The Institute of Chartered Accountants of Pakistan

CA PAKISTAN

# ICAP PROPOSALS FOR FEDERAL AND PROVINCIAL BUDGET 2022-2023

BUSINESS

PLANNING

BUDGET

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# BUDGET PROPOSALS 2022-23

## PRESIDENT'S MESSAGE

The Institute of Chartered Accountants of Pakistan (the Institute) with its consistent commitment to support a strong and growing Pakistan economy, every year shares its proposals on tax policy to serve all the key stakeholders i.e. consumers, business, organizations and governments.

The Institute believes that Pakistan has to address its low tax-to-GDP ratio to undertake sustainable economic development. State's inability to raise enough direct taxes has led to a reliance on regressive indirect taxes, unequal burdening of citizens of lower socioeconomic classes and increase in informal sectors of the economy. The complicated and inequitable tax laws force citizens to remain out of the tax-net.

The Institute strongly recommends the need for forward looking policy reforms to strengthen the collection mechanism, improve public confidence, expand the tax base, facilitate the documentation of the economy, improve enforcement and tax administration.

The Institute, with a consistent commitment to developing and promoting a modern, responsive, and equitable taxation system, formulated these proposals for the consideration of policy makers in the forthcoming budgetary process.

In developing these proposals, I would like to express my gratitude for the input and guidance of the Chairman and the Members of the Institute's Committee on Fiscal Laws.

**Ashfaq Yousuf Tola, FCA**

## CHAIRMAN'S MESSAGE

The Institute, with its commitment to play its role in the economic development of the Country always promotes a responsive and equitable taxation system. ICAP endeavors to share an independent and well thought perspective on matters concerning Pakistan's tax policy with relevant stakeholders including the Federal and Provincial Governments together with all Revenue Authorities.

We understand the Coronavirus Pandemic has affected socio-politico-economic worldwide and the economic experts predict the situation to prevail for longer time, however the political uncertainty prevalent in the Country has added more to the deterioration of economy of Pakistan.

We hope that in this testing time, the efforts will be made by the New Government to strengthen foreign exchange reserves and improve tax collection. However, there is a need to think economic success by going beyond GDP and stopping focusing on one or two popular economic indicators. This is the right time to strengthen our manufacturing sector so as to not only produce more goods and control inflation but also provide employment to our labour force.

Our proposals mainly aim at broadening the tax base, improving revenue collections, increasing taxpayers' compliance and monitoring, that will eventually lead toward an all-inclusive and sustained economic growth. Foremost in our recommendations, are proposed policy actions with the objective of broadening the tax base to enhance resources and plug tax leakages, and to ensure that all sectors of the economy are brought within the tax-net that will eventually lead toward an all-inclusive and sustained economic growth. Pakistan's tax-to-GDP ratio is the main impediment in the economic development, which has compelled governments to take short-term tax measures. At present, there is over dependence on the indirect taxes.

There is a dire need for administrative reforms and building long term strategic policy for modernizing the tax system. Tax policy and tax administration should be separated and FBR should only be responsible for implementation of policies and collection of revenue. Further, capacity building and structural reforms at FBR is inevitable.

Further, most of the major service providers operate across the country, therefore, there is dire need for increased harmonization among Provincial and ICT sales tax on services. The proposals for sales tax on services have been made while aiming to initiate a process of creating common standards across the Provinces and ICT. Harmonization should be seen strictly from the perspective of bringing uniformity in the sales tax legislations of the Provinces and ICT and their application. A complete harmony and integration of federal and provincial sales tax laws and a single return to declare federal and provincial figures is required. Government should consider policy of one nation one tax for indirect taxation with a uniform tax return.

I wish to place my gratitude to the ICAP Council, President ICAP – Ashfaq Tola Sb and my Mentor – Abdullah Yusuf Sb for placing utmost trust on me that has made possible strong representation of ICAP Proposals to the newly formed Government.

I wish to place on record the efforts and dedication of the Committee Members with special thanks to the Conveners of respective Task Forces, who have worked dedicatedly and tirelessly to make it possible to submit these proposals.

**M. Ali Latif**
**Chairman Fiscal Law Committee**
**Vice President [2020-2021]**

# GLOSSARY OF TERMS

| | |
|---|---|
| BSTSA | Balochistan Sales Tax on Services Act 2015 |
| BSTSR | Balochistan Sales tax on Services Rules 2018 |
| FED | Federal Excise Duty |
| FEA | Federal Excise Act, 2005 |
| ITO | Income Tax Ordinance, 2001 |
| ITR | Income Tax Rules, 2002 |
| KSTSA | Khyber Pakhtunkhwa Sales Tax on Services Act 2013 |
| KPKWTR | Khyber Pakhtunkhwa Sales Tax on Services Special Procedure (Withholding) Regulations 2015 |
| PATR | Punjab (Adjustment of Tax) Rules 2012 |
| PSTSA | Punjab Sales Tax on Services Act 2012 |
| PSTSPR | Punjab Sales Tax on Services (Special Provisions) Rules 2012 |
| PSTWTR | Punjab Sales Tax on Services (Withholding) Rules 2015 |
| SSTSA | Sindh Sales Tax on Services Act 2011 |
| SSTSR | Sindh Sales Tax on Services Rules 2011 |
| STAWTR | Sales Tax Special Procedure (Withholding) Rules 2007 |
| SSTWTR | Sindh Sales Tax Special Procedure (Withholding) Rules 2014 |
| ST/STA | Sales Tax Act 1990 |
| STR | Sales Tax Rules 2006 |
| FER | Federal Excise Rules 2005 |

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# GLOSSARY OF TERMS

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# 1 BROADENING OF TAX BASE

Pakistan has population of 225.18 million people (approx.), out of which only 2.2 million have filed their income tax returns for tax year 2021. This apart from being due to trust deficit between the tax collectors and taxpayers is mainly also due to ineffective use of resources by tax collectors to improve the number of taxpayers.

In order to improve tax system, Federal Board of Revenue is taking steps to convert from manual system of record maintenance to automation. Such approach has led to huge amount of data being available with the FBR, however, the revenue collection authority has failed to effectively utilize the available data to increase number of income tax return filers and thus ultimately increasing the tax revenues. Majority of stakeholders are of the view that FBR did not consider enhancing competence and capacity building of field officers which is proving to be the main hurdle in effective utilization of such data.

There have never been serious efforts made to widen the tax base. Most of the efforts failed simply because there was no political will of the government. Furthermore, a significant trust deficit lies between tax collectors and taxpayers resulting in unwillingness to pay such taxes due to perception of people of Pakistan that significant malpractices exists in FBR.

In the name of widening or broadening of the tax base, the Revenue Authorities in Pakistan have targeted to further squeeze or burden the existing or compliant taxpayers. In addition, instead of widening, they actually resorted to a policy of deepening the tax base (which by no means qualify as widening or broadening of the tax base) by increasing the tax rate on the same taxable activity or putting restrictions on deductibility of expenditure or disallowing deductible legitimate expenditure in the name of tax audit or otherwise. Failure of the tax machinery in widening of the tax base has resulted in the recent trend to exert further pressure on the law-abiding taxpayers. Such unwise policies of the government force the taxpayers to opt for wrong practices which includes maintenance of two sets of books i.e formal and informal – so as to avoid excessive taxation.

Effective utilization of data collected through various means by competent and reliable field officers and engaging external agencies/organizations will enable to increase the number of tax payers and also give credibility to the process. Other measures include; providing incentives to existing and new taxpayers as well as providing a mechanism of reaching tax authorities through efficient and effective online system, running media campaigns, eradicating the malpractices will also enable the apex revenue collecting authority to eliminate the distrust of the general public which shall resultantly increase the tax revenues.

## 1.01 REACTIVATION OF BROADENING OF TAX BASE DIRECTORATE

HIGH

Directorate General of Broadening of Tax Base was introduced through section 230D of Income Tax Ordinance, 2001 but it is still not operative in true sense. Re-activation of Broadening of Tax Base Directorate is recommended by taking steps to either outsource their investigating activities to different expert agencies/organizations working in Pakistan (including Members & Affiliates of ICAP).

FBR may need to call for representations from different people willing to work for this outsourced function by reviewing their methodology of working in order to facilitate in enhancing the tax base and identifying new taxpayers who are liable to file tax return but have not done so. These outsourced expert agencies/organizations may be given a share in collection of taxes if they are able to identify collection from new taxpayers. This will not only increase revenue of the FBR but at the same time will not result in incurring any additional fixed administrative cost that might result in further burden on the exchequer. The main reason why the existing force of the FBR is not able to increase tax base seems to be over burden of existing work on the field officers. Hence, outsourcing this function would be of great help in increasing new taxpayers and new collections of taxes.

Directorate General of Broadening of Tax Base should also collect and analyze data from different authorities. Currently, a large volume of financial and non-financial data is available with various revenue and other government bodies working at National and Provincial level that could be reviewed for broadening of tax base. This includes but not limited to information being filed by the banks regarding withholding tax, cash withdrawal over specified limit and credit card transactions. Following modes can be used to identify the non-filers:

- Use of withholding tax data available with the FBR to tap increase in taxpayers' base;
- Mobiles users' withholding tax data;
- Electricity bills withholding data;
- Bank Account holders withholding tax data (import, export, profit payment);
- Property registration data; and
- Vehicle registration data.

FBR should empower Directorate-General of Broadening of Tax Base and make appropriate mechanism for assessing the non-filers from data obtained from FBR and other authorities. This includes:

- Making proper criteria for making assessment of non-filers;
- Provisional assessment of non-filers;
- Case send to relevant Commissioner;
- Provide opportunity of being heard or provide complete information required;
- Make best assessment of the non-filers on basis of available information; and
- Compulsory NTN for non-filers under section 114 of Income Tax Ordinance, 2001 if criteria is met.

### 1.02 REAL-TIME REPORTING OF SOCIETIES / BUILDERS FOR PROPERTY SALE / TRANSFER

HIGH

It is proposed that housing societies/developers/builders engaged in selling of plots, building unit should integrate their systems with FBR on same mechanism as POS integration and share real time transfer of file/plot/building/building unit. etc. Such information should be transferred to Broadening of Tax Base department so as to analyze the information and cross-match the same with wealth statements and tax returns of buyers and sellers. Further FBR should modify its tax returns and wealth statements format to allow for standardized property declaration mechanism to ease matching of the property for the field officers and calculation of capital gains.

### 1.03 NATIONAL TAX NUMBER REQUIRMENT FOR CERTAIN SERVICES / FACILITIES FROM GOVERNMENT / SEMI GOVERNMENT / PRIVATE ORGANIZATION

HIGH

It is proposed that compulsory NTN be issued to persons using following facilities if they are non-filer in accordance with Income Tax Ordinance, 2001 and such services should not be provided unless they become filer:

- Issuance/renewal of passport;
- Commercial/industrial electricity, gas and water connection;
- Three phase residential electricity connection;
- Sale and purchase of vehicle/motor bike;

- Transfer/purchase of properties;
- Foreign travel; and
- Membership of renowned clubs.

Exceptions may be given to:

- Non-residents not required to file return u/s 114 of Income Tax Ordinance, 2001;
- Education/medical purposes;
- Dependent ladies/ widows;
- Pensioners; and
- Persons under 21 years of age, in this case tax return of sponsor is required.

## 1.04 WHISTLE BLOWING

MEDIUM

The Whistle Blower protection concept was initially introduced through Whistle Blower Protection and Vigilance Commission Act, 2019 published on November 01 2019. But there have been no fruitful results due to deficit of trust.

Therefore, it is proposed to reinforce the concept that if any person comes forward and provides any information with respect to tax evasion/inconsistency/tax fraud then complete anonymity should be granted to that person. No information should be available to any field officer of FBR relating to the whistle blower. Whistle Blower should be considered for reward of 20% of the tax recovered by directly crediting into his/her bank account. FBR should also incorporate this feature in Tax Asaan App for use.

## 1.05 REFUNDS TO SALARIED INDIVIDUAL

MEDIUM

It is proposed that refunds created for salaried individuals below or equal to the amount of Rs. 300,000/- should be directly credited to their bank accounts without any application for refunds, on basis of refund showing in annual tax return provided that such refund amount is readily verifiable. The timeframe for the refund is proposed to be 6 months from the date of filing of tax returns.

## 1.06 FIXED INCOME TAX REGIME FOR SMALL RETAILERS

MEDIUM

The retail sector in Pakistan has been amongst the fastest growing markets, contributing almost 20% to the national GDP. It is the third largest sector of the country and the second highest employer, employing 15% of the labour force. Pakistan has millions of retailers, majority of which represents the FMCG trade and other general trade channels, including but not limited to kiryanas, general stores, medical stores, supermarkets, hypermarkets, etc. With the fifth highest population in the world, there is massive potential in the market due to ever-increasing consumerism. Sales in the retail sector in Pakistan have nearly doubled in the last 10 years.

There should be categorization of small retailers on the basis of location and area. FBR has already started working on tapping tier 1 retailers and furthermore, it is proposed that a fixed income tax regime should be introduced for small retailers. For this purpose, tax can be collected by either of following way:

- The relevant Provincial Authorities/Development Authorities can play an important role in enhancing tax base by either collecting income taxes on behalf of FBR or verifying that tax challan is directly paid by the small retailers, other than Tier 1 retailers as defined in STA, on provision or annual renewal of trade license to operate, etc; and

- A simple tax return form should be available for such retailers, individual retailers should be required to file their wealth statement along with simplified tax returns and such authorities shall ensure the same when they annually visit such business premises for collection of annual trade license fee.

It is proposed that FBR should begin this exercise with CDA in first phase in order to take capital city retailers in tax ambit and in phase two spread it other major metropolitan cities and thereon. Also GPS mapping of such shops can also be done through this exercise simultaneously.

## 1.07 CAPACITY BUILDING OF REVENUE AUTHORITIES

HIGH

Tax Laws applicable in Pakistan are complex in nature and require a detailed study and understanding before application in different scenarios, therefore, it requires qualified persons with an aptitude to understand and comprehend such laws. Hence, FBR should ensure that it employs persons with relevant knowledge of tax, accounting and auditing laws/rules to ensure the accuracy and completeness of the system.

Furthermore, FBR should train its new employees/officers for a period of six months before assigning them any specific tasks to ensure that they have relevant knowledge and experience to meet the requirements of specific scenarios.

In addition, FBR should plan and implement trainings of existing employees to ensure that they are updated about any amendments or changes in requirements/laws/rules so that they respond accordingly.

## 1.08 MEDIA CAMPAIGNS AND INCENTIVES TO TAXPAYERS/FILERS

MEDIUM

One of the reasons of lesser tax returns filers is attitude of the tax authorities towards the existing taxpayers due to which people prefer to remaining non filer even by paying higher tax which is evident from insubstantial increase in number for filers after introducing the concept of non-filers and active taxpayers. The following measures need to be taken:

- Implementation of self-assessment scheme in the true spirit;
- Selection for audit should be through “risk based automated tools”;
- Least possible direct interaction of the Tax Department personnel with Tax Payers;
- Rationalizing the existing tax rates; and
- Outsource the audit function to experts.

A commissioner should not be authorized to conduct audit of a taxpayer himself rather he/she could only forward the case to one of the registered firms of Chartered Accountants for Audit.

Previously, media campaigns have been conducted by FBR to raise awareness on tax return filing, which have been effective to significant level. Furthermore, engagement of people in POS prize scheme has also proved to be fruitful.

It is suggested that media campaigns should be conducted which are not limited to tax return filing but also broadening the tax base. These campaigns should focus on tax facilitation/incentives that shall be provided to existing and new taxpayers.

The incentives shall be as follows;

- Recognition for high taxpayers (Top 100 to 1000);
  - Representation at certain public offices/ committees;

  - Priority at Airports, Public Amenities, Healthcare and Govt. Offices; and
  - Increase in tax rebate on stock exchange listing from 20% to 30%.
- Lower tax rates - Single flat rate for income tax;
  - 20% on corporate sector;
  - 15 % on individuals;
  - Single stage sales tax on goods and services; and
  - Taxation of retailers with turnover less than Rs. 5 Million at a flat rate on the basis of their location.
- Improved and effective tax facilitation centers at every tax office to help support filing of tax returns;
- Simplified tax guidelines and assistance through qualified staff;
- Encourage interaction and improve the trust deficit;
- Tax incentive for newly registered companies – reduced tax for first 3 to 5 years;
- Filers should be given priority treatment at various infrastructural facilities e.g., at NADRA, schools, excise and taxation (when registering motor vehicles), courts of law, banks, hospitals, airports etc;
- Incentive for compliant taxpayers and professionals (Doctors, Engineers, Lawyers, Chartered Accountants) for reduction in tax rates; and
- Some benefits like free medical, education for children, insurance or other privileges must be associated with the payment of taxes for the filers.

On top of this, Government can also incentivize the existing taxpayers with following small benefits by categorizing them on the basis of annual tax paid during the last three years:

- Preferred treatments in the Government owned hospitals and offices;
- Discounted toll tax on the roads and discount at air tickets;
- Discount to the children in Government schools, colleges and universities; and
- Unemployment allowance for six months; and
- Higher insurance coverage limit through Sehat Card etc.

## 1.09 FOCUS ON FINANCIAL INCLUSION

LOW

Population of Pakistan availing financial services or having bank account is around 20% of adult population. Less financial inclusion is a big cause of non-documentation and cash economy. Focus in financial inclusion would result significant growth in tax revenue and documentation of the economy. Financial inclusion supports documentation of the economy and enhances tax base in various forms including contribution in withholding taxes. Support from SBP needs to be obtained for encouraging small savings accounts with Tax incentive / lower tax rate for these small saving account – one per CNIC to avoid misuse.

## 1.10 WIDENING OF TAX ON INCOME FROM PROPERTY

HIGH

There is a strong perception that income from property is not fully tapped due to lack of monitoring. It is suggested to take the following steps for expanding the tax base under the head income from property:

- For preventing escape of taxation on rent from immovable property, every tenant, by statute, should be required to file a copy of the lease agreement to the FBR or any other designated office to ensure that tax return is filed by the lessors and tax thereon is paid; and
- Data should also be collected from the police stations, development authorities or municipal administration of the rented-out properties (both commercial and residential) subject to property tax.

## 1.11 WITHDRAWAL OF TOTAL EXEMPTIONS FROM TAX

MEDIUM

Second Schedule to the ITO has provisions that gives a message that the government is not impartial in levying tax on all sectors of the economy or sections of the society. It demonstrates partiality by providing tax concessions and exemptions to those in power or hold high profile positions in the government thereby giving a message that the tax policy is tilted towards elites including landlords or wealthy. The classic example is of exemptions available to agricultural income and the perquisites given to the military, judges, etc.

The Government should seriously consider withdrawal of all unwarranted and discriminatory tax exemptions/ concessions provided in the Second Schedule to the ITO as without it broadening of tax base will remain a dream. This should be done proactively rather than on the behest of IMF.

# 2 EASE OF DOING BUSINESS (EODB)

The World Bank ranking of Pakistan in EODB kept on deteriorating from 85 to 148 during the period from 2008 to 2019. The latest rankings released by the World Bank in January 2021 was 108 out of 190 countries. The improvement in ranking was due to end to end automation of company registration process, decrease in time for getting construction permits & registration of commercial property and online payment of taxes etc.

The ranking of EODB has improved in spite of lack of documentation, parallel economy, poor law and order, political instability, bureaucratic hassles, frustrating foreign exchange regulations and challenging environment of tax regulation.

The proposals presented here are merely from tax perspectives. Accordingly, the measures to be taken to address EODB issues also relate to regulations, business friendly environments, better infrastructure, cross border compliances, foreign exchange regulations, facility of one-stop window etc., which are not discussed in this document.

The issue that requires serious consideration from tax perspective is to have a highly improved tax framework, which should, inter alia, include true enforcement of self-assessment scheme, minimization of red-tap, eliminating final, minimum, alternate and super tax regimes for corporate taxpayers, reduction of withholding tax regimes and compliances, setting up of independent appellate forums, easy and quick disposal of tax refunds, limiting the incidence of tax audits (exception to apply only in case of tax fraud or false tax declarations), attachment of bank accounts for recovery of disputed tax to be used only as a final course of action, rationalization of penalty and default surcharge for offenses, etc. Similarly, a uniform tax system for goods and services tax needs to be introduced within the constitutional framework of Pakistan.

Since ICAP is covering proposals for EODB only from tax perspective, the government should give due consideration to the following proposals, which are presented from high level perspective and implementation of the same would require detailed analysis.

1. Complete Automation of Tax Processes;
2. Reformation of Tax Laws and Procedures;
3. Revisit Tax Rates and Tax Regimes;
4. Tax Recovery and Tax Refund Mechanism;
5. Rapid Tax Dispute Resolution;
6. Independent and Transparent Tax Administration;
7. Streamlining of Withholding Tax Management;
8. Coordination between Federal and Provincial Tax Authorities; and
9. Monitoring of Withholding Tax – Section 161.

## 2.01 COMPLETE AUTOMATION OF TAX PROCESSES

Pakistan has progressed well overtime in introducing information technology ("IT") in tax administration. However, it is still following a mix of manual and IT based tax collection system. There is a need to make enormous investment in IT for achieving complete automation of IT Processes. We are of the view that with the use of IT in the tax administration, the country will gain significantly in terms of tax collections. IT greatly helps in voluntary compliance by the taxpayers and ensures effective monitoring of compliance. IT further helps the tax administration in efficiently processing tax returns, tax assessments and tax refunds. It also supports and provides an effective tool for the following:

i. conducting audit of tax administration covering its functions of tax assessment, tax collection, and effective use of IT for broadening of tax base; and

ii. creating and maintaining a computerized folder of each taxpayer's complete tax record including but not limited to:

    (a) Withholding tax information;

    (b) Notices issues year wise;

    (c) Replies of the taxpayer;

    (d) Assessment orders;

    (e) Rectification applications and rectification orders;

    (f) Appeal orders and appeal effect orders;

    (g) Refunds outstanding and refunds issued; and

    (h) Tax Demand outstanding

It is strongly recommended to carry out a benefit analysis for making a decision for procurement and implementation of integrated IT system interlinked with other organizations of the Country including but not limited to NADRA, CAA etc.

As withholding statements are being e-filed, hence, major information relating to a taxpayer vis-à-vis transactions subject to Withholding tax, already stand captured and are available with FBR. Efforts now need to be made to prepare pre-populated Income Tax Returns available to the taxpayer at the close of the Tax Year thereby facilitating tax compliance and also bringing accountability. Most of the countries are relying on the automated systems/processes for tax compliance, hence it is need of the hour that Pakistan should keep on focusing on enhancing automation in coming years.

## 2.02 REFORMATION OF TAX LAWS AND PROCEDURES

HIGH

Over the time, the complexity level of tax laws and procedures have substantially increased mainly due to rapid significant changes made in the tax laws by introducing several final, minimum, alternate and super tax regimes along with several exceptions which further added to the confusion. Similarly, a large number of withholding taxes were introduced by the name of "Transitional Advance Tax Provisions – Chapter XII"., The five (5) sections allotted to it have been extensively used for introducing numerous withholding tax provisions, though they are being curtailed recently. This, at times, becomes more vulnerable as field officers of the revenue authorities make different interpretations which opens the doors for long drawn litigations giving rise to exorbitant increase in "cost of doing business". Above all, predictability of the laws has always been questionable, and that prevented the taxpayers from making long-term business plans. Similarly, every government has the tendency of announcing tax amnesty at regular intervals for meeting budgetary targets, thereby raising expectations of regular amnesty schemes.

Further, interaction with revenue authorities in multiple tax jurisdictions without harmonization of goods and services tax laws of the federal and provincial governments results in tax disputes which adds significantly to the cost of doing business.

A concerted effort is needed for bringing all revenue authorities together on the agenda of reformation and harmonization of goods and services tax laws of the federal and provincial governments. Similarly, it is strongly recommended to reform the existing tax framework to make it less complex and easy to comply.

These measures may include the following:

i. Harmonization of rates of sales tax on goods and services across the country;

ii. Single tax collecting platform for all federal and provincial taxes;

iii. True enforcement of Self-assessment scheme;

iv. Commissioner's open-ended power to select cases for audit should be restricted only to cases where the Commissioner has definite information that the taxpayer has either committed fraud or has made false declaration;

v. Efficient completion of assessments where cases are selected for tax audits under an automated and transparent selection process;

vi. Automatic transfer of tax refunds to designated bank account of the taxpayer;

vii. Reduction in number of tax payments and their filing requirements; and

viii. Workers related federal and provincial taxes and levies namely Employees old-age pension benefits, social security, surplus (un-distributable) workers profit participation fund and workers' welfare fund should be deposited in designated banks and financial institutions using one consolidated payment document.

## 2.03 REVISIT TAX RATES AND TAX REGIMES

HIGH

Tax Rates for corporate taxpayers has been reduced gradually but at the same time the tax administration has been making several changes to curtail the admissibility of expenditure and making harsh assessments to snatch away the relief given by reduction of tax rates. Some significant negative changes made overtime are: (a)eliminating or significantly reducing the initial depreciation on tangible assets; (b)increasing the maximum period for amortization of intangibles from 10 to 25 years; (c) reduce depreciable value of motor vehicles used for business; (d)restrictions on admissibility of sales promotion and advertisements. Simultaneously, the tax administration has been introducing several new tax regimes including massive withholding tax regime, minimum tax regimes, fixed tax regime, super tax regime, and alternate corporate tax regime thereby leaving less options for normal tax regime. In fact, the FBR has systematically moved away from net profit taxation and embraced gross income taxation. Actually, it would be justified to say that FBR is following the agenda of indirect taxation in the guise of direct taxation.

It is strongly recommended to take the following steps for smooth operation of the businesses, particularly for the startups and MNCs set up by foreign investments:

i. Alternate Corporate Tax regime should be abolished;

ii. Minimum tax regime based on turnover should be abolished otherwise Maximum rate of taxation should also be defined;

iii. Withholding tax regime (including sales tax withholding) should be rationalized or completely done away with. The hassles of compliances should be minimized and the risks associated with non-compliance be curtailed. Corporate sector should only be subjected to advance tax, the frequency of which could even be increased from quarterly to monthly;

iv. The restriction on depreciable vehicles for business use and sales promotion and advertisement be removed or relaxed; and

v. Tax rates for non-corporate sector, which includes salaried and business individuals, SMEs and AoPs should be reduced and it should not, by any means, be more than the rates prescribed for small companies.

## 2.04 TAX RECOVERY AND TAX REFUND MECHANISM

HIGH

Current tax recovery mechanism fully provides for all imaginable recovery options. What it lacks is its fair application particularly in cases where harsh tax assessment is made and is under challenge at appellate forums. Whilst it is hoped that with the setting up of independent and transparent tax administration manned by quality staff would result in fair taxation, it is strongly recommended to make amendments in the tax recovery provisions for introducing mandatory approval mechanism before initiating any coercive recovery option, such as attachment of bank account, arrest or appointment of receivers. Such approval should be sanctioned only in cases where tax dispute resolution options are exhausted or there is a high risk of the taxpayer absconding or leaving country. This is necessary as uncontrolled use of such powers, could financially and operationally cripple the taxpayer.

Current tax refund mechanism is highly inefficient, and, in cases where the amount of refund is greater, it is usually withheld deliberately for one reason or the other. Denying, or delayed processing of, assessed tax refunds has significantly distorted the business image of Pakistan. The Finance Act, 2019 has tried to address this issue by introducing refund bonds for the settlement of long outstanding income tax refunds. These refund bonds carry a simple interest of 10%, which is payable along with principal amount of refunds on attaining maturity period of three years. However, it did not auger well as such bonds are neither traded freely in the market nor eagerly discounted by the banks.

It is strongly recommended to take the following steps for addressing the refund issues:

i. Processing of refunds should be entrusted to a separate wing, and such process should be completed within a maximum period of 90 days reckoning from the date of filing of the application;

ii. Tax laws should be amended to allow inter-adjustment of Income tax and Sales tax refunds;

iii. Amendment should be made in the FTO Ordinance to allow the FTO to accept cases of refund disputes for issuing an order binding on the tax authorities; and

iv. Delayed payment of refund should be eligible for a return at monthly KIBOR plus 3% per annum.

## 2.05 RAPID TAX DISPUTE RESOLUTION

MEDIUM

Tax disputes could arise between the tax administration and the taxpayers both under local tax laws and tax treaties. Currently available options for dispute resolution are; (a) appellate forum starting from Commissioner Appeal (which is a part of tax administration) to the Appellate Tribunal (which is a quasi-judicial forum) where disputes covering matters both on fact and law are decided; (b) High Courts and Supreme Court (which are independent ) but where only point of law arising from the order of the Appellate Tribunal is decided and (c) alternate dispute resolution, where a dispute resolution committee decides issues other than point of law provided the taxpayer is willing to withdraw appeal on the disputes pending resolution at the appellate forum or in courts.

Current dispute resolution options are a lengthy exercise and most of the disputes remain undecided for longer period. In several cases, particularly in case of MNCs (where huge foreign investments are at stake), the cases remain undecided for five or more years. Absence of rapid dispute resolution mechanism becomes not only a costly affair, but also works as an obstacle in routine operation of the businesses, particularly where the disputed tax is either recovered through coercive measures or the bank accounts are attached and become non-operationally if the recovery is not prevented by order of appellate forum.

It is strongly recommended to take the following steps for providing rapid resolution of the tax disputes:

i. The appellate forum of Commissioner Appeals and Tribunal should be declared totally independent;

ii. A separate bench should be set up in all high courts for hearing of tax cases only;

iii. An independent permanent body for Alternate Dispute Resolution be set up, and they should be given full powers to decide all kinds of dispute and making its decision binding on the tax administration;

iv. It is strongly recommended that the Office of Commissioner Appeals should be brought under the Ministry of Law & Justice and the Appellate Tribunal under the High Courts; and

v. In order to build the confidence of the taxpayers in the appeal system, it is also recommended to publish all of the decisions of the Commissioner Appeals and the Appellate Tribunals.

## 2.06 INDEPENDENT AND TRANSPARENT TAX ADMINISTRATION

MEDIUM

Tax Administration plays an important role in enforcing tax laws to collect tax for the governments for their use for the social uplifting of the general public including the taxpayers and for creating infrastructure for long-term economic development. It is therefore necessary that the Tax Administration should not only be efficient but also be fairly independent – having either detached from, or less control of the government.

It is our understanding that a proposal was already under active consideration of the Government to convert the FBR into an autonomous body on lines similar to SBP and SECP. Whilst this is indeed a welcome step, it is proposed to consider the following minimum steps for functioning of an effective independent and transparent tax administration till such a decision is implemented:

i. The FBR Act and related rules and regulations should be amended appropriately for improving the governance structure and making it highly autonomous, transparent and subject to accountability by independent external auditors and Office of the Auditor General of Pakistan;

ii. FBR should operate and work with a corporate governance structure with a Board of Directors, vested with powers similar to the Boards of Public listed companies. Fifty percent of the Board members including Chairman FBR may be nominated by the government (Ministries of Finance, Law, and Commerce) and, the remaining fifty percent should be nominated by the established trade and professional bodies like OICCI, PBC and ICAP;

iii. FBR should be headed by an experienced qualified professional, who should be assisted by qualified and trained professionals having established knowledge and experience of accounting, taxation, law, IT, economy, and business administration. For this purpose, full autonomy be given for remunerating the hired personnel and elevating and incentivizing them based on performance evaluated using a balance score card; and

iv. An Internal Audit Department should be set up for conducting effective internal audits of FBR affairs and directly reporting to a Committee of Board members comprising government and non-government members.

## 2.07 STREAMLINING OF WITHHOLDING TAX MANAGEMENT

LOW

The largest part of the annual tax collection is currently made through withholding tax regime. It would be justified to consider it as the backbone of current tax collection system. However, there is still so much to be done for gathering of withholding tax data and its use both for the benefit of tax collectors and taxpayers. Accordingly, it is strongly recommended to streamline the withholding tax management by taking the following minimum steps:

i. Ensure gathering of accurate withholding tax data of each taxpayer from the withholding agents including those who are currently not providing such data, i.e., utilities, financial institutions, airlines;

ii. Provide access to withholding tax data to the taxpayers on a real-time basis;

iii. Where the withholding agents, i.e. governments, utilities, financial institutions, airlines, who do not provide Computerized Payment Receipt (CPR), a certificate of tax withheld or collected issued by such withholding agents should be accepted as valid evidence of tax withheld or collected for admissibility for tax adjustment including refunds;

iv. Withholding tax deducted or collected by the withholding agents represents tax of the persons from whom tax is deducted or collected. There is a provision for recovery of un-deducted or un-collected tax from the withholding agents (section 161) where default committed by the withholding agent in this respect surfaces through a monitoring exercise. There is also a provision (section 162) which prevents recovery of such tax from the withholding agent where the tax is paid by the actual taxpayer. The tax collector usually proceeds against the withholding agent and penalize him by recovering the un-deducted or un-collected tax as revenue measure, instead of first ensuring that the payments to the recipient that escaped tax deduction or collection have been offered to tax by the actual taxpayer in his tax declaration;

v. Due date of payment of withholding tax deducted or collected by the withholding agent should be uniformly applied on a monthly basis for all withholding agents; and

vi. The requirement of filing statement of taxes withheld by the withholding agent can also be withdrawn, as FBR could use its IT resources to generate such statement based on the information provided in the CPR.

## 2.08 COORDINATION BETWEEN FEDERAL AND PROVINCIAL TAX AUTHORITIES

MEDIUM

The Amendments in the Constitution of Pakistan provided substantial fiscal and legal autonomy to the provinces for raising finance and enacting new laws. Following enactment and implementation of the service tax laws and labour laws by the provinces, the businessmen, who have businesses located in more than one tax jurisdiction, are facing jurisdictional challenges and duplicate taxation leading to tax disputes. This is causing financial and operational hardships as number of challenges overtime has increased substantially.

It is strongly recommended to establish (preferably within FBR) a permanent cell or directorate which should be equally represented by nominees of the federal and provincial tax authorities to provide a common platform to the taxpayers for resolving jurisdictional issues and preventing duplicate taxation.

It is also recommended that one authority be empowered to collect all types of federal and provincial taxes for onward transmission to respective revenue authorities within the country without burdening the business entities and the provincial taxes should be consolidated specially the labour levies e.g., EOBI,SESSI,WPPF,WWF etc.

Special attention may need to be given to tax implication arising on emerging e-business models and asset free web service providers who act as coordinator between supplier and buyer. Mechanism for sales tax and income tax application for such models should be placed for revenue generation.

## 2.09 MONITORING OF WITHHOLDING TAX - SECTION 161

LOW

In most of the notices for monitoring of withholding taxes, figures are taken from the financial statements and withholding agent is required to reconcile those figures with the payments. This lengthy exercise involves lot of time and resources of the taxpayers.

*As per provision of Section 174 of the ITO, a taxpayer is required to maintain accounts and documents for six years after the end of tax year to which they relate*. Since no time limit is prescribed in Section 161 of the ITO for monitoring of withholding tax, the taxpayers are receiving notices for the period beyond six tax years for which they are not obliged to maintain / retain records, which create hardship to the taxpayers furthermore, the field officers force recovery from the withholding agent despite the fact that the person from whom tax was to be withheld has already discharged his tax liability.

Since the taxpayers are filing withholding tax statements, same data should be used for monitoring, and notices should only be issued in case of material differences. Moreover, monitoring of one year should be carried out at one time and a time limit be provided in Section 161 of the ITO for monitoring of withholding taxes. It is recommended that time limit of 5 years should specifically be provided under the Income Tax Ordinance, 2001 for carrying out exercise of monitoring of withholding taxes.

Although section 161(1B) exists, application of section 162 of the ITO should be mandatory for field officers before invoking section 161 of the ITO. Following amendments in section 161(1) of the ITO

*"the person shall be personally liable to pay the amount of tax to the Commissioner who may pass an order within a period of five years from the end of the financial year in which the payment was made, after ensuring that provisions of sub-section (1B) are not met"*

Monitoring of withholding taxes is to be used as deterrent and not as revenue measure. This kind of exercise also results in harassment and unethical practices, which can be avoided.

# DIRECT TAXATION

## KEY RECOMMENDATIONS

## 3.01 RATIONALIZATION OF MINIMUM TAX REGIME

HIGH

The Institute highly appreciates the policy change of moving from Final Tax Regime to Global Taxation of Income subject to Minimum Tax under various provisions of the Income Tax Ordinance, 2001 adopted in the Finance Acts 2019 and 2020, which was effective from the tax years 2020 and onwards.

However, the taxpayers while preparing the tax returns and computation of income subject to Minimum Tax for the tax years 2020 and 2021 come across various issues, which need consideration of the Tax Policy Wing of the Federal Board of Revenue. These are enumerated under sub-titles (I) through (IX) below:

### I. Minimum tax - section 148 and section 153

*Through the Finance Act, 2020, income tax withholding under section 148 of the Ordinance has been reduced to 1%/ 2% for certain plant & machinery and raw materials. However, items which are not appearing in Part I and Part II of the Twelfth Schedule are subject to tax collection of tax @ 5.5%.* This has created various anomalies which are required to be properly addressed –

- In cases where the taxpayers wish to obtain approval from the Commissioner to classify raw materials and plant & machinery to be imported by them under Part -II, such an approval should be an ongoing approval unless revoked by the Commissioner. Moreover, for raw materials, maximum limit of 125% of imports made during the preceding year should be removed. This would create an ambiguous situation where imports of raw materials up to a maximum of 125% would subject to withholding of tax @ 2% and would be adjustable and imports beyond such limit would be subject to minimum tax @ 5.5%; and
- *Commercial importers are exempt from tax withholding on supply stage whereas corporate manufacturers are subject to additional 4% income tax withholding (section 153) on supply of goods under section 153*. This is an apparent anomaly specifically considering the fact that transactions undertaken by commercial importers are more prone to under invoicing, therefore, it would not be possible for manufacturers to compete with commercial importers. Consequently, corporate manufacturers should also be exempted unconditionally from supply stage withholding tax i.e. under section 153;

To address the above issues, following amendments are proposed:

- Industrial undertaking should be ousted from applicability of minimum tax;
- Restrictions in respect of issuance of exemption certificate for new projects / capacity expansions / formula and process changes may be removed which will allow industrial growth in the country;
- Maximum volume restriction on classification of raw material under Part II of Twelfth Schedule should be removed;
- Amendments may be made to allow any available tax credits while working out previous year's tax liability for newly established undertakings already under immense cash-flow burden. This would help eliminate piling up of unnecessary refunds for newly established undertakings; and
- The rate of tax on import of raw material and plant & machinery for industrial undertaking may gradually be reduced to 1%.

**Rationale:**

The recommended measures will help in decreasing the cost of doing business and would also have a positive impact on profitability, which will ultimately contribute to more taxes.

New industries need to be supported for industrialization and job creation therefore these measures will ease their working capital requirement and in turn allow them to invest such funds in productive activities rather than being stuck in refunds.

**II. Treatment of Opening and Closing Stocks of imports by other than industrial undertaking**

The applicability of Minimum Tax is with reference to tax payable on the income for the year from such imports. However, in almost all cases of other than an industrial undertaking the corresponding income relating to closing stocks of such imported goods does not form part of the current year (the year of import of goods) and on the other hand the income arising from the opening stock forms part of the current year income (though not imported during the current year). The law is silent as to its treatment and no uniform method to offset the effects of opening and closing stock of such imported goods exists.

**Recommendations**

For this purpose, sub-section (7) of section 148 be further amended, by addition of the words "consumed during the year" as under:

"The tax required to be collected under this section shall be minimum tax on the income of importer arising from the imports consumed during the year subject to sub-section (1) and this sub-section shall not apply in the case of import of goods by an industrial undertaking for its own use."

**III. Comparison of Minimum Tax**

It goes without saying that the word "Minimum" when and wherever used postulates that there exists something else to make a comparison with. However, the analysis of the corresponding provisions reveals as under:

- Existing provisions of Minimum Tax providing for both the components to ascertain the difference of minimum tax payable;
- *Section 113 tax payable for the tax year and minimum tax (amount worked out by applying the applicable percentage on the turnover); and*
- *Section 113C (Corporate Tax; and Alternative Corporate Tax).*

Currently following provisions of Minimum Tax do not provide for the other component to ascertain the minimum are as under:

- *Section 148(7);*
- *Section 152(1B);*
- *Section 152(2B);*
- *Section 153(3);*
- *Second Proviso to Section 154(5);*
- *Section 233(2B);*
- *Section 233(3);*
- *Section 235(4)(a);*
- *Proviso to section 236C (2); and*
- *Section 236Q (3).*

The main reason of the deficiency pointed out above is that earlier all these provisions were in respect of final tax and through Finance Acts, 2019, 2020 and 2021 the word "Final" has been replaced with the word "Minimum", without considering other consequential amendments. Another reason for this deficiency is that the legislators did not took into consideration the majority of the cases with composite sources of income i.e., both income subject to minimum tax and not subject to minimum tax as well.

**Recommendations**

The Institute proposes for introduction of comprehensive provisions for income subject to Minimum Tax Regime parallel to Section 169 for Final Tax Regime. The draft of such provisions is given in point No. VIII below.

**IV. Minimum Tax on which amount?**

Following provisions do not specify Minimum Tax on which amount or income need to be charged and therefore require appropriate amendments.

A plain reading of section 152(2B), and Second Proviso to Section 154(5) suggests that this minimum tax is not on the income arising from the transactions referred to in said clauses, but it is on the overall income of the taxpayer for a tax year.

**Recommendations**

The proposed amendments to remove the deficiencies are as under:

Section 152(2B)

The tax deductible under sub-section (2A) shall be minimum tax on the income arising from transactions subject to sub-section (2A).

Second Proviso to Section 154(5)

Provided further that the tax deducted under this sub-section shall be minimum tax.

Section 236Q (3)

Tax deductible under sub-section (1) and (2) shall be minimum tax on income of such resident person arising from transactions referred to in sub-section (1) and (2) of this section.

**V. Problems in following Mercantile System of Accounting**

In case of taxpayers following “mercantile system of accounting” (accrual-based accounting), which is:

- Applicable on all Companies;
- Adopted by all Sales Tax Registered Individuals and AOPs (to reconcile sales as per sales tax return and as per income tax return);
- Adopted by most of the Individuals and AOP’s even otherwise; and
- Taxable income for the year is determined irrespective of the fact whether revenue and expenses are received or paid. On the other hand, all provisions of withholding tax also apply at the time of making the payment or clearance of goods.

There is every possibility that:

- Taxable income declared for the year is inclusive of income in respect of unrealized revenue (under mercantile system) on which withholding provisions will apply in the following year(s);
- Taxable income declared for the year is exclusive of income in respect of realized revenue relating to preceding year(s) on which withholding provisions will apply in the current year;
- Taxable income declared for the year is exclusive of income in respect of stock-in-hand of un-sold imports on which withholding provisions will apply in current year;
- Taxable income declared for the year is inclusive of income in respect of brought forward stock-in-hand from the previous year of commercial imports on which withholding provisions had applied in preceding year.

**Recommendations**

In these situations, the comparison of normal tax liability with minimum tax liability for a particular tax year is not appropriate / correct, hence these anomalies should be removed.

**VI. Implications of the word "deductible" used in various withholding tax provisions under the Income Tax Ordinance, 2001:**

Under almost all withholding tax provisions the time of collection or deduction of tax by the withholding agent is at the time of making the payment, e.g., Section 153(1) reads "…shall, at the time of making the payment, deduct tax from"

Similarly, under various withholding tax provisions the tax collectible or deductible (as stated above) is the minimum tax, e.g., *Section 153(3) reads "The tax deductible under clauses (a) and (c) of sub-section (1) and under sub-section (2) of this section, on the income of a resident person, shall be minimum tax".*

**Recommendations**

Some of the professionals are of the view that the word "deductible" used in provisions declaring tax deducted as minimum tax, e.g., *section 153(3), will cover the entire sales made during a tax year to a withholding agent irrespective of the fact whether payment has been made and tax has been deducted by the withholding agent or not.*

On the other hand some of the professionals are of the view that the word "deductible" used in provisions declaring tax deducted as minimum tax, e.g., section 153(3), should not be read in isolation and should be read in conjunction with the main section dealing with deduction of tax, e.g., section 153(1), which defines the time of deductibility of tax (i.e., at the time of making the payment) and therefore, if the payment has not been made, the tax on such un-paid amount could not be classified as "deductible" for the purpose of provisions declaring tax deducted as minimum tax, e.g., section 153(3).

Precisely, this gives rise to the issue of treatment of un-realized sales of the year out-standing on the last day of tax year (Trade Debtors, who are withholding agents) i.e., whether such out-standing sales, the income of which is reflected in the taxable income of the current tax year and normal tax thereon is being paid will be included in the sales subject to minimum tax or not.

**VII. Rate of Minimum Tax for persons not appearing in active taxpayers list**

*Under the 10th Schedule the rate of withholding tax (in particular those falling under final and minimum tax regime) are increased by 100% in case persons is not appearing on the active taxpayers list.*

However, after the end of the financial year or after the provisional assessment is made, if the taxpayer furnishes the return of income or statement under section 115, the applicable rate of final tax, in view of provisions of section 169(4), will be those as applicable to a person appearing on the active taxpayer list and the excess deduction can be claimed as refund.

Contrary to above, in the absence of any provision parallel to section 169(4) for the purposes of minimum tax, the tax deducted or collected in respect of transactions falling under minimum tax regime at 100% higher rates will be the minimum tax. This means that:

- The return forms (in particular "final / fixed / reduced / relevant" and "minimum tax regime") has to also provide for such 100% increased rates; and
- No incentive to taxpayers to become filers.

**Recommendations**

It is suggested that in the 10th Schedule or as otherwise appropriate, provision parallel to section 169(4) for the purposes of minimum tax be incorporated retrospectively.

## VIII. Attributable Income for the purposes of Minimum Tax [Problems in IRIS]

IRIS calculates attributable Income on transactions subject to Minimum Tax by apportioning the entire cost of sales, administrative expenses, selling expense and financial expenses considering the same as common cost/expenses for different segments of the business in total disregard to the provisions of *section 67 of the Income Tax Ordinance, 2001 read with Rule 13 of the Income Tax Rules, 2002, which provides for apportionment of only common expenditures and not the directly attributable expenses;*

IRIS calculates attributable Income on transactions subject to Minimum Tax by applying Section 67 of the Income Tax Ordinance, 2001 read with Rule 13(2)(a) of the Income Tax Rules, 2002 and completely ignoring the alternate method provided in Rule 13(2)(b) of the Income Tax rules, 2002.

IRIS calculates attributable Income on transactions subject to Minimum Tax by applying the formula: A/B x C

Where

A is the Taxable income from business; divided by

B is the Total Turnover subject to normal tax; multiply by

C is the Turnover of the respective transactions subject to Minimum Tax

Without prejudice to the mistakes stated (a) and (b) above the formula is correct but component B is taken exclusive of Sales Tax and component C is taken inclusive of Sales Tax, hence this needs to be rectified for uniformity purposes.

**Recommendations**

The only solution is to remove this absurdity is to bring in the concept of carry forward of "Difference of Minimum Tax" for adjustment against the tax liability of the following years. In the light of above analysis and discussions, following is the proposed insertion of a new section 169A to remove the deficiencies:

"**169A. Tax collected or deducted as a minimum tax. —**

This section shall apply where the tax required to be collected or paid is a minimum tax under sub-section (7) of section 148, sub-section (3) of section 233 or sub-section (3) of section 234A; or the tax required to be deducted or paid is a minimum tax under sub-sections (1B), and (2B) of section 152, sub-section (3) of section 153, 2nd proviso to sub-section (5) of section 154, sub-section (2B) and (3) of section 233, clause(a) of sub-section (4) of section 235, proviso to sub-section (2) of section 236C or sub-section (3) of section 236Q.

Where this section applies —

minimum tax is on the attributable taxable income relating to transactions subject to collection or payment of tax under sub-section (1) of section 148, sub-section (1) of section 233 or sub-section (1) of section 234A; or minimum tax is on the attributable taxable income relating to transactions subject to deduction or payment of tax under sub-sections (1A), (1AA), (1AAA) and (2A) of section 152, sub-section (1) and (2) of section 153, section 154, sub-sections (1) and (2A) of section 233 or sub-sections (1) and (2) of section 236Q .

"attributable tax" means amount of tax on attributable taxable income arrived at as under: A / B X C

Where

A is the amount of tax on taxable Income;

B is the amount of taxable income; and

C is the amount of attributable taxable income

"tax on taxable income" means:

(i) Income tax on taxable income computed by applying the rate or rates of tax specified in Division I or II of Part I of the First Schedule.

(ii) Reduced by adjustment of brought forward minimum tax under section 113 from earlier years and under section 113C from earlier years.

(iii) Reduced by tax reduction under sub-clause (2) of clause (1) and clause (6) of Part III of second schedule and tax credits under sections 61, 62, 62A, 63, 64B, 64D, 65E, 65F, 65G and 103; and

(iv) Increased by difference of Minimum Tax Payable for the year under section 113 and 113C."

"taxable income" does not include income subject to fixed tax as a separate block, i.e., monetization of conveyance, golden handshake, arrears of salary, capital gains on disposal of securities and capital gains on disposal of immovable property.

"attributable taxable income" means taxable income apportioned in accordance with section 67 of the Ordinance and related rules under the Income Tax Rules, 2002 in respect of transactions subject to collection or deduction of tax under the Ordinance as minimum tax.

where the attributable tax on the attributable taxable income under the respective provisions referred to in clauses (a) and (b) of sub-section (2) is less then minimum tax collectible or deductible under the said sections, then the minimum tax collectible or deductible under that section shall be the amount of tax payable on such attributable taxable income instead of attributable tax.

where the minimum tax exceeds the attributable tax, the excess amount of tax shall be carried forward for adjustment against tax on taxable income computed by applying the rate or rates of tax specified in Division I or II of Part I of the First Schedule of the subsequent tax year:

Provided that the amount under this clause shall be carried forward and adjusted against tax on taxable income computed as above for five tax years immediately succeeding the tax year for which such excess amount was determined.

Subject to clause (j), there shall be no refund of the tax collected or deducted unless the tax so collected or deducted is in excess of the amount for which the taxpayer is chargeable under this Ordinance.

Where a taxpayer has paid tax in a tax year on a transaction on which tax has been collected or deducted in the following tax year or tax years, such tax collected or deducted in the following tax year or tax years shall be refundable; and tax collectible or deductible has not been collected or deducted, or short collected or deducted, the said non-collection, non-deduction, short collection or short deduction may be recovered under section 162, and all the provisions of this Ordinance shall apply accordingly.

Where all the income derived by a person in a tax year is subject to minimum tax under the provisions referred to in sub-section (1), the person shall be required to furnish a return of income under section 114 for the year.

Where the tax collected or deducted is minimum tax under any provision of this Ordinance and hundred percent higher tax rate has been prescribed for the said tax under the Tenth Schedule, the minimum tax shall be the tax rate prescribed in the First Schedule and the excess tax collected or deducted under the Tenth Schedule specified for persons not appearing in the active taxpayers' list shall be not minimum tax, in case the return is filed before finalization of assessment as provided in rule 4 of the Tenth Schedule.

This section shall be deemed to have been inserted with effect from July 01, 2019."

## IX. EXEMPTION FROM MINIMUM TAX UNDER FOR ENTITIES COVERED UNDER CLAUSE 145A OF PART I OF SECOND SCHEDULE

*The income of residents of former FATA/PATA are not chargeable to tax under clause 145A and of Part I of Second Schedule to ITO up to 30 June 2025*, it is proposed that exemption from minimum tax u/s 113 of the ITO should also granted to entities covered under the said clauses up to 30 June 2025.

The following addition is proposed to be introduced in clause (11A) of Part IV of Second Schedule of Income Tax Ordinance, 2001.

"(xlv) Person qualifying for exemption under section 145A of Part I of Second Schedule to Income Tax Ordinance."

**Rationale:**

On merger of FATA/PATA regions with the Province Khyber Pakhtunkhwa, they were given a cooling-off exemption period by giving exemptions from income tax and sales tax, however, no exemption was provided from charge of minimum tax. This exemption shall only be available in true sense if such exemption is also granted from the charge of minimum tax.

## 3.02 REPLACING WITHHOLDING TAX REGIME WITH ADJUSTABLE ADVANCE TAX REGIME FOR LISTED COMPANIES

HIGH

The corporate sector taxpayers are compliant taxpayers and contribute significantly to the tax revenue, but they are still exposed to several challenges including very stringent and cumbersome ever-expanding withholding tax regime and facing difficulties in getting credit of withholding taxes due to non-availability of CPRs or late or non-deposit of withholding tax by the withholding agents or their non-verification in the FBR's electronic database.

As a first step, the FBR should seriously consider lifting the burden of withholding taxes and substituting it with payment of monthly advance tax in case of listed companies. Accordingly, it is proposed that instead of exposing the listed companies to a large number of withholding taxes on their income and expenditure, amend Section 147 of the ITO for the listed companies to make them pay the advance tax on a monthly basis, instead of quarterly.

## 3.03 FULL ACCESS TO WITHHOLDING DATA TO TAXPAYER ON REAL TIME BASIS.

MEDIUM

A positive step has been taken by FBR by implementation of MIS-Information Center in 'IRIS', where in a taxpayer can view income tax paid by way of collection or deduction at source. However, the scope of this Information Center needs to be expanded to the entire withholding tax regime like tax collected or deducted on import of goods, with utility bills, banking transactions, etc. so that the taxpayer can reconcile its position on real time basis.

**Rationale:**

Implementation of this proposal will lift a significant burden from the listed companies and make the life of FBR officials easier as they would be getting the payment of taxes on a monthly basis directly from the taxpayers instead of through withholding agents. It would also substantially reduce the unnecessary documentation and hassle of verification and risk of withholding agents committing frauds. It will also improve the cash flow of the companies and minimize the exposure of tax refunds. Through MIS, taxpayer is able to check various taxes deposited in their name in real sense. Further, any lapse on part of withholding agent can also be pursued by the taxpayer without any issue of its verification and availability of tax credit.

### 3.04 WITHDRAWAL OF ALTERNATIVE CORPORATE TAX (ACT) - SECTION 113C

HIGH

*Whilst there is already a minimum tax regime which imposes tax on the gross turnover u/s 113, alongside minimum tax regime for supplies, services, etc. under various section of the Ordinance, and ACT, which actually operates as alternative minimum tax regime, for the corporate sector (with exceptions), has rendered the computation of income and tax liability very complex for the corporate sector. It is also noted that the ACT rate, which was fixed at 17% by the Finance Act, 2014 (i.e., 50% of the corporate tax rate then applicable) remained unchanged whereas the rate of corporate tax has reduced from 34% to 29%, and in case of small companies, the rate was reduced from 25% to 24% in 2019. On the other hand, the rate of minimum tax u/s 113 is increased from 0.5% to 1.5% during this period.*

*In addition to the above, an important thing to note is that an exception provided in sub-section (8) of section 113C states that it would not be applicable on any receipts subject to minimum tax under any of the provisions of the Ordinance. This effectively makes ACT redundant and only results in taxing anomalies created due to various accounting treatments under IFRS which otherwise would not have been taxable.*

Considering the above, it is strongly proposed that the ACT should be withdrawn; or the rate be revised downward to 50% of the normal corporate rate of tax applicable to the companies.

**Rationale:**

The minimum tax regime of ACT at such a high rate in the presence of two more Minimum Tax Regimes is highly unreasonable and discriminatory. Only one type of Minimum Tax Regime should be applicable on the taxpayer.

### 3.05 DEFINITION OF PERMANENT ESTABLISHMENT - SECTION 2(41)

LOW

*Under section 2(41) (d), furnishing of services, including consultancy services by any person through employees or other personnel engaged by the person for such purpose is considered to be Permanent Establishment*. However, minimum threshold of presence of employees or other personnel in Pakistan is not provided.

It is proposed to amend the definition to provide that, in case of services, a PE shall be established where the stay of employees or other personnel exceeds 90 days in a tax year.

**Rationale:**

The absence of minimum threshold for services give rise to a situation where services provided for even a day in Pakistan could give rise to a PE situation thereby disentitling the non-resident from fixed taxation envisaged in section 6 at the rate of 15%.

### 3.06 SALARY - SECTION 12

HIGH

Income under the head “salary” is currently taxed on the gross amount. This policy was introduced by bringing down the corresponding rates of tax for each income slab. However, gradually the income slabs as well as rates of tax were enhanced without restoring the deductible allowances when income from salary was taxed at higher rates.

Through the Finance Act 2019, the threshold of salary income was increase to 75% of the taxable income, in order to apply the tax rate applicable to salaried individual. For other than salary income, the tax rate prescribed is higher than the slab for salary income.

It is proposed to either rationalize the rates of tax or restore the deductible allowances on account of house rent, utilities, conveyance, etc. to minimize the tax burden of salaried individuals.

The threshold of salaried income as a portion of total taxable income needs to be reverted back to 50% which was the threshold of all past years in order to allow the persons who earn mainly salary income. As stated above the rates of salary income are already high without any corresponding exemption that were available earlier. Therefore, the benefits of reduced slab rates applicable to salaried person may continue to be applicable to them even they are earing income from other sources which mainly in most cases would be passive income.

**Rationale:**

It is not justified to tax the salaried individuals (particularly in high income slabs) at such a high rate when other taxpayers are normally subject to tax on their net profits.

### 3.07 DEDUCTION OF TAX FROM PAYMENT OF SALARY - SECTION 149

MEDIUM

The employer is entitled to make certain adjustments from the average rate of tax for the purposes of deducting tax from payment of salary, which includes tax credits under section 61, 62, 63, and 64.

It is proposed to rewrite this section to provide full coverage to the following provisions of the ITO for computation of withholding tax due from salary by the employer in each tax year:

- Allow adjustment of “Deductible allowances" available under Part IX of Chapter III of the ITO.
- Allow adjustment of “Tax credits" available under Part X of Chapter III, read with Second Schedule, of the ITO.
- Allow adjustment of “Advance tax” collected at source under Chapter XII of the ITO; and
- Allow application of average rate of tax of preceding three tax years for determination of withholding tax on payments received by an employee under sub-clause (iii) of clause (e) of sub-section (2) of section 12 of the ITO.

**Rationale:**

The amendments are necessary to ensure that the employees are allowed full adjustments of all withholding taxes deducted or collected and tax credits and the employees do not suffer tax in excess of what is due.

### 3.08 TAXATION OF AOPs OF PROFESSIONALS - SECTIONS 92 & 93

HIGH

The income of association of persons (AOP) of the professionals, which are prohibited from incorporating as a limited company, should not be taxed in hands of the AOP and instead share of each partner / member be taxed in his/her hands equated with salary income or rate applicable for business individuals for the purposes of determining the tax liability.

For this purpose, sub-section (2), (3), (4) and (5) of Section 92 and Section 93 of the ITO omitted by Finance Act, 2007 should be restored.

Alternately if this is not possible, then rate of tax of AOP prohibited from converting into a company may be equated with the rate of tax applicable to corporate sector i.e. 29%. This will provide alignment of the tax rate with that of the company and provide a level playing field for such AOPs having limitation in forming themselves into a company.

**Rationale:**

Professionals like Architects, Accountants, Advocates etc., are not allowed by their respective governing statues to form a limited liability company. Thus, the professionals have no alternative but to join hands in the status of an AOP. This brings the AOP of professionals at a disadvantageous position in respect of effective tax rate as compared with a company, since member's salary is not a deductible expenditure, whereas in case of a company, director's remuneration is a deductible expenditure, and such remuneration is taxed at rates applicable to a salaried individual. Further, where the members of such AOP have no other taxable income, they are deprived of all deductible allowances and tax credits available under the ITO.

### 3.09 WITHHOLDING TAX ON PRIZES - SECTION 156

MEDIUM

Withholding tax @ 20% is required to be withheld from prizes offered by companies for promotion of sales.

The term Prize should be distinguished from normal trade schemes which are offered by manufacturing & trading companies to their distributors and dealers as per the business norms. The following explanation should be added under Sec 156:

*"The term Prize means winning by chance and does not include:*

- *free samples,*
- *promotional giveaways of petty amounts, and*
- *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"*

**Rationale:**

The tax authorities tend to treat the normal trade schemes like post sales discounts, free issues, promotional giveaways and target incentives as 'prize', and accordingly demand 20% withholding tax.

### 3.10 AMORTIZATION OF INTANGIBLES - SECTION 24

MEDIUM

The maximum amortization period of intangibles having unascertainable life for tax purposes be restored to 10 years.

**Rationale:**

Intangibles are significant business assets both for manufacturing and service sectors of the economy. 25 years' period too is quite long as compared to the initial, normal and first year depreciation allowances available on tangible assets.

### 3.11 TAX ON SURPLUS FUND OF NON-PROFIT ORGANIZATION - SECTION 100C

MEDIUM

*Currently, sub-section (1A) of section 100C of the ITO provides that surplus funds of non-profit organization shall be taxed at a rate of ten percent. Moreover, surplus funds under section 100C(1B) have been defined as funds or monies:*

*i. not spent on charitable and welfare activities during the tax year;*

*ii. received during the tax year as donations, voluntary contributions, subscriptions and other incomes;*

*iii. which are more than twenty-five percent of the total receipts of the non-profit organization received during the tax year; and*

*iv. are not part of restricted funds.*

Most of the non-profit organizations establish and run welfare related projects such as schools, clinics, vocational training centers etc. and for the purpose, huge capital expenditures are required to be incurred to develop the infrastructure, erect the buildings, provide equipment etc.

Such capital expenditure is incurred over a period and cannot be expended in one fiscal year. Further, to incur such expenditure, as and when required, cash is to be retained in respect of projects, which are to be completed over a period exceeding one year.

It is proposed to abolish sub-section (1A) and (1B) of section 100C of the ITO as it is directly causing hindrance to the welfare activities involving capital expenditure to be incurred over a period exceeding one year.

Alternatively, the limit of spending in a year on charitable and welfare activities from receipts during that year currently set at minimum 75% of such receipts may be analyzed over a reasonable period (at least three years), to account for expenditures which are inevitably spread over a period exceeding one year.

Surplus funds may be calculated after taking impact of revenue expenditure as well as capital expenditure incurred during the year.

The proposed recommendation is being suggested to ensure the smooth functioning of welfare projects that are specially meant for the benefit of the deprived members of the society.

**Rationale:**

There is a dire need in the society for charitable and welfare related projects specially in the education, health and social sector for uplifting of the under-privileged class dominating the population. The prevailing provision is imposing restriction and hindering the smooth functioning of such welfare projects.

## 3.12 INDIRECT TRANSFER OF ASSETS OUTSIDE PAKISTAN - SECTION 101A

MEDIUM

*The Finance Act, 2018 introduced a new section 101A to tax gain arising on disposal of Pakistan assets through non-resident holding company structures. Advance tax collection mechanism has been kept within the provisions of section 101A to ensure payment of tax at the higher of 10% of the Fair Market Value of the asset or 20% of the gain arising on such disposal.*

A specific provision should be added within section 101A empowering the Commissioner to issue an exemption or lower rate certificate on an application to be filed by a Resident Company or the seller where it can be demonstrated that the actual capital gains tax liability on such transaction is lesser than 10% of FMV or where the seller is covered under the provision of a favorable Double Taxation Treaty.

As an alternative, section 101A can be placed within the Chapter of withholding taxes to which the provisions of section 159 are applicable.

**Rationale:**

In certain cases, 10% of FMV can result in much higher incidence of tax if compared with usual Capital Gains Tax rate on direct disposal transactions. Furthermore, in certain cases, the alienator would be genuinely covered under Double Taxation Treaty whereby such gains cannot be taxed in Pakistan.

### 3.13 APPELLATE FORUMS – SECTION 127

LOW

Commissioner appeals should be brought under the administrative control of Federal Ministry of Law and the Appellate Tribunal under the control of the High Court of the respective jurisdiction. Further, establish Tax courts appointing learned judges of High Court as its member for speedy process against the decision of ATIR.

All decisions of Commissioner appeals and Appellate Tribunal should be reported for transparency and improvement of confidence of the taxpayer on the taxation system in Pakistan.

It is also suggested that an officer once appointed as Commissioner appeals should not be subsequently assigned any functions, powers and responsibilities of an office or authority subordinate to the Federal Board of Revenue.

**Rationale:**

It is felt that the principles of justice and total independence are not met at the appellate forums in real terms. In this regard, recently a directive was also being issued (later withdrawn) by the FBR whereby Commissioners (Appeals) have been advised not to annul orders. Moreover, it has also been mentioned that in case any such action, there performance appraisal would be affected. Therefore, it is imperative that appellate forum should be independent from the body responsible for collection of tax.

### 3.14 GRANT OF STAY BY COMMISSIONER (APPEALS) - SECTION 128(1A)

LOW

*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 Sections 128(1A) and 128(1AA) by Finance Act, 2012 and 2015 respectively. Now, the aggregate period of stay that can be granted is for 60 days, besides the auto stay until decision of appeal by the Commissioner (Appeals) subject to payment of 10% of the disputed tax demand raised through the assessment order.*

*The Finance Act, 2018 inserted a provision that allows the taxpayer to seek automatic stay till the decision of appeal on payment of 10% of the disputed tax demand.*

With the exorbitant tax demands created in certain cases, even 10% payment is likely to cause grave hardship for the taxpayers. Further, no mechanism is provided for refund of the 10% tax demand, if the demand is extinguished or materially reduced in the appeal. The payment by the taxpayer may also cause prejudice to his case or cause.

In Section 128(1A), the period of "thirty days" should be substituted with "till the decision of the appeal" and sub-section 128(1AA) be deleted. Moreover, at all appellate stages, stay should also be deemed to have been granted in case of availability of refunds to the taxpayer in excess of the tax demand. Further, the condition of 10% payment of tax demand may be done away with and instead 100% of the disputed demand be stayed until the decision of first appellate authority.

In addition to the above, to provide a relief to the taxpayer and absolve them from physical payment of 10% of tax demand, it is suggested that an explanation may also be inserted after first proviso of section 140 of the Ordinance to treat the adjustment of 10% of tax demand from available refunds of a taxpayer as payment made for the purpose of seeking automatic stay till the decision of appeal.

**Rationale:**

The change is proposed in the interest of natural justice and to give due consideration to the established history of unsustainability of the tax demands at the appellate forum.

### 3.15 STAY BY APPELLATE TRIBUNAL BEYOND 180 DAYS - SECTION 131

LOW

Prior to amendments introduced through the Finance Act, 2018, the Appellate Tribunal Inland Revenue was empowered to stay recovery of tax payable under the Ordinance till the time appeal is pending for disposal. *A new proviso has been inserted through the Finance Act, 2018 in the section providing such powers to the Tribunal, which has restricted the effect of such stay for a period not more than 180 days.*

It has been observed in various cases that due to the pendency of appeals before the Tribunal, on the expiry 180 days of stay granted by the Tribunal, the taxpayers have to approach the Higher Courts for necessary intervention and for seeking further stay. Through the amendments made through the Finance Act, 2018, the Government has effectively encroached into the power of the Tribunal whereas focus should be given to introduce measures for expediting the disposal of cases pending with the Tribunal.

**Rationale:**

Considering the aforesaid grievances and limitation on the powers of the Tribunal, the Courts are generally considering this aspect judiciously and graciously granting stay in all such cases. However, this is requiring the intervention of Courts on this matter and also resulting in additional litigation cost to the taxpayers.

This matter requires re-examination with reference to the pronouncements by the Higher Courts in respect of power of stay by the judicial forum. For fairness and equality, it is suggested that amendments made through the Finance Act, 2018 restricting the powers of the Tribunal should be deleted and the powers of the Tribunal for granting stay till the pendency of appeal (as available prior to Finance Act, 2018) should be restored.

### 3.16 RECOVERIES OF DISPUTED TAX - SECTION 140(1)(d)

HIGH

It has become practice of tax authorities of visiting the taxpayer’s bank with a notice u/s 140 without first exhausting the requirement of notice u/s 138 of the ITO and coercing the bank manager to immediately pay the amount from taxpayer’s account against the tax amount recoverable or else face the consequences. In some cases, recoveries have been made in haste even where the matter has already been decided by the judicial forum in favor of taxpayer or even where huge amount of refund is pending to the taxpayer exceeding the amount of demand raised.

While recognizing the need of some surety of recovery for the exchequer, in view of some cases where the taxpayers tend to deliberately avoid payment of tax by resorting to malpractice of withdrawing money from their account, it is suggested (in view of parallel presentation of compliant, honest and prestigious taxpayers) to first exhaust the requirement of section 138 to allow all taxpayers some time to resort to legal means of contesting the recoveries which are considered by the taxpayers to be unlawful.

After having exhausted the requirement of section 138 of the ITO, the win-win situation for both the exchequer and taxpayers would be to ask the taxpayer’s bank, by a notice in writing, to freeze the bank account(s) and set-aside the amount sought to be recovered, in the first instance, till end of the fifteen days from the date of receipt of notice served on the bank and in the second instance, requiring the bank to make payment of the default amount after end of fifteen days unless the bank notice of recovery is withdrawn. Necessary amendment is suggested in the law to incorporate the above proposal.

Moreover, there exists a concept of automatic stay on payment of 10% of the disputed tax demand until the appeal is decided by the Commissioner Appeals.

It is proposed to extend this option to the next appellate forum, i.e. Appellate Tribunal by amending the Proviso as follows:

In proviso to section 140(1)(d) after the words “under section 127” the words “or section 131” should be inserted and after the words “Commissioner (Appeals)” the words “or the Appellate Tribunal” should be inserted.

**Rationale:**

The relief provided against recovery of disputed tax demand should be extended as this is a mutually win-win situation for the taxpayers and the FBR. Taxpayers will prefer to deposit 10 per cent of the tax due instead of seeking stay from the Appellate Tribunal without any payment against the disputed tax. It will also drastically reduce the burden of ATIR dealing with hundreds of stay cases on a daily basis, thereby preventing it from deciding the main appeals within a reasonable time.

### 3.17 DEPRECIABLE COST - SECTION 22(13) (A)

MEDIUM

*The maximum cost of vehicle for claiming tax depreciation is currently fixed at Rs.2.5 million, irrespective of the actual cost of vehicle.*

The depreciable cost of vehicle should be increased to Rs.7.5 million due to substantial increase in cost of vehicles.

This is due to the economic conditions affected by inflation which now probes a need for the old capping to change.

*In addition to the above, it is also to highlight that section 28(b) provides that the purpose of determining the deduction on account of lease rental for the cost of passenger transport vehicle not plying for higher to the extent of Principal amount should not exceed 2.5 Million rupees*. This gives an understanding that since the amount linked with the above proviso is similar to the provisions defined in clause 13(A) of the Ordinance, any increase in the cost of luxury vehicles shall also require the above proviso of Section 28(b) to be increased.

**Rationale:**

Use of vehicles having engine capacity of 1800CC and above has now become common in Pakistan, and their prices have gone up significantly due to depreciation of Rupee and general inflation.

### 3.18 INITIAL ALLOWANCE - SECTION 23

LOW

It is proposed that the Initial Depreciation Allowance rate be restored to 50% for Plant, Machinery & Equipment and 25% for Buildings as was the case prior to the Finance Act 2013 and 2014 respectively.

**Rationale:**

This incentive is a major investment driver and motivates investments in different sectors of the economy. The benefits of accelerated depreciation are merely a timing difference whereby providing relief to the investor by paying less tax in the initial period of investments.

### 3.19 TRANSACTIONS UNDER DEALERSHIP ARRANGEMENT – SECTION 108B & SECTION 21(ca)

HIGH

*Finance Act, 2019 introduced Section 108B penalizing the compliant taxpayers for the fault/non-compliance of dealers apparently jeopardizing the freedom of trade. Under this section, 75% of dealer’s margin shall be added to the income of the supplier where the supplier makes supplies to a person who is not registered under the sales tax and is not on active taxpayers list. Margin of dealer is to be taken at 10% for making additions to the income of the supplier.*

It is proposed to delete section 108B of the ITO.

> *Similarly, section 21(ca) puts a restriction on admissibility of Commission exceeding 0.2% of the gross amount of supplies of items listed in the Third Schedule of Sales Tax Act, 1990, as deductible expenditure if the person receiving the Commission is not on the Active Taxpayers List.*

It is proposed to delete clause (ca) of section 21 of the ITO.

**Rationale:**

These are harsh provisions and amount to interference in the business affairs of the taxpayers. When complete particulars of the transactions are reported by the suppliers, it is highly unreasonable on the part of FBR to shift the burden of making supplies only to the registered persons listed on the Active Taxpayers List and penalize them so heavily for making supplies to unregistered persons or those who are not on the ATL. FBR should perform its duties of bringing the defaulters/non-compliant persons into tax net on the basis of information provided by compliant taxpayers in their sales tax and income tax returns and/or as and when demanded by the tax authorities.

### 3.20 Section 124 & 124(A)

MEDIUM

The following provision of law are prescribed for giving effect to the findings/direction/decision of various appellate forums where an appeals filed by a taxpayer against any order passed by the tax authorities:

| | | |
|---|---|---|
| 124 | For direction of giving effect | *Where, in consequence of, or to give effect to, any finding or direction in any order made under Part III of this Chapter by the Commissioner (Appeals), Appellate Tribunal, High Court, or Supreme Court an assessment order or amended assessment order is to be issued to any person, the Commissioner shall issue the order within two years from the end of the financial year.* |
| 124(2) | For set aside issue | *Where, by an order made under Part III of this Chapter by the Appellate Tribunal, High Court, or Supreme Court, an assessment order is set aside [wholly or partly,] and the Commissioner [or Commissioner (Appeals), as the case may be,] is directed to pass a new assessment order, the Commissioner or Commissioner (Appeals), as the case may be, shall pass the new order within one year from the end of the financial year.* |
| 124 (4) | In case of direct relief | *Where direct relief is provided in an order under section 129 or 132, the Commissioner shall issue appeal effect orders within two months of the date the Commissioner is served with the Order.* |
| 124(A)(2) | Case where decision is reversed by the Superior Court | *In case the decision of High Court or the Appellate Tribunal, referred to in sub-section (1), is reversed or modified, the Commissioner may, notwithstanding the expiry of period of limitation prescribed for making any assessment or order, within a period of one year from the date of receipt of decision, modify the assessment or order in which the said decision was applied so that it conforms to the final decision.* |

**Issues:**

In practice, the FBR officials do not issue the appeal effect orders based on the refundable position. Therefore, if the taxpayer has completed the above-mentioned period, the taxpayer therefore, is not able to receive the appeal effect order. The said refund accordingly is not available for adjustments in the subsequent year's tax liability, nor the taxpayer is able to claim the refund through refund application in the FBR web portal.

In addition to the above, the FBR web portal does not provide option for filing of appeal effect application. Therefore, the officer is not bound to respond to the queries raised within the stipulated time.

**Recommendation:**

The institute suggest that the FBR web portal should provide the facilities of online filing of the appeal effect applications. It is further suggested that the taxpayer should be allowed to file the appeal effect applications along with the revised working which is based on the order passed by the Appellate and higher authorities. If the concerned Officer has not initiated any actions with the given time against the provided relief by the Appellate and higher authorities on completion of the statutory time limit, then the submitted revised working by the taxpayer will be considered deemed to be accepted.

## 3.21 AMENDMENT OF ASSESSMENTS - SECTION 122(6)

LOW

It is proposed that following proviso should be added in section 122 (6):

*"Provided that order under this section shall be speaking order with logical conclusions, free of error and issued with conscious application of mind after giving reasonable opportunity of being heard with at least 3 Notices giving 15 days each for reply."*

**Rationale:**

This is an effort to curb corruption, streamline format of orders, lessen undue discretionary powers of taxation officers and to regularize extensions/ adjournments.

## OTHER RECOMMENDATIONS

## 3.22 MONITORING OF WITHHOLDING TAX - SECTION 161

MEDIUM

The taxpayers are being selected for monitoring of withholding tax under Section 161 simultaneously for more than one year. In most of the notices, figures are taken from the financial statements and withholding agent is required to reconcile those figures with the payments. This lengthy exercise involves lot of time and resources of the taxpayers.

*As per provisions of Section 174 of the ITO, a taxpayer is required to maintain accounts and documents for six years after the end of tax year to which they relate.* Since no time limit is prescribed in Section 161 of the ITO for monitoring of withholding tax, the taxpayers are receiving notices for the period beyond six tax years for which they are not obliged to maintain / retain records, which create hardship to the taxpayers.

Furthermore, the field officers force on recovery from the withholding agent despite the fact that the person from whom tax was to be withheld has already discharged his tax liability.

Since the taxpayers are filing withholding tax statements, it is suggested that the same data should be used for monitoring, and notices should only be issued in case of material differences. Moreover, a time limit should also be provided in Section 161 of the ITO for monitoring of withholding taxes.

Although section 161(1B) exists, application of section 162 of the ITO should be mandatory for filed officers before invoking section 161 of the ITO. It is proposed to make the following amendments in section 161(1) of the ITO

*"the person shall be personally liable to pay the amount of tax to the Commissioner who may pass an order within a period of five years from the end of the financial year in which the payment was made, after ensuring that provisions of sub-section (1B) are not met".*

**Rationale:**

Monitoring of withholding taxes is to be used as deterrent and not as revenue measure. This kind of exercise also results in harassment and unethical practices, which will be avoided.

## 3.23 CERTIFICATE OF COLLECTION / DEDUCTION OF TAX – SECTION 164

MEDIUM

The Institute fully appreciates and endorses the need for submissions of the challans as evidence of tax paid. However, keeping in view the prevailing ground realities, it is very difficult for the taxpayers to obtain copies of challans from the withholding agents in many cases and in particular where the tax withheld is paid through book entry or through a single consolidated challan without the details of the persons from whom it has been collected or deducted e.g., tax collected or deducted from dividend, profit on debt, export realizations, petroleum products, cash withdrawal from a bank, issuance of instruments, sale of securities (NCCPL), registration of motor vehicle, gas consumption by CNG stations, electricity consumption, telephone usage, domestic and international air tickets, etc. and tax collected or deducted by Governments under various provisions. Accordingly, the Institute is of the view, that until each and every withholding agent complies with his obligation of providing the challans of tax collected or deducted at source, any other equivalent document or certificate of tax collected or deducted should be acceptable as evidence of tax paid by way of collection or deduction of tax at source.

*Sub-section (1) of section 164 requires that the withholding agent has to provide copies of the challan (CPR) or any other equivalent document along with a certificate of the amount of tax collected or deducted.*

*Sub-section (2) of section 164 requires furnishing of copies of challan (CPR) along with the return of income as evidence of tax paid by way of collection or deduction at source but does not provide for acceptance of 'any other equivalent document'.* The term 'any other equivalent document' used is sub-section (1), is neither defined nor explained.

It is proposed to consider the following amendments to address this issue:

- The term 'any other equivalent document' used in section 164(1) should be defined or explained, which may include electricity bills, telephone bills, airline tickets, bank statements, etc.;
- In section 164(2), the words 'any other equivalent document' be added as evidence of tax payment to be furnished along with the return; and
- A proviso be added under section 164(2), whereby only a certificate of collection or deduction of tax would also be acceptable as evidence of tax payment, where the withholding agent does not separately identify the person from whom tax has been collected or deducted in the respective tax deposit challan (CPR) or the tax is deposited through internal government adjustments.

In addition, a new clause should be inserted in Part IV of Second Schedule as follows:

"Section 164 shall not apply in the case of following withholding agents:

- Electricity Distribution Companies;
- Telecommunication Companies;

- Airlines;
- Banks and other financial institutions and
- Local, statutory and other government bodies.

The certificate issued by the above companies or bodies or their agents mentioning the amount of tax collected shall be treated as sufficient evidence."

**Rationale:**

This may result in resolving dispute with tax authorities and restricting disallowance of credit for taxes deducted at source.

Various withholding agents including but not limited to electricity distribution companies, telecommunication companies, airlines and other government and local bodies do not provide copies of challans to the taxpayers, as their customer base is too high.

### 3.24 REFUNDS - SECTION 170(4)

MEDIUM

*Sub-section (4) of Section 170 states that "The Commissioner shall, within sixty days of receipt of a refund application under sub-section (1), serve on the person applying for the refund an order in writing of the decision after providing the taxpayer an opportunity of being heard."*

The following proviso should be added to the said sub-section:

"*Provided that where the Commissioner does not pass an order after the expiry of sixty days from the date of receipt of a refund application, the said order shall be deemed to have been passed by the Commissioner on the basis of application under sub-section (1).*"

On insertion of aforesaid Proviso, clause (b) of sub-section (5) of section 170 should be deleted.

**Rationale:**

Providing for early release of tax refunds increases the confidence of the taxpayers in discharging their tax obligations, even the disputed tax on the assurance of getting refunds as soon as appeal is decided favorably.

### 3.25 ADDITIONAL PAYMENT FOR DELAYED REFUNDS - SECTION 171

LOW

*Under Section 170(4) of the ITO, the Commissioner on receipt of a refund application may serve an order within 60 days. Section 171(1) provides that the refund may be paid within three months of the due date, which has been explained to be the date of order under Section 170.*

**Rationale:**

In order to remove anomaly in the law, it is suggested that where the refund order is not passed by the Commissioner within 60 days, it shall be deemed to have been passed on the 60th day.

### 3.26 OFFENCES AND PENALTIES - NON-FURNISHING OF STATEMENT WITHIN THE DUE DATE - SECTION 182

MEDIUM

*Penalty for non-furnishing of statement under section 165, 165A or 165B (where tax is not deposited within the due date and statement is filed after lapse of 90 days) is prescribed under section 182 as Rs. 2,500 for each day of default subject to a minimum penalty of Rs. 10,000.*

It is proposed that such exuberant penalty should be reduced to Rs. 500 per day subject to a maximum penalty of Rs. 50,000; and in case of continuation of default after the imposition of first penalty a further penalty of Rs. 1,000 per day.

It is also proposed to insert an Explanation or Proviso stating that no penalty shall apply in a case where there was nothing to report in the statement u/s 165.

**Rationale:**

The present quantum of penalty is too harsh and highly unreasonable. In many cases, practically, the quantum of penalty exceeds the actual tax liability itself.

## 3.27 CONDONING OF TIME LIMIT BY THE BOARD - SECTION 214A

LOW

The Federal Board of Revenue (FBR) is empowered to condone the time or period specified under any of the provisions of the ITO or rules made thereunder 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 scope of exemption was extended by introducing an explanation in Section 214A vide Finance Act, 2012 by way of which the scope to grant condonation was extended to cover the defaults of the officials of Inland Revenue for non-fulfillment of their official duties within the prescribed time.*

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

The provisions of Section 214A, prior to amendment made through Finance Act, 2012, implied that this power cannot be used in a manner 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 be condoned.

**Rationale:**

This amendment is highly prejudicial to the interest of taxpayers and indirectly gives a blanket power to the FBR to override the statutory time limit or period of any act or thing to be done by the Income Tax Authorities. This provision is also unconstitutional as it gives power to an administrative body to nullify the time limitation provided to the income tax authorities under the ITO to act or do things within the timeline provided in the ITO.

## 3.28 POWERS OF DIRECTOR GENERAL (INTELLIGENCE & INVESTIGATION) - SECTION 230 READ WITH SRO 115(I)/2015

LOW

The Federal Board of Revenue vide S.R.O.272 (I)/2021 dated 02 March 2021 conferred upon the Directorate General (Intelligence and Investigation), Inland Revenue, the powers of the Chief Commissioner/Commissioner:

- to exercise powers and perform functions under Sections 174, 175, 176, 177 (other than power to initiate audit), 178, 179, 180, 181, 182, Part III, Part XI of Chapter X, Sections 205 and 221; and
- to investigate Suspicious Transactions Reports (STRs) or other assets of persons or classes of persons impounded by any department or agency of the Federal or Provincial government and prepare/transmit reports to respective RTOs or LTUs for the purpose of application of Section 111 and for taking appropriate action under the ITO.

The law should be amended so that the authority of Director General Intelligence and Investigation is exercised only to investigate Suspicious Transactions Reports (STRs) or other assets of persons or classes of persons impounded by any department or agency of the Federal or Provincial government and prepare / transmit reports to respective RTOs or LTUs for the purpose of application of Section 111 and for taking appropriate action under the ITO.

**Rationale:**

The creation of parallel authorities for the purpose of sections 174, 175, 176, 177, 178, 179, 180, 181, 182, Part III, Part XI of Chapter X, Sections 205 and 221 is causing problems to the taxpayers.

## 3.29 GREENFIELD INDUSTRIES

HIGH

Through the Tax Laws (Second Amendment) Ordinance, 2019, the term Greenfield industries was defined in the Income Tax and Sales Tax laws.

However, to promote industrialization of the existing goods and services being produced in Pakistan in underdeveloped areas, the Institute is of the view that the condition No. "(iv)" of the definition of Greenfield industry may be removed. The condition states that technology to be used for such projects should be as such which is not previously used in Pakistan. However, this may be subjected to condition that if one such greenfield project has been established in an area, thereafter, similar industry would not qualify for greenfield status for that particular area.

**Rationale:**

The aim to introduce benefits to Greenfield industries was to promote industrialization by providing exemption from minimum turnover tax due to initial years' losses and heavy depreciation. In the presence of existing condition then it would not be possible for the Government to attract investment in existing industries where total local demand is not being met or where potential to export surplus production exists.

## 3.30 EXEMPTION OF INCOME OF WPPF & WWF – SECTION 54

LOW

Income of the Workers' Profit Participation Fund and Workers Welfare Fund is exempt under the WPP Fund Act and WWF Ordinance respectively, and the same was accepted under the ITO by virtue of proviso to Section 54 of the ITO 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 ITO was omitted.

As a result, exemption provided to the income of the WPP Fund under the WPP Act and WWF under the WWF Ordinance lost its applicability, which appears contrary to the entire scheme.

A corresponding amendment should be made giving exemption to the income of WPP Fund established under the WPPF Act or under any provincial WPPF Act and WWF established under the WWF Ordinance, 1971 or under any provincial WPPF and WWF Acts. Accordingly, it is proposed that the following sub-clause be inserted in Clause (66) of Part I of Second Schedule to the ITO.

"Workers Participation Fund established under the Companies Profits (Workers Participation) Act, 1968 or under any provincial WPPF Act and Workers Welfare Fund established under the Workers Welfare Fund Ordinance, 1971 or under any provincial WWF Act."

**Rationale:**

The amendment in Section 54 of the ITO had 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 ITO granting exemption from Income Tax to entities, which were enjoying such exemptions under their respective statutes after the proviso to Section 54 of the ITO, was withdrawn. However, due to an oversight, the exemption of income of WPPF and WWF could not find a place in Clause (66) of Part I of the Second Schedule.

### 3.31 GROUP RELIEF – SECTION 59B

MEDIUM

*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 59B. One of the conditions under sub-section 2(c) of Section 59B 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."*

It is proposed that clause (c) of sub-section (2) of Section 59B be substituted as follows:

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

*Similarly, sub-section (1A) restricts the admissibility of loss of the subsidiary company to the percentage of shareholding in the subsidiary, which requires to be revisited in view of provision of sub-section (6).*

It is proposed to delete sub-section (1A) as sub-section (6) puts a condition on the loss acquiring company to transfer cash equal to the amount of tax payable on profits to be set off against the acquired loss to the loss surrendering company.

**Rationale:**

This would bring the condition in line with 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 lose control on its entire entities within the group.

Restricting the availability of loss to the percentage of shareholding, when cash equal to the amount of tax payable on the profit to be set off against such loss, is unjustified.

### 3.32 EXPRESSION 'ANY BUSINESS CONNECTION' - SECTION 101(3)(d)

LOW

The words 'any business connection' have very broader meaning. The same has been used liberally by tax authorities even for activities carried out by independent third parties including but not limited to distributors and other intermediaries, in the ordinary course of their own business, outside Pakistan. This results in unnecessarily extending the scope of Pakistan source income.

It is proposed that clause (d) in sub-section (3) of Section 101 be omitted or clarity provided so as to prevent its misinterpretation.

**Rationale:**

The concept of 'any business connection' is no more applicable internationally due to the usage of the term 'permanent establishment', which is understood internationally in the context of Double Taxation Treaties and their commentaries.

## 3.33 FOREIGN TAX CREDIT - SECTION 103(7)

LOW

*A credit is allowed under Section 103(7) only if the foreign income tax is paid within two years after the end of the tax year in which the foreign income to which the tax relates was derived by the resident taxpayer.*

This sub-section should be omitted. Alternatively, the period of two years should be increased to at least five years.

Where a taxpayer adopts accrual basis of accounting, the foreign source income is offered to tax in the year in which it becomes due. However, receipt of the income in some cases is delayed beyond the time period of two years due to procedural limitations and regulations imposed by the remitting country. The taxpayer in this case is unable to claim foreign tax credit (usually withheld by the remitting country in the year of payment) on the income already taxed two years ago.

**Rationale:**

In many countries, assessment of the income and tax liability takes a long time and the tax paid on completion of such assessments cannot be claimed due to the limitation of two years from the end of tax year. In particular, this problem is very common in case of resident taxpayers deriving foreign source income from Azad Kashmir, which for taxation purposes is treated as a foreign country.

Further, where a taxpayer adopts accrual basis of accounting, the foreign source income is offered to tax in the year in which it becomes due. However, actual receipt of the income and deduction of tax in some cases is delayed beyond the time period of two years and, as a result, the taxpayer is unable to claim foreign tax credit on income already taxed on accrual basis of accounting.

## 3.34 CAPITAL GAIN ON DISPOSAL OF ASSET UNDER A SCHEME OF ARRANGEMENT AND RECONSTRUCTION

LOW

Presently, the sub-sections (1), (2) and (5) of section 97A of the Income Tax Ordinance 2001 (the "Ordinance") are read as follows:

i *No gain or loss shall be taken to arise on disposal of asset from one company (hereinafter referred to as the "transferor") to another company (hereinafter referred to as the "transferee") by virtue of operation of a Scheme of Arrangement and Reconstruction under sections 282L and 284 to 287 of the Companies Act, 2017 (XIX of 2017) or section 48 of the Banking Companies Ordinance, 1962 (LVII of 1962), if the following conditions are satisfied, namely:*

   *(a) the transferee must undertake to discharge any liability in respect of the asset acquired;*

   *(b) any liability in respect of the asset must not exceed the transferor's cost of the asset at the time of the disposal;*

   *(c) the transferee must not be exempt from tax for the tax year in which the disposal takes place; and*

   *(d) scheme is approved by the High Court, State Bank of Pakistan or Securities and Exchange Commission of Pakistan, as the case may be, on or after first day of July 2007.*

*ii No gain or loss shall be taken to arise on issue, cancellation, exchange or receipt of shares as a result of Scheme of Arrangement and Reconstruction under sections 282L and 284 to 287 of the Companies Act, 2017 (XIX of 2017) or section 48 of the Banking Companies Ordinance, 1962 (LVII of 1962) and approved by:*

   *(a) the High Court;*

*(b) State Bank of Pakistan; or*

*(c) Securities and Exchange Commission of Pakistan, as the case may be, on or after the first day of July 2007.*

*iii Where sub-section (2) applies and the shares issued vested by virtue of the Scheme of Arrangement and Reconstruction under sections 282L and 284 to 287 of the Companies Act, 2017 (XIX of 2017) or section 48 of the Banking Companies Ordinance, 1962 (LVII of 1962) and approved by the High Court or State Bank of Pakistan or Securities and Exchange Commission of Pakistan as the case may be, are disposed of the cost of shares shall be the cost prior to the operation of the said scheme.*

**Proposed Changes**

i. The existing reference to sections 282L of the Companies Act 2017 should be replaced with 'section 282L of the repealed Companies Ordinance 1984';

ii. The existing reference to section 284 to 287 of the Companies Act 2017 should be replace with 'sections 279-282 of the Companies Act 2017';

iii. Section 284 of the Companies Act 2017 should remain part of section 97A of the Income Tax Ordinance 2001; and

iv. Section 97A should be amended to account for the effect of section 284 of the Companies Act 2017, where under, the requirement of approval of the Scheme of Arrangement and Reconstruction by the High Court or Securities and Exchange Commission of Pakistan has been waived off for amalgamation of (i) wholly owned subsidiaries in holding company; and (ii) two or more companies, each of which is directly or indirectly wholly owned by the same person.

**Rationale:**

Companies Ordinance 1984 was repealed by the Parliament in 2017 vide Companies Act 2017 and reference to the Companies Ordinance 1984 was substituted with Companies Act 2017 vide Finance Act 2020. However, for the following reasons, further amendments to section 97A, as proposed above, are need of the hour to correctly and appropriately account for the provisions of the Companies Act 2017:

1. According to section 509 (Repeal and Savings) of the Companies Act 2017, the Companies Ordinance 1984 has been repealed except for Part VIIIA consisting of sections 282A to 282N (that includes section 282L); and the provisions of the said Part VIIIA along with all related or connected provisions of the repealed Companies Ordinance 1984 will be applicable mutatis mutandis to Non-Banking Finance Companies in a manner as if the Companies Ordinance 1984 has not been repealed;

2. Section 279 to 282 of the Companies Act, 2017 are the provisions corresponding to sections 284 to 287 of the repealed Companies Ordinance 1984;

3. Provisions of section 284 of the Companies Act 2017 were introduced for the first time under the Companies Act, 2017 and there were no corresponding provisions under the repealed Companies Ordinance 1984; and

4. Moreover, section 284 of the Companies Act 2017 has waived off the requirement of approval of the Scheme of Arrangement and Reconstruction by the High Court or Securities and Exchange Commission of Pakistan for amalgamation of (i) wholly owned subsidiaries in the holding company; and (ii) two or more companies, each of which is, directly or indirectly, wholly owned by the same person.

In view of the foregoing reasons, the afore-mentioned changes have been proposed to amend the section 97A of the Income Tax Ordinance, 2001 to correctly and appropriately account for the changes introduced under the Companies Act 2017.

## 3.35 TAXATION OF NON-RESIDENTS

### FOREIGN-SOURCE INCOME OF SHORT-TERM RESIDENT INDIVIDUALS

HIGH

Subsection (1) of section 50 of ITO, states that:

*The foreign-source income of an individual:*

*(a) who is a resident individual solely by reason of the individual's employment; and*

*(b) who is present in Pakistan for a period or periods not exceeding three years.*

*Shall be exempt from tax under this Ordinance.*

It is proposed that the above mentioned period of three years should be increased to at least six years. This amendment will attract foreign experts and help Pakistan based companies to hire those experts on their payroll. It is also proposed that such short term residents should be exempt from filing of wealth statement applicable u/s 116 of ITO.

However, the other Pakistan Source income e.g. profit on debt or capital gain on securities etc. (including Salary) would remain taxable.

### DEFINITION OF PERMANENT ESTABLISHMENT - SECTION 2(41) (d)

HIGH

Furnishing of services, including consultancy services by any person through employees or other personnel engaged in Pakistan by the person for such purpose is considered as having a Permanent Establishment ("PE") in Pakistan. Ironically, no minimum threshold of physical presence of the employees or other personnel in Pakistan is provided in Law.

It is proposed to amend clause (d) to provide that a PE shall be established where the stay of the employees or other personnel exceeds 90 days in a tax year.

**Rationale**

The absence of minimum threshold of stay of employees or other personnel for services could trigger a PE situation even with one-day presence in Pakistan, which cannot be the intention of legislature.

### DEFINITION OF PERMANENT ESTABLISHMENT-SECTION 2(41) (g) - EXPLANATION B

MEDIUM

Explanation B at the end of sub-clause (g) in Section 2(41) should be amended to insert the words "other than the actual buyer of the goods imported" immediately after the words "any other person".

**Rationale**

These amendments are more of clarifying nature to remove ambiguity.

### TAX ON CAPITAL GAINS (SECURITIES) IN CASE OF NON-RESIDENT – SECTION 37 & 37A

MEDIUM

The mode of computation of capital gains in case of non-residents requires a change for ensuring that the impact of the devaluation or depreciation of Pakistan Rupee is duly considered for fair taxation.

It is proposed that the capital gain in case of non-residents should be first determined in foreign currency and then reconverted into Pakistan currency to undo the effect of devaluation or depreciation of Pakistan Rupee against foreign currency in which the investment is made.

**Rationale**

The change is necessary to rationalize the regime for taxation of capital gains in case of non-residents.

## MINIMUM TAX ON TURNOVER OF PE OF NON-RESIDENTS – SECTION 113

MEDIUM

The application of minimum tax on turnover was extended to the PE of non-residents by the Finance Act, 2020. It is more likely to create tax interpretation issues, particularly where the PE of non-residents would claim protection available to it under the DTA, which provides for taxation of business or commercial profits.

The scheme of minimum tax is in direct conflict with the scheme of taxation of business or commercial profits provided in the DTA.

It is proposed to withdraw the amendment retrospectively.

**Rationale**

The levy of minimum tax on PE of non-residents is contrary to the spirit of DTA or even where DTA does not apply, as most of the PEs undertake projects of shorter duration and it is less likely that they would be able to avail the adjustment of minimum tax normally allowed against normal tax within a period of five immediately succeeding tax year in which the tax was first assessed.

## SEEKING WEALTH STATEMENT BY THE COMMISSIONER - SECTION 116(1)

HIGH

*Under sub-section (2) of section 116, only residents are required to file wealth statement. However, sub-section (1) of section 116 authorizes the Commissioner to seek wealth statement from any person being an individual, which may include non-resident individual.* Since non-resident is not required to file his return on world income basis, the extension of this sub-section to non-resident individual does not seem appropriate. It is therefore proposed as under:

a) exclude non-resident individual from the scope of sub-section (1); or

b) the wealth statement should be requested for seeking the information of wealth creation of non-resident in Pakistan only.

**Rationale**

This amendment is necessary to prevent the risk of it being used to seek wealth statement from a non-resident who is not liable to be taxed on world income basis.

## RESTORATION OF FINAL TAX REGIME- Section 152(1AA) & 152 (1AAA) read with Section 152(1B)

LOW

*Taxation of income of non-residents from insurance and re-insurance premiums under section 152(1AA) and advertisements relaying from outside Pakistan under section 152(1AAA) read with section 152(1B) has been moved from final tax to minimum tax regime by the Finance Act, 2021,* perhaps, without realizing that it would increase the complexity level for determination of taxable income arising from such transactions in Pakistan.

**Rationale**

Considering that the non-residents are less likely to offer taxable income that will be subject to tax more than the minimum tax, thereby field officers would challenge such tax declarations. Accordingly, it is strongly suggested to withdraw the minimum tax regime and restore the final tax regime retrospectively.

**BUSINESS INCOME OF A NON-RESIDENT PERSON - SECTION 152**

MEDIUM

*The Finance Act 2018 introduced amendments in sections 2(41), 101(3) and 152(7) to tax supply of goods by a non-resident under an overall arrangement for the supply of goods, installation, construction, assembly, commission, guarantees or supervisory activities ("EPCC Contract") even if the supply is made outside of Pakistan and the importer on record is the purchaser.*

These amendments were made to stop Base Erosion and Profit Shifting ("BEPS") by an artificial use of permanent establishment and misuse of bilateral treaties.

Primarily, taxing supply of goods from outside Pakistan is contrary to the principles of international taxation. The jurisdiction to tax such supply of goods should remain with the country from where the supply originated.

These amendments are more likely to have following ramifications:

a) it is detrimental to the overall strategy of winning foreign investments in Pakistan as under these amendments, tax is more likely to be levied in Pakistan on supply of plant machinery and equipment by the offshore suppliers;

b) non-residents would be hesitant in accepting projects in Pakistan unless the tax is borne by the recipient of goods or services in Pakistan;

c) the cost of doing business in Pakistan is more likely to increase if the offshore supplier of goods and services require grossing up of the price to neutralize the risk of tax levied in Pakistan on such goods and services; and

d) the non-residents may not be able to claim credit for taxes paid in Pakistan on such supplies taxed in the home jurisdiction.

It was observed the field officers in several cases challenge the automatic withholding tax exemption available to the non-residents where they implied that the supplies made by the non-resident was a part of EPCC contract and alleged that the activities were performed by the associate or PE of the non-resident in Pakistan. Using this provision, the field officers try to recover the withholding tax under section 152(4B) as well as treating the non-resident having a PE as per newly inserted clause (g) of Section 2(41).

**Rationale**

The amendments were introduced to implement the recommendations of BEPS Action Plan 7. However, the scope of BEPS Action Plan 7 is to ensure taxation of artificial splitting of contracts or transactions, and not to tax off-shore supplies altogether. Hence, the amendments in sections 101(3), 152(7) and the explanation in section 2(41) are beyond the scope covered by Action Plan 7 and should be modified to prevent taxation of offshore supplies. The field force may examine the EPCC contracts to determine arm's length price of the offshore supply and onshore services under section 108 and 109, and challenge if there is a pricing issue for onshore services.

Further, misuse of these provisions could result in increasing the cost of doing business in Pakistan and impacting the foreign investments.

**PAYMENTS TO NON-RESIDENTS – SECTION 152**

MEDIUM

There is a requirement to serve a notice to the Commissioner by a person making payment to a non-resident without deduction of tax. The Commissioner is mandated to pass an order within 30 days of the service of such notice either concurring with the payer; or directing the payer to make payment after

deducting tax under sub-section (2) of Section 152, read with DTA. However, the law is silent on allowing any extension in the time for passing of the order; or whether an order shall be deemed to have been passed on the expiry of 30 days. In the absence of an order of the Commissioner, the payers are reluctant to take the risk of making payment without deduction of tax on the expiry of 30 days for two major reasons:

a) Risk of recovery of un-deducted tax under section 161 of the Ordinance; and

b) the Banks insist on production of an order of the Commissioner to remit the payment to the non-resident outside Pakistan.

In order to address this issue, it is strongly recommended that a sub-section be inserted providing that the Commissioner shall be deemed to have concurred with the notice served by the payer if the order is not passed within 30 days. The electronic system may also provide for issue of deemed order automatically.

**Rationale**

Timely payments to non- residents are critical for business. Accordingly, 30 days' time allowed for passing of the order without a provision of deemed order on expiry of 30 days is quite repressive from business perspective. The Finance Act, 2021 has already inserted provisos in section 159 for automatic issue of exemption certificate in case of a company if the certificate requested is not issued within 15 days.

**REPRESENTATIVE - SECTION 172**

LOW

*Clause (a) of sub-section (3) of section172 provides that a person who is employed by, or on behalf of, the non-resident person may be declared a representative of the non-resident for tax purposes.*

It is proposed that clause (a) of sub-section (3) of section 172 should be ether deleted or modified to restrict it to an employee who is an associate of, or beneficially connected with, the non-resident person.

**Rationale**

This amendment is necessary to prevent the paid employee of the non-resident facing the unnecessary brunt of the tax authorities on tax matters related to a non-resident employer.

**FEDERAL SALES TAX ON GOODS**

**ADVANCE RULING FOR SALES TAX**

HIGH

Currently, there is no provision in the STA which allows a person to seek advance ruling from FBR on any sales tax matter on the lines it is available in case of income tax matters under Section 206A of the ITO.

It is proposed to insert a new section in the STA to allow a person to obtain an advance ruling on any sales tax matter from the FBR.

**Rationale**

Advance Ruling should be able to assist greatly in case of merger and acquisition transactions and entering into business in Pakistan by the foreign investors.

# INDIRECT TAXATION

## KEY RECOMMENDATIONS

### 4.01 REDUCED RATE OF SALES TAX

HIGH

Currently, Standard sales tax rate is 17% which is high thereby leading to lower level of registered person of about 200,000 when compared with taxpayer for income tax of about 2.2 million. Moreover, Tier 1 retailers engaged in the business of finished fabric, and locally manufactured finished articles of textile, textile made-ups, leather and artificial leather are allowed reduced sales tax rate of 12%, if their sales transactions are integrated with the FBR system. Unfortunately, several income taxpayers are not willing to register owing to high rate and even retailers are not interested in implementing the POS integration with FBR.

It is proposed that the Government should seriously consider taking following steps to achieve implementation of POS system by retailers:

a) consider reduction in the standard sales tax rate and further reduce rate for Tier 1 Retailers; and

b) consider extending the reduced rate to all retailers.

**Rationale**

Tier 1 retailers are significant players and it is necessary to build their confidence in the tax system and convince them to achieve full implementation of POS system. Reporting of increased turnover due to integration will also lead to increased income tax, which can be partly offset by effects of sales tax rate reduction.

### 4.02 BAR CODE ON ALL NOTICES AND ORDERS – ST SECTION 56(2) & FED 47(2)

HIGH

Currently, the requisition, notices and orders are issued without system generated Bar Code, whereas this system is implemented by the FBR in case of income tax with effect from July 1, 2015 read with recent direction dated January 28, 2021 which appears to be also for Sales Tax and FED too.

Although after FTO instruction, FBR has issued instructions to field formation, however, it is proposed to insert the following proviso in section 56(2) of the STA and 47(2) of the FEA so that every taxation officer and registered person all over Pakistan are aware about the same:

*"Provided that the notice, order or requisition served as mentioned in clauses (a) to (d) above shall be valid only if the said notice, order or requisition bears system generated bar code on them duly verifiable from the FBR's database"*

**Rationale**

Implementation of bar code system will strengthen the controls over the issue and delivery, of notices and orders.

### 4.03 ISSUE OF DRAFT SROs

HIGH

Currently, the SROs under the STA and FEA are issued without publication of draft for comments of the stakeholders, whereas it is so done in case of income tax under section 237(3) of the ITO.

It is proposed to introduce new sections in the STA and FEA for publication of draft SROs for comments of stakeholders before their implementation.

**Rationale**

The issue of SROs without publication of drafts for seeking comments is contrary to the procedure followed in case of income tax and it is also against the best practices.

## 4.04 RATIONALISATION IN TIME LIMIT FOR COMPLIANCES / FILINGS – SECTIONS 7, 9, 66 & 73

MEDIUM

The time period specified in various sections and rules require rationalizations to facilitate compliances by the taxpayers.

Moreover, such powers are being used by Commissioners Inland Revenue to allow condonation to tax officers to perform tax assessment for time barred cases, which is against the spirit of these sections.

Powers of condonation should be allowed to be used rationally with specific restrictions on condonation for tax assessment of time barred cases.

It is proposed to rationalize the time period provided in the following sections:

i. Time period for claiming of input tax u/s 7 should be increased from 6 months to 1 year.

ii. Time period for filing of refund claim u/s 66 should be increased from 1 year to 2 years.

iii. Time limit of 180 days for payment of input tax u/s 73 should be either withdrawn as under STRIVE it is now allowed when the sales tax is paid by the seller; or the time limit be increased to at least 1 year.

iv. Time limit for issuing debit / credit notes u/s 9, as provided under the rules, should be increased from 180 days to 1 year.

**Rationale**

The implementation of this proposal will not only facilitate taxpayers but will also reduce the burden of seeking approvals for condonations and related workload of both taxpayers and tax collectors.

## 4.05 ADVANCE RULING FOR SALES TAX AND FEDERAL EXCISE

HIGH

Currently, there is no provision in the STA and FEA which allows a person to seek advance ruling on any sales tax & federal excise matter from the FBR, as it is allowed to a non-resident in case of income tax under Section 206A of the ITO.

It is proposed to insert a new section in the STA and FEA to allow a person to obtain an advance ruling on matter from the FBR.

**Rationale**

Advance Ruling should be able to assist local as well as foreign investors.

## 4.06 INPUT TAX ON PROVINCIAL SERVICES – SECTION 8(1)(j)

HIGH

*The Finance Act, 2015 inserted clause (j) in Section 8(1) to put a restriction on claiming input tax on services (including reduced rate services) where such input tax adjustment is barred under the respective provincial sales tax on services laws. Provincial Sales Tax laws disallow input tax credit on goods or services used or consumed in a service liable to sales tax at ad valorem rate lesser than standard rate and consequently said input tax is also disallowed under Section 8(1)(j) of STA.*

It is proposed to delete clause (j) as it is contrary to the generally accepted principles of VAT worldwide.

**Rationale**

It is unjust to prevent a taxpayer paying output tax at the general rate (full rate) from claiming the input tax suffered at reduced rate whether it is paid under the Federal or Provincial sales tax laws.

### 4.07 JOINT AND SEVERAL LIABILITY OF REGISTERED PERSONS IN SUPPLY CHAIN WHERE TAX IS UNPAID- SECTION 8A

HIGH

*Section 8A stipulates joint responsibility of buyer and seller of goods in case all of the tax payable in respect of that supply or any previous or subsequent supply of the goods supplied would go unpaid.*

Section 8A states "*Where a registered person receiving a taxable supply from another registered person is in the knowledge or has reasonable grounds to suspect that some or all of the tax payable in respect of that supply or any previous or subsequent supply of the goods supplied would go unpaid, of which the burden to prove shall be on the department, such person as well as the person making the taxable supply shall be jointly and severally liable for payment of such unpaid amount of tax*".

It is proposed to remove the text from the section or any previous or subsequent supply of the goods supplied" as this condition has made irrational burden on buyer.

**Rationale**

The existing provisions makes Taxpayers responsible for the wrong doings of any party in the entire supply chain which is not justified and tantamount to give unnecessary powers to the Tax Authorities.

### 4.08 UNFAIR APPLICABILITY TO EXPORTERS – SECTION 8B

MEDIUM

*Currently, section 8B does not apply to manufacturers achieving an export threshold of 50% on a monthly basis as per SRO 1190 dated October 2, 2019.*

*Section 8B restricts Input tax adjustment to the extent of 90% of the Output tax [i.e. ratio of Input / Output ≤ 90%]. Input tax relating to Exports is included in working out the 90% limit, therefore, manufacturers failing to achieve the threshold of 50%, are always forced to pay minimum tax as per existing condition.*

In order to facilitate the manufacturers engaged in exports, the threshold for non-application of section 8B should be relaxed from 50% to 20%.

**Rationale**

This change is more likely to encourage manufacturers to maximize export of their surplus production and will also minimize refund issue.

### 4.09 ADJUSTMENT OF PRIOR PERIOD REFUND CLAIMS AGAINST SUBSEQUENT LIABILITIES – SECTION 10

HIGH

*Section 7 of STA allows taxpayer to adjust input tax paid on purchases from their output tax liability within six months. Section 10 of STA allows taxpayer to file refund claims in case input tax paid on purchases exceeds output tax on account of zero-rated local supplies or export, while for non-zero-rated cases the Rule 34 of STR allows selected category of taxpayers to claim refunds instead of carry forward of unadjusted input tax.*

*Further, Section 10 of STA requires payment of refund claims within 45 days of the filing. However, practically refund claims are neither processed nor paid within the prescribed time.*

It is proposed to address this issue by inserting a proviso or sub-section in Sections 7, 10 and 66 of STA to allow taxpayers to adjust refund claims against any subsequent tax liability in any of the following three situations:

(i) where the refund application is filed but the processing did not commence; or

(ii) where the application is processed and the registered person has complied with all the requirements of the Tax Department, but the refund payment order (RPO) has not been issued; or

(iii) where the RPO has been issued, but the Refund Cheque is neither received, nor credited into account of the taxpayer.

**Rationale**

Timely refund of sales tax has always been a painful and disturbing issue for the taxpayers from liquidity perspective and it would be a welcome move if the refunds are allowed within a reasonable time whether in cash or through adjustment against any existing or future tax liability to Government under any fiscal laws.

## 4.10 REFUND / INPUT TAX CREDIT NOT ALLOWED - SECTION 21(3)

HIGH

*Under sub-section (3) of Section 21, the invoices issued by a person during the suspension of his registration shall not be entertained for claiming sales tax refund or input tax credit. Further, once such person is black listed, the refund or input tax credit claimed against the invoices issued by him, whether pre or post black listing, shall be rejected through a self-speaking appealable order and after affording an opportunity of being heard to such person.*

It is proposed to rationalize the provisions of Section 21(3) to create an exception to allow input tax in the following situations:

a) where the buyer holds valid tax invoice;

b) where the supplier's name was appearing in the Active Taxpayers' List at the time when purchases were made;

c) where purchase relates to the date prior to the date of suspension and blacklisting; and

d) where the payments were made through banking channel in compliance with Section 73 of the STA.

**Rationale**

Refund/Input tax is only claimable by buyer once the same is deposited into the Government treasury by the supplier, therefore, there is no justification for disallowance of input tax adjustment claimed by the buyer in respect of period prior to blacklisting / suspension and that too for non-compliance of the supplier without knowledge of buyer at the time of execution of transaction. A registered person should not be deprived of his legitimate right of input tax relating to period before suspension or blacklisting of supplier if the transaction is falling in the ambit of abovementioned situations. The principle of natural justice demands that a taxpayer should not be penalized for a non-compliance of another taxpayer.

## 4.11 SERVICE OF ORDERS & DECISION- SECTION 56 OF STA & 47 OF FEA

HIGH

*The Finance Act 2017 inserted clause (d) in Sub- section (1) section 56 of STA and in sub-section (2) of Section 47 of FEA, whereby the service of notice and order are treated as properly served if they are served electronically through email or to the e-folder maintained for each taxpayer on IRIS.* This was not a welcome provision as the taxpayers have been finding it difficult to switch over to the changed system from the traditional service of notice as fully elaborated in these sections. Accordingly, it became a point of dispute in appeal that notices sent or order served electronically did not reach the taxpayer mainly for the following reasons

a) it was not practically possible for most of the taxpayers to visit e-folder every day or

b) in various cases, the email address of the senior person is given who may not be checking his emails on regular basis.

Considering the above, and for the Rationale provided below, it is proposed that electronic service of notice may be declared mandatory, but until such time, the taxpayers are well conversant with the computers and developed the skills and habits to visit electronic sites regularly, the following proviso should be inserted to provide for simultaneous delivery of notices and orders as was done prior to introduction of electronic delivery

*"Provided that the service of notices, orders, etc. referred to in clause "d" shall be treated as validly served if the same has been duly served under any of the clauses "a" to "c" above. "Similar proviso should be inserted in section 47(2) of the FEA*

**Rationale**

Most of the taxpayers may not have been using computers or have expertise to use email either due to lack of skills or absence of internet

## 4.12 INADMISSIBLE INPUT TAX - SECTION 73

HIGH

*Section 73 puts a time limit of 180 days for the buyer to make the payment to the suppler, failing which the input tax of buyer becomes inadmissible.* It appears to be a harsh proposition considering the fact that related sales tax is already paid by the supplier into government treasury at the time of issuing tax invoice.

In case of receivable and payable balance from the same party, section 73 allows settlement on net payment basis subject to approval from the Commissioner.

Seeking approval from the Commissioner for each transaction / payment is a cumbersome exercise. It is proposed to allow constructive payment on the basis of intimation to the Commissioner only and requirement for approval should be abolished.

**Rationale**

The knocking off of receivable and payable with the same party is normal in every business and that should be accommodated without explicit approval by Commissioner. This has already been accepted in case of ITO by Circular No. 1 of 2009 without any condition.

## 4.13 CONDONATION OF TIME LIMIT – SECTION 74 OF STA AND 43 OF FEA

MEDIUM

*In terms of Section 74 of the STA and Section 43 of FEA read with notifications SRO 394(I)/2009 and 395(I)/2009 respectively, the Commissioner and the Board are allowed to condone a lapse of one year and more in any compliance related issue respectively, where any timeline has been prescribed under any provision of the law.*

However, e-FBR web portal does not allow automatic adjustment of purchase invoice or debit / credit notes where manual condonation has been granted by the Commissioner or the Board, as the case may be. Further, there is no procedure for e-filing of Condonation Applications. The taxpayer has to file manual applications and physically follow-up with the Tax Officers for processing.

Furthermore, there is no prescribed time limit to decide condonation applications or filing of review application where the application is rejected by the Commissioner.

It is proposed to insert a provision within the STA and FEA to address the following:

i. a detailed mechanism for e-filing of Condonation Applications and approval may be laid down by the Board;

ii. Approval of Condonation Application, should automatically be uploaded and available on STRIVE system;

iii. where the Condonation Application is rejected by the Commissioner, it should be subject to review by the Chief Commissioner or the Board, as the case may be; and

iv. Timeline should be provided for deciding the Condonation Application or the Review Application, failing which the Condonation or the Review Application, as the case may be, shall be deemed to have been treated as approved. The timeline provided shall exclude the additional time requested by the taxpayer to provide any additional information or explanation or evidence required by the Commissioner or the Chief Commissioner or the Board, as the case may be.

**Rationale**

The above changes are necessary to make the process efficient and prevent unreasonable delays, and ensure proper accountability of the FBR officials in attending to taxpayers' genuine issues.

## 4.14 EXTRA TAX ON ELECTRIC / GAS BILLS

HIGH

*In terms of S.R.O. 1222(I)/2021, every electric power and gas distribution company / organization supplying electricity or gas to commercial & industrial consumers is required to charge and collect extra tax @ 17% for unregistered industrial consumers and ranging from 5%-17% for unregistered commercial consumers based on amount of bill.*

It is proposed to make reasonable amendments in the SRO 1222(I)/2021to make changes to prevent burdening the taxpayers with extra tax by the Utility companies considering the following practical issues being faced by them.

**Rationale**

- Majority of electricity connections / accounts are maintained in the name of person who possesses the ownership of commercial / industrial property. Therefore, particulars of the consumers available on sales tax registration certificate / upon FBR portal do not match with the name of the account holders;

- Banks, Insurance companies, Telecommunication companies, Large Multinational and other similar organizations operate through numerous business locations, manufacturing premises, facilitation offices, distribution & warehouses, which, in most cases, are not in the name of such organizations. Further, sales tax registration particulars on FBR Portal do not reflect all such business places from which business operations are carried out. If the procedures envisaged in SRO are followed, extra tax would be charged and collected from registered persons in respect of all of their electric connections, which are not in the name of such registered persons;

  Furthermore, updating of these particulars (e.g. business locations) on FBR database may take considerable time and Banks, Insurance companies, Telecommunication companies, Large Multinationals which are already registered for sales tax, will have to bear extra tax on all such electricity and gas connections just because data is not updated;

- Institutions owned by Federal and Provincial governments, defense organization, social sector institution and various other service providers are either not required to obtain sales tax registration number or are registered under the Provincial Laws. Hence, they neither possess any sales tax registration number nor are required to obtain any registration under the STA. However, most of the aforesaid organizations or institutions are commercial consumers and, by virtue of the SRO, they are unnecessarily suffering extra tax; and

- Cottage Industry, retailers, hospitals, various agencies, diplomatic missions, privileged persons and organizations have been specifically exempted under the Sixth Schedule to the STA and are not required to obtain registration. However, most of the aforesaid organizations or institutions are commercial consumers and, by virtue of SRO, they are unnecessarily suffering extra tax.

## 4.15 ADJUSTMENT OF EXCISE DUTY - SECTION 6 AND RULE 13

HIGH

Federal Excise Duty (FED) on purchases is adjustable on payment basis rather than on accrual basis. Moreover, there is also a condition for adjustment that sales proceeds of goods including related FED are received through banking channel.

*Section 6 read with Rule 13 specifically mention that the adjustment of duty of excise is allowable, only if it is paid on purchase of dutiable goods, which are used directly in manufacture or production of dutiable goods only.*

This means that FED paid on acquisition of dutiable services may not be adjusted against supply of dutiable goods and further no adjustment of duty whether paid on dutiable goods or services is at all available against rendering of dutiable services.

It is proposed to make the following changes:

i. adjustment of FED should be allowed on accrual basis i.e. in the month in which purchase is made, in the same manner as it is allowed under the STA; and

ii. cross adjustment of FED on acquisition of dutiable goods or services should be available for adjustment against both dutiable goods and services charged or levied by registered person on supply, or rendering, of such goods or services.

**Rationale**

The above changes are necessary for addressing cash flow problem and cost of doing business of the registered person.

## 4.16 ADJUSTMENT OF SALES TAX AND FED REFUNDS WITH INCOME TAX, SALES TAX & FED LIABILITY AND VICE VERSA

HIGH

It has been seen that a registered person's cash flows are tied up with the Inland Revenue in the form of sales tax and FED refunds and, at the same time, the taxpayer is required to pay income tax at the time of assessment of his income tax liability.

It is proposed to introduce enabling provisions in the STA and FEA for adjustment of sales tax and FED refunds against sales tax, FED and income tax payable and vice versa.

It is also proposed to incorporate in the Law the existing mechanism for refund adjustment as laid down in FBR's Circular letters dated 20 December 1999 and C.No.3(6) ST-L&P/2002 dated 24 April 2007.

**Rationale**

These changes are necessary to prevent accumulation of refunds and address the cash flow issues faced by the taxpayers.

## 4.17 DEFINITION OF FRANCHISE – SECTION 2(12a) OF FEA

MEDIUM

The definition of 'Franchise', reproduced below, has been subject to varied interpretation leading to unending tax disputes.

*(12a) "franchise" means an authority given by a franchiser under which the franchisee is contractually or otherwise granted any right to produce, manufacture, sell or trade in or do any other business activity in respect of goods or to provide service or to undertake any process identified with franchiser against a fee or consideration including royalty or technical fee, whether or not a trade mark, service mark ,trade name, logo, brand name or any such representation or symbol, as the case may be, is involved;*

It is proposed to substitute the existing definition with the following:

*“Franchise” means an authority given by a franchiser by an agreement under which the franchisee is granted any right to produce, manufacture, sell or trade in goods or to provide services or undertake any process identified with the franchisor in consideration of a fee or charge, regardless of whether the agreement involves the use of a trade mark, service mark, trade name, logo or any such symbol.*

**Rationale**

Existing definition is contrary to the commercial understanding of the said term.

**OTHER RECOMMENDATIONS**

## 4.18 AFGHAN TRANSIT TRADE

Smuggling through Afghan Transit Trade has always been the biggest threat for economic growth and this menace has affected all sectors of the economy. Smuggled goods through the borders of Iran, China, India and the Afghan Transit Trade form a chunk of the informal economy which is costing the national exchequer in billions.

Markets across the country are flooded with smuggled goods and local industries are struggling for survival as smuggled goods are not only easily available everywhere but are also attracting the buyers who prefer foreign merchandise.

In order to allow industry to fairly compete with unscrupulous imports and Government to benefit from increased revenue, it is proposed to implement the following protocols:

i. Scanners be installed at Pak Afghan Borders at Turkham and Chaman as it is presently working at Port Qasim (ICG3) Karachi for USA exports, in order to check/verify contents of each and every container to cross verify that the same have been delivered to Afghan Border without its misuse. The scanning machines and its tracking/integration should be initiated right from import gate to Pak border to Afghanistan border;

ii. Scanning image of import should be compared with the scanning image of goods delivered to Afghan border, until then entry should remain open for scrutiny;

iii. Afghan importers should also file the entry in the WeBOC system of Afghanistan (which Pakistan is helping to develop) and then Pakistan should have access to the Afghan WeBOC system to mark the cleared container green in the Afghan WeBOC. The containers not yet cleared; or in transit; or if not cleared after 7 days of being released from Pakistan port, should be marked red (for the risk of being misused);

iv. Pakistan Customs should collect duties on behalf of Afghan government at the time of entry via Pak port and the said amount be handed over to Afghan government once the said consignment is cleared / entered into Afghanistan;

v. Pakistan government should collect 17% sales tax as "commitment fee for safe transit into Afghanistan" on all imports under ATT citing past data of rise in ATT on high tariff items and the same amount should then be refunded on clearance of goods into Afghanistan, just as it is done with our exporters; and

vi. Income Tax / Sales Tax registration number of Importer under ATT should be submitted in the Afghan transit trade entry filed in port of import at Karachi and the same should be verified online with Afghanistan's tax registration system. Data base of imports value per year under each registration number be maintained. Moreover, importer should be made liable to submit copy of Afghan sales tax return with Pak customs at end of the year to monitor that such importer is declaring these imports in his afghan import in order to enable him to qualify for next year under

ATT. In order to circumvent this, traders may close old company and form a new company but then Pakistan will have a data base of how many companies did that. Incase Afghan Government says that Income Tax / Sales Tax registration number is not allotted to importers then they should be allowed specified timelines to create such system and allot registration number.

**Rationale**

Improved protocol for Afghan transit trade is necessary to curb smuggling, illegal trade and fake imports & exports.

### 4.19 CPEC AND THE MENACE OF SMUGGLING / ILLEGAL TRADE

HIGH

China Pakistan Economic Corridor (CPEC) is a journey towards economic regionalization in the globalized world. This will deepen and broaden economic links between Pakistan and China and will surly leave a positive impact on other countries in the region. However, this also carries the risk similar to Afghan Transit Trade.

The success of CPEC is directly proportional to three factors vis-a-vis. (a) security arrangements, (b) infrastructural development and (c) smooth e-based Customs operations. Whereas, a number of initiatives are being taken and also proposed to be taken, on two fronts vis-a-vis. security and infrastructure, but Customs operations, have hitherto been given little attention. In order to ensure that the foreign trade conducted through CPEC is free from menace of smuggling or illegal trade, it is proposed to take the following steps:

- Scanners be installed at Pak China Borders and at Gwadar / Karachi Port in order to check / verify contents of each and every container to cross verify that the same have been exported / imported without its misuse;
- Scanning image of exports from China border should be compared with scanning image of goods delivered from Gwadar / Karachi port and vice versa for imports until then entry should remain open for scrutiny;
- Chinese exporters / importers should also file the entry in the WeBOC system of China, and Pakistan should have access to the China WeBOC system to mark the cleared container green in the WeBOC. Entry to remain open until the same is verified by actual export / import routed through Gwadar / Karachi. The containers not yet cleared; or in transit; or if not cleared after 7 days of being released from Pakistan port; should be marked red (for the risk of being misused). In such cases, show cause notices be sent to exporters / importers, as the case may be, for further inquiry;
- In case of exports, goods should only be allowed in containers loaded in China and evidence of shipping line booking and Bill of Lading be obtained as proper evidence; and
- There should also be a set up for custom offices after every 200 km intervals along the routes of CPEC to ensure effective monitoring of transit trade flows;

In order to ensure swift and smooth monitoring, e-tagging should be installed on vehicles carrying cargo, some further measures are:

- When a vehicle crosses the designated customs office at the pre-marked route, the data of cargo movement should automatically enter the system showing location and brief description of goods, etc;
- The online movement of the cargo should be viewed by both customs offices at port of entry and exit. The containers carrying cargo be sealed and de-sealed by customs at entry and exit points respectively. This will ensure safety of the cargo and avoiding en-route pilferage;

- Both Governments must agree to strengthen customs controls at the border and to establish "Electronic Data Interchange" (EDI) linkage between Pakistan and China on "Real Time Basis" to ensure reconciliation of export/ import data of cargo routed through CPEC route; and
- In case of imports, evidence of payment of goods by Chinese importer to their suppliers and submission of bank guarantee equivalent to government levies to be collected on China imports by Pakistan Customs before release.

Transit cargo will be transported from and to China, which needs Customs facilitation as well as monitoring both en-route and entry/exit stations to avoid menace like presently being faced in case of Afghan Transit Trade.

CPEC also envisages establishment of export processing zones, special economic zones and free zones. This requires Customs facilitation to ensure swift clearances of goods without any pilferages. More importantly, the duty/tax free goods will be transported across Pakistan, which needs en-route monitoring so that the same are not pilfered, jeopardizing the very essence of CPEC. Moreover, any smuggling/pilferage of Chinese goods en-route will have direct and serious repercussions on Pakistani industry and duty paid goods.

**Rationale**

A case in hand is Afghan Transit trade cargo. It used to suffer from different infirmities, which kept on hindering its smooth operations. These issues ranged from misdeclarations, delays, isolated and partial-monitoring, en-route pilferages, smuggling etc. A number of adhoc arrangements such as verifications of cross border certificates, random examinations at port of entry and enhancement of anti-smuggling operations etc. were made, but desired results could not be achieved.

## 4.20 NON-AVAILABILITY OF INPUT TAX PAID THROUGH BILLS OF ADDITIONAL DUTY (BoAD)- SECTION 7(2)(ii)

LOW

The registered persons are currently unable to claim adjustment of sales tax paid through Bills of Additional Duty (BoAD) in Annexure B of the sales tax return as the same is not uploaded automatically in Annexure B of sales tax return on FBR portal; and manual entry is also not allowed in the Annexure. The BoAD is generally issued in the following situations:

- Where additional duty is paid due to difference in currency exchange rate or weight of the consignment, etc; and
- Where the imported raw material could not be used in manufacturing items of export within the prescribed time limit provided under sales tax SRO 492(1)/2009 dated June 13, 2009 and customs SRO 490(1)/2001 dated June 18, 2001.

It is proposed to address this important issue by uploading the BoAD document on the FBR's e-filing system portal as it is done in case of duties paid through GDs.

**Rationale**

It is a genuine issue and its redressed is necessary to allow the taxpayers to claim sales tax which is actually paid to the customs authorities.

## 4.21 SALES TAX ON TOLL MANUFACTURING, HOTEL AND RESTAURANT- SECTION 2(33) (d)

HIGH

The Federal Government has been collecting sales tax on toll manufacturing charges as it has repeatedly defined/clarified that the toll manufacturing activity falls under the definition of manufacturing. *The Federal Government has further strengthened its stance over collection of sales tax on toll manufacturing by inserting clause (d) in Section 2(33) through the Finance Act, 2015; followed by FBR clarification letter dated January 8, 2016 to KCCI that only the Federal Government is authorized to charge and collect sales tax on processing of goods owned by other persons.*

Whilst the Federal Government is considering toll manufacturing charges paid to a third party as chargeable to sales tax, the Governments of the Punjab and Sindh have ruled that the toll manufacturing activity is a service and chargeable to provincial sales tax. This has created a tax controversy between the Federation and Provinces, but the dispute is heavily impacting the registered persons, as they cannot afford to pay taxes to both Federal and Provincial Governments.

National Tax Council (NTC) in meeting held September 16, 2021 settled the matter in favor of FBR on quid pro quo basis. It was agreed that provinces shall not levy/collect sales tax on toll manufacturing services and the FBR shall, likewise, not levy/collect sales tax on the food/beverages served in hotels and restaurants located in the provinces. The FBR had issued a letter to its field formations dated October 28, 2021 whereby the FBR had directed its field formations to start collecting sales tax on toll manufacturing, however, the circular does not cover hotel and restaurant matter. Hence, the issue remains unresolved as SRB informed FBR that provinces will continue to charge sales tax on toll manufacturing as the FBR's aforesaid letter dated 28th October 2021 does not mention the agreed decision about the non-levy of federal sales tax on the food/beverages served in hotel and restaurants. This stance of SRB is backed by the PRAs in their meeting held on October 30th, 2021.

It is proposed to address these disputes immediately to save the registered persons from double taxation and associated cost of contesting the tax controversy thrust upon them due to indecision / proper directions of the Federal and the Provincial Governments.

**Rationale**

Making the registered persons to bear the brunt of disputes between the federal and provincial revenue authorities is highly unreasonable and amounts to enhancing difficulties for toll manufacturers, hotels and restaurants.

### 4.22 HIRE PURCHASE - TIME OF SUPPLY & VALUE OF SUPPLY - SECTION 2(44) & 2(46)

HIGH

*Section 2(44) defines time of supply in case of supply of goods under hire purchase agreement to be the time at which agreement is entered into.*

Hire Purchase (HP) transaction involves payments in installments over a period of time. Currently, sales tax is being charged at the time of signing of hire purchase agreement on full value of the transaction under the agreement.

It is proposed to modify the definition of 'time of supply' in case of supply of goods under hire purchase agreement to be the time of payment of each installment.

It is also proposed to modify the definition of 'value of supply' to exclude the element of interest embedded in each instalment paid under the hire purchase.

**Rationale**

Charging sales tax on full amount including embedded interest at the time of signing of hire purchase agreement is not justified.

### 4.23 TAX CREDIT NOT ALLOWED – SECTION 8(1) (ca) & (caa)

HIGH

Under STRIVE system, input tax adjustment is available to the buyers only after the related output tax is deposited by the suppliers. In this respect appropriate amendments have been made in section 7 and section 8(1)(l) of the STA.

It is proposed to delete clauses (ca) and (caa) of sub-section (1) of Section 8 as necessary enabling provisions are already made in section 8 of the STA.

**Rationale**

Clauses (ca) and (caa) have become redundant owing to implementation of STRIVE with effect from 1 July 2016.

### 4.24 INPUT TAX CREDIT ON BUILDING MATERIALS – SECTION 8(1)(h)

MEDIUM

*In terms of Section 8(1)(h), input tax paid on acquiring building materials is not allowed except for those used directly in the production or manufacture of taxable goods. The department disallows input tax paid on building materials even in cases of construction of projects assisting the taxable activity.*

It is proposed to relax the restriction and allow input tax on building materials especially in case of construction of projects assisting the taxable activity.

**Rationale**

Removal of restriction is in line with generally accepted VAT principles worldwide, and will reduce the cost of doing business and is more likely to boost the investment in projects with corresponding increase in revenue generation for the Government.

### 4.25 ADJUSTABLE INPUT TAX – SECTION 8B

MEDIUM

*Section 8B restricts the claim of input tax up to 90% of the output tax and requires mandatory payment of 10%. Although, relief is provided to Listed Public Limited Companies under Finance Act, 2021 and this requirement is now not applicable on listed companies but it is unjustified on part of unlisted companies to make 10% mandatory payment.*

Considering the aforesaid change, it is proposed to delete Section 8B as a mandatory payment of at least 10% of the output tax for unlisted companies too is highly unjustified.

Any provision deferring the claim of legitimate input tax / refunds of a registered person is not justifiable in any fiscal law as it poses serious liquidity problems for the taxpayers. It will also reduce the refund piling up issue for the government.

### 4.26 SHOW CAUSE NOTICES - SECTION 11 OF STA AND 14 OF FEA

MEDIUM

It has been observed that Show cause notices are invariably issued to taxpayers under Section 11 of the STA and Section 14 of the FEA on frivolous and intangible basis. This leads to passing of illegal and unsustainable assessment orders.

In order to address this issue, the aforesaid sections should be amended to the effect that unless definite information of any tax evasion, illegal input tax adjustment or refund is available with the tax officer, show cause notice should not be issued. Further, definite information should be defined on the suggested lines in STA and FEA respectively:

*"definite information includes relevant substantial evidence about sales or purchases of any goods and rendering or acquiring of services on which sales tax is not paid and illegal input tax adjustment or refund."*

*"definite information includes relevant substantial evidence about sales or purchases of any goods and rendering or acquiring of services on which duty is not paid and illegal input tax adjustment or refund."*

Order for assessment of tax based on definite information surely helps in passing of legally sustainable order, in addition to saving time of both the taxpayers and tax collectors.

### 4.27 DISCHARGE OF LIABILITY AT SUBSEQUENT STAGE – SECTION 11

LOW

The Sales Tax law requires the payer to withhold certain amount of sales tax from the recipient and deposit the same to the credit of the recipient. In case of default, the tax authorities can recover the amount of sales tax not withheld from the withholding agent.

Based on the judgements of the Superior Court, it is now a settled principle of law that if any liability for tax is not deducted but is subsequently discharged by the person from whom tax was deductible, then the same cannot be recovered from the taxpayer again, as it would tantamount to double taxation. However, such a provision is not part of the STA.

It is proposed to insert a new sub-section 4B in Section 11 as follows:

"Where at the time of recovery of tax under sub-section (4A) it is established that the tax that was to be deducted from the payment made to a person from a person has meanwhile been paid by that person, no recovery shall be made from the person who had failed to deduct the tax but the said person shall be liable to pay default surcharge at the rate of twelve per cent per annum from the date he failed to deduct the tax to the date the tax was paid."

Provided that the default surcharge, for delay in payment of sales tax, will be recoverable from the person who has failed to pay or deduct or deducted but not deposit the sales tax."

**Rationale**

The proposed amendment is similar to Section 161 (1B) of the ITO.

### 4.28 CERTIFICATE BY AUDITORS – SECTION 22

MEDIUM

*As per sub-section 4 of section 22, registered persons whose accounts are subject to audit under the Companies Ordinance, 1984 (XLVII of 1984) shall be required to submit a copy of annual audited accounts along with a special certificate by the auditors certifying the payment of tax due has been discharged by the registered person.*

It is proposed to either delete the requirement of submitting a special certificate by the auditors or it may be modified to provide for issue of a certificate in consultation with ICAP.

**Rationale**

Issue of a certificate in the manner requested under the STA is not within the mandate of auditors' role as external auditors under the Companies Act, 2017.

### 4.29 MULTIPLE AUDITS – SECTIONS 25, 38 AND 72B

HIGH

*Section 25 and Section 38 empower the tax authorities to conduct sales tax Audit / Investigation. Section 72B empowers the Board to select persons or classes of persons for audit of tax affairs through computer ballot. In terms of Section 25, an audit of a registered person may be conducted once a year. On the other hand, Section 38 empowers the tax department to conduct investigation of registered persons without any time limitation and allied framework.*

Each year companies are served notices, requiring to produce large volume of data and reconciliations, which is against the concept of universal self-assessment. Thereby, companies incur huge administrative costs for every audited year.

It is proposed that no audit should be initiated unless specific scope, guidelines and mechanism of Investigation is available in the law to bring clarity vis-à-vis risk based sample driven audit. Likewise,

if detailed investigation of a registered person has already been conducted under Section 38, there should be no need to conduct audit of that person under Section 25 and Section 72B again in order to save taxpayers from double jeopardy. The previous limitation of conducting tax audit once in three years should be restored.

Alternatively, Section 38 be amended to include time limitation of six years, in line with record keeping requirements in Section 24 of STA.

**Rationale**

Multiple audits of sales tax record of the same tax period without any incontrovertible evidence of tax fraud or wrongdoing is a burdensome and unproductive exercise both for the taxpayers and tax collectors.

### 4.30 POWER TO ARREST - SECTION 37A

MEDIUM

Presently, Inland Revenue Officers are authorized to execute arrest of any person if that officer on the basis of material evidence has reason to believe that such person has committed a tax fraud or any offence warranting prosecution under STA. Moreover, the powers given to officers also include powers to arrest any director of the company if the officer has reasons to believe that such director or officer is personally responsible for actions of the company contributing to tax fraud.

It is proposed that this Section should only be applicable where the tax fraud has already been established at the stage of first appeal. Alternatively, the amendment to be made in Section 37A in line with the amendment made in Section 8A through Finance Act 2015 and the burden to prove the allegations should be on the tax department.

**Rationale**

Such an open-ended power could lead to harassment of genuine taxpayer.

### 4.31 POSTING OF INLAND REVENUE OFFICER TO PREMISES OF REGISTERED PERSON SECTION 40B

MEDIUM

*Section 40B authorizes the FBR to post officer of Inland Revenue to the premises of registered person or class of such persons, to monitor production, sales of taxable goods and the stocks position.*

There is a general perception that this provision leads to misuse of power or authority and undue harassment by the tax authorities and is voiced as a main concern of various trade bodies.

It is proposed to prescribe a detailed and transparent mechanism for compliance by the Officer before exercising such power.

**Rationale**

Such an open-ended power could lead to the harassment of the genuine taxpayers if they are applied without following a well-documented procedure and defining the time limit / number of days of posting of Inland Revenue Officer should also be mentioned in this section which should correspond to the production or volume of sales.

### 4.32 RECOVERY OF ARREARS OF TAX - SECTION 48

MEDIUM

i. Finance Act, 2018 introduced a provision in law that allows automatic stay up to the first stage of appeal on payment of 10% of the disputed tax demand. However, considering that the tax demands mostly are frivolous and legally unsustainable, the option of automatic stay was very

rarely exercised by the taxpayers. Another reason for not opting for automatic stay is the absence of any provision that provides immediate refund of the tax paid if the appeal is decided in favor of the taxpayer. In addition, there are reported judgments of the courts that held that recovery of disputed tax should not be made until it has been reviewed by one independent forum.

Considering the above, particularly the court judgments, and in order to meet the principles of natural justice, it is proposed that the condition of 10% payment of tax demand may be withdrawn and instead automatic stay should be extended up to decision of the first appeal, and a 10% payment of disputed tax demand may be introduced for automatic stay when the appeal is pending before the ATIR.

ii. For Recovery Notice, minimum 15 days' prior show cause notice be issued in order to explain the matter.

**Rationale**

i. The option of 10% payment for automatic stay is reasonable considering that the first appeal is decided and most of the issues are filtered at that level, and it is more convincing for the taxpayer to pay 10% for getting automatic stay when the case is pending before ATIR. It certainly is more likely to reduce the extra-ordinary burden on the ATIR to decide hundreds of stay applications on a daily basis thereby leaving less time to decide the pending appeals.

ii. To remove hardship for registered person and to create trust on the department to take reasonable action with proper notice.

### 4.33 LIABILITY FOR PAYMENT OF TAX - SECTION 58

MEDIUM

Where any private company is wound up, then following persons are jointly and severally liable for payment of outstanding tax:

i. Director

ii. Shareholder, owning not less than ten per cent of the paid-up capital

This section neither defines director nor provides the extent to which the outstanding liability could be recovered from the directors and shareholders. For instance, under the Companies Act, 2017, director could be a nominee director or independent director or an employee director with or without shares. Similarly, whether it would be justified to recover tax exceeding the percentage of shareholding of the shareholders.

It is proposed to insert the following further provisions in this section:

*i. Define director as "Director to exclude employee director, nominee director and independent director";*

*ii. The shareholders and directors cum shareholders owning not less than ten per cent of the paid up capital shall be liable to payment of outstanding tax not exceeding the percentage of their holding in the company.*

**Rationale**

It is not just and equitable to make recoveries from employee director, nominee director and independent director. Moreover, recoveries of outstanding tax from those shareholders who own more than 10% of the paid-up capital to the extent of their ownership in the company may be reasonable.

### 4.34 BUSINESS BANK ACCOUNTS - SECTION 73

MEDIUM

Explanation to Section 73 of STA defines 'Business Bank Account' to mean a bank account utilized by registered person declared to Commissioner through Form STR-1 or change in particulars in registration database.

Currently, the Form STR-1 does not exist online as the e-FBR website portal (used for Sales Tax return filing and change in particulars) automatically re-directs to IRIS web portal (used for filing of Income Tax returns). Thus, the change in particulars application is submitted on IRIS portal via "181 (Form of Registration filed for modification -Income Tax)". This Form is not covered under the Sales Tax Act.

Owing to non-availability of Form STR-1 on e-FBR portal, reference to Form STR-1 in Section 73 should be replaced with Form "181 (Form of Registration)" which, at present, is applicable to Income Tax (pursuant to Section 181 of ITO). Moreover, title of said Form be changed to "181-73 - Form of Registration / Modification (Income Tax, Sales Tax and FED)".

**Rationale**

It is a glitch to be addressed for the taxpayers facing difficulty in adding business bank account or a change in business bank account.

### 4.35 INVENTORY RECORD FOR GOODS DESTROYED – RULE 23

LOW

*Rule 23 of the STR requires that when goods are returned by the buyer being unfit for consumption, the same is required to be destroyed by the supplier after obtaining permission from the Collector of Sales Tax having jurisdiction.* Practically speaking, the tax department may not have the capacity and human resource having specialized skills required to decide the application for approval for destruction.

It is proposed to amend the rule to provide for engaging independent verifier (to be appointed by the Collector) to work with the tax team to physically inspect the goods and carry out other procedures to decide the application and arrange the destruction of such goods under the supervision of the representatives from the tax department, taxpayer and independent verifier. The rule should also prescribe the qualification of "independent verifier".

**Rationale**

Implementation of the above proposal would certainly ease out the process of approval and destruction of goods unfit for consumption.

### 4.36 INITIATION OF RECOVERY ACTION - RULE 71

HIGH

i. *Rule 71 of STR and Rule 60 of FER require that on expiry of 30 days from the date on which the Government dues are adjudged, the referring authority shall deduct the amount from any money owing to the person from whom such amount is recoverable and which may be at the disposal or in the control of such officer.*

   *Rule 201B of the Income Tax Rules requires that prior approval of the Chief Commissioner shall be obtained who shall satisfy himself as to the service of order and that no refund due to the defaulter is available for adjustment against the tax demand.* He shall also satisfy himself that no application for rectification or appeal effect which is likely to result in creation of refund is pending hearing before the Commissioner.

   It has been noted that Sales Tax and Federal Excise Orders passed by taxation officers generally contain factual inaccuracies leading to determination of incorrect Tax Demand on which taxpayers apply for rectifications. However, Taxation Officers proceed to initiate recovery proceedings, without passing self-speaking Order on the rectification applications.

It is proposed to amend Sales Tax and Federal Excise Rules be amended to add similar provision (in line with relief already available under Income Tax Rules 201B)

ii. *Rule 71 of STR provides that the proceedings for recovery of tax demand may be initiated after 30 days from the date on which the Government dues are adjudged (date of order)*. The date of order is generally misinterpreted as the date mentioned on the order, whereas legally an order is treated as order on the date it is served on the taxpayer.

It is proposed to amend the rule to substitute the words "date on which the Government dues are adjudged" with the words "date of service of the order".

**Rationale**

Prevent unnecessary litigation and hassle to taxpayer and taxation officer. Prevent misinterpretation and harmonize it with Section 45B of the STA.

### 4.37 UNDUE RESTRICTIONS OVER EXPORTS TO AFGHANISTAN

MEDIUM

*As per SRO 190(I)/2002 dated April 2, 2002 (read with SRO 136(I)2012 dated February 14, 2012_and SRO 691(I)2019 dated June 29, 2019), zero rating on Exports under section 4 of the STA is not applicable in respect of supply of certain categories of goods, exported by air or via land route to Afghanistan and through Afghanistan to Central Asian Republics. Categories of goods specified in SRO 190(I)/2002 (as amended) have been reproduced below for ready reference:*

i. *items other than PVC and PMC materials (PCT Code 39.01 to 39.14) as are manufactured in the Export Processing Zones or in manufacturing bonds;*

ii. *exported, other than against irrevocable letters of credit, or advance payment, in convertible foreign currency;*

iii. *exported without fulfilling the conditions prescribed in paragraphs 8, 12B, entry 9 of the Schedule I and Schedule IV to the Export Policy and Procedure Order, 2000; and*

iv. *specified in the list below, namely: -*

(a) *cigar, cheroots, cigarillos, and cigarettes of tobacco or of tobacco substitutes;*

(b) *dyes and chemicals;*

(c) *yarn all types;*

(d) *polyester metalized film;*

(e) *ball bearings;*

(f) *vegetable ghee and cooking oil (if exported from Export Processing Zones or manufacturing bonds); and*

(g) *all petroleum products whether imported or produced locally (unless there is a Government to Government contract done through oil marketing companies only). Unquote*

*Similar restrictions on exports to Afghanistan and through Afghanistan to Central Asian Republic as specified in clause (a), (b) and (d) above are also part of the Export Policy Order, 2016 issued vide SRO 344(I)/2016 dated April 18, 2016.*

It is proposed to revisit and relax the restrictions on zero rating facility on all items, as per SRO 190(I)/2002 dated April 2, 2002 and SRO 344(I)/2016 dated April 18, 2016 in order to increase overall exports and to prevent other countries like India to capture the market in Afghanistan. The following restrictions may be considered:

- restriction on exports via manufacturing bond be removed and only conditions relating to exports against irrevocable letters of credit, or advance payment, in convertible foreign currency should remain intact owing to the fact that goods manufactured through the manufacturing bond facility are subject to strict scrutiny of the Customs authority;
- for export, other than through manufacturing bond, of goods specified in clause "(d)" of SRO 190(I)/2002 as well as items specified in Schedule III of the Exports Policy Order, 2016, exporters should be made liable to comply with the following conditions:
  - i. export transactions must be executed against irrevocable letters of credit, or advance payment, in convertible foreign currency;
  - ii. zero rating be allowed only in case of exports by manufacturers from Pakistan to manufacturers in Afghanistan;
  - iii. where the proof that goods exported have reached Afghanistan has been verified on the basis of a copy of import clearance documents by Afghan Customs Authorities; and
  - iv. exports should only be routed through authorized export land routes i.e. Torkham, Chaman, Ghulam Khan and Qamar Uddin Karez (when it becomes operational).

**Rationale**

We understand that goods manufactured in manufacturing bonds are subject to strict scrutiny by the Customs authorities from import until the final exports stage in accordance with the procedure given in Customs SRO 450(I)/2001 dated June 18, 2001. Therefore, goods manufactured in the manufacturing bonds are less prone to be used for unscrupulous activities.

We also understand that restrictions under SRO 190(I)/2002 and SRO 344(I)/2016 were imposed to prevent misuse of zero-rating benefits by traders by exporting goods to Afghanistan and thereafter re-importing the same via unlawful means. We believe that a blanket restriction, on all goods manufactured in the manufacturing bond as well as on specific items, instead of bringing the desired results, has dented our Exports market and has also helped the other countries like India, to increase their exports to Afghanistan, which otherwise would have been supplied from Pakistan.

These suggestions, if implemented in true spirit, will not only increase the overall Exports and Foreign Exchange reserves but will also encourage documented sectors thereby resulting in a major barrier for operations of undocumented sector.

### 4.38 SALES TAX WITHHOLDING – ELEVENTH SCHEDULE

MEDIUM

Sales Tax is to be withheld at the time of payment to unregistered person and Inactive registered person without any threshold.

In most of the cases, withholding tax from unregistered persons is being shown in bulk in the return. It is proposed to consider making following changes in the Schedule:

(i) Require the registered persons to identify the person from whom sales tax is withheld while depositing the sales tax withholding so that the same could be used for broadening of the tax base; and

(ii) A minimum threshold of purchases should be prescribed for sales tax withholding on the lines it is done for income tax under the ITO.

Until June 2019, 1% Sales Tax was to be withheld on payment to unregistered person however said rate was increased to 5% vide Finance Act 2019 and now, Sales Tax withholding agents are required to deduct Sales Tax @ 5% of gross value of supplies from persons other than Active taxpayers. The rate of 5% is additional burden on registered taxpayers as unregistered suppliers include said impact in their Selling Prices and thus this needs to be rationalised. Further lower withholding rates be prescribed for withholding agents who declare registration number of unregistered supplier.

Since essence of withholding regime is to broadening of tax base thus it is proposed that Rate of Sales Tax withholding be brought down from existing 5% to 1% for those suppliers who provide CNIC to the buyer and buyers declare CNIC of the supplier in monthly sales tax return (and does not declare the same as bulk unregistered sales).

*Rule 150ZZI (2) of STR requires that sales tax is to be withheld at the time of payment. However, Rule 150ZZI (5) inadvertently requires deposit of sales tax withheld by 15th of the month following the month during which the purchase has been made.*

It is proposed that sub-Rule (5) be amended in line with sub-Rule (2) to bring consistency.

**Rationale**

To broaden the tax base and ease of doing business for small transactions.

### 4.39 DEBIT AND CREDIT NOTES - RULE 14 A OF FEA

LOW

*Rule 14A allows issuance of debit or credit notes for dutiable goods and making corresponding adjustment in return where the amount mentioned in the tax invoice needs to be modified. However, said facility has not been extended to dutiable services.*

It is proposed to amend the rule to extend the application of Rule 14A to excisable services.

**Rationale**

Proposed amendment would facilitate the taxpayer for issuance of debit / credit notes relating to FED on services.

### 4.40 FED ON FRANCHISE SERVICES

LOW

Adjustment of sales tax levied whether under Federal sales tax law or Provincial laws suffered by a taxpayer on acquiring goods or services is not available against specified dutiable goods and services on which FED is not collected in the sales tax mode.

It is proposed that franchise services should be subject to FED in the Sales Tax mode so that same can be claimed as Input Tax.

Alternatively, considering that franchise is also subject to sales tax in provinces, it is proposed to delete franchise services from FEA and shift it to ICT (Tax on Services) Ordinance, 2001 along with the revised definition of franchise as proposed above.

**Rationale**

The implementation of the proposal would put to rest ongoing tax controversies.

### 4.41 INPUT TAX ADJUSTMENT AGAINST FED

LOW

Adjustment of sales tax, whether under Federal sales tax law or Provincial laws, suffered by a taxpayer on acquiring goods or services is not available against specified dutiable goods and services on which FED is not collected in the sales tax mode.

It is proposed to declare all the services listed in the First Schedule to the FEA be classified as services on which FED is payable in the Sales Tax mode so that same can be claimed as Input Tax.

**Rationale**

This would reduce the cost and improve the cash flow of the taxpayer.

## 4.42 EXEMPTION FROM FED WHERE PROVINCES HAVE INTRODUCED TAX ON SERVICES

LOW

Although a Note is inserted at the end of Table II relating to excisable services which provides that excise duty shall not apply to services on which sales tax is levied by the Provinces under the provincial sales tax on services laws.

It is proposed to revise the schedules of excisable services by omitting the list of all excisable services which are subject to provincial sales tax.

**Rationale**

This will eliminate the risk of double taxation.

## 4.43 EXPORT FACILITATION SCHEME – SALES TAX IMPLICATIOSN ON LOCAL SUPPLY

MEDIUM

*Export Facilitation Scheme [EFS] was promulgated vide SRO 957 dated July 30, 2021with an aim to consolidate and thereafter within a period of 2 years, override other export promotions schemes i.e. Manufacturing Bond Scheme, DTRE and Export Oriented Units [EOU]. In order to promote exports and easy procurement of materials, components, parts etc., sales tax zero rating, under EFS, is allowed on local supply of such items, to authorized exporters of the said scheme. In line with the said scheme, entry no. 15 of the 5th Schedule also provided for sales tax zero rating on such local supplies, however, vide the Finance Supplementary Act, 2022, entry no. 15 of the 5th Schedule has been deleted.* Consequently, there is now clash between EFS and the STA. In order to encourage exporters to locally procure raw materials, intermediary goods etc., from other exporters under the EFS, zero rating should be allowed on such transfer / sales of goods.

**Rationale**

Goods purchased by exporters under EFS are on the basis of quota approved by Custom authorities against which they have to show actual export of goods on the basis of approved input / output ratio. Therefore, there are no chances of misuse of items locally purchased under the EFS.

## 4.44 ANNEXURE H - FASTER SYSTEM FOR SALES TAX REFUND PROCESSING

LOW

From July 1, 2019, FBR has implemented systems for expeditious processing of sales tax refunds, for which taxpayers are required to file Annexure H of the sales tax return. However, the registered persons have been facing following challenges in filing of Annexure H:

- For the first time, Annexure H can only be filed if there is no brought forward sales tax input balance appearing in the sales tax return. In case, sales tax brought forward balance [carried forward from prior months] is appearing in sales tax return portal and Annexure H was not submitted in prior months, registered exporter will not be able to file Annexure H from now onwards. In case a person has not claimed sales tax refund in prior periods but wants to file refund claim from now onwards, he should be given an option to file Annexure H [while carrying forward earlier months' balance];
- In case any taxpayer does not want to carry out cumbersome exercise of filing Annexure H on a monthly basis, then such taxpayers should also be given an option to file Annexure H on an annual basis covering the data from July to June each year; and
- Taxpayers dealing in exports as well as local supplies are usually required to pay minimum sales tax @ 10% under section 8B of the Sales Tax Act unless export value is 50% or more of the total sales. However, Annexure H does not provide any option to incorporate / fit in carry forward balance relating to amount paid under section 8B. This issue should properly be addressed.

**Rationale**

Unless the above shortcomings are addressed the objective of faster processing of sales tax refund cannot be achieved.

### 4.45 Abolish Sales tax on supply of Capital Goods to Export Processing Zones [EPZ]

MEDIUM

*Through Finance Act 2022, clause 6A of 5th Schedule has been deleted whereby sales tax zero rating on supply of capital goods to persons in EPZ has been abolished and consequently, such supply has been subjected to sales tax @ 17%.* On the other hand, as per the customs law, supply to EPZ is still considered as exports and is subject to zero rating of sales tax. It is proposed to reintroduced zero rating.

**Rationale**

EPZs are zones dedicated only for exports. Considering that exports are zero rated, therefore, levy of sales tax on capital goods meant for use in exports will unnecessarily hurt exports and will created bottlenecks in investments for export promotion and jobs generation.

### 4.46 Avoid Taxation of Investments which is Not Generating Permanent Tax Revenue

MEDIUM

With the omission of Serial Nos 149 & 150 of the Sixth Schedule by the Finance (Supplementary) Act, 2022, Import of Plant and Machinery has been subjected to sales tax at the rate of 17% and 3% Minimum Value Addition Tax (MVAT) [except imported for setting up of a Special Economic Zone (SEZ) by zone developers and for installation in that zone by zone enterprises, on one-time basis and for assembly/ manufacturing of electric vehicles]. Moreover, MVAT is being collected at import stage on import of plant and machinery [except chapter 84 and 85]. Sales tax as well as MVAT on import of the Plant & Machinery for Green Field as well as existing industries be exempted.

**Rationale**

Although the sales tax collected on import of Plant & Machinery is adjustable, even though it utilizes significant cash flows owing to huge investment. Further, the concept of MVAT is principally applicable for any item imported by commercial importers for subsequent sales in same condition and therefore, the said levy of 3% should not be applied to manufacturers. Both the exemptions will promote investment, ease of doing business and create jobs.

### 4.47 UNADJUSTED INPUT TAX - RULE 34

MEDIUM

In terms of STR, unadjusted input tax has to be carried forward for a minimum twelve months' before it may be applied as refund.

It is proposed to reduce the timeline to three months.

**Rationale**

This will provide an opportunity to the taxpayers to get their refunds processed early to lessen their liquidity issues.

# PART-II

# PROVINCIAL TAXATION

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# GLOSSARY OF TERMS

| | |
|---|---|
| BSTSA | Balochistan Sales Tax on Services Act 2015 |
| BSTSR | Balochistan Sales tax on services Rules 2018 |
| FED | Federal Excise Duty |
| FEA | Federal Excise Act, 2005 |
| ITO | Income Tax Ordinance, 2001 |
| ITR | Income Tax Rules, 2002 |
| KSTSA | Khyber Pakhtunkhwa Sales Tax on Services Act 2013 |
| KPKWTR | Khyber Pakhtunkhwa Sales Tax on Services Special Procedure (Withholding Regulations 2015 |
| PATR | Punjab (Adjustment of Tax) Rules 2012 |
| PSTSA | Punjab Sales Tax on Services Act 2012 |
| PSTSPR | Punjab Sales Tax on Services (Special Provisions) Rules 2012 |
| PSTWTR | Punjab Sales Tax on Services (Withholding) Rules 2015 |
| SSTSA | Sindh Sales Tax on Services Act 2011 |
| SSTSR | Sindh Sales Tax on Services Rules 2011 |
| STAWTR | Sales Tax Special Procedure (Withholding) Rules 2007 |
| SSTWTR | Sindh Sales Tax Special Procedure (Withholding) Rules 2014 |
| ST/STA | Sales Tax Act 1990 |
| STR | Sales Tax Rules 2006 |

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## 1 HARMONIZATION OF TAX LAWS

### PRELIMINARY COMMENTS

Under the Constitution of Pakistan, levying sales tax on services is in the domain of Provinces. Accordingly, Harmonization should not be interpreted as centralization, rather it should be seen strictly from the perspective of bringing uniformity in the sales tax legislations of the Provinces and ICT and their similar application across the Provinces & ICT. The purpose of these proposals is to initiate a process of creating common standards across the Provinces and ICT. It does not mean to encroach upon the powers of enacting laws and regulations from the Provinces. Since most of the major service providers operate across the country, the need for increased harmonization of Provincial and ICT sales tax on services laws has become crucial. The principal areas which are conflicting or raise serious cause of concern are:

- Jurisdiction;
- Incidence of tax;
- Admissibility of common input;
- Reverse charge mechanism;
- Inconsistent rate of tax;
- Uneven penalty and default surcharge;
- Inter-province transactions; and
- Tax classification issues including HS Codes/ Tariff headings and inconsistency in definitions etc.

The following areas may be considered to achieve Harmonization:

### 1.01 INTEGRATION OF TAXATION AUTHORITIES FOR ONE-WINDOW SOLUTION

HIGH

We strongly recommend integration of federal and provincial revenue authorities across the country in such a way that provides one window solution to the taxpayers without undermining the existence and independence of each authority. One window solution should, inter alia, achieve the following:

a) Early finalization of filing of a single return for Federal and Provincial sales tax;

b) introduction of common online software/application like STRIVE at federal and provincial levels; and

c) enable inter-adjustment of refunds across all provincial revenue authorities & ICT.

The FBR is practically not allowing refunds for Provincial sales tax, owing to settlement disputes / claims pending with the Provincial Tax Authorities. Further, unnecessary notices are issued against input tax claims on account of non-verification of Provincial sales tax in FBR's system.

Furthermore, this ends ups in filing monthly tax return in each province and ICT totaling some five monthly and 60 returns annually in number of organizations.

Recently, the FBR has introduced a single portal return (National sales tax return) primarily for declaration / reporting of details subject to Sales Tax / FED collection by the FBR. The Provincial Sales Tax Authorities have not yet aligned / integrated their web portals with the Single Portal Return for declaration of information on a centralized basis. This issue needs to be taken up with the Provincial sales tax authorities for its resolution at the earliest.

**Rationale**

This will facilitate genuine taxpayers, avoid hardship due to lack of harmony between the Federal and Provincial tax system and will also be instrumental in ease of doing business.

### 1.02 INCONSISTENT CONCEPT OF REVERSE CHARGE IN PROVINCES

MEDIUM

The concept of reverse charge is used in many countries to exempt the exporters of services from registering themselves in the country of the importer.

The Provincial Sales Tax Statues in Pakistan also have Reverse Charge provisions under which inter-province services are subject to collection of tax from the recipient of service. Since the inter-province transactions are not zero-rated or exempt in the jurisdiction of origin, such transactions are also taxed in the province of the service provider.

It is strongly recommended that the reverse charge should be restricted to such cases where service provider is located outside Pakistan. Further, tax paid under the reverse charge mechanism should be allowed as an input tax.

**Rationale**

The implementation of this recommendation will provide exemption to the exporters of services from registration in importing countries. Moreover, the admissibility of input tax on reverse charge would help in reduction of cost and ease of doing business.

### 1.03 EXPORT OF SERVICES

MEDIUM

Zero rating of export of services to foreign countries is not provided in the provincial statutes on the lines it is provided for export of goods under the Federal Sales Tax Act and export of services under ICT (Sales Tax on Services) laws. In Punjab, zero rating is allowed subject to stringent conditions, and in Sindh, it is allowed merely to Accountants & Auditors and Software Consultants.

It is strongly recommended that zero rating of export of services should be allowed by all provinces in order to promote export of services in the international market, and the laws in this respect be harmonized with the Federal Sales Tax Act and ICT (Sales Tax on Services) Laws.

**Rationale**

This step will promote export of services in harmony of the Federal Sales Tax Act and ICT (Sales Tax on Services) Laws. It will be instrumental in enabling the government to increase its foreign reserves and reduce Current account deficit.

### 1.04 TIME LIMITATION FOR CLAIMING INPUT TAX

HIGH

Presently, the time to claim input tax credit is not uniform in all provinces. Whilst it is four months in the Punjab, it is six months in other provinces.

It is strongly recommended that the time period for claiming input tax credit be made consistent across the provinces. Furthermore, for the newly established industries where startup period is over six months it is recommended that time period of said credit be increased up to one year in order to enable them to claim input after the commercial option. As regard to claiming refund or carry forward period an extension in time period should be allowed with the due approval of designated authorities.

**Rationale**

This will provide level playing field to genuine taxpayers, reduce burden on cash flow and help in ease of doing business.

## 1.05 SALES TAX WITHHOLDING

HIGH

Except for Punjab, other Provinces require withholding of sales tax from registered / active taxpayers as well. This results in unwarranted administrative and operational issues.

It is strongly recommended that sales tax withholding be made exempt in all provinces where the service provider is registered with the revenue authorities. Where a service is provided by an unregistered person to the registered service recipient, the liability to pay the tax practically falls upon the person receiving the service in almost all cases. The whole amount of sales tax is required to be withheld from the payment made to the unregistered person.

It is suggested that the rate of withholding tax for unregistered service providers may be reduced to 5% in line with the Federal Sales Tax Withholding Rates.

**Rationale**

To avoid unwarranted administrative and operational issues as well as to minimize cost.

## 1.06 CLASSIFICATION OF TAXABLE SERVICES RULES

MEDIUM

The Provincial and ICT tax laws are silent on the following:

(i) classification of services that apparently fall under two or more category of taxable services simultaneously; and

(ii) classification of multiple or composite services.

For example, supply chain management or distribution (including delivery) services inserted through Finance Act, 2016 are also covered under business support services as ‘Managing distribution and logistics’. Renting of immovable property services through Finance Act, 2015 are also covered under business support services as ‘Infrastructural support services’.

It is proposed to introduce classification of services rules. The Classification rules play a vital role and are generally crucial in the following situations:

- Applicability of different tax rates, or where one of the possible headings is not taxable;
- Availability of exemption when one of the possible headings is exempt from tax; and
- Determination of date from which the tax is to be levied where a service falls under two headings, one attracts tax from an earlier date.

Moreover, a facilitation Guide may also be issued by revenue authorities with examples discussed in detail.

**Rationale**

These steps will provide clarity and reduce unnecessary litigation.

## 1.07 H.S CODES / TARIFF HEADINGS TO VARIOUS SERVICES IN FIRST SCHEDULE

MEDIUM

Several categories of services mentioned in the First Schedule are without H. S Code/ Tariff Headings. It is proposed that proper coding should be done for such services and these codes may be updated.

**Rationale**

It is necessary to avoid confusions on the part of assessing authorities and the registered persons.

## 1.08 DEFINITION OF TAXABLE SERVICES

MEDIUM

Unlike Sales Tax laws relating to Sindh and Punjab, the definitions of taxable services given under KPK Act are limited to certain services only.

It is suggested that the definition in respect of all the taxable services should be introduced which should be aligned with the definitions given under other Provincial Sales Tax laws.

**Rationale**

It is necessary for harmonization of definitions across the provinces.

## 1.09 CLAIM AND ADJUSTMENT OF WORKERS WELFARE FUND – PROVINCIAL LAW VS FEDERAL ANOMALIES

HIGH

The worker welfare fund used to be a federal subject prior to the promulgation of Provincial Laws pertaining to the same. However, it has been observed mainly in the jurisdiction of Sindh and Punjab Provinces, the FBR still continues to demand the same from the taxpayer resulting in instances of double taxation and litigation.

It is recommended to align the Federal Laws with Provincial Laws and clear instructions be issue to Field Officers not to demand the same from taxpayers. An immediate action is required to avoid the loss borne by the genuine taxpayers.

Furthermore, the second proviso of Section 60 A of the Income Tax Ordinance disallows of adjustment of WWF paid by trans-provincial establishment which creates undue hardship for taxpayers dealing in more than one provincial jurisdiction (as a result of nature of their entities operations). The same provision is strongly recommended to be deleted so as allow the due adjustment of said payments made.

**Rationale**

It may be noted that the double taxation is creating undue hardship for genuine taxpayer which is required to be dealt with for the benefit of taxpayers. Furthermore, the disallowance of adjustment to trans-provincial establishment is unconstitutional and against the rights of compliant taxpayers.

## 2. PROVINCIAL SALES TAX ON SERVICES

## KEY RECOMMENDATIONS – COMMON ISSUES

### 2.01 BROADENING OF TAX BASE

HIGH

Information collected for potential unregistered taxpayers operating in the economy is not being systematically reviewed. The existing provisions of law has not provided any mechanism for systematic utilization of such information to broaden the tax net. This can be a regressive tool in the longer run where only existing registered person would be subject of revenue target and compliance of law.

It is proposed that a proper mechanism be introduced in law to bring in the tax net the potential unregistered persons whose information is available in the shape of NTN/CNIC through sales tax withholding provisions as well as through filing of sales tax returns by the registered persons requiring full disclosure of information of unregistered persons.

**Rationale**

This step would greatly assist in broadening of the tax base and reducing disparity in the economy.

### 2.02 ISSUES RELATING TO INPUT TAX ADJUSTMENT

#### i) TIME LIMIT TO CLAIM INPUT TAX BEFORE COMMENCEMENT OF BUSINESS

MEDIUM

*SECTION 15A(1)(I) OF SSTSA; SECTION 16(1) OF PSTSA; SECTION 16B(1)(I) OF BSTSA; REGULATION 44(1)(IX) OF KPK REG*

*Currently, input tax is not allowed on goods or services procured or received by a registered person during a period exceeding six months prior to date of commencement of the provision of taxable services by him.*

It is proposed that in case of large projects, where the installation and commissioning into service takes longer, the time limit for claiming input tax be allowed from the date of commencement of project to the date of commissioning into service.

**Rationale**

Bar on admissibility of input tax borne by the taxpayer prior to six months preceding the commencement of provision of taxable services is not justifiable in case of large projects having longer set up time with no visibility of subsequent taxation of their services.

#### ii) INPUT TAX ADJUSTMENTS

MEDIUM

*SECTION 15A OF SSTSA; SECTION 16B OF PSTSA; RULE 27(5) OF BSTSR 2018 & SECTION 32 OF THE KSTSA*

*A registered service provider has been prevented from claiming or deducting input tax paid on the goods or services including but not limited to goods and services subject to tax at fixed or specified rate, sales tax paid on building material, office equipment and further tax or value addition tax levied under the STA.*

It is proposed that the aforesaid provisions relating to input tax adjustment should be harmonized and revamped.

**Rationale**

This will bring harmony between the federal and provincial tax laws as well as reduce the cost of doing business and avoid litigations.

### iii) ADJUSTMENT OF INPUT TAX ON CAPITAL GOODS, MACHINERY AND FIXED ASSETS SECTION 15B OF SSTSA

HIGH

*Adjustment of input tax on acquisition of capital goods, machinery and fixed assets is available in twelve equal monthly installments. Apparently, no such specific restriction is given under other provincial Sales Tax laws.*

It is proposed to delete the provision and align it with the provision of STA which allows full adjustment of input tax in the month of acquisition.

It is necessary to achieve harmonization of input tax adjustment provisions both under the federal and provincial sales tax laws. In addition, it is also just and equitable to allow adjustment in the tax period in which the capital goods are acquired.

### iv) SALES TAX AT REDUCED RATE & ITS ADMISSIBILITY AS INPUT TAX

HIGH

Currently, certain services are chargeable to Sales Tax at a reduced rate subject to certain restrictions, limitations and conditions (including inadmissibility of related input tax credit / adjustment), and in some cases option is also provided to pay tax at standard rate. Similarly, where reduced rate is applied on services, there is a restriction on adjustment of such input tax by the person receiving such services.

For instance, under the PSTSA laws, services liable to tax rate lesser than 16% is not admissible for input tax adjustment. As such, there is an ambiguity that services which are subject to standard rate of Sindh Sales Tax at 13% cannot be claimed as input tax, which may not be the intent of the law.

It is proposed that-

i) an option for general rate taxation be extended to all services for all provinces subject to reduced rate taxation similar to the option given under section 26A of the KPK laws. Under the KPK laws, a registered person providing services chargeable at a reduced rate of tax can opt to pay sales tax at the standard rate and take input tax adjustment after taking approval from the authority; and

ii) services procured at reduced rate of sales tax should be available as adjustable input tax if the recipient of service is liable to sales tax at normal rate on his services as in the case of KPK.

**Rationale**

It is just and equitable and in line with the true spirit of Law

### v) VALUE ADDITION TAX AT IMPORT STAGE

MEDIUM

*SECTION 15A(1)(K) OF SSTSA; SECTION 16B(1)(R) OF PSTSA; REGULATION 44(I)(IV) OF KPK REG. & SECTION 16B(1)(D) OF BSTSA*

*The existing law provisions restrict or disallow the input tax claim of value addition tax paid on import of goods (used for rendering of services) under the Federal Sales Tax Act or Sales Tax paid on taxable goods in excess of the standard rate applicable in provinces.*

Whilst we consider that harmonization of sales tax laws across provinces is more likely to address the above issues, meanwhile, it is proposed to amend the existing provisions as follows:

i) lift the restrictions on adjustment of input tax to the extent of standard rate; and

ii) withdraw the provision restricting admissibility of minimum value addition tax paid on goods at import stage where the goods are consumed or used in the process of rendering of services.

**Rationale**

It is unjust to put a restriction on input tax as it is against the generally accepted principles and also increases the cost of doing business.

## 2.03 JOINT AND SEVERAL LIABILITY OF REGISTERED PERSONS IN SUPPLY CHAIN WHERE TAX IS UNPAID

LOW

*SECTION 18 OF SSTSA; SECTION 19 OF PSTSA; SECTION 35 OF KSTSA; SECTION 19 OF BSTSA*

*The Provincial Statutes stipulate that where a registered person, receiving a taxable service from another registered person, is in the knowledge of, or has reasonable grounds to suspect, that some or all of the tax payable in respect of that taxable service or any previous or subsequent taxable service provided would go unpaid, both the recipient and provider of the taxable service shall be jointly and severally liable for payment of such unpaid tax.*

It is proposed that the provision should be aligned with Section 8A of STA where the burden of proof that the service provider and service recipient acted in connivance rests upon the tax authorities.

**Rationale**

This will bring harmony between the federal and provincial sales tax laws. This would also restrain the assessing officer from using the power hastily without carrying out proper enquiry.

## 2.04 TIME LIMITATION FOR ASSESSMENT & RETENTION OF RECORDS

MEDIUM

*SECTIONS 24(2) & 32(1) OF PSTA; SECTIONS 23(2) & 27(1) OF SSTA; SECTION 40(2) & 49(1) OF KPSTA, SECTION 24(2) & 32(1) OF BSTA & SECTION 11(5) & 24 of STA*

*The period for retention of records and time limitation for assessment of tax are not aligned and consistent under the Provincial Sales Tax laws, as tabulated below:*

| Sales Tax Law | Records Retention Period | Time limitation for assessment |
|---|---|---|
| *Federal Sales Tax* | *6 years* | *5 years* |
| *Sindh Sales Tax* | *10 years* | *8 years* |
| *Punjab Sales Tax* | *8 years* | *8 years* |
| *KPK Sales Tax* | *5 years* | *5 years* |
| *Balochistan Sales Tax* | *10 years* | *8 years* |

It is proposed that the time period for retention of records and assessment of tax should be rationalized and fixed at 6 years in all provinces as is similarly applicable under the STA and ITO.

**Rationale**

Longer period of retention and assessment is not only burdensome, but also creates uncertainty for the taxpayers for assessment as well as results in additional cost for retaining information / documents for such extended period of time.

**ASSESSMENT OF TAX**

LOW

*SECTION 23(5) OF SSTSA; SECTION 24(5) OF PSTSA, SECTION 24 (5) OF BSTSA & SECTION 40(5) OF KSTSA*

*Currently, the law provides that any assessment order can be amended by directly issuing a show cause notice by the tax officer on the basis of any subsequent information, etc.*

It is proposed to shift the power of amendment of an assessment order to the Commissioner or with the approval of Commissioner or Board, as the case may be, with the condition that an enquiry shall be carried out based on possession of some definite information (which should be explicitly mentioned in the notice) and a show cause notice should be issued only when there is a substantial reason available that warrants reopening or amendment of the assessment order.

**Rationale**

This is necessary to introduce transparency in the system and provide justice to the taxpayer.

## 2.05 SELECTION OF CASE FOR AUDIT

LOW

*SECTION 28 OF SSTSA; SECTION 33 OF PSTSA, SECTION 33 OF BSTSA & SECTION 14 OF KSTSA*

Under Provincial Sales Tax laws, any officer not below the rank of Audit Officer may initiate audit proceedings on its own without assigning any reason. It is proposed that in line with established goods practices we need to implement the self-assessment scheme in true spirit and additionally, the power to select a case for audit should be vested in officer not below the rank of Commissioner. Further, it should be mandatory to record the reasons for selection of case for audit as well.

**Rationale**

Core feature of any self-assessment scheme based tax law is that declaration by taxpayers enjoy certain level of sanctity which can be disturbed only under certain circumstances. Separation of powers to select audit from conducting authority will bring transparency in the process.

## 2.06 CERTIFICATE BY THE AUDITORS

LOW

*SECTION 26(5) OF SSTSA; SECTION 31(5) OF PSSTA; SECTION 48(5) OF KSTSA; SECTION 31(5) OF BSTSA*

*The registered service providers, whose accounts are subject to audit under the Companies Act 2017, are required to submit a copy of the annual audited accounts along with a certificate by the auditors certifying the payment of the tax due and any deficiency in the tax paid by the registered person.*

It is proposed to delete the requirement of auditor's certificate certifying the payment of tax due and deficiency therein.

**Rationale**

With the current scope of statutory audit, the auditor is not obliged to certify the payment of the sales tax due and any deficiency therein. There are provisions available in the sales tax laws which allow the revenue authorities to appoint independent auditors to conduct sales tax audit.

## 2.07 RETURN REVISION

LOW

*SECTION 35(6) OF PSTSA; SECTION 52(6) OF KSTSA; SECTION 30(6) OF SSTSA & SECTION 35(6) OF BSTSA*

*Currently, no time limit is provided for passing of an order on an application filed by the taxpayers seeking approval for filing of revised return. This causes delay in passing of the revision order and also delay in filing of subsequent returns, and subsequent removal of name of taxpayers from the list of active taxpayers.*

It is proposed that specific timelines should be prescribed in the laws wherein the order needs to be passed and if no such order is passed within such timelines on the application, then the same should be considered as deemed approved.

**Rationale**

Fixation of timeline for passing of revision order greatly helps in preventing delays in filing of subsequent returns.

## 2.08 OBLIGATION TO PRODUCE DOCUMENTS AND PROVIDE INFORMATION

MEDIUM

*SECTION 52(1) OF SSTSA; SECTION 57OF PSTSA, SECTION 57(1) OF BSTSA & SECTION 73 OF KSTSA*

*The tax officer is empowered to solicit any information or record from any person without specifying any reason and without specifying the reference of any case being investigated by him.*

It is proposed that the scope of above referred sections should be restricted to specific parties and transactions already identified by the tax authorities.

**Rationale**

This will put a restriction on fishing enquiries and unnecessary probe into the tax affairs of a person.

## 2.09 TAX EXEMPTIONS OR ZERO RATING FOR CHARITY

LOW

Currently, the provincial sales tax statutes do not have any provision to allow zero-rating or concession or exemption from payment of sales tax to persons engaged in running charity, social welfare organizations, trusts, hospitals, schools and similar nonprofit organizations.

In line with the Government's overall policy for health and well-being of the citizens of Pakistan, it is suggested that the services provided or rendered to nonprofit organizations should be zero-rated or exempted under the provincial sales tax laws. The said relief should at least be provided to the organization which have already been given exemption by the Federal Government.

**Rationale**

This will enable the social sector to spend more on the social welfare activities instead of spending on the taxes which increases the cost of services/facilities to the general public.

## 2.10 E-HEARING AT THE LEVEL OF COMMISSIONER APPEALS / APPELLATE TRIBUNAL

MEDIUM

*RULE 10 OF PSTSR; RULE 157 OF BSTSR & RULE 57H OF SSTSA SECTION 35(6) OF BSTSA*

*The facility for e-hearing of appeals is currently available under the Sales Tax laws in Punjab as per Rule 10 of the Punjab Sales Tax on Services (adjudication and Appeals) Rules, 2012 and Balochistan as per Rule 157 of the Balochistan Sales Tax on Services Rules, 2018, and Sindh (only for Hyderabad and Sukkur regions) as per Rule 57H of Sales Tax on Services Rules, 2011. The KP Sales Tax does not have provisions for e-hearing facility for the taxpayers.*

Considering that major service providers operate across the country and their tax affairs are generally managed from one location, normally from the head office, hence it is proposed to set up facilities for e-hearing of appeals before the Commissioner Appeals and Appellate Tribunal by all revenue authorities collectively in all major cities in the Country.

**Rationale**

This will not only make the appeal process efficient and less costly, but also greatly help in deciding appeals expeditiously.

## 2.11 MINIMUM THRESHOLD FOR REGISTRATION

LOW

Currently, the provincial sales tax laws do not prescribe minimum taxable threshold for small service providers. This issue is partly addressed by issuing Notifications by Sindh, but other provinces are not aligned on this issue. For instance, constructions services, workshop for electric or electronic equipment and automobile washing services where annual turnover does not exceed Rs. 4 Million in a financial year and auto-workshop services whose turnover does not exceed Rs. 4 Million in a financial year, are exempt from the chargeability of Sindh Sales Tax.

It is proposed to introduce a uniform minimum taxable threshold for small service providers by all provinces within the statute, rather than through Notifications.

**Rationale**

This is necessary to provide relief to small service providers across the provinces and to achieve harmonization.

## 2.12 SALES TAX ON SERVICES RELATING TO E-COMMERCE / E-BUSINESS OR DIGITAL ECONOMY

MEDIUM

E-commerce or E-business is getting momentum and such activities are conducted throughout Pakistan using a digital platform located either outside Pakistan or in one of the provinces in Pakistan, but taxation of their services may not be fully captured. A question also arises with reference to determination of place of such businesses, its jurisdiction and allocation of revenue.

It is proposed that the provincial revenue authorities should get together and agree to the following steps for introducing provisions for taxation of services under e-commerce or e-business:

a) a detailed mechanism for capturing such services in the tax net by the province in which digital platform is located for services provided from within Pakistan and through banks and financial institutions for services rendered from digital platform located outside Pakistan;

b) fair allocation of tax so collected among the provinces based on a formula; and

c) filing of a single return by the service providers located in Pakistan in line with the newly introduced sales tax return by FBR.

**Rationale**

Unless the Provinces agree to be together on capturing such services and the distribution formula based on a single return filed by the service providers, the services provided through digital platform from within and outside Pakistan may largely remain untaxed by creating confusion whether they are taxable by provincial or federal tax authorities.

## 2.13 AUTOMATIC STAY FOR RECOVERY OF TAX ARREARS

MEDIUM

*SECTION 70 OF PSTSA; SECTION 66 OF SSTSA & SECTION 72(1)(f) OF BSTSA*

*The current law requires for deposit of 10% (under the PSTSA laws) and 25% (under the SSTSA and the BSTSA laws) of the disputed demand for automatic stay against recovery of the remaining tax demand (90% or 75%, as the case may be) until the appeal is decided by the Appellate Commissioner. However, it does not provide any mechanism for refund of the tax deposited if the demand is extinguished or curtailed to below 10% or 25% (as the case may be).*

It is proposed to delete this condition and allow automatic stay without any payment of disputed tax until the appeal is decided by an independent appellate authority. Alternatively, the condition for payment of disputed tax demand should be relaxed to 10% for automatic stay against recovery of balance tax demand till the decision of the Appellate Tribunal. Furthermore, there is no such provision available in the KSTSA, therefore, the same should also be introduced to safeguard the interest of the registered person.

**Rationale**

The payment of tax demand during pendency of appeal causes grave hardships to the taxpayers and it is contrary to legal judgments where it is held that the disputed tax demand should not be recovered unless it has been reviewed at least by one independent forum.

## 2.14 REFUND OF EXCESS INPUT TAX

HIGH

*RULE 23B OF SSTA; RULE 29 OF BSTSA; SECTION 32 OF KPSTA & SECTION 16 OF PSTSA*

*The existing law does not cater for refunds arising from the following situations:*

*a) excess input tax not adjusted against tax liabilities of twelve consecutive months; and*

*b) tax withheld in excess of net tax liability for the relevant tax period and remained unadjusted against tax liabilities of twelve consecutive months.*

It is proposed to align the refund related provisions with those applicable in case of sales tax on goods under the STA.

**Rationale**

This amendment is necessary for adoption of best practices and harmonization of sales tax laws.

## 2.15 SALES TAX ON SERVICES OF ACCOUNTANTS AND AUDITORS

HIGH

*Currently, the services of accountants and auditors are subject to varied rates under the Provincial Sales Tax laws in the following manner:*

| *Provincial Law* | *Standard Rate of Tax* | *Reduced Rate* |
|---|---|---|
| *Sindh Sales Tax* | *13%* | *8% subject to certain conditions* |
| *Punjab Sales Tax* | *16%* | *5% subject to certain conditions* |
| *KPK Sales Tax* | *15%* | *2% subject to a condition* |
| *Balochistan Sales Tax laws* | *15%* | *6% subject to a condition* |
| *Islamabad Sales Tax laws* | *16%* | *Not available* |

It is proposed that the rate of tax in all the territories should be aligned and reduced to 2% as applicable under the KPK laws.

**Rationale**

There should be harmonization between all the provinces and such rate of tax should be reduced to 2% under all the jurisdictions to promote the regulatory culture and to reduce the cost of compliance.

**BAR CODE ON ALL NOTICES AND ORDERS**

LOW

Currently, the requisition, notices and orders are issued without system generated Bar Code, whereas this system is implemented by the FBR in case of income tax with effect from July 1, 2015 read with recent direction dated January 28, 2021 which appears to be for Sales Tax and FED too.

It is proposed that necessary amendments should be made in the respective Provincial Sales Tax laws and ICT on Services Laws for mandatory bar coding on service of requisition, notice and order.

**Rationale**

Implementation of bar code system will strengthen the controls over the issue, delivery and action on the requisition, notices and orders, both by the tax collectors and taxpayers.

## 2.16 ISSUE OF DRAFT SROs

LOW

Currently, the SRO Notifications s under the Provincial Sales Tax laws are issued without publication of draft for comments of the stakeholders.

It is proposed to introduce new sections in the Provincial Sales Tax on Services laws as well as under the Islamabad (ICT) Sales Tax on Services laws for publication of draft SROs for comments of stakeholders before their implementation.

**Rationale**

The issue of SROs without publication of drafts for seeking comments is against best practices.

# PROVINCE - WISE SPECIFIC ISSUES

## SINDH SALES TAX ON SERVICES

### 2.17 APPOINTMENT OF OMBUDSMAN

LOW

SSTSA law envisage the concept of Ombudsman, however the Government has not yet implemented it despite considerable lapse of time. It is proposed that Government should appoint Ombudsman and frame relevant rules.

**Rationale**

Appointment of Ombudsman will bring a check over maladministration and abuse of authority by the tax administration.

### 2.18 100% SALES TAX WITHHOLDING FROM CERTAIN SERVICE PROVIDERS

MEDIUM

*Under Rule 3(5) of SSTWTR certain active taxpayers are subject to 100% sales tax withholding which effectively deprives such taxpayer from Input tax adjustment right.* It proposed that withholding where service provider is active taxpayer should either be done away or its rate should be reduced.

**Rationale**

Such amendment is necessary to remove undue hardship being faced by such registered taxpayers who are not able adjust their input tax.

### 2.19 DELEGATION OF POWERS

LOW

*SECTION 36(1)(A)*

*The Board is empowered to appoint a Deputy Commissioner to exercise the powers of Commissioner (Appeals).* It is proposed to delete this provision.

**Rationale**

It undermines the quasi-judicial function and weakens the judicial process when a junior ranked officer is allowed to assume the powers of a quasi-judicial authority.

## PUNJAB SALES TAX ON SERVICES

### 2.20 TAXATION THROUGH REPRESENTATION

LOW

The Tax Administration heavily relies on notifications issued for enforcement of law, but they are not formally placed before the Provincial Assembly as per requirements of section 5(3) of the PSTSA. Further, certain reduced rate notifications are issued on yearly basis instead of amending the governing law.

It is proposed that the notifications issued should be tabled before the assembly as required under section 5(3) of the PSTSA. Further, instead of repeating notifications each year, the governing law should be amended.

## 2.21 INPUT TAX ADJUSTMENT UNDER REVERSE CHARGE MECHANISM

HIGH

***RULE 6 OF PUNJAB SALES TAX ON SERVICES (ADJUSTMENT OF TAX) RULES, 2012***

*Under Rule 6 of Punjab Sales Tax on Services (Adjustment of Tax) Rules, 2012, the tax required to be charged, deducted and paid under reverse charge mechanism is required to be deposited in entirety and thus the same is not allowed to be adjusted against any input tax credit.* However, the said law is presently not drafted in the manner to depict the said interpretation very clearly. Thus, creating an unnecessary confusion for the registered person in ensuring correct compliance of the law.

It is proposed that necessary amendment should be made to remove any ambiguity and unnecessary inconvenience to the taxpayers.

## 2.22 RESTRICTION ON INPUT TAX ON VEHICLES

LOW

***SERVICES - SECTION 16B OF PSTSA***

*The other three Provinces (excluding PSTSA) do allow the input tax on vehicles if directly used and consumed in the economic activity of a registered person, which is also aligned with the principles decided by the higher Courts. A comparative statement analysis below spells out the details:*

It is proposed that necessary amendments should be incorporated so that discrimination between provinces can be avoided.

| Balochistan<br>Sales Tax 16B(1)(g) | Sindh<br>Sales Tax 15(A)(1)(g) | Punjab<br>Sales Tax 16B(1)(i) | KPK<br>Sales Tax |
|---|---|---|---|
| *Clause(g) of subsection 1 of section 16 B, The Input tax credit not allowed on goods and services acquired for personal or non-business consumption, excluding the following ones directly used and consumed in the economic activity of a registered person in provision of the services paying sales tax at a rate not less than 15% advalorem such as – Vehicles classified under chap 87 of the first schedule to the Custom Act 1969 and part (including batteries and tyres and tubes of such vehicles ……….* | *Clause(g) of subsection 1 of section 15 A, the Input tax credit not allowed on the following goods and services, excluding the ones directly used and consumed in the economic activity of a registered person in provision of the services paying sales tax at a rate not less than 13% advalorem such as – Vehicles classified under chap 87 of the first schedule to the Custom Act 1969 and part (including batteries and tyres and tubes of such vehicles ……….* | *Clause(i) of subsection 1 of section 16 B, the Input tax credit not allowed on vehicles including three and two Wheelers* | *Chapter V of the KPK Sales tax on Services Reg. 2017, per the sub clause (vii) of clause 44 the Input tax credit not allowed on the following goods or services, excluding the one directly used and consumed in the economic activity of a registered person in provision of the services paying sales tax Vehicles classified under chap 87 of the first schedule to the Custom Act 1969 and part (including batteries and tyres and tubes of such vehicles ……….* |

This will align and harmonize the chargeability of services amongst all the Provincial Sales Tax laws and would avoid discrimination.

### 2.23 INPUT TAX ADJUSTMENT ON FRANCHISE SERVICES

***SERVICES - RULE 61 OF PSTSPR***

MEDIUM

Under the current law, the tax paid or deducted and deposited on franchise services is required to be deposited in entirety and thus the same is not allowed to be adjusted against any other tax liability. However, the said law is presently not drafted in the manner to depict the said interpretation very clearly. Thus, creating an unnecessary confusion for the registered person in compliance of the law.

It is proposed that necessary amendment should be made to remove any ambiguity and unnecessary inconvenience to the taxpayers.

**Rationale**

To align the law in line with sales tax principles and with other service tax laws.

## KHYBER PAKHTUNKHWA SALES TAX ON SERVICES

### 2.24 TAXABILITY OF SERVICES BY CERTAIN PROFESSIONAL

HIGH

*Serial number 19 of Second Schedule to the KPSTSA provide that certain services by professionals operating other than as corporate entities are taxable at reduced rate of 5%, whereas such services provided by corporate entities are taxable at standard rate of 15%.* It is proposed that uniform tax rate be adopted for all such professional services irrespective of status of service provider.

### 2.25 PROCEDURE FOR ELECTRONIC INVOICING, MAINTENANCE OF RECORDS ETC.

MEDIUM

*No procedure or software have been prescribed by the Authority under Section 48 (4) of the Act for electronic invoicing or billing, maintenance of records, filing of tax returns, and for any other matter by a registered person or class of such persons.*

It is proposed that the Authority must prescribe the procedure or software for electronic invoicing, billing, filing of returns, etc.

### 2.26 SPECIAL PROCEDURAL RULES ON APPOINTMENT OF ELECTRONIC INTERMEDIARY

MEDIUM

*As per section 93 (6) of the Act, the Authority may prescribe rules for the conduct and transaction of business of e-intermediaries, however no such rules have been prescribed to date.*

It is proposed that the Authority should issue special procedure/ rules regarding appointment, and suspension and cancellation of appointment of e-intermediary.

## BALOCHISTAN SALES TAX ON SERVICES

### 2.27 ZERO RATE / REDUCED RATE ON MEDICAL & HEALTH SERVICES

MEDIUM

Under Balochistan Provincial Sales Tax Law, Sales Tax is charged on services provided and rendered by medical practitioners, consultants and services provided by laboratories and x-rays whereas the same is not chargeable under other Provincial Laws.

Similar services were earlier chargeable to Sales Tax at a reduced rate of 5% (subject to certain condition) under the Punjab Sales Tax laws, however, the same has now been made chargeable to tax at zero rate.

It is proposed that medical and health related services should not be chargeable to Sales Tax.

**Rationale**

This will bring harmony amongst all the Provincial Sales Tax laws and reduce the cost of medical treatment.

## ISLAMABAD SALES TAX ON SERVICES

### 2.28 ENACTMENT OF INDEPENDENT SALES TAX ON SERVICES LAW

HIGH

The scope of Islamabad Capital Territory (tax on services) Ordinance, 2001 (ICT STO) was expanded by substituting the Schedule of services on the lines it is done by other provinces. However, nothing was done to make it a totally independent legislation. It continued to rely on the provisions of the Sales Tax Act, 1990 for their application as if it is a sales tax levied under the STA. Since the ICT STO is enforced by the FBR through its enforcement team in the field offices, who are responsible for enforcement of STA, they invariably apply the provisions of STA as if the entire law was applicable for charging and recovering sales tax on services. The indiscriminate application of STA creates confusion and controversy. Classic example was charging of sales tax on the income of regulatory authorities by declaring the fees collected for compliance by those regulated under the laws as taxable services. No distinction was drawn between a service and regulatory function, which is the function of State carried out under the Act of Parliament. This was sorted out by inserting a new section in the ICT STO. Similar issue came up for taxation on export of IT software and IT enabled services in the absence of definitions within the ICT STO. This again became a point of dispute, which culminated in favor of the taxpayer at the Tribunal.

After having extended the scope of ICT STO to bring in the ambit of tax almost all kinds of services that are taxable under the Provincial Sales Tax Laws, it has become extremely necessary to convert it into a full-fledged independent law on the lines it is done by the Provinces, and while doing so, cognizance should be taken of the fact that these laws are to be harmonized with the provincial sales tax laws and the rules framed thereunder.

**Rationale**

Mutatis Mutandis application of the provisions of the STA (which applies to goods) related to certain matters including any other allied and ancillary matters related thereto, without identifying the sections, rules, orders, notifications etc. promotes ambiguity and makes it difficult for both the taxpayers and the tax collectors to follow the law. Following expansion of the list of services in the Schedule of Services, ICT STO has become a very active law and cannot be applied properly an effectively if they continue to be enforced through the unclear application of STA.

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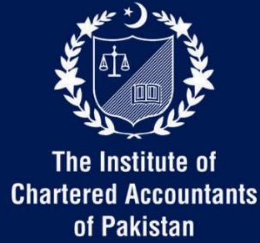


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