

Reformed General Sales Tax (RGST) and Additional Revenue Generation

Commercial Solutions of Major Issues

**Presentation to: CPD Seminar of Institute of Chartered
Accountants of Pakistan (“ICAP”)**

Presentation by: Ashfaq Yousuf Tola FCA, FCMA

Part I

RGST Commercial Solutions – Major Issues

Major Issues – Commercial Solutions Scope of Presentation

- **Scope**
 - **Commercial Solutions of Major Issues,**
 - **Issues related to Federal and Provincial Governments are not touched upon,**
 - **Legal Solutions i.e. appropriate amendments in Sales Tax Act, are also not touched upon, and**
 - **Views are personal of author as dutiful Pakistani and has no relevance to his position in any trade body.**

Major Issues – Commercial Solutions Objectives

- **Objectives:**
 - **Amicable Resolution of Matters between Government and Stakeholders,**
 - **Minimum Inflationary Effects,**
 - **Attaining desired Documentation Levels,**
 - **Increase in revenue to exchequer,**
 - **Broadening of Tax Base / Tax Net,**

Objectives Continued...

Major Issues – Commercial Solutions Objectives

- Objectives Continued....
 - **Increase in Direct Tax Payers net,**
 - **True levy of Consumption Tax,**
 - **Incremental Revenue to exchequer, and**
 - **Exploring Other Revenue Generating Measures to remove disparity.**

RGST / VAT – Historic Perspective

Introduction

- Historic Perspective:
 - *Conceived and Proposed by Dr. Wilhelm von Siemens in 1918, and*
 - *Introduced in France by Maurice Lauré in April 1954.*
- Definition:

“RGST / VAT is an indirect tax charge on Goods and Services. Unlike General Sales Tax (“GST”) VAT is charge only on value addition at each stage”.

RGST - Introduction

How it works

Illustration:

Initiation of Transaction

- Manufacturer Sold Soap to Wholesaler @ PKR 10 + 15% VAT i.e. PKR 11.50 (PKR 10 Cost + PKR 1.50 VAT). Manufacturer received payment inclusive of VAT,
- Wholesaler ADDED his Margin of PKR 1 and sold the same to Retailer. Hence he added PKR 0.15 VAT, therefore, the total price paid by Retailer is PKR 12.65 (PKR 11 Cost + PKR 1.65 VAT). Wholesaler recover tax paid from Retailer,
- Retailer Sold Soap to Consumer by adding a profit PKR 1, hence he added tax of PKR 0.15 VAT to arrive at a price of PKR 13.80 (PKR 12 Cost + PKR 1.80 VAT). Retailer Recovers the price from Consumer

Conclusion of Transaction

RGST – Introduction

Harsh Measures in Previous VAT Act (Draft)

- Price of any good can be challenged by authority on the basis evidence, however, authorities are not bound to buy them if seller is willing to sale at the assessed price,
- At present, Value addition at import stage on some imports attracts immunity from audit, whereas new law prohibited the same,
- Tax prayers, in the event of disputes, were barred from going to superior courts, however, it is informed by FBR that this clause is suitably amended,
- Excess Amount will be refunded after six years unless otherwise adjusted within that period,
- Plethora of information like buyers' CNIC, NTN etc. are required for invoice and in event of default or untrue supplier will be penalized heavily,
Continue.....

RGST – Introduction

Harsh Measures in Previous VAT Act (Draft)

- 3% extra payment on supply to unregistered supplier, which will undo the entire concept of documentation of economy,
- Unlimited power were given to the official for recovery of amounts, including raiding on business premises without serving prior notices,
- The IRS was extended with the same powers as enjoyed by civil court for recovery of unpaid amount, however, it has been reversed due to intervention of Senate Committee on Finance,
- Carrying of audit (including forensic audit) with direct interaction between payer and collector will enhance the chance of corruption,

Continue.....

RGST – Introduction

Harsh Measures in Previous VAT Act (Draft)

- Abolishment of **ZERO RATING** on local supply of export oriented industries i.e. textiles, sports, surgical, leather, and carpet, will encourage fraud as infrastructure is not available to curb the missing entities and in the past excess refunds over collections were paid,
- Multiple Windows of collection and adjustments i.e. Federal and Provincial will create confusion,
- Various SROs', including 549 and 868, granting exemptions will also be abolished, hence, scope of taxable goods is widened.

RGST – Issues & Implications

Advocates of VAT , their arguments....

Description	Argument... FOR	Argument... AGAINST
Documentation	Invoice and tax at each stage will promote documentation	By imposing 3% penalty for unregistered supplier, documentation of economy is unwind.
Enhance Tax to GDP Ratio	More number of tax payers will increase Tax to GDP Ratio	Details are presented in coming slides
Increase Revenues	More tax payers will enhance the tax base and more revenues will be earned	It will increase inflation and consequently revenues will also increase

RGST – Issues & Implications

Advocates of VAT , their arguments....

Description	Argument... FOR	Argument... AGAINST
Increase in Inflation	With reduction in rate by 1% and consequent increase in scope will marginally increase inflation	Detailed Analysis is presented in subsequent slides. Effects will be out of proportion
Refund will be expedited	With state-of- art IT system to be introduced with VAT	It is yet to be tested practically, and old refunds are not discussed

RGST – Issues & Implications

RGST from International Standpoint

- International Scenario:
 - VAT was first introduced in France in 1954,
 - Every EU Member State Must follow VAT System with a minimum 15% rate and a few discounted rates not below 5%,
 - NORDIC Countries, Denmark has a highest rate 25% (introduced at 9% in 1962), Finland 23% from July 2010, Iceland 25.5, Norway 25%,
 - Bangladesh in 1991, India 2004 (State Based 9 States refused to implement), Sri Lanka 1990,
 - New Zealand 12.5%, Australia 15%, and
 - Mexico 16%, neighboring US States California, Texas, Arizona 16%, Canada / US 13%.

RGST – Issues & Implications

RGST from International Standpoint

Country	VAT / GST Rate	Per Capita Income (US \$)	Tax to GDP Ratio	CPI %	Discou nt Rate %	Unempl oyment Rate %	GDP Growth %
Banglades h	15	1,600	8.5	5.7	5.00	2.5	5.88
India	12.5	3,100	17.7	10.7	6.00	10.7	6.50
Pakistan	16	2,600	10.6	14.2	12.50	15.2	2.07
Sri Lanka	12	4,500	15.3	3.4	7.50	5.9	3.50
China	17	6,600	17.0	(0.8)	5.00	4.3	8.70
Indonesia	10	4,000	11.0	7.0	6.50	7.7	1.00
Malaysia	5	14,800	15.5	0.2	6.80	5.0	(2.20)
Philippines	12	3,300	14.4	3.2	6.89	7.5	0.90
Thailand	7	8,100	17.0	(0.9)	1.25	1.6	(2.80)
Turkey	18	11,200	32.5	6.5	6.50	14.5	(5.60)
UK	17.5	35,200	39.0	2.1	0.66	9.8	(4.80)
US	10.25	48,400	28.2	(0.9)	0.25	9.3	2.40

RGST – ISSUES & IMPLICATIONS

Economic Implications

- Inflationary Effects:
 - **RGST will cause astronomical effects of Inflation and its effect will be around 6 to 9 %,**
 - **Out of 43 items on current CPI Basket, 41 are food related and best estimates suggests 70% of current 41 food items are non-GST,**
 - **Most of the services are currently out of GST scope and their addition will leave spiral effect on inflation,**
 - **Indirect effect of cost of doing business will also increase the inflation by 3% (best estimates), and**
 - **Our High inflationary rate will be translated to almost HYPER-INFLATION and will leave consequent effects on common man's lives.**

RGST – ISSUES & IMPLICATIONS

Economic Implications

- **Effects on Businesses:**
 - **Cost of Doing Business:**
 - **Maintenance and Filing of records by traders,**
 - **Increase in cost due to inflationary adjustments, and**
 - **Increase in Management Expenses of Trade and Industry due to increase in salaries and other related employees cost.**
 - **Probable Increase in Mark-up Rate:**
 - **Due to probable hefty increase in inflation, mark-up is bound to go up, and**
 - **Due to stuck-up refunds more working capital will be required and consequently more mark-up charges will occur**

RGST – ISSUES & IMPLICATIONS

Economic Implications

- **Effects on Economy as a whole:**
 - **Regressive Tax:**
 - It relies on end-user, hence it is regressive in nature, and
 - Every one pays at equal rate, hence, poor to pay more as a percentage of their income than rich.
 - **Cost Push Inflation:**
 - VAT will cause cost-push inflation.
 - **Deadweight Loss:**
 - Due to increase in price, government may be better off on short term basis while it will leave less working capital for traders. The phenomena is called “Deadweight Loss”. This causes demand shift and eventually both government and businesses are losers.

RGST – ISSUES & IMPLICATIONS

Economic Implications

– Refund Mechanism:

- **Refund system, although claimed to be state-of-art, is yet to be tested to handle refunds of PKR 140 billion worth of refunds, and**
- **Status of outstanding refunds are yet to be known.**

– Corruption:

- **Re-introduction of refund on export oriented industries will trigger avenues of corruption again,**
- **Introduction of tax at grass-root level will again lead to corruption, and**
- **Coercive clause in Proposed VAT Laws with handsome discretionary powers will also open floodgates of corruption.**

Major Issues – Proposed Policy Reforms

- **Proposed Policy Reforms:**
 - **Threshold of PKR 5 million needs to be abolished,**
 - **Sale to non-registered Buyers needs to be stopped forthwith,**
 - **Every Person attaining an age of 24 must obtain NTN and consequently file tax returns,**
 - **Every person engage in Sale and Purchase i.e. Manufacturing and / or Trading activities must obtain GST Certificate,**
 - **List of Input (quantity basis) shall be agreed between FBR and respective Trade Bodies through FPCCI,**

Major Issues – Proposed Policy Reforms

Proposed Policy Reforms (Continued)

- Gradual increase in tax rates i.e. 3%, 6%, 9%, 12%, and 15% in year 1 through 5,**
- 5% GST payers may be selected for independent audit through ballot,**
- There shall be no direct interaction between authorities and tax-payers,**
- Severe penalties shall be imposed on misdeclaration and / or fraud, and**
- Appeal provisions are proposed to be abolished and direct appellate mechanism is proposed to be introduced**

Major Issues – Elimination of Zero Rating

- **Background:**
 - Introduced, to stop payment of excess refund over collection, in 2005 on five export oriented industries i.e. Textiles, Leather, Surgical, Carpet, and Sports Goods,
 - Local Sales of aforesaid sectors were also declared “Zero Rated”,
 - Since last five years no resolution is made to circumvent corruption issues, and
 - Refund on account of a few inputs like packaging material, on these sectors, are still pending.

Major Issues – Elimination of Zero Rating

- **Proposed Refund Method 1: Quantity Basis:**
 - Pre established criterion of Quantity shall determine the proportion of local and export sales, where an entity is engaged in dual activity,
 - Where multiple products are dealt, input quantity list of each product shall be pre-agreed upon to determine the claim proportion,
 - FBR shall update list of dubious entities on weekly basis and input claims (export proportion) shall be withheld if any post-dated input is claimed, and
 - Automatic right of refund adjustment from withholding tax payment shall be introduced.

Major Issues – Elimination of Zero Rating

- **Proposed Refund Method 2: Standardized Rates**
 - Pre-determined rates, based on input calculations, may worked out and agreed between FBR and Trade Bodies through FPCCI, and
 - Refund shall automatically be credited upon receipt of export proceeds.

Major Issues – Elimination of Zero Rating

- ***Expected Results:***
 - More collection of GST on account of imposition of GST on local sales of “Zero Rated” goods,
 - Controlled Inflation,
 - Direct Tax will be broadened,
 - Tax to GDP Ratio will also improve, and
 - Corruption will be minimized.

Major Issues – Stage-wise deduction (3rd Schedule Items)

- ***Background:***

- VAT ensure stage-wise deduction and deposit of tax which is a bone of contention between FBR and traders.

- ***Proposed Solution:***

- Existing Methodology of Deduction and Deposit of Tax by Manufacturer / Importer shall remain continue in force, and
- A new return, requiring details of each invoice, shall be made mandatory for all the sellers except eventual seller of goods unless he is selling at higher price then MRP

Major Issues – Stage-wise deduction (3rd Schedule Items)

- ***Expected Results:***
 - More collection of GST on account of removal of threshold,
 - More transparency due to submission of invoice details,
 - Direct Tax will be broadened,
 - Tax to GDP Ratio will also improve, and
 - Corruption will be minimized.

Major Issues – Imposition of GST on Goods & Services across the board

- ***Imposition of GST on Goods & Services across the board:***
 - **Background:**
 - **GST across the board (excluding mentioned in 1st schedule of VAT (Draft) Act may increase the inflation drastically.**
 - **Subsequent announcement by Hon. Finance Minister on exclusion of following:**
 - **Food Items,**
 - **Dairy,**
 - **Health, and**
 - **Education.**

Major Issues – Imposition of GST on Goods & Services across the board

- ***Proposed Resolution:***
 - A comprehensive list of all goods and services shall be compiled,
 - All Goods & Services necessary for living of a common man shall be excluded from GST,
 - Value added services like Mineral Water, High-end Schooling, Cellular Services, High-end Medical Facilities must be made taxable, and
 - High-end traveling services like traveling in Business Class & Economy Plus must be made more expensive.

Major Issues – Imposition of GST on Goods & Services across the board

- ***Expected Results:***
 - **More collection of GST due to proper classification of High-end Goods & Services,**
 - **True form of Consumption Tax will be introduced instead of proposed form of Regressive Tax,**
 - **Direct Tax will be broadened,**
 - **Tax Net will also be broadened, and**
 - **Corruption will be minimized.**

Major Issues – Value Addition on Imports for Immunity from Audit

- ***Value Addition on Imports for immunity from Audit:***
 - **Background:**
 - Immunity was introduced in 2005 to generate additional
 - Immunity from Audit is the main source of undocumented trade, and
 - GST collection may be much higher

Major Issues – Value Addition on Imports for Immunity from Audit

– Proposed Solutions:

- **Immunity is proposed to continue to remain in force till June 30, 2011 with following conditions in force:**
 - **No sale to any unregistered GST buyer,**
 - **Monthly e-return of Importer and subsequent buyers except eventual seller,**
 - **Details of each and every invoice shall be made mandatory**

Major Issues – Value Addition on Imports for Immunity from Audit

- ***Expected Results:***
 - More collection of GST on account of removal of threshold,
 - More transparency due to submission of invoice details,
 - Direct Tax will be broadened,
 - Tax to GDP Ratio will also improve, and
 - Corruption will be minimized.

Major Issues – Commercial Solutions Road Map

- ***Road Map to Resolution:***
 - **Presentation to High-ups,**
 - **Formation of teams to suggest appropriate changes,**
 - **Meeting with Relevant Trade Bodies,**
 - **Drafting relevant amendments in law,**
 - **Submission to Parliament for approval,**
and
 - **Enforcement**

Part II

Additional Revenue Generation

Additional Revenue Generation

- Exploring Additional Avenues for Revenue Generation:
 - Basic Requirements to be revisited:
 - **Constitution of Pakistan shall be revisited to bring Agriculture and Immovable Properties in the tax net,**
 - **Tax Collection system should be made simple to ensure transparency, and**
 - **Impose heavy fines on misdeclaration on taxpayer and those who aided and abetted such act**

Additional Revenue Generation

- ***Imposition of Withholding Tax on Agricultural Products at collection stage:***
 - **Withholding Tax may be imposed on output at final collection point instead of PIU so that legal battle on constitutional jurisdiction is avoided,**
 - **That semi-direct tax shall deem to be the final discharge of liability and no further return of tax shall be required to be submitted, *nonetheless*, NTN shall be must for all the suppliers.**
 - **Political will of Government may not be strongly in favor of imposition of such tax**
 - **A well thought-out policy shall be formulated to meet the challenges ahead**

Additional Revenue Generation

- **Capital Gain Tax on Sale / Purchase of Immovable Properties:**
 - **Wide difference between Collector Value vis-à-vis Market Value is not only causing a massive parallel economy but is also resulting in severe dent on tax imposition and collection. Following methodology is proposed to be adopted to explore this avenue:**
 - **Capital Gain Tax (CGT) shall be imposed on Real Estate,**
 - **No levy or a little levy of CGT on the size of plots of 3 Marla and houses built thereon to accommodate common citizen of Pakistan,**

Additional Revenue Generation

- As a first step, one time exemption on the first transaction may be extended to all citizens of Pakistan, if they are not pursuing real estate as trading business. NTN shall be made a pre-condition for all real estate transactions**
- On subsequent deal i.e. 2nd transaction 5% CGT may be levied on seller at prevailing market price of plot or house**
- On all subsequent transactions 15% CGT may be levied on seller at prevailing Market price of the plot or house, and**
- It is also proposed that this tax may be introduced forthwith as considering the size of the market**

Additional Revenue Generation

- **Small Shop Token Tax Scheme**

- It is proposed that a small tax token scheme may be introduced for the small shop owners (commercially used) based on the following broad guidelines:

- Location and area of premises,
- Computer Generated Tax Tokens to be issued and paid directly in National Exchequer, and
- Policy of No Question Asked by FBR,
- Tax rates should be minimum possible