



Value Added Tax

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Proposed Implementation Plan-1

1. A new Value Added Tax Act, 2009 (VAT) effective from July 1, 2010. To be placed to parliament by December 31, 2009
2. VAT to be applicable effectively on all economic activities. Covering all ‘Supply of Goods’ and ‘Rendition of Services’. Very limited exceptions.
3. Present Sales Tax Act, 1990 and Five Provincial Sales Tax Acts to be repealed.



Proposed Implementation Plan-2

5. Federal Excise Duty to be realigned and streamlined.
6. Levy of tax on ‘Goods’ by Federation and ‘Services’ by the Provinces. Collection of tax on services by the Federal Government. This is the basis of the present and proposed law.
7. However the principle agreed in recent NFC award [on December 11, 2009] collection of VAT on services also by Provinces.



Variation from the present system

- What is the change from the present system?
- The proposed changes are:
 - VAT- All input/ output and at all stages
 - All items to be covered (withdrawal of exemptions),
 - Manner of implementation (no distortions from VAT)
 - Simplification of the law
 - Realigned administrative structure
- Emphasis on services and trade sectors



Constitutional Issues on VAT

- Under the constitution Federation is only entitled to levy tax on goods. Services are to be taxed by the Provinces.
- A full scale, across the board, VAT can only be effectively implemented when tax on both the streams are levied and collected at one level.
- Nevertheless we would have to look ways and means to implement the system with what has now been decided at the NFC. A unique model.



International and Regional Experience

- Traditionally the world is divided into two parts. In the unitary form of governments like UK, Europe and Bangladesh there is a Consumption Tax (VAT) on Federal Level.
- In Federal forms of governments like USA, India, and others. There are single stage taxes on production or consumption.
- We are in unique position, having a VAT structure with Federation not having the right to tax services.



Economic significance of VAT

1. Pakistan is struck up at less than 10 percent Tax to GDP ratio.
2. At least 7.5 percent growth [17.5 %] is essential for our economic survival.
3. This requires concerted efforts for a broad based consumption tax.
4. A proper VAT, can add around Rs 800 to 1500 billion over a period of 3 to 5 year.



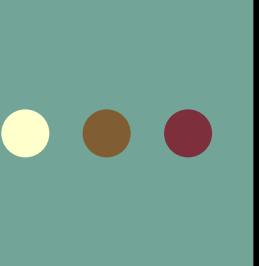
Important Changes in the proposed law

○ **Removal of distortions**

- Third Schedule (Tax on full value at production stage)
- Availability of all input tax-goods, services, mixed supplies etc

○ **Removal of Exemptions**

- Effectively all economic activities to be brought within the net.
- Powers to exempt subject to parliament sanction.



Implementation Issues – Wholesale and Retail

Trade-1

- Since 1996, when GST was implemented for the first time, VAT on Wholesale and Retail Trade has not been successful.
- At present effectively the whole sector is outside the VAT net.
- Implementation has failed on account of both policy and administrative issues.

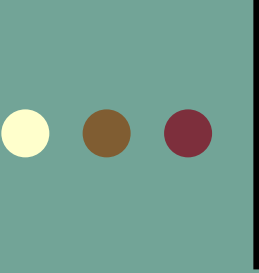


Implementation Issues-Wholesale and Retail

Trade-2

○ Policy and law

- Threshold- regular, normal and declared size of bulk of retail traders-distortions in trade and business.
- Income tax provisions promoting presumptive tax regime



Implementation Issues—Wholesale and Retail Trade- 3

○ **Economic Issue**

- Availability and trade in
 - Under invoiced imported goods.
 - Smuggled and Afghan Transit Trade's siphoned out goods
 - goods originating in informal sector



Implementation issues-Wholesale and Retail Trade-4

○ **Administrative Issues**

- Capacity, quality and information base of the administrator
- Street and nuisance power of delinquents
- Lack of executive and political support



Implementation Issues -Export Oriented Sectors-1

- **History**-Export Oriented Sectors including their local supplies were taken out of VAT only due to administrative failure
- **Importance**-Meaningful VAT implementation is not possible unless that major distortion is removed.
- For export oriented sectors VAT necessarily require refunds of inputs. The inherent problems in overall documentation level and informal economy creates a disability in implementation. This chokes the system both for business and the government.



Implementation issues-Export Oriented Sector-2

- Economic status is not much different now as compared to the time when this unpleasant decision was undertaken.
- **Exporters issues**
 - Delay in refunds
 - Uneven playing field
 - Documentation at different stages and the nature of industry
- **Governments issues**
 - Capacity to deliver-Issue refunds-matching invoices
 - Fake and flying invoices-informal economy



Implementation issues-Service Sector-1

- **Constitutional issue**
- **Identifying services-Is One system for all is right?**
 - **Organized**-financial services, insurance, advertisement etc. Services already subject to FED.
 - **Unorganized**-transport, logistics, food (hotel and restaurants)
 - **Personalized**-Doctors, engineer, other professionals



Implementation issue-Service Sector-2

- Failure of overall tax system- Documentation base-PTR etc
- Ultimate increase in cost for the user-somebody will bear the cost.
- Dual tragedy-If there is a 'Recovery and Collection' gap.



Administrative Issue-Powers of the Officers

- Tax officials believe that proper implementation require adequate enforcement powers.
- Business [specially those in organized sector] believe that an inadequate balance leads to harassment and fishing adventures for personal benefits.
- The balance is difficult however legislations should be unambiguous and not prone to multiple interpretation.



Administrative Issue-Audit

- Audit is an essential ingredient of VAT implementation system.
- Audit is however not a measure to improve tax collection. Audit should remain a deterrence.
- Major audit issue in practical sense arises in relation to refunds in relation to export. This is essential element of VAT if applicable across the board.



Administrative Issue-Integration of Services

- Integration of services in the FBR is essential for VAT implementation.
- It would however be a difficult exercise to create a vibrant team in the present cultural environment in FBR specially at lower field cadres.
- Capacity and capability of the provincial and local governments essential for overall implementation of VAT specially for services.



Action & Way Forward-1

- Political and social consensus and acceptability.
- Proper communication with the stakeholders.
- Serious actions against Under invoicing, smuggling and abuse of Afghan transit trade.
- Serious efforts against informal economy.



Action & Way Forward-2

- Creation of national business information data base.
- Acceleration in the use of IT and automation. Reduction in human intervention.
- No 'fit for all' formula for service sector.
- Single stage service tax by provinces for unorganized and personalized service sector



Actions & Way Forward-3

- Downward revision of the applicable rate. To be brought down to 12.5 %.
- Coordination with Provincial and Local governments-sharing of data.
- Abolition of FTR in income tax.
- Industry specific data and information on transparent basis.



Conclusion

Lack of success in the implementation of VAT earlier do not bring down my resolve to the fact that as a nation we have all ingredients to be successful. The state of affairs in this field is also not discouraging . Whole world including USA and India are now seriously considering to implement a federal consumption tax. We have developed a base, though narrow in size, that can now be converted into a vibrant system. What we need is the development of information data base, automation and the simplification of law. There is no short cut and out of box solution. In the present state of affairs we do not have many choices. This nation of 180 million people can not be taken for granted. I foresee a prosperous country if we decide it to make it so.

‘yeh kare zameen hay kar asman nahi..’