This would bring the condition in line with the other condition of minimum holding discussed above where a higher holding is only required if none of the companies in a group is a listed company. Further the requirement to list the holding company is against the principle of group formation and consolidation as a group may not like to keep its investments in a listed company due to the risk of hostile takeovers etc. as in such an event the group may loose control on its entire entities within the group.

It is therefore suggested that sub-section (2)(c) of section 59B be substituted as follows:

"At least one of the companies of the groups shall get itself listed within three years from the year in which loss is claimed if all companies of the groups including the holding companies are private limited companies."

2.4.5 CONTRADICTION IN THE PROVISIONS OF SECTION 169 VIZ-A-VIZ 65B, 65D AND 65E

Section 65B, 65D and 65E were amended through Finance Act, 2012, whereby the tax credit allowed under these sections could be set-off against minimum tax (under section 113) and final tax (under section 169) as well.

Under section 113(1) minimum tax is attracted even if the tax payable as reduced by tax credits fall short of the minimum tax on turnover. Similarly, section 169(2)(d) does not allow set-off of tax credits in respect of final tax.

Recommendation:

Appropriate amendments in section 113 and 169 to remove the lacuna in law.

2.4.6 TIMINGS FOR FILING OF RETURN OF INCOME – SECTION 114

The due date for filing of income tax returns by salaried individuals by 31 August is too short for compiling the required information and obtaining proof and evidences. Earlier, the deadline was 30 September.

Past experience shows that the Income Tax Return forms etc. are not notified well in time and the e-filing system is also not in place in time. On the other hand our history is that the due date of filing of Income Tax Returns etc. is always extended on one pre-text or other.

The institute feels that delay in finalizing the Income Tax Return forms etc. and extension in due date of filing of Income Tax Returns etc. causes un-necessary burden of last minute rush of work.

Recommendation:

Due date for filing of income tax return by salaried individuals, non-salaried individuals and AOP's be aligned to 30 September or 60 days from the date the e-filing system is in place, which ever is later.

2.4.7 COLLECTION OF TAX IN THE CASE OF PRIVATE COMPANIES AND ASSOCIATIONS OF PERSONS - SECTION 139

It is without any doubt that corporate sector is better regulated and documented as compared to an association of persons or individuals doing business. However, there are a number of provisions in the Income Tax Ordinance, 2001, that do not support the formation of corporate sector which in turns implies non-formation of regulated and documented sector.

One of such provision is section 139 of the Income Tax Ordinance, 2001 placing un-limited liability on the directors/shareholders of a Private Limited Company, which is against the basic concept of formation of limited liability business entity.

Recommendation:

Section 139 should be suitably amended to exclude the directors and shareholders of a Private Limited Company from the discharge of tax liability of the Company.

It may be mentioned over here that in case of fraud by the director(s), the Companies Ordinance, 1984 does not protect them for discharge of any liability of the Company.

2.4.8 IMPORTS - SECTION 148

In pursuance of the clause (9A) of Part II of the Second Schedule to the Ordinance, income tax @3% was being collected on import of raw materials by industrial undertaking for its own use subject to the issuance of the certificate by the Commissioner Inland Revenue. Currently, this facility has been withdrawn. Resultantly the industrial undertakings have to pay income tax at the standard rate of 5% on import of raw materials for their own use.

The Institute is of the opinion that collection of income tax at import stage in respect of raw materials for own use of an industrial undertaking beyond 1% is a huge burden, particularly on large scale manufacturers, resulting into cash flow problems on the one hand and accumulation of huge refunds on the other hand.

Recommendations:

- Advance tax rate on import of raw materials by industrial undertaking for its own use is substantially high which should either be abolished or be reduced from 5% to 1% by re-instating clause (9A) of Part II of the second Schedule.

- Further the requirement of said certificate should be abolish by eliminating proviso clause (9A) of Part II of second schedule as it provides hassle for manufacturer to get certificate after every six months.

2.4.9 DUE DATE FOR PAYMENT OF TAX - SECTION 137

Finance Act, 2008 had unreasonably decreased the numbers of days specified for making payment into Government treasury to 15 days.

This curtailment of time resulted into:

- Culture of creating unfair demands and unjustified liabilities by the assessing officers; and

- Short sighted approach adopted by field formations in meeting their tax collection targets, is hampering business confidence building measures adopted by the Pakistan Government during last decade.

Recommendation:

The original time of 30 days should be restored to remove the hardship faced by the business community and taxpayers.

2.4.10 PAYMENTS TO NON-RESIDENTS – SECTION 152

The law requires that where a payment is not likely to be chargeable to tax, then the payer is required to file a notice to the Commissioner. The Commissioner is required to make an order on such notice within 30 days. Since payments to non-residents are critical for business, therefore, 30 days appears to be higher side. Further, there is no mention in the law that if a Commissioner does not pass an order within 30 days, what should be the outcome.

Further that approval of Commissioner is required u/s 152 (5) for reimbursement of expenses to foreign group companies and other foreign distributors, even for payments of iterative nature.

Recommendations

- It is suggested that the period of 30 days provided in section 152(5A) be curtailed to 15 days

- a proviso should be inserted that if the taxpayer is not served with an order on notice filed under section 152(5) within 15 days, the notice shall be taken as grant of exemption from withholding tax.

- If multiple payments are made on account of reimbursement of expenses from time to time under a formal agreement, approval by the Commissioner for one such payment be treated as enough for all other payments under the same agreement.
- Exemption from approval of the Commissioner be provided for small payments amounting up to a maximum limit USD 1,000 or equivalent currency. A similar exemption has been allowed to insurance companies making payment to reinsurers located in countries having agreements for avoidance of double taxation with Pakistan vide Supreme Court order in C.P. 261K to 271K of 2010.

2.4.11 PAYMENT FOR GOODS AND SERVICES - SECTION 153(1)(c)

The term 'execution of contract' is unique in Pakistan as this term does not exist in any regional or international fiscal laws. The term 'execution of contract' under section 153(1)(c) is open ended (except for specific exclusion of sale of goods and rendering or providing of services) as every transaction is an execution of a contract under the Contract Act e.g. sale and purchase of immoveable property, right to use an intangible, etc., which do not necessarily have any element of profit.

Recommendation:

The term 'execution of contract' for the purposes of section 153 be defined.

2.4.12 OFFENCES AND PENALTIES – Section 182

Section 182 was substituted vide the Finance Act, 2010 to consolidate penalty provisions contained in the Ordinance in various sections. Entry No. 1 of the table provides penalty for failure to furnish return of income or a statement of final tax or wealth statement, or wealth reconciliation statement or statement under section 165 within the due date. Penalty for such failure was prescribed equal to 0.1% of the tax payable for each day of default subject to a minimum penalty of Rs. 5,000 and a maximum penalty of 35% of the tax payable in respect of that tax year.

Subsequently, vide Finance Act, 2011, an explanation has been inserted whereby for the purpose of this entry, it has been declared that the expression ‘tax payable’ means tax chargeable on the taxable income on the basis of assessment made or treated to have been made under sections 120, 121, 122 or 122C of the Ordinance.

At the outset, the prescription of above penalty for default in submission of withholding tax statement is not relevant as the same is not related to tax on taxable income.

Consequent to insertion of the said explanation, it has been noted that the tax authorities have invariably started levying penalty for a single day of default on the basis of tax payable in the return without taking into account the taxes already paid / deducted. Further, the tax authorities are now imposing this penalty for prior years / periods as well, which is against the established principle that any amendment putting additional burden can operate only prospectively. This situation is causing a serious hardship to the taxpayers, as now due to this explanation, the tax authorities are using the explanation as tax collection avenue instead of a deterrent.

Logically, imposition of penalty should have been restricted to the extent of short tax paid with the return, as was held by the appellate authorities before insertion of the said explanation, and if there was no tax payable then token amount of penalty should have been imposed, as was the case before substitution of section 182 of the Ordinance.

Recommendation:

Offence for failure to file statement under section 165 be specified separately from entry 1 and the penalty for such failure be restricted to base penalty of Rs. 5,000 per statement and even if after notice to file the statement the taxpayer commit defaults then further penalty of Rs. 200 per day of default be imposed.

2.4.13 DOMESTIC AIR TICKET

In case of domestic air ticket, advance tax of 5% is deducted by the airline which is adjustable by the taxpayer. Airlines do not provide CPR to the companies or to their travel agents. Further, FBR system usually fails to verify the tax so deducted, which results in additional burden to the companies.

Recommendation

It is suggested to either abolish this tax or facilitate tax payers in this regard.

2.4.14 ADVANCE TAX COLLECTION BY THE MANUFACTURER SECTION -153A

A new section 153A was inserted through Finance Act, 2012, whereby the scope of withholding had been further enlarged and every manufacturer is required to collect tax at source at the time of sale to its distributors, dealers or wholesalers at the rate of 0.50% of the gross sales.

The major difficulties in the tax net by registering the implementation of this section were:

- This section made every manufacturer a withholding agent irrespective of size, nature, turnover and status (i.e., individual, association of persons or company);
- In many cases the same transaction attracted collection/deduction of tax at source twice i.e. under this section by the manufacturer from its distributors, dealers or wholesalers and under section 153 by such distributors, dealers or wholesalers from the manufacturers;
- The “manufacturer” has to comply with all the obligations imposed on a withholding agent including timely deposit of tax so collected and filing monthly withholding tax statements, etc;
- The manufacturer has to collect the tax at the “time of sale”, irrespective of the fact that the consideration for the sale has been realized or not;
- The term “at the time of sale” is not defined; and
- In various business segments buyers were not ready to provide NTN/CNIC which further increased the difficulties of the manufacturers.

Realizing the practical difficulties in the implementation of this newly inserted section, vide SRO 1487(1)/2012 dated December 24, 2012 the provisions of this section had been kept in abeyance till June 30, 2013.

Recommendations:

- The provisions of section 153A kept in abeyance till June 30 2013 should be permanently omitted from the Income Tax Ordinance, 2001 being an anti business provision;

  Alternatively;

- All distributors, dealers and wholesalers who are registered under the Sales Tax Act, 1990 or are withholding agents under section 153 or who have furnished their Income Tax Return may be excluded from the operation of this section.

2.4.15 WITHHOLDING AGENT- SECTION 153

The companies dealing with "Government Authority" face problems in withholding tax as they are not subject to any tax. The companies dealing with Government Authorities are exposed to risk of non compliance of withholding tax. Many withholding tax agents are facing similar problems while dealing with Local Authorities. And this problem is not particular with Local Authorities. Resultantly the companies have to gross up the payment and bear the withholding tax.

Recommendation

It is suggested that the withholding agent should be allowed to refer the matter to FBR in confidence and if reply from FBR is not received within 10 days, there should not be any liability. Further any such forced deposit should be made under "miscellaneous" head of account so that supplier could not claim in this tax return.

2.4.16 WITHHOLDING TAX ON PROMOTIONAL MATERIAL- SECTION 156

Many businesses and in particular manufacturers allow incentives to their distributors, wholesalers and retailers of giving free of cost goods on achieving sales targets as an incentive to promote sales of their products. Such incentive or benefit clearly falls in clause (d) of sub-section (1) of section 18 and is chargeable to tax under the head income from business.

Contrary to this The tax authorities tend to treat the post sales free issues and incentives as 'prize', and accordingly demand 20% withholding tax by invoking section 156 of the Income Tax Ordinance, 2001.

Recommendation:

The following explanation should be added under Sec 156:

"The term Prize means winning by chance and does not include payments either in cash or in kind to any person on achieving sales target. The explanation shall be deemed always to have been so added and shall have effect accordingly"

2.4.17 DEPOSIT OF WITHHOLDING TAX

Previously withholding agents were required to deposit withholding tax within seven days from the end of each fortnight however by virtue of SRO # 392 19-05-2009 it is now required to be paid within seven days from the end of each week, which is very time consuming and increases the cost of compliance.

Recommendation

It is suggested that law should be amended so that withholding amount may be deposited within 7 days of end of month, i.e. on monthly basis.

2.4.18 MONTHLY WITHHOLDING STATEMENTS-RULE 44

Since, now all withholding agents are depositing withholding tax challans electronically through E-portal and complete information of withholding is being provided in tax challan, which is available to FBR, therefore submission of monthly withholding statements under Rule 44 of the Income Tax Rules, is a duplication.

Recommendation

We suggest the requirement of submission of monthly withholding statements under Rule 44 should be abolished.

2.4.19 EXPORT PROFITS AND TAX ATTRIBUTABLE TO EXPORT SALES – RULE 231

Rule 231(1) of the Income Tax Rules, 2002 reads as under:

"Where a taxpayer exports any goods manufactured in Pakistan, the taxpayer's profits attributable to export sales of such goods shall be computed in the manner, namely:-

(a) where a taxpayer maintains separate accounts of the business of export of goods manufactured in Pakistan, the profits of the export business shall be taken to be such amount as may be determined by the Commissioner in accordance with the provisions of Ordinance on the basis of such accounts; or ……."

The words 'separate accounts' (underlined above), are subject to different interpretations. One view is separate books of accounts in respect of business of export of goods manufactured in Pakistan and the second view is books of accounts of the taxpayer maintained in a manner from which the profits attributable to the business of export of goods manufactured in Pakistan can be separately determinable.

The Institute subscribes the second view as stated above.

Recommendation:

The rule 231(1)(a) be substituted as under:

"(a) where a taxpayer maintains books of account from which the profits of the business of export of goods manufactured in Pakistan are separately determinable, the profits of the export business shall be taken to be such amount as may be determined by the Commissioner in accordance with the provisions of Ordinance on the basis of such books of account; or……."

2.4.20 BANKS AND FINANCIAL INSTITUTIONS

2.4.20.1 Allowability of 1% or 5% of advances as charge against Bad & Doubtful Debts

The Taxation Officers are interpreting total advances as 'Advances' shown on the face of the balance sheet which are net of provision for bad debts (non-performing debts) specifically created by the banks. This means an illogical calculation of admissible provision for bad debts on the net advances (gross advances minus provision made in the accounts) as shown on the face of the balance sheet instead of the gross advances. In other words, to exclude the provisions from the gross advances would be to disallow the actual provisions twice which cannot otherwise be claimed under any provisions of the Seventh Schedule.

Recommendation:

An explanation should be inserted in Rule 1(c) of the Seventh Schedule that total advances means 'Gross Advances' before the accounting provisions for Bad & Doubtful Debts.

2.4.20.2 Transitional provisions - Rule 8A

- Through the Finance Act, 2010, the Seventh Schedule was amended to include that amounts provided for in or prior to the tax year 2008 which were neither claimed nor allowed as a tax deductible in any tax year, will be allowed in the tax year in which such advances are actually written off against such provisions, in accordance with the provisions of sections 29 and 29A.

  All such debts that have been written off are legally admissible deductions. In case they have not yet been allowed, all such claims should be allowed as a deduction. It is hard to comprehend a situation whereby a Bank can demonstrate that a write off of bad debts was neither claimed by the tax payer nor disallowed by the tax authorities.

Recommendation:

Rule (8A) of the Seventh Schedule requires suitable amendment in order to avoid misinterpretation and removal of the ambiguity. It is the suggested that existing Rule 8A (1) be replaced with the following text:

“Amounts provided for in the tax year 2008 and prior to the said tax year for or against irrevocable or doubtful advances which were not allowed as tax deductible in any tax year, shall be allowed as a deduction in the tax year, when there are reasonable ground for believing that the debt is irrecoverable.”

- Reference to section 29A in Rule (8A) of the Seventh Schedule is misplaced as the same is no more applicable to Banking Companies vide amendments made through Finance Act, 2009.

Recommendation:

Reference to section 29A in Rule 8A should be removed from the transitional provisions.

2.4.20.3 IAS 39 & 40 whilst arriving at Taxable income

The banking companies have not adopted and applied the requirements of IAS 39 and 40 in the preparation of their annual accounts, in view of the instructions issued by the SBP under BSD circulars. However, the taxation officer tends to amend the assessment on this account by invoking clause (g) of Rule (1) of Seventh Schedule and subjecting to tax the Mark-to-Market (MTM) adjustment by taxing the unrealized losses.

Since the applicability of IASs 39 and 40 have specifically been deferred by the SBP, the financial assets and liabilities of the banks are classified, measured and reported under the SBP's BSD circulars. Accordingly, additions made by the tax department on the plea that unrealized losses due to Mark-to-Market are in accordance with IAS 39 and 40 are both factually and legally incorrect. It would be completely absurd to presume that the requirements of these are in line with the measurement criteria of IAS 39 and 40.

Recommendation:

Explanation should be added under Rule (1)(g) of the Seventh Schedule in order to avoid misinterpretation and removal of the ambiguity.

2.4.20.4 Auditor's Certification under Clause (c) of Rule (1) of Seventh Schedule

The charge for provision of bad debts in the financial statements is subject to verification by the external auditors', who also examine the adherence to the Prudential Regulations.

In the presence of an overall auditor's report (which also covers adherence to Prudential Regulations), the requirement of furnishing a separate auditors' certificate for the claim of bad debts is superfluous and duplication.

Recommendation:

The requirements of furnishing a separate auditor's certificate should be dispensed with by making appropriate amendment in Rule 1(c) of the Seventh Schedule.

2.4.21 INSURANCE COMPANIES

2.4.21.1 Determination of the taxable income

Determination of the taxable income of the life insurance business is made as per the Fourth Schedule the Income Tax Ordinance 2001 Life insurance companies are required to produce two sets of financial statements viz statutory accounts under Section 46(1) (a) of the Insurance Ordinance 2000, referred to as “Regulatory Returns” and annual accounts under Section 233 of the Companies Ordinance 1984, referred to as “Published Financial Statements”.

Both the Regulatory Returns and Published Financial Statements consist of similar statements including a profit and loss account. There is a current initiative of ICAP to modify the contents of the Published Financial Statements so as to produce a single Statement of Comprehensive Income instead of two separate statements for the shareholders’ fund (Profit and Loss Account) and Statutory Funds (Revenue Accounts) in accordance with the requirements of the International Financial Reporting Standards (IFRS).

As a result it is necessary to clarify that the reference to “profit and loss account” in rule 2 of the Fourth Schedule of the Income Tax Ordinance 2001 relates to the statement required to be produced under Section 46(1)(a)(ii) of the Insurance Ordinance 2000. The suggested change is set out in the next sub-section.

Recommendation

Following amendment (underlined) is suggested to be made in Rule 2 of the Fourth Schedule of the Insurance Ordinance, 2000 (XXXIX of 2000):

"The profits and gains of a life insurance business shall be the current year's surplus appropriated to the Shareholders' Fund as disclosed in the profit and loss account prepared under section 46(1)(a)(ii) of the Insurance Ordinance, 2000 (XXXIX of 2000), as per advice of the Appointed Actuary, net of adjustments under sections 22(8), 23(8) and 23(11) of the Insurance Ordinance, 2000 (XXXIX of 2000) so as to exclude from it any expenditure other than expenditure which is, under the provisions of Part IV of Chapter III, allowed as a deduction in computing profits and gains of a business to the extent of the proportion of surplus not distributed to policy holders."

2.4.21.2 Deduction of tax at source (as recipient)

In the case of banking companies subject to Seventh Schedule under Rule 5 (2), an exemption has been provided to banks from withholding tax as 'reci pient' as such entities are all in organized sector and are subject to advance payment of tax.

Recommendation:

It is recommended that same principle be adopted for the insurance companies.

2.4.21.3 Capital gains on securities

Consequent to withdrawal of exemption of capital gains contained in Rule (6A) and introduction of tax on securities by insertion of section 37A, new Rule (6B) was inserted in Fourth Schedule to provide tax rate on capital gains on securities in the case of insurance companies. The proviso of this rule states as under:

"Provided that this rule shall not apply to the securities held for a period of more than twelve months".

Unlike the rates provided for the purpose of section 37A of the Ordinance, the rate card provided in rule (6B) does not provide zero rate for capital gains on securities held for a period of more than twelve months.

The very intention of the above proviso is akin to provisions of section 37A whereby capital gains on securities held for a period of more than twelve months should not be chargeable to tax, but the wordings of the proviso does not reflect such intention in clear terms.

Recommendation:

Proviso to Rule (6B) should be amended in the manner that capital gains on disposal of specified securities held for a period of more than twelve months will be exempt from tax.

2.4.21.4 Withholding tax on Maturity proceeds of Life Insurance Policies

Benefits paid out under life insurance contracts have always been exempt from income tax. In the recent past, however, the Income Tax Department have sought to pressurize life insurers to deduct withholding tax under Section 151(1)(d) of the Income Tax Ordinance 2001 from maturity values paid out on life insurance policies under the grab of section 151 of the Income Tax Ordinance, 2001. The relevant section is as follows:

"151. Profit on debt:- Where

(d) a banking company, a financial institution, a company referred to in sub clauses (i) and (ii) of clause (b) of sub-section (2) of section 80, or a finance society pays any profit on any bond, certificate or debenture or instrument of any kind (other than a loan agreement between a borrower and a banking company or development finance institution) to any person other than financial institution.

the payer of the profit shall deduct tax at the rate specified in Division I of Part III of the First

Schedule from the gross amount of the yield or profit paid as reduced by the amount of Zakat, if any, paid by the recipient under the Zakat and Ushr Ordinance, 1980 (XVII of 1980), at the time the profit is paid to the recipient."

The sub-section reproduced above clearly is meant to apply to financial instruments and not to policies of life insurance.

Further, vide FBR's C. No. IT.JI.1(7)/84 dated February 08, 1988 it was clarified that insurance premiums to and claims discharged by the Insurance Companies are not liable to deduction of tax under the corresponding section 50(4) of the Income Tax Ordinance, 1979 and this fact was further re-confirmed vide C. No. 1(25)IT-1/80 dated October 01, 1980.

In order to remove any ambiguity it is suggested that a provision be included in the Income Tax Ordinance clearly stating that section 151 does not apply to any amounts paid out under a contract of life insurance.

Recommendation

A new sub-section - 151 (2A) should be introduced as under:

"This section shall not apply to any amount paid out under a contract of life insurance as defined in Section 2(xxvii) of the Insurance Ordinance, 2000 (XXXIX of 2000)."

2.4.22 TRANSFER PRICING

Throughout the world, fiscal regulations prescribe provisions relating to non-arm's length consideration and taxing the sum falling outside this purview. This is termed as taxation of 'Transfer Pricing'.

Through the Income Tax Ordinance, 2001 special provisions were introduced for that purpose (Section 108). These provisions are almost in line with the international best practices as laid down in the principles laid down by the Organization for Economic Cooperation Development (OECD).

Almost all the entities engaged in manufacturing sector, especially those in pharmaceutical group, were subjected to arbitrary additions to income on that account under the repealed Act. These additions were contested in appeals and some companies are engaged in protracted litigation. That experience has revealed that there is no deficiency or shortcoming in the law. The problems arose in implementation and arbitrary attitude of tax officials. Provisions relating to non-arm's length consideration were streamlined in the Income Tax Ordinance, 2001. Furthermore, it has been specifically provided that such laws will be implemented in line with the guidelines laid down by OECD.

Since the introduction of the Income Tax Ordinance, 2001 there are very few cases where tax proceedings have been finalized under the new provisions of the Ordinance. All the cases from Tax Year 2004 to Tax Year 2008 are effectively exposed to action by the tax officers on that matter. It is considered that unless well laid down processes and procedures are agreed upon between tax officials and the taxpayers in accordance with the principles laid down by the OECD, it is expected that problems which arose under the repealed Act are expected to be repeated notwithstanding the improved and well laid down laws. That eventuality has to be avoided.

Recommendation:

The institute can undertake an effective role in the implementation of revised and improved provisions relating to non-arm's length consideration. It has been experienced throughout the world that fiscal issues relating to non-arm's length consideration are matter of determination of fact rather than application and interpretation of any law. OECD model also supports the same principle.

It is suggested that an exercise and then agreed upon processes be undertaken to prescribe the procedures for implementation of fiscal measure for taxing non-arm's length transactions.

2.5 TECHNICAL AND EDITORIAL

2.5.1 EXEMPTION OF INCOME OF INTERNATIONAL DONOR/DEVELOPMENT AGENCIES

All the aid agreements entered into with the international donor/development agencies such as the United Nations (UNO, UNICEF, UNCTAD, WFP, UNCHCR, UNDP) US AID, Japan International Cooperation Agency (JICA), Department for International Development (DFID UK), Asian Development Bank etc. contains a covenant whereby the amounts given under the grant or aid would not be utilized for the purposes of paying direct taxes in the recipient (donee) countries.

In the absence of any specific provision in the Income Tax Ordinance, 2001 there is always an ambiguity and doubt on the taxability of income, if any, of such donor agencies and in particular with reference to withholding taxes.

Recommendation:

Appropriate amendments should be made in the Ordinance to specifically exempt such international donor/development agencies from the application of income tax laws.

2.5.2 DEDUCTIONS NOT ALLOWED - SECTION 21(l)

Section 21(l) provides for deductions not allowed for transactions exceeding Rs. 10,000 paid otherwise than crossed cheque etc. Such provision is the need of the time to curb non-documentation and to increase the tax base. At the same time this section does not apply to certain transactions specified in second proviso.

The agro based industries are facing problem while making payments for purchase of agricultural produce directly from the growers/farmers, who either do not maintain any bank account or are not willing to accept crossed cheque etc.

Recommendation:

Exemption from payment through crossed cheque etc. should be provided in respect of transactions for purchase of agricultural produce directly from the growers/farmers.

2.5.3 CAPITAL GAIN ARISING ON DISPOSAL OF IMMOVEABLE PROPERTY – SECTION 37(1A) AND 37(5) AND DIVISION VIII OF PART 1 OF FIRST SCHEDULE

Capital gain arising on disposal of immovable property irrespective of the holding period was excluded from the ambit of “capital assets” and accordingly such gain was not chargeable to tax under the Income Tax Ordinance, 2001. Effective tax year 2013, capital gain arising on disposal of immovable property held for a period of two years is chargeable to tax as a separate block of income as under:

Where holding period of Immovable property is:

Up to one year	10%
More than one year but not more than two years	5%

By excluding immovable property from the list of assets which were specifically excluded from the definition of “capital assets” (i.e. now capital assets includes immovable property), the gain arising on disposal of immovable property irrespective of the holding period falls in the ambit of capital gains chargeable to tax under sub-section (1) of section 37. On the other hand the new sub-section (1A) inserted through Finance Act, 2012 specifically deals with the taxation of the capital gains arising on disposal of immovable property held for period up to two years and does not cater for capital gains arising on disposal of immovable property held for more than two years. Thus capital gains arising on disposal of immovable property held for more than two years shall be chargeable to tax under sub-section (1) like any other capital assets.

However, the intention of the legislature does not appear to tax capital gains arising on sale of immovable property held for more than two years but due to poor drafting of the amendments such gains falls in the mischief of capital gains covered under section 37(1).

Recommendation:

Appropriate amendments to cater for non-taxability of capital gain arising on disposal of immovable property held for more than two years.

2.5.4 TAX CREDIT TO A MANUFACTURER REGISTERED UNDER SALES TAX ACT, 1990 – SECTION 65A

The existing provisions of Section 65A(1) of the Income Tax Ordinance, 2001, granting tax credit to a manufacturer registered under the Sales Tax Act, 1990 and making at least 90% of the sales to persons registered under the Sales Tax Act, 1990.

The existing provision is subject to a very illogical interpretation by the field officers that the tax credit is available only to a manufacturer who makes at least 90% sales to a person registered under the Sales Tax Act, 1990 for the first time in the relevant tax year. This illogical interpretation is due to the poor drafting.

The Institute feels that such a restricted interpretation would defeat the entire idea and purpose of this section.

Recommendation:

Section 65A(1) of the Income Tax Ordinance, 2001 may be substituted as under:

"(1) Every manufacturer, registered under the Sales Tax Act, 1990 shall be entitled to a tax cred it of two and a half per cent of tax payable for a tax year, if ninety per cent of his sales during the said tax year are to the person who are registered under the aforesaid Act."

2.5.5 MINIMUM TAX (TAX ON TURNOVER) - SECTION 113

Minimum tax on turnover under section 113 was levied on association of persons and individuals having turnover of Rs. 50 million or above through Finance Act, 2009. However, the corresponding clause (c) of sub-section (2) of section 113 when referring to the actual tax paid refers to the respective Division of the First Schedule that refers to tax levied on companies. As a result it appears the concept of carry forward of minimum tax for adjustment against normal tax payable in the following five years is restricted to companies only. We understand that this is a lacuna in law.

Recommendation:

The concept of carry forward of minimum tax be also extended to association of persons and individuals by making appropriate amendments in clause (c) of sub-section (2) of section 113 whereby instead of referring to the specific Division reference should be made generally to tax levied under the First Schedule to the Ordinance.

2.5.6 TAXATION OF INCOME OF CERTAIN RETAILERS - SECTION 113B

Through Finance Act, 2010 the rate of tax on retailers being an individual or an association of persons having turnover upto Rs. 5 million was raised from 0.50% to 1.00% by amendment in Division IA of Part I of First Schedule.

However, under section 113B, the rate of tax on retailers having turnover of more than Rs. 5 million and registered under the special procedure for payment of sales tax continues to be 0.5% on turnover upto Rs. 10 million and 0.75% for the turnover in excess of Rs. 10 million.

Recommendation:

In Section 113B in the table in column 3 against serial number 1 the figure "0.5" should be substituted by "1.00" and against serial number 2 the figure "0.75" should be substituted by "1.25".

2.5.7 FILING OF WEALTH STATEMENT - SECTION 116(4)

Filing of wealth statement along with its reconciliation is obligatory on every person (other than a company) who is required to file the statement of final tax, where the final tax amounts to Rs. 35,000 or more.

Inadvertently, the obligation of filing wealth statement has also been placed on an Association of Persons. Wealth statement is only in respect of an individual and therefore placing this obligation on an Association of Persons is not appropriate.

Recommendation:

The words 'Every person (other than a company)' should be substituted by 'An individual'. Alternatively, if the intention is filing of wealth statement of members of an association of persons than the entire section needs to be suitably re-drafted.

2.5.8 APPEAL TO THE COMMISSIONER (APPEALS) - SECTION 127

Section 127 (1) of the Income Tax Ordinance, 2001, provides for orders against which an appeal lies with the Commissioner (Appeals). For this purpose, specific sections have been referred to in this section.

As a result dispute arises as to whether an appeal lies before the Commissioner (Appeals) against orders under the sections that are not specifically mentioned in section 127(1) e.g. orders under section 123, 124 etc.

Originally, this section provided for all orders of the Commissioner under the Ordinance against which an appeal lies with the Commissioner (Appeals), just like the existing section 131(1) [orders against which an appeal lies before the Income Tax Appellate Tribunal].

Recommendation:

In order to remove, the ambiguity in section 127(1) of the Income Tax Ordinance 2001, it should be substituted as under:

"Any person dissatisfied with any order passed by a Commissioner (other than the Commissioner (Appeals)) or an Officer of Inland Revenue under the Ordinance other than an order against which a specific remedy is provided under the Ordinance, may prefer an appeal to the Commissioner (Appeals) against such order".

2.5.9 ADVANCE INCOME TAX - SECTION 147(6A)(b)

2.5.9.1 Advance tax on taxable income - Section 147(1)

Two types of advance tax payment are now envisaged, i.e., advance tax against taxable income (Section 147(1)) and advance tax against certain capital gains (Section 147(5B)). Sections 147(1) does not operate to the exclusion of section 147(5B), which is erroneous.

Recommendation:

Appropriate amendment of section 147(1) to exclude certain capital gains against, which advance tax is payable under section 147(5B).

2.5.9.2 Advance tax on taxable income - Section 147(4B)

Section 147(4B) provides for the formula of calculating the amount of quarterly advance tax payable by an individual.

Under section 147(1)(c), salary income subject to deduction of tax at source under section 149 is excluded for the purposes of payment of advance tax and similarly in the component "B" of the formula given in section 147(4B) tax deducted under section 149 cannot be deducted from the each quarterly instalment.

Accordingly, the advance tax payable should have been the proportionate tax attributable on taxable income as reduced by income from salary. Contrary to this the component "A" of the formula given in section 147(4B) requires to pay advance tax equal to the tax assessed for the latest tax year which is inclusive of tax on income from salary as well.

Recommendation:

In component "A" of the formula given under section 147(4B), the words "tax assessed" should be substituted by the words "proportionate tax attributable on taxable income excluding income from salary assessed".

2.5.9.3 Advance tax on taxable income - Section 147(6A)(b)

Under clause (b) of section 147(6A), a company is entitled to 'make adjustment for the amount (if any) already paid'. The words 'make adjustment for the amount (if any) already paid' are ambiguous.

Recommendation:

The words "make adjustment for the amount (if any) already paid" should be substituted with the words "make adjustment of tax already paid for which a tax credit is allowed under section 168".

2.5.10 IMPORTS (COLLECTION OF TAX AT SOURCE) - SECTION 148(8)

Through Finance Act, 2009, tax collected at source on import of 'packing material' has been made minimum tax. A plain reading of the amended section reveals that 'packing material' imported by any one is subject to minimum tax. However, contrary to the provisions of the law, Para 32.2 of Circular No. 3 of 2009 states that by virtue of this amendment the import of packing material by manufacturers of edible oil, will be subject to minimum tax. The amendment made last year is against the intent as explained in Para 32.2 of Circular No. 3 of 2009. Accordingly, section 148(8) of the Ordinance needs to be suitably amended to reflect the true intent to avoid any misconception.

Recommendation:

In section 148(8) after the word 'oil' a semicolon should be inserted and after the word 'material' the words 'imported by the manufacturers of cooking oil or vegetable ghee or both' be inserted.

2.5.11 PRESCRIBED PERSONS FOR THE PURPOSES OF WITHHOLDING TAX FROM PAYMENT TO A PERMANENT ESTABLISHMENT OF A NON-RESIDENT ON ACCOUNT OF SALE OF GOODS, SERVICES AND EXECUTION OF CONTRACTS – SECTION 152(2A)

Section 152(2A) was inserted through Finance Act, 2012 requiring “prescribed person” to deduct tax at source while making payment to a permanent establishment in Pakistan of non-resident on account of sale of goods, rendering or providing services and execution of contracts.

However, inadvertently the “prescribed persons” have not been defined which is an anomaly.

Recommendation:

In section 152(2A) appropriate amendments are required to prescribe the “prescribed persons”

2.5.12 EXPORTS (DEDUCTION/COLLECTION OF TAX AT SOURCE) - SECTION 154(3C) AND FIRST SCHEDULE - PART III - DIVISION IV

The Collector of Customs has been empowered to collect tax at source from the gross value of goods at the time of clearing of goods exported [section 154(3C)] in addition to an authorized dealer in foreign exchange at the time of realization of foreign exchange proceeds on account of export of goods by an exporter [section 154(1)].

A plain reading of the section 154(1) and 154(3C) reveals that the tax on export of goods will be collected twice, once at the time of clearing of goods and again at the time of realization of export proceeds of such goods. Although, this is not the intent of law as explained in Para 36 of Circular No. 3 of 2009 that sub-section 154(3C) applies only on clearing goods for export made without form "E". However, the sub-section inserted is silent as to what has been explained in Circular No. 3 of 2009.

Recommendation:

In section 154(3C), after the word 'exported' the words "without Form 'E'" or the words 'through land routes' be inserted.

2.5.13 CERTIFICATE OF COLLECTION OR DEDUCTION OF TAX AT SOURCE

2.5.13.1 Section 164(1)

A withholding agent collecting or deducting tax at source is also required to provide the copies of tax deposit form (challan) of the tax duly deposited on behalf of the person from whom it is collected or deducted or "any other equivalent document".

The Ordinance and the Rules are silent as to what is meant by 'any other equivalent document'. This will be open to different interpretations and continuity of the problem of allowing credit of tax or refund of tax collected or deducted at source, particularly in case of utility bills, book transfers by government departments / banks in respect of profit on debt and cash withdrawal, etc.

Recommendation:

The term "any other equivalent document" should be defined in section 164(1).

2.5.13.2 Section 164(2)

The sub-section on one hand requires submission of the tax deposit form (challan) in respect of tax collected or deducted at source along with the return and on the other hand states that the certificate of tax collected or deducted in the prescribed form shall be treated as sufficient evidence thereof, which is a contradiction.

Recommendation:

The contradiction in section 164(2) needs to be removed.

2.5.14 PROSECUTION FOR NON-COMPLIANCE WITH CERTAIN STATUTORY OBLIGATIONS -SECTION 191

Under sub-section (1) non-compliance of statutory obligations results in prosecution proceedings which may result into a fine or imprisonment for one year or both and under sub-section (2) a further fine or imprisonment for two years or both if the compliance is not made within the time allowed by the court.

Sub-section (2) dealing with a further fine or imprisonment or both, after the amendment made through Finance Act, 2009, provides for a maximum limit of fine of Rs.50,000 while sub-section (1) continues to remain open ended as to the quantum of fine.

Recommendation:

In section 191(1) after the word 'fine' the words 'not exceeding fifty thousand rupees' be added.

2.5.15 ELECTRICITY CONSUMPTION (COLLECTION OF TAX AT SOURCE) - SECTION 235(4)

In case of non-company taxpayer, tax collected along with electricity bills is a minimum tax where the monthly bill amount does not exceed Rs. 30,000 and adjustable tax where the monthly bill amount exceeds Rs. 30,000. As a result such tax collected during the year is partly minimum tax and partly adjustable tax depending upon the each month bill amount. Accordingly, each and every bill for a month has to be seen to establish which is the 'minimum tax" and which is the 'adjustable tax'. It is not a simple job, both for the taxpayer and the department, and it becomes more difficult where more than one electricity connection is involved.

Recommendation:

In section 235(4) instead of threshold of Rs. 30,000 of each electricity bill amount an annual threshold of Rs. 360,000 on total expenditure of electricity should be prescribed for the purposes of determining whether the annual tax collected is minimum tax or adjustable tax.

2.5.16 EXEMPTION OF INCOME OF WORKERS' PROFIT PARTICIPATION FUND - CLAUSE (66) OF PART - I OF SECOND SCHEDULE

Income of the WPP Fund is exempt under the WPP Fund Act which was accepted under the Ordinance by virtue of Proviso to section 54 of the Ordinance as it stood before an amendment brought in through the Finance Act, 2008.

However, through the Finance Act, 2008 the proviso to section 54 of the Ordinance was omitted. As a result exemption provided to the income of the WPP Fund under the WPP Act lost its applicability, which appears contrary to the entire Scheme.

The WPP Fund itself is not an entity engaged in any profit earning activity for the reason that the sums available to it are either to be paid to the workers or deposited with the Government. It is for this reason that the relevant Act provided exemption to a WPP Fund and such exemption was also protected under the Income tax law.

The amendment in section 54 of the Ordinance as discussed above jeopardized a number of entities which were exempt from Income-tax under various statutes other than the Income tax law. Accordingly, certain sub-clauses were inserted in Clause (66) of Part I of the Second Schedule to the Ordinance granting exemption from Income Tax to entities which were enjoying such exemption under respective statutes after the proviso to section 54 of the Ordinance was withdrawn. However, due to an oversight the exemption of income of WPP Fund could not find its place in Clause (66) of Part – I of the Second Schedule.

Recommendation:

In view of the above it is imperative that a corresponding amendment should be made giving exemption to the income of WPP Fund established under the WPPF Act. Accordingly, it is proposed that the following sub-clause be reinserted in Clause (66) above after sub-clause (xxiii) - *"(xxvi) Workers Participation Fund established under the Companies Profits (Workers Participation) Act, 1968."*

2.6 LABOUR LEVIES

2.6.1 GENERAL

During the first tenure of the present government in 70's, labour levies were introduced to let the labourers share the benefit in the profits of the companies. Nevertheless, over the last three decades, such levies have been abused in such a manner that this social benefit has become a tool for exploitation in the form of high tax rate. In Pakistan, the effective corporate tax rate is 35 percent plus 2 percent Workers' Welfare Fund (WWF) and 5 percent Workers' Profit Participation Fund (WPPF). This effectively makes the rate equal to 42 percent which may be one of the highest corporate tax rates in the world. There is a need to immediately review the same.

Recommendation:

Consolidation of all labour levies with a rate of 2 to 3 percent in line with regional standards.

2.6.2 WORKERS' WELFARE FUND [WWF]

Every business establishment is required to pay a 2 percent WWF at higher of returned income or accounting profit. This is a straight levy. The amount is collected along with the income tax.

This levy effectively places the profitable organized sector at serious disadvantage viz-à-viz unorganized sectors which are prone to under declaration of income.

The amount collected is apparently handed over to the Ministry of Labour to be utilized for the welfare of the workers. We are not aware of any instance where labourers employed have directly or indirectly been benefited by any scheme undertaken out of such funds. This places serious question on the continuity of this levy. For effective use of WWF it is advised that the employers be allowed to retain certain portion of the contribution enabling them to make investments for welfare of workers.

Workers Welfare Fund is levied under Workers Welfare Ordinance 1971 on all industrial establishments operating in Pakistan. Upto 30th June 2008 it was levied as 2% of the total income as determined under the Income Tax Ordinance 2001. Certain changes were introduced in the Finance Act 2006 to amend the concept of total income. In order to implement the above change, further amendments were made in Section 4 of the above Ordinance by Finance Act 2008. The above amendments have changed the total scheme of Workers Welfare Fund and the burden of Industrial Establishment on account of Workers Welfare Fund has increased manifold.

Further, the scope of this levy has been extended to almost all entities by inclusion of establishments covered under the Shops and Establishment Act, 1969 in the definition of Industrial Establishment in the Workers Welfare Ordinance, 1971. Historically, this levy was restricted to 'Establishments' where industrial labour/workers were involved. The amendment made has extended this levy to almost all establishments and has substantially increased the quantum of such levy as well.

Effect of Changes:

The concept of total income was changed and the same was defined to mean as under:

"(i) " total income" means:

(i) where Return of Income is required to be filed under this Ordinance, the profit (before taxation or provision for taxation) as per accounts or the declared income as per the return of income whichever is higher; and

(ii) where return of Income is not required to be filed, the profit (before taxation or provision for taxation) as per accounts or four per cent of the receipt as per the statement filed under section 115 of the Ordinance, whichever is higher."

The effects of above change in the definition of 'total income' under the Workers Welfare Ordinance, 1971 are discussed as under:-

Tax payers filing Return of Income:

In case of income liable to tax under normal law the return of Income is required to be filed. In such circumstances, the Workers Welfare Fund is payable at 2% of the income as per the accounts or income as per the Income Tax Ordinance whichever is higher.

It is to be noted that main difference between accounting income and taxable income arise on account of timing difference in claiming of depreciation allowances. In taxation law, initial depreciation is allowed on all new assets purchased by the taxpayer in addition to normal depreciation. Moreover, the rate of depreciation may also differ in accounting and tax laws. Therefore, the taxing higher of the both income would mean that the taxpayer will be denied the genuine expense of depreciation. In other words, the Workers Welfare Fund would be charged without allowing deduction of major expense in shape of investment made in the project. Therefore, the Workers Welfare Fund would be payable on income which is not real income of the industrial undertaking. The above treatment is not legally tenable and is also against the spirit of Workers Welfare Fund which allows the workers to participate in genuine profits of the industrial undertaking.

Moreover, under the International Financial Reporting Standard, the income of the subsidiary/associated company is also clubbed in the accounting income of the holding company under equity method. Therefore, in these circumstances, accounting income and holding company may include income of subsidiary, which has either itself paid the Workers Welfare Fund on its income or is not an industrial undertaking at all. Under the new scheme, the company will be burdened to pay Workers Welfare Fund on income of subsidiary which is totally unreasonable and not legally tenable.

Tax payers filing Statement of Final Tax (PTR cases)

This scheme is for all those cases which fall in the presumptive tax regime and are not required to file the return of income. Under the above regime the tax payer will be required to pay the Workers Welfare Fund on higher of profit as per accounts or 4% of the receipt.

It practically means that even a loss making unit has to pay Workers Welfare Fund at 2% of 4% of receipt as the same will be higher in case the company is making loss as per accounts.

As discussed in (a) above, this treatment is against the basic concept of Workers Welfare Fund scheme and put extra burden on industrial undertaking.

Recommendations:

- The Workers Welfare Fund may be charged on a consistent basis based on taxable profit as under the old scheme;
- Employers should be allowed to retain certain portion of the contribution enabling them to make investments for welfare of workers;
- The pre-amended position be restored for restricting the levy to establishments where industrial labour/workers are involved for whose benefit the fund was originally established i.e. establishments covered under the Shops and Establishment Act, 1969 should be excluded.

2.6.3 WORKERS' PROFIT PARTICIPATION FUND [WPPF]

The Income Tax Ordinance, 2001 ("Ordinance") provides exemption in the hands of workers receiving sums out of the WPP Fund vide Clause (26) of Part I of the Second Schedule and allows deduction of the sum allocated to the WPP Fund by the Company vide section 60B of the Ordinance.

Under the law all business establishments are required to contribute a sum equal to 5 percent of the profit as WPPF. This amount is in principle required to be distributed amongst the workers of that establishment. However, due to constant and intentional bureaucratic mismanagement this share of labour in profit has been converted into a direct levy for such establishment.

This intentional mismanagement has been undertaken by placing unnatural and unreasonable restrictions on the distribution of such amount. Under the law only the workers getting salary of a very low level are entitled to receive any sum out of such fund. Any excess not so distributed amongst the workers is transferred to the Fund that effectively ends up with the Government. Thus for all practical purposes it is Government levy.

In the case of organized sector, the salary and wages of the workers are such that in almost all the cases workers do not get any sum out of WPPF. This is definitely not the objective of WPPF.

Recommendations:

- Allow the establishments to utilize the contribution of WPPF for the welfare of labour in the form of providing health, education and housing for the labour. This was exactly the intention of the law when it was introduced.

- Enhance the threshold of worker's salary in line with current prevailing structure.

3 INDIRECT TAXES

3.1 POLICY MATTERS

3.1.1 TAX AMNESTY / WHITENING SCHEMES

Amnesties, presumptive taxation, fixes tax regime, reduced rate regime curb documentation and effectively have been counter-productive in formalisation of economy and development of tax base. In view of value addition tax scheme offered to commercial importers coupled with immunity from audit, there is effectively a ceiling on the genuine value addition as very few businesses declare value addition which leads to serious distortion.

ICAP has always opined that tax amnesty schemes not only prove inefficient for revenue generation but also encourages tax evasion and illegitimate avoidance since the businesses tend to believe that future amnesty measures would help them legalise all their out of books transactions. In line with such principle stand, the ICAP vehemently opposed the recent amnesty / whitening scheme proposed by the previous government.

The Institute believes that tax evaders must be dealt with strictly. Tax intelligence system and the process of survey and search should be effectively brought in place to point out the tax delinquents and bring them into the tax net in order to increase the tax base which will ultimately help in boosting the revenue collection.

3.1.2 TAX RATE & PROTECTION AND PROMOTION OF INDUSTRIAL SECTORS

Present rate of 16% Sales Tax with an additional 3% value addition tax, on commercial Imports is a bottle-neck in inducing people to come within tax net at one hand, and is also contributing to inflation on the other hand.

Originally the rate of sales tax was 12.5% which was enhanced to 15%, then 16% on account of merger of octroi on its abolition.

From an economic context, especially in relation to the present state of affairs there is a need to review the present rate of VAT in Pakistan. This matter will be more clearly appreciated on the review of the composition of total collection and sectors contributing to the same. There is no general consensus on the rate of VAT around the world. However, it has to be appreciated that in the region being China, India, Thailand, Malaysia and UAE, there is no or much lesser incidence of VAT in the form of sales tax. For example, in India it is provincial subject with a straight tax rate of around 5% to 10%. In China, there is effectively no VAT. The only country in the region with a full fledged VAT is Bangladesh where the incidence is closer to Pakistan.

Unlike all the developing countries of the world, Pakistan does not offer any substantial protection to its manufacturing / industrial sector. Consequently, businesses prefer to operate as traders and enjoy associated tax / duty benefits. To address the growing inflation, unemployment and shrinking business environment, not only the rate of indirect taxes needs to be reviewed but policies should be geared to make indigenously manufactured goods competitive against imported goods.

3.1.3 HARMONY AMONG FEDERAL AND PROVINCIAL SALES TAX LAWS

Services rendered, initiated or consumed in the Province of Sindh and Punjab are being taxed under the respective Provincial laws. There are certain overlapping situations under the Federal and provincial laws e.g. admissibility of Sindh / Punjab Sales tax on services for refund claim with FBR. It is proposed that FBR, Sindh Revenue Board and Punjab Revenue Authority should agree upon legal framework and thrash out the legal and procedural impediments.

3.1.4 REFUNDS

Sales Tax regime, as adopted in Pakistan, basically adheres to the concept of Value Addition with the key objective to pass on the ultimate charge of tax through different value addition process to the end user of goods or services. Therefore, in legislating the law and devising any policymeasure this basic principle should remain in focus. In true spirit, there should not be any concept of monthly refunds except for Exporters and taxpayers exposed to reduced taxation.

3.1.5 FEDERAL EXCISE DUTY ON SERVICES

Notwithstanding certain services being taxed under independent Provincial Sales Tax Laws in vogue in Sindh and Punjab, such services are still taxable under Federal Excise Act as well as under Punjab and Sindh Sales Tax Laws, which may result to double taxation.

Therefore, it is recommended that if any tax is payable on any service under any provincial sales tax law in Pakistan, it should be made exempt from the scope of Federal Excise Act 2005 and allied rules.

3.1.6 PRESUMPTIVE / VALUE ADDITION / FIXED TAX SCHEMES

Presumptive taxation, fixed tax regime, reduced rate regime curb documentation and effectively have been counter-productive in formalization of economy and development of tax base. Pakistan is effectively the only country in the world where whitening of black money is possible with a minimal cost equal to the presumptive tax. The negative effect of this system is a major handicap in development of tax base and documentation. This has been explained as under:

- Under and over invoicing has become a very serious issue which is badly affecting the collection of taxes at import stage. Under invoicing also promotes outflow of differential proceeds via Hundi / Hawala, which is detrimental to the economy.

- In view of value addition tax scheme offered to commercial imports coupled with immunity from audit, there is effectively a ceiling on the genuine value addition as very few businesses declare actual value addition which leads to serious distortion.

- Implied whitening of income by way of paying 6% Income Tax & 19% Sales Tax and declaring any sale price which is final liability for Income Tax purposes is another aspect which needs to be addressed on war footings.

ICAP therefore recommends that, in line with VAT International Best Practices, all Presumptive / Value Addition / Fixed Tax Schemes should be abolished and all such sectors / goods may be brought under the uniform tax regime.

Under Section 11(6) of the Act, a presumptive assessment can be made in case the taxpayer fails to file the return. The parameters of presumptive assessment are defined in Para (I) of Part II of Sales Tax General Order 3 of 2004. However, in numerous cases, the superior courts have held that any assessment on the basis of assumptions is not legal and permissible under the law.

ICAP, therefore, recommends that Section 11(6) of the Act and the related Para I of Sales Tax General Order 3 of 2004 may be deleted altogether.

3.1.7 COMMERCIAL ELECTRICITY CONNECTIONS

At present large number of persons doing business either as retailer or manufacturer on small scale and are not registered. In order to bring such persons into the tax net, it is suggested that condition of having NTN should be made mandatory for new commercial electricity connections and for three phase electricity connections used for manufacturing purpose, registration for sales tax should be made mandatory.

3.1.8 INCENTIVE FOR REGISTERED PERSONS

Parallel economy in our country is many folds as compared to the documented economy which has made it very difficult for the registered persons to do business. ICAP believes that some extra incentive may be offered to the registered persons, if they deal only with registered and organised sectors. This may be in the shape of fixed or variable tax credit(s) at the end of the year. This may help in increasing the number of registered person.

3.1.9 SALES TAX ON SERVICES

Effective 01 July 2011, services rendered, initiated or consumed in the Province of Sindh are being taxed under the provisions of Sindh Sales Tax on Services Act 2011 (SSTSA) and administered by Sindh Revenue Board (SRB). Likewise, Punjab Revenue Authority (PRA) has also started collection sales tax from 01 July 2012 on services rendered, initiated or consumed in the Province of Punjab under the vires of Punjab Sales Tax on Services Act 2012 (PSTSA).

The provision of SSTSA / PSTSA and allied rules are more or less akin to that of the Act. However, at various places, the provisions of the Act and SSTSA / PSTSA are not only overlapping but also lack clarity especially with reference to the kitty, i.e., provincial or national, where sales tax needs to be deposited by the taxpayer. Further, position is not only uncertain but overlapping regarding mechanism and procedure of sales tax on restaurants, franchise services and advertisement services. On the other hand, FBR authorities still dispute admissibility of Sindh / Punjab Sales Tax as tax refund.

ICAP believes the taxpayers operating across provinces being confronted simultaneously by FBR, SRB and PRA for payment of Sales Tax on the same services largely due to the following reason;

- multiple and overlapping provisions of Sales Tax Act 1990, Federal Excise Act 2005, SSTSA and PSTSA.
- lack of clarity on the applicability of the provisions law amongst FBR, SRB and PRA
- lack of coordination amongst FBR, SRB and PRA for facilitation of tax payers on legal and procedural matters

- row of arguments amongst FBR, SRB and PRA over the interpretation of respective laws and 18th Amendment.

For the foregoing reasons, services providers like banking companies, telecommunication companies, TV channels, FMCGs, pharmaceutical companies and other sectors face severe financial and compliance pressures and at occasions such situations result in unwarranted litigation.

If the above stated issues are not addressed in timely manner to save the tax payers from undue litigation and the federal and provincial tax laws are not harmonized, we are afraid, that it might result in:

- leakage of due taxes from the federal and provincial kitty
- great concern for federal provincial governments on generation of tax revenue
- failure of implementation of 18th Amendment in its true spirit

It is, therefore, suggested that FBR, SRB and PRA should agree upon a legal framework and thrash out the various legal and procedural matters which remain unsettled to date. Besides, the Institute also recommends that specific provisions need to be simultaneously incorporated in all the tax statutes i.e., SSTSA, PSTSA and Federal Excise Act 2005 whereby taxpayer would not be called upon to pay the tax twice, in case FBR / SRB is satisfied that the tax payer had rightly discharged his tax liability but inadvertently deposited such tax it into a wrong account head of either FBR / SRB / PRA.

ICAP also recommends setting up a "Coordination Committee" comprising of representatives from Ministry of Finance, FBR, SRB, PRA and ICAP so the ongoing and potential issues in dispute are tabled, discussed and sorted out.

3.1.10 EXCISE DUTIES

Excise duties are, in principle, levied to curb consumption of luxury and unwarranted products. Nevertheless, that general principle is being seriously violated in Pakistan. There are excises on many essential items. There is a need to determine the equitable basis for commodities and services which should be subject to the levy of Federal Excise. At present, Federal Excise is effectively an additional indirect tax on major manufacturing sectors. This high incidence of indirect taxation encourages evasion. It is due to this reasons that there is very high evasion of taxes in those sectors where both excise duty and sales tax is leviable. This also promotes manufacturing in unorganized sector e.g. paints, beverages, etc.

There is a need to review the issue of overall incidence of indirect taxes so that possibilities and comparative advantages for evasion are reduced or minimized.

3.2 HARDSHIP / COMPLIANCE ISSUES

3.2.1 SALES TAX REGISTRATION

The sales tax registration procedure has been made very cumbersome and lot of time is wasted in getting sales tax registration. There is need to simplify the procedure and the time required for registration should also be reduced especially for those persons who are already for income tax purpose. CNIC, NTN and bank certificates should be considered as adequate requirements for registration.

Further, registration under the category of 'manufacturer' has become a peculiar and problematic area as a person cannot be registered as a manufacturer unless he has a manufacturing facility. This particular requirement is posing problems for new industrial units who wish to be registered as a manufacturer and import machinery under concessionary SROs. Such SROs also award tax remission / reduction to persons registered as manufacturers. In this case, such industrial unit has to first pay applicable taxes on import of plant and machinery and then acquire registration as manufacturer. This unnecessarily tightens and drains his liquidity.

Hence, it is recommended that an SOP may be developed in consultation with business community to facilitate sales tax registration of new business entities in a facilitative manner.

3.2.2 E-FILING

It has been observed that whenever there is some change in the statute which has effect on the calculation of sales tax liability or the format of return is changed, the tax payers have to face problems in e-filing the return on the web portal due to technical faults in the FBR portal resulting in multiple extensions of date for e-filing of sales tax return. This results in wastage of time and resources of tax payers. It is suggested that when new sales tax return is uploaded on the web portal, trial tests should be performed by the FBR officials to make sure that the portal works as desired and the return is e-filed without any hassle and technical problem.

3.3 SPECIFIC TAXATION PROPOSALS

3.3.1 WITHHOLDING SALES TAX- SRO 660(I)/2007

The menace of undocumented and benami business is the root cause of our economic ills. Undoubtedly, we need to put a strong barrier against such trend. However, keeping in view the peculiar business and tax culture prevailing in the country, measures akin to recently issued SRO 821(I)/2011 and SRO 191(I)/2012 may not yield the desired results for the Government.

In line with ICAP's recommendations submitted through our Budget Proposals for the year 2012-13, the Government has re-introduced a revamped and much broader model of withholding sales tax. However, the recent amendments in Sales Tax Special Procedure (Withholding) Rules 2007 (the rules) vide SRO 98(I)/2013 dated 14 February 2013 poses certain focal issues for the business which have not been addressed in the said SRO. Further, ICAP believes that the scheme should be further modified to yield desired results for the exchequer and documentation of economy. In this respect, the following modifications are suggested in such scheme:

- Rule 5 of the rules provide exemptions to certain goods from the purview of sales tax withholding. It is recommended that except for POL products and utilities, such exemptions may be done away with to provide a level playing field for the businesses. Alternatively, all such exemptions may be notified with respective PCTs to avoid confusion regarding exemption or otherwise of such goods under WHT rules.

- In the wake of SRO 98, commercial importers are likely to face liquidity problems in case of sales to withholding tax agents. In terms of Rule 58C of Sales Tax Special Procedure Rules 2007, commercial importers are not entitled to claim refunds including that of tax withheld by their customers / buyers. Thus, it is recommended that all commercial imports may be declared as exempt under Rules 5 of the rules or refunds may be allowed under Rule 58C of the rules.

- In case of purchases of taxable goods from unregistered persons, the withholding of sales tax may be made compulsory at the applicable tax rate, e.g., 2%, 5%, 16%, 19.5%, etc. out of the total purchase bill. After deduction, the balance sum may be paid to the concerned seller. To promote such scheme and as a reward of such compliance work for the exchequer, the withholding agent should also be offered the claim tax credit of an equivalent sum as has been deducted by him from payment made to unregistered persons.

3.3.2 JOINT LIABILITY OF BUYER & SUPPLIER- SECTION 8A

In terms of Section 8A of the Act, a registered person purchasing goods is jointly and severally liable if the sales tax is not paid by the seller of the goods. It is quite unjustified to punish a genuine buyer for an offense committed by corresponding supplier.

The Institute believes that Section 8A is against the law of natural justice where a person is punished for an offense which he has not committed. Therefore, it is strongly recommended that the provision of Section 8A should be amended to provide protection to registered buyer, in case(s) where compliance of Section 73 of the Act has been duly made.

3.3.3 INADMISSIBLE INPUT TAX- SECTION 73

1. In case of payment not made by the buyer within 180 days, his corresponding input tax becomes inadmissible. It appears to be an irrational proposition for the government to impose such restriction on the buyer considering the fact that related sales tax is already paid by supplier into government treasury at the time of issuing tax invoice.

   ICAP recommends that such an anomaly may be taken care of and done away with.

2. The law does not take into account transactions where payments are made by some other person / guarantor on behalf of the buyer. Part payment of invoice, to the extent of sales tax, is also not catered in the statue, although the same was permissible in the Finance Act 2003 but withdrawn vide Finance Act 2004.

It is, therefore, suggested that:

- Payment made by third party on behalf of registered person should also be recognized for taking input credit.
- In case where payment of sales tax amount has been made within the time limit provided under Section 73, the same should be allowed as input tax.

3. At present, gas / electricity and petroleum sectors are caught by the vicious circular debt problem and payment of invoices are delayed because of their liquidity issues.

   ICAP suggests that as a special case and till the time the issue of circular debt is amicably sorted out, utility companies may be exempted from the application and requirement of Section 73 of the Act.

3.3.4 DEBIT & CREDIT NOTES- SECTION 9

There is no provision in the Act to recognize sales tax which becomes a bad debt subsequent to supplier's payment thereof to the exchequer. It is suggested that, in line with Section 29 of the Income Tax Ordinance 2001, bad debts should be recognized and made adjustable by virtue of debit and credit note mechanism envisaged under Section 9 of the Act.

Further, in the present era where technology checks can be placed, as long as the registered person is able to prove the genuineness of original and revised transaction, no time limits may be imposed upon him under the rules for issuing credit and debit note or enjoying related tax credit / adjustment. At least, the minimum time period should be extended to 365 days.

3.3.5 EXCESSIVE TAXATION ON EXEMPT SECTOR- SECTION 13

There are certain industries / sectors which have not been brought under the sales tax net. However, such sectors are prone to excessive taxation at input stage. For instance, pharmaceuticals finished products are exempted from sales tax and their prices are also government regulated. However, pharma sector continues to bear the ever increasing cost and allied sales tax on packing materials like PVDC, PVC Aluminum foil, utilities and cold formable.

Being regulated by the government, the increase in cost of packing material and utility services prices and allied sales tax cannot be passed on to consumer nor can be claimed as input tax. Therefore, ICAP suggests that sales tax on packing material and utility bills of pharmaceutical industry should be classified as zero rated.

3.3.6 REDUCED RATE REGIME FOR EXPORT ORIENTED SECTORS-SRO 1125(I)/2012

By virtue of recent amendments, domestic zero rating of textile, leather, surgical, sports and carpet sectors has been done away with by levying 2% sales tax. Through SRO 221(I)/2013 dated 19 March 2013; such sectors have also been debarred from claiming refunds of excess input tax.

However, such reduced rate taxation and restriction on claiming monthly refunds, the allied and support industries of the above 5 sectors, e.g., chemical manufacturers have been put in severe disadvantageous position in the following manner:

- The incidence of input tax is 11% higher than that suffered by commercial importer, i.e., 1% higher
- Manufacturers are now exposed to Section 8B whereas commercial importer still enjoys exemption from the purview of Section 8B
- Manufacturers would suffer sales tax @ 16% and pay output tax @ 2%. The excessive input tax will not be claimable but carried forward to next tax period(s). This way, huge liquidity would become stuck up which, till todate, was refundable on monthly basis
- Every month 10% of output tax will become payable under Section 8B

In view of the foregoing practical and business problems, it is suggested that goods exposed to reduced rate tax on sales stage may be exempted from Section 8B. Further, SRO 221 may be amended to allow monthly refunds to such industries / sectors who suffer 16% sales tax on imports local procurements.

3.3.7 SUPPLY- SECTION 2(33)

The amended definition of the term 'supply' does not include the term "Other Disposition" as part of supply. "Other Disposition" was discussed in Para 1(E) of Sales Tax General Order (STGO) No. 2/2004 dated 12 June 2004 wherein the FBR had opined that return of goods by the vendor back to the principal tantamount to "Other Disposition" and accordingly liable to sales tax. It appears that Toll Manufacturing is now out of the tax ambit. Besides, the Sindh High Court, in case reported as 2006 PTD 1459 has also declared that no sales tax is payable by the vendor either on the value of goods returned to its principal or on the charges received for the conversion of goods made by him.

Since now Toll manufacturing is out of the ambit of term 'supply', it is suggested that Part I (E) of above STGO may also be withdrawn to avoid potential problems for the taxpayers during audit.

3.3.8 TAX FRAUD- SECTION 2(37)

There is a need to review the definition of Tax Fraud. Currently supply of taxable goods without getting registration with the department is treated as 'tax fraud' on the part of the supplier. Therefore a genuine businessman is facing problems to commence his business till the time he is awarded his sales tax registration number. On the contrary, supply of taxable goods without getting actually registered could penalize him with the most serious offence of 'tax fraud' under the Act. Moreover, this is inconsistent with the exemption available to businesses having turnover lower than Rs. 5 million during the last 12 months.

It would be more business friendly to encourage a new entity to start the commercial activity immediately without requiring for procedural compliance at the starting stage provided a bank guarantee for a requisite amount is provided and a registration is acquired within a stipulated time. Moreover, FBR may also consider allotting provisional Sales Tax Registration number.

3.3.9 TIME OF SUPPLY- SECTION 2(44)

There is a need to clarify tax incidence on 'hire purchase' transaction. As it involves periodical instalments received/earned over a period of time, charging tax on full amount at the signing of hire purchase agreement is not justified and is in conflict with the definition of value of supply which states that it is the consideration which the supplier receives from the recipient for the supply.

It is suggested to bring the chargeability of hire purchase transactions in accordance with the international practice and coherence (timing and the amount on which the sales tax is payable) i.e. tax should be levied at the time of each payment of the instalments. Further, the element of interest should also be excluded for assessment of sales tax.

3.3.10 TAX CREDIT NOT ALLOWED- SECTION 8

The tax auditors have been objecting adjustment of input tax paid by the taxpayer on electricity and gas consumed in residential blocks of the factory where its production facilities are located. The tax department is of the view that this area falls under the mischief of section 8(1)(a) and thus such claims of input tax are inadmissible.

For IPPs, the in-house consumption of electricity is also included in the overall cost of production, which is charged to sales tax when billed to WAPDA. Such in-house consumption justifies to be considered for sales tax exemption.

It is pertinent to note that the Customs Tribunal has already allowed input tax credit related to electricity and gas consumed in residential blocks of the taxpayer's factory. Even otherwise such input tax very much becomes refundable to the taxpayer's since it is paid on workforce without which the factory operations cannot function. Consequently, the input tax paid on electricity and gas consumed within residential colony was disallowed vide SRO.490(I)/2004 dated 12 June 2004, as amendment in June-2007. This disallowance is contrary to the principles of VAT regime. It is, therefore, suggested that suitable amendments may be made to allow input tax on electricity and gas consumption within residential colonies of the registered person, particularly where the round the clock supervision of production activities is indispensable and plants are based at remote locations.

Further, we also recommend that input tax should also be allowed on food supplied to staff or electricity or gas consumed in industrial canteen by the industrial undertaking.

3.3.11 ADJUSTABLE INPUT TAX- SECTION 8B

The concept of mandatory payment to the exchequer across the board was first introduced in the statute vide Section 8B which primarily was inserted in the law to guarantee certain monthly cash flows to the exchequer in the form of sales tax.

Any provision requiring mandatory payment from taxpayers and deferring their legitimate refunds is not justified in any fiscal law. Even otherwise, with new tax measures recently announced by the Government, the tax incidence has gone up to a significant extent and Government revenues budgeted accordingly. Therefore, it is imperative that the sword of Section 8B may be removed from the statute.

3.3.12 RECORDS- SECTION 22

While conducting audit under Section 25, the tax officers usually demand records / information which is not specified under Section 22 of the Act or the Sales Tax Rules 2006. For instance, apart from prescribed sales tax records, auditors usually demand income tax returns, cost audit report, etc. which is not permissible in any fiscal statue. Consequently, tax demands have been created on the basis of such extra records submitted by the taxpayers before tax auditors.

It is notable that the ATIR has already held that sales tax liability created on the basis of income tax returns, not specified in Section 22, is not legal and permissible. Registered persons whose accounts are subject to audit are required to submit a copy of annual audited accounts alongwith a certificate from auditors certifying payment of due tax by the registered person.

ICAP recommends that:

- In sub- section 2(a) the word 'fiscal' be removed.
- The FBR and Federation of Pakistan Chamber of Commerce & Industry (FPCCI) have already agreed upon records which may be sought by the tax administration during tax audit. This agreement was also made public vide FBR's letter dated 17 November 2001. It is suggested that the suitable amendments be made in section 22 of the Act by incorporating the above FBR letter as part of the statute.
- Certifying that due tax has been paid does not come under audit purview. This requirement should be done away with because none of the provisions state that if such a certificate is produced by RP, he would not be further subject to audit by FBR.

3.3.13 ADDITIONAL TAX / DEFAULT SURCHARGE- SECTION 34(1)

It should be clarified that in case of past cases (cases related to all preceding years) additional tax will be levied at the rate presently applicable as default surcharge subject to a maximum of principal tax liability.

Simultaneous levy or penalty and additional Tax under the Act may need to be removed, being unjustified, since both the provisions are of punitive nature. There should be only one penalty on a single default. Moreover, default surcharge should not be charged on an inadvertent error as was the case of additional tax.

3.3.14 POWER TO ARREST- SECTION 37(A)

This section should only be applicable where the case of tax fraud has already been established at the stage of Order-in-Appeal.

3.3.15 APPEALS TO TRIBUNAL- SECTION 46

In the larger interest of justice and fair play, the criteria for appointment of "Accountant Member" in the Appellate Tribunal may be modified. Accordingly, 'Accountant Member' may be the individual who is a 'Chartered Accountant' within the meaning of Chartered Accountants' Ordinance 1961 with at least 10 years of tax practice experience at Tribunal level.

Likewise, a 'Judicial member' may be a person who has been an advocate for the last 10 years with 5 years experience in tax practice.

The present law does not support the Tribunal to rectify its own decision. Law should be amended to remove such a lacuna.

3.3.16 APPEALS TO HIGH COURT- SECTION 47(8)

It is proposed that section 47(8), which allows stay to the extent of 6 months only, may be deleted.

3.3.17 LIABILITY FOR PAYMENT OF TAX- SECTION 58

Section 58 dealing with the "Liability for payment of tax in the case of private companies or business enterprises" is not happily worded. Under the existing law a person who was a shareholder representing even one share can be held responsible for the liability of the company. Similarly a person who is a nominee director or employee director can be held responsible for the liability of the company.

In the Income Ordinance 2001, such matters are covered under section 139 which comprehensively deals with the liability both in case of company and association of persons. The section 139 needs to be replicated in the Sales Tax Act on the similar lines.

3.3.18 CONDONATION OF TIME LIMIT- SECTION 74

In terms of Section 74 of the Act, the Board and the Commissioner IRS is allowed to condone the time where any timeline has been prescribed under any provision of the law. However, e-FBR web portal does not allow adjustment of purchase invoice or debit / credit note where manual permission has been granted by the Board or the Commissioner, as the case may be.

It is suggested that an option should be inserted in online monthly sales tax return in the like manner as already available for revision of return to cater the situation.

3.3.19 SPECIAL PROCEDURE FOR PAYMENT OF SALES TAX BY IMPORTERS- CHAPTER X OF THE SALES TAX SPECIAL PROCEDURES RULES 2007

Rule 58B excludes goods imported by manufacturer for in-house consumption from value addition tax of 3%. Such exemption should be extended to the service providers or other persons engaged in the trading business who imports equipment, fixed assets or other goods for in-house consumption rather than for trading.

Rule 58C restricts to claim refund of excess of input tax over output tax, which is attributable to tax paid at import stage. This limitation causes hardship to the genuine commercial importers who have been doing business on low margin since they would never be able to adjust carried forward input tax which will ultimately become their cost. Accordingly, such restriction to claim the refund should be removed and the dishonest taxpayers should be identified through the process of audit.

3.3.20 SUPPLY TO EXPORT PROCESSING ZONES- FIFTH SCHEDULE

Sales tax @ 0% is applicable on supply of raw materials, components and goods for further manufacture of goods in the Export Processing Zone vide serial number 5 of Fifth Schedule to the Act. This means, supply of goods which are not used in manufacturing of goods in EPZ are not entitled to zero rating of sales tax.

The intention behind not allowing zero rating sales tax on goods used otherwise than in manufacturing / production was in the context of SRO 578 (I)/98 dated June 12, 1998 which inter-alia had disallowed input sales tax on building materials. Since now under the existing provisions of the Act, input tax is allowed on building material, it is proposed that zero rated sales tax supply may be allowed on building material to EPZ as well.

3.3.21 APPEAL EFFECTS

It is suggested that a new section be introduced to the effect that any issue decided by the Commissioner (Appeals), Appellate Tribunal Inland Revenue, High Court or the Supreme Court will be given effect in the returns / orders for the subsequent period. If that order or decision is reversed by a superior forum then such assessment / returns shall be revised to that effect. This section should in principle be in line with section 124A of the Income Tax Ordinance 2001. It may be noted that absence of similar provision leads to unwarranted litigation.

3.3.22 THIRD SCHEDULE

On items included in 3rd Schedule of the Act, sales tax is recovered from the manufacturer at the retail price which is against the concept of VAT. In 1996, amendments had been made to reduce number of items to three. In the recent past a regressive approach has been adopted for the same that needs to be changed and items from the Third Schedule provisions be gradually deleted.

ICAP suggests that, as a major distortion of modern VAT principles, Third Schedule should be deleted.

3.3.23 FIFTH SCHEDULE

Unlike Income Tax Law where a mechanism is available to provide income tax exemption to charitable institutions, there is no concept of allowing exemption / zero-rating of sales tax for charitable institutions except the following exemption available under clause 52A of Sixth Schedule to the Sales Tax Act 1990:

52A. Goods supplied to hospitals run by the Federal or Provincial Governments or charitable operating hospitals of fifty beds or more or the teaching hospitals of statutory universities of two hundred or more beds.

Hence, except certain hospitals falling within the ambit of aforesaid Clause 52A of Sixth Schedule to the Act are currently availing any sales tax exemption / zero rating.

It is proposed that the following amendment is introduced in Fifth Schedule to the Act to provide zero-rating for charitable institutions that are considered and recognized as non-profit organizations under the Income Tax Ordinance 2001:

Serial No.	Description
(1)	(2)
2A.	Supplies to a non-profit organization as defined in Section 2 (36) of Income Tax Ordinance 2001

3.3.24 ACTIVE TAXPAYERS LIST- SALES TAX GENERAL ORDER 34/2010

The aforesaid Sales Tax General Order 34/2010 (STGO) has been issued in terms of section 55 of the Act and introduces a wider definition of 'non active taxpayers'. Besides, various serious repercussions have been listed therein when either such non active taxpayers carry out businesses or when business transactions are made with them.

We understand the STGO suffers from fundamental legal infirmity since, on one hand, the Act does not contain any specific definition or criteria whereby a taxpayer may be classified as 'non active', on the other hand, the STGO does not only lists down a self contradictory definition of 'non active taxpayers' but also specifies the repercussions if business is conducted by / with such taxpayers.

In short, the FBR has attempted to legislate an entirely new mechanism which obviously cannot be made under Section 55 through a General Order. In short, following are the various stipulations of STGO and legal defects thereof which, in our view, should be considered by the Government in the upcoming budget:

Stipulations of STGO	Legal Defects / Comments
Every person who fails to file the return under section 26 of the Act within the prescribed period for two consecutive months has been classified as a Non Active Taxpayer.	Usually FBR Web Portal suffers from system problems near the filing date which delays timely filing by the taxpayer. Nonetheless, the STGO does not has provision to condone the where the delay in filing is beyond the control of businesses. Secondly, this requirement is in direct conflict with Rule 11(4) of Sales Tax Rules 2006 (the rules) whereby non filing of tax returns for consecutive 6 months may lead to deregistration of concerned taxpayer. A person who fails to file any missing return within 15 days of notice issued to him can also be classified as non active. However, it has not been specified whether this reference is made towards missing return in the departmental data base or otherwise.
Anyone who fails to file any due Income Tax return under section 114 or who fails to file the monthly withholding tax statement under section 165 of the income Tax Ordinance 2001 for two consecutive quarters will also stand disqualified as Non Active Taxpayer.	The term 'non active' has also not been defined in the Ordinance. Also, in the absence of any inter-tax / contra penal action prescribed in both Act and the Ordinance, the proposed action under STGO lacks due legal backing. In two identical judgments pronounced by the Appellate Tribunal Inland Revenue, it was held that the department is not authorized to use the data or information and figures, supplied by the businessmen in their Income Tax Returns, as basis for assessment of sales tax liability.
Whosoever fails to respond to the "discrepancy notice" or any other notice issued by tax authorities within 15 days of the issuance of such notice will also be treated as non active. The term" discrepancy" has been defined in STGO to mean "mismatching of invoice summary statements between registered buyers and sellers, mismatching of import goods declaration in the sales tax return by the registered person vis.a.vis data furnished by the Customs or any other discrepancy intimated by the tax administration to the taxpayer".	The condition of filing invoice summary statements in no longer prescribed in the statute since it was done away with 2 years back. Moreover, the clause regarding mismatching of invoices in taxpayers' tax return is also legally defective since such mismatching is duly protected under section 7(1) of the Act which empowers the buyer to claim his input tax credit in any of the 6 succeeding tax periods to which the purchase relates.

Stipulations of STGO	Legal Defects / Comments
Mismatching of Goods Declaration between taxpayer's records and that furnished by customs may result in penal action against the taxpayer.	Such mismatching could also be when a particular import was not recorded / uploaded by Customs' in its own database.
The discrepancy, sent to taxpayer's email address or placed in his e-folder at e.fbr portal, will need to be removed by taxpayer getting himself 'audited' by tax authorities or explaining his position.	Under Section 56, a notice shall only be treated as having served to the taxpayer if it is personally delivered to him or his representative, sent by registered post or courier or served as prescribed under Code of Civil Procedure 1908. Even otherwise, the service of notices through email is also likely to incite other questions such as proof of service to the taxpayer, date of email, etc.
In clause 2(vi) of STGO, the taxpayer is required to furnish reply against discrepancy notice within 15 days of issuance.	Interestingly, on other hand, clause 3(ii) requires him to furnish his reply within 15 days of the receipt of discrepancy notice. Thus, STGO appears to be carrying serious self contradiction.
The taxpayer may be declared as 'non active' without service of any formal show cause notice and associated appealable order being served upon him.	The absence of such a mandatory procedure is against all norms of natural justice and fair play and negates the fundamental principle of equity which is the basis of every taxation system.
The buyer procuring goods from Non Active Taxpayer would be deprived of related input tax credit in case he purchases goods from a non active supplier. In such a case, the FBR's web portal would blink such message whenever he tries to feed his purchases over his tax return.	No mention of the law under which the department seeks to disallow the sales tax credit of a person if he fails to file his income tax return.
Taxpayers have been advised not to have any transaction with non-active taxpayers unless they are restored on active taxpayers list on the recommendation of their respective tax office or appellate forum. The 'advice' has also placed upon another restriction of settlement of transaction with non active taxpayers through banking channels even if the value of goods is below the limit of Rs.500,000 prescribed in section 73 of the Act.	The STGO has crossed the ambit of statute which categorically prescribes settlement of business transactions through banking channel only when the value of supply exceeds Rs. 50,000.

3.3.25 INVENTORY RECORD FOR GOODS DESTROYED RULE 23

Rule 23 of the Sales Tax Rules 2006 requires that when goods are returned by the buyer on the ground that the same are unfit for consumption, the same to be destroyed by the supplier after obtaining permission from the Collector of Sales Tax.

It is suggested that taxpayer should be allowed to incinerate such obsolete inventory after obtaining a certificate in lieu of approval from the Sales Tax department from an independent professional person e.g. Chartered Accountant or Cost and Management Accountant.

3.3.26 INITIATION OF RECOVERY ACTION RULE 71

By virtue of Section 45B of the Act, a registered person aggrieved by any decision, may file an appeal within 30 days from the date of receipt of such order. However, on the contrary, under Rule 71 of Sales Tax Rules 2006, the proceedings for recovery of impugned tax may be initiated after 30 days from the date of order. This anomaly results in initiation of recovery proceedings where the registered person receives order after sometime from the date of order and he still enjoys right of appeal under section 45B of the Act.

Therefore, to keep harmony and in the spirit of natural justice, Rule 71 may be amended to provide commencement of recovery proceedings after 30 days from the receipt of order.

3.3.27 PAYMENT OF ARREARS THROUGH INSTALMENTS

There is no provision available in the Act for payment of arrears in instalment. Further, legally speaking, no officer is authorised to approve any tax instalment plan.

ICAP suggests that necessary legislation may be made to allow the taxpayer to make payment of arrears in instalments.

3.3.28 ACTIVATION TAX

Currently the cellular mobile operators are required to collect and pay Rs. 250 for every mobile set energized in lieu of sales tax on import / local sale of mobile hand-sets. The estimated collection during FY 2011-12 by the CMO`s is at Rs. 5 Billion. The charge of Rs. 250 is fixed for every hand-set which equates to import / local sale price of Rs. 1,563 / hand-set converted at GST rate of 16%. This average price of Rs 1,563 is less than the low priced models of branded sets, and thereby the Government is incurring revenue loss. During Year 2012, mobiles of worth 463 million USD were imported and the exchequer could have collected a higher chunk of sales tax had mobiles set were taxed at actual value of import.

Further the mechanism of exemption and collection of sales tax through SRO 542(1)/2008 dated 11 June 20008 suffer serious flaws as under:

- timing of hand set sale (which is a charging event) vs. activation / energization of handset by cellular operator.
- responsibility to collect and pay sales tax has been assigned to third party (cellular operators) rather than the seller or the purchaser.
- lack of uniformity of charge and thus discriminatory in its nature, i.e., the handset of Rs. 100,000 and Rs 2,000 is charged at a same rate of Rs. 250 per set.

In view of above, it is suggested that a reasonable threshold may be introduced whereby cheaper handsets may continue to be taxed @ Rs. 250, while costly handsets should be charged based upon their value of supply and by the person importing / selling the handsets.

3.4 FEDERAL EXCISE ACT 2005

3.4.1 ADJUSTMENT OF DUTY - SECTION 6

Under section 6, Federal Excise Duty is adjustable only if the registered person holds a valid proof to the effect that he has paid the price of goods purchased by him including FED and received the price of goods sold by him including FED through banking channels. The condition of payment and receipt is creating lot of problems for the taxpayers.

It is, therefore, suggested that FED should be made adjustable on accrual / paid basis as per section 7 of Sales Tax Act 1990. Further the duty adjustment should not be made subject to receipt of sale proceeds and related duty.

3.4.2 DEBIT / CREDIT NOTE - RULE 14A

Identical to section 9 of Act, Rule 14A of FED Act also allows adjustment(s) in tax invoice or return for dutiable goods. However, the benefit of such Rule has not been extended to dutiable services.

It is suggested that necessary amendments may be made in Rule 14A to include reference of dutiable goods and dutiable services.

3.4.3 MANDATORY PAYMENT BEFORE FILING APPEAL - SECTION 37

Before preferring appeal before Office of Commissioner (Appeals) or Appellate Tribunal, a taxpayer is required to deposit the impugned duty demanded or penalty imposed in the appealable order. This mandatory compulsion is considered as a hindrance in the dispensation of justice.

The identical provisions in Income Tax and Sales Tax have already been repealed. Therefore, it is suggested that the same should also be removed from the excise law.

3.4.4 EXCISE DUTY ON ROYALTY

'Royalty' payments have been subject to FED. The term used in the law is 'Franchise fee' which at times distinguishable with royalties in strict commercial and practical sense. This has lead to serious issues of interpretation and misapplication in many entities. Taxpayers are more seriously affected for the reason that in such cases on account of use of technology etc. and their nature of operation, such entities engaged in various activities, necessarily require such payments.

It is recommended that FED procedures for franchise fee be streamlined and the same be brought in line with the State Bank's regulation. Such measures will resolve the issue correctly as most of the organized entities remit such fees through SBP and there are well laid down procedures for the same.

3.4.5 EXPLANATION OF TARIFF HEADING OF CHAPTER 98

In the absence of any explanatory notes / material regarding Chapter 98 of the Customs Act 1969, service providers are facing immense problems in classification of headings and sub headings thereof. In particular, sub headings titled “Others” are creating enormous disputes among the taxpayers and FBR. Various cases have also been made against service providers like banks, etc. which are now pending in litigation thereby causing undue hardship for both the tax department and taxpayers.

It is suggested that specific nature and scope of all tariff heading and sub headings in Chapter 98 may be issued by the Federal Board of Revenue to avoid unnecessary hardship being faced by businesses.

3.4.6 FRANCHISE SERVICES

In terms of Section 3 of FED Act, where the franchiser is a foreigner, the liability to pay FED on franchise services falls upon local franchisee through reverse charge basis. Such FED operates under a Non-VAT mechanism meaning whereby the local franchisee who pays FED from his own pocket is not entitled to claim the same against his excise or sales tax liability. This creates a huge drain of funds from the franchisee's pocket and is causing undesired distress among the taxpayers.

ICAP proposes that all excisable services including franchise or royalty may be brought under the VAT mode and taxpayers may be allowed to claim the same from their output tax / duty.

3.4.7 FED ON TELECOM

Post 18th amendment in the Constitution of Pakistan, the right of federating units of charging Sales Tax on service sector has been seconded. Accordingly, the province of Sindh and Punjab have introduced their sales tax on services laws. Telecom being the service is now being administered by provincial revenue authorities. The decentralization of sales tax on Telecom has created many problems for industry, including the identification of provincial share, maintenance/classification of provincial record of input, justifying the provincial share to each and every province etc.

Unlike bank branch or a hotel, telecom is not a stand-alone service provider unit. Rather different and distinct setups (BTS, MSC etc.) work together to enable the provisioning of telecom service to subscriber. In doing so, the networks of two or more provinces can be involved. Therefore, ideally the sales tax on telecom service should be federal subject. However, considering the constitutional restriction, at-least the administrative function of sales tax on telecom should be assigned to FBR.

It is, therefore, recommended that a policy decision should be taken by FBR after due consultation with SRB and PRA on the issue so that the telecom industry may not face unwarranted hassles in discharging its due tax liabilities.

3.4.8 FED ON 'CONCENTRATE'

FED on Concentrate has been levied @ 50% under section 3 of the Federal Excise Act, 1990. Beverage industry has not been able to adjust 100% FED on this raw material as FBR has restricted the input tax adjustment on concentrate maximum up to out-put liability of FED.

It is, therefore, proposed that FED @ 50% on "Concentrate" should be levied in same manners on "Sugar" under section 7 of the Federal Excise Act, 2005 i.e. in sales tax mode. Alternatively, adjustment of excess payment of input FED on 'Concentrate' should be allowed against output sales tax liability.

3.5 CUSTOMS DUTY

3.5.1 IMPORT AND EXPORT CONTROL ACT 1950

To promote exports of pharmaceutical products, Export of free samples should allowed up to 15% of the commercial quantity exported instead of presently 10% of commercial quantity exported and up to 40% on first shipment instead of presently 25% through amendment in export policy order 2009 and SRO # 767(I) dated 4 September 2009.

3.5.2 FOREIGN EXCHANGE MANUAL 2002

To promote exports, retention on export realization should be increased to 25% presently it is allowed up to 10% & (15% for pharmaceutical companies) vide circular FE circular # 9 of 2008.

3.5.3 CASCADING OF RATE OF DUTY ON LOCAL INDUSTRY

Over the last two decades custom duty rates on raw materials, intermediaries and finished products have been substantially reduced. The objective is to reduce possibilities of evasion and avoidance on account of high rates of duties. There are two primary reasons for the same viz:

- The whole world has changed on account of financial turmoil in the USA and there is a consensual view that ultimate stability in economics will require concentration on manufacturing sectors; and

- in the wake of reduction of custom duty 'cascading' with the duty structures were not appropriately taken care of due to which local manufacturing sector has been seriously hampered.

There is a need to review the custom duty structure afresh to facilitate the promotion of local manufacturing industry. In the absence of proper cascading in the duty structure such opportunity cannot be effectively availed. Present structure supports the promotion of trade in commodities rather than manufacturing the same in Pakistan. This results in unemployment and poverty.

3.5.4 COMPOSITION OF MAJOR COLLECTION

The present collection is being made from very few sectors. Major contributories are:

a) crude oil imports;

b) import of commodities like edible oils etc;

c) import of consumables; and

d) minimum import duties on plant and machinery items

This analysis of collection reveals that there is a need to align the objective of overall economic policy with the fiscal measures. Pakistan's annual import bill is around US $ 40 billion requires a substantial reduction to meet the constant pressures on foreign reserves. Rationalization of custom duties will ensure facilitation of the local manufacturing sector. This requires a comprehensive tariff review. Furthermore, it should be ensured that custom duty is taken as a measure to manage the trade policy rather than tax collection.

3.5.5 AFGHAN TRANSIT TRADE AND UNDER INVOICING

Pakistan is faced with two fundamental menaces in relation to implementation of import duty structure and abolition of smuggling. These are:

- Abuse of Afghan Transit Trade (ATT); and
- Under invoicing at import stage.

Both of these issues are directly affecting the organized sectors. No meaningful improvement can occur unless such abuses are either abolished or substantially reduced in the short run. This in itself is a complete subject of fiscal policy. However, at the outset following suggestions may lead to constructive framework:

(i) In case of ATT, like all other land locked countries, the agreement [treaty] for facilitation of imports with Afghanistan be revised. There has to be 'quantitative ceiling' for imports required for Afghanistan; and an effective mechanism should be implemented to collect duty on ATT at import stage to be refunded on confirmation of passage from Pakistan to the Afghan border should also be subject to quantitative restrictions.

(ii) Exchange control mechanism be streamlined so that economic barriers are placed for financing of under invoiced goods. At present, liberation of exchange controls are being abused to finance such under invoiced imports.

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