

PRE BUDGET SEMINAR 2016-17

KARACHI TAX BAR ASSOCIATION

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28 APRIL 2016

Overview

- ▶ Pakistan has experimented many ways to develop a tax culture but with least concern to actual stake holders.
- ▶ Reliance on specific schemes for broadening of tax base instead of focused fieldwork by the field formations for broadening coupled with behavior of masses of not discharging their obligation to the state has resulted in a very low level of tax compliance in the country.
- ▶ Enhancing collection of direct tax in indirect mode through FTR and MTR were the measures aiming towards improving collection of revenue alone instead of inculcating the culture of disclosure of real income and assets in the society.
- ▶ Frequent changes in the tax laws (e.g. Super tax, tax on undistributed reserves, Alternative Corporate Tax etc.) will lead to a reduction in tax collection in the long run as investment plans would be reviewed by corporate sector.

Overview

- ▶ The current tax policy is leading to a reduction in investable surpluses for the corporate sector.
- ▶ The existing taxpayers are being subject to harsh taxation while less efforts are being made to expand the tax base in reality.
- ▶ The 2016-17 Budget gives the Government another opportunity to address the structural weaknesses of the economy and to introduce effective policies to increase documentation of the economy and to widen the tax base.

Broadening of tax base

- ▶ The Government faces a challenge with regards to the widening of current tax base. Following steps may be undertaken to broaden the tax base –
 - ❖ Profiling persons through FBR's database of owners of property, motor vehicles, club memberships, international traveling, utilities, credit cards, investments etc.
 - ❖ National Tax Number should be mandatory for purchase/sale/transfer of immovable property, motor vehicles, club memberships, investments, credit cards etc., without any exceptions.
 - ❖ Submission of information by the respective authorities dealing with the aforesaid transactions.
 - ❖ Exemption from taxation of unexplained income under section 111(4) be restricted to home remittances by overseas Pakistanis and only for fresh industrial investment.
 - ❖ Tax credit @ 2.5% may be allowed to taxpayers whose 90% purchases are from persons who are registered under the Income tax and Sales tax laws.

DIMINISHING THE COST OF DOING BUSINESS

Alternative Corporate Tax

- ▶ The introduction of Alternative Corporate Tax (ACT), section 113C, through the Finance Act, 2014 at the rate of 17% of accounting income has placed an additional burden on corporate taxpayers specially those companies which have huge unabsorbed tax depreciation and prior years' tax losses.
- ▶ It appears that the legislature aims to recover more taxes from the existing documented sector instead of broadening the tax base.
- ▶ Since the parallel application of ACT with Minimum tax under section 113 is not appropriate, it is strongly recommended that only one of the two Minimum Tax Regimes should be in force.
- ▶ Alternatively, practical issues relating to ACT may be accounted for including adjustment of brought forward losses and acceptability of accounting income disclosed in the financial statements by the tax authorities.

Minimum tax on services

- ▶ Currently, the tax withheld at source under section 153(1)(b) is a minimum tax for service providers including corporate service sector.
- ▶ Presently, if the service sector does not achieve a net profit margin of approximately 25%, it is liable to 8% to 10% minimum tax on their gross receipts.
- ▶ Practically, 25% net profit margin is not achievable as most of the services have less margins resulting in unreasonable tax liabilities for number of service providers.
- ▶ It is proposed to reinstate the position prior to Finance Act, 2015 where tax withheld at source was not a minimum tax for corporate service sector entities.
- ▶ Alternately, the 8% to 10% rate may be reduced to 2% as has been provided to certain sectors.

Tax on undistributed reserves

- ▶ The Finance Act, 2015 inserted section 5A – Tax on undistributed reserves in terms of which tax @ 10% has been imposed on every public company (excluding scheduled bank or a modaraba) that derives profit for a tax year but does not distribute cash dividends either within a specific time or to a certain specified extent.
- ▶ This section penalizes companies whose management has identified projects which will allow for the expansion of the company and lead to long term gains for the shareholders.
- ▶ The Bar strongly recommends to repeal this section.

Opting out of final tax regime

- ▶ The Finance Act, 2012 introduced positive steps for opting out of presumptive tax regimes in respect of sale of goods, import and export of goods.
- ▶ However, the Finance Act, 2014 not only reversed the amendments but also inserted new clauses whereby the persons engaged in import or supply of goods and execution of contracts were provided an option to opt out of FTR subject to the condition that their minimum tax liability under NTR shall not be less than tax already collected / deducted.
- ▶ The taxpayers in practicality were not able to obtain any financial benefit by opting out of the FTR and were instead required to face additional burdens and risks of tax audit by filing returns of income.

Opting out of final tax regime

- ▶ To facilitate the taxpayers and to reduce the additional burden, it is proposed to –
 - ❖ Reinstate the options introduced by Finance Act, 2012.
 - ❖ For corporate taxpayers, FTR be converted into minimum tax with the facility to carry forward excess minimum tax paid
 - ❖ The benefit to opt out of FTR be extended to section 153(1)(c), 233, 234 and 234A.

Imports – Section 148

- ▶ Previously, as per Clause (9A) of Part II of the Second Schedule to the Income Tax Ordinance, 2001, manufacturers importing raw material for their own use were subject to tax collection at 3% under section 148 of the Ordinance. This rate was increased to 5% in financial year 2013 and then to 5.5% through the Finance Act, 2015.
- ▶ This increase has resulted in significant cash flow problems for manufacturers and is resulting in generation of huge income tax refunds specially in the year of reinvestment for expansion or BMR.
- ▶ To minimize the piling up of refunds in case of manufacturers having huge brought forward losses and tax credits, it is proposed to reduce the rate of collection of tax under section 148 to 1% on import of raw material.

Exemption on imports

- ▶ Current rules do not support issuance of exemption certificate for import of raw material by manufacturers starting new business, gone into expansion in the current product or launched a new product etc. It is suggested that these restrictions may be relaxed and therefore the existing criteria should be revisited.
- ▶ For qualifying for exemption, the maximum import of a raw material is restricted to the extent of 110% of the previous year's import volume.
- ▶ It is mandatory to pay tax equal to higher of last two tax years' tax liability.
- ▶ Coupled with a high rate of withholding at 5.5% these restrictions badly affect the working capital of the manufacturers.
- ▶ It is therefore suggested that the maximum volume restriction be at least enhanced to 150% and the requirement to meet the tax payment equal to previous two tax years be abolished.

General imports

- ▶ The withdrawal of general powers of Commissioner Inland Revenue in issuing exemption certificate under section 148 to the taxpayers who are not industrial undertakings but are importing goods for own consumption has created problems and hardships for the genuine taxpayers specially in the service sector.
- ▶ Therefore, powers may be delegated to the respective Chief Commissioners of RTOs and LTUs for issuance of exemption certificates in genuine cases, where hardship is being faced by the taxpayers.

Taxing supply chain under the garb of prizes and winnings

- ▶ Section 156 of the Ordinance required a company to deduct tax @ 20 percent on “prize offered by companies for promotion of sale”.
- ▶ The clear intention of this section is to capture tax through withholding at source from persons who are recipient of the prizes and winnings; the intention is not to tax any person who belongs to the supply chain of the companies i.e. dealers, distributors etc.
- ▶ Performance discounts paid to the supply chain by manufacturers are being unfairly equated to prizes and winnings and being subjected to tax @ 20%.
- ▶ To clear any ambiguity in law regarding application of this section, it is suggested to amend the section and to add the term “to end consumers” after the term ‘prize offered by company for promotion of sale’ to oust any person in the supply chain from the ambit of this section.

Withholding tax on supplies by FMCG distributors

- ▶ The distribution of fast moving consumer goods is a high turnover and low margin business.
- ▶ Accordingly, rate of minimum tax for the distributors of FMCG companies is prescribed at 0.2% of the turnover.
- ▶ Due to enhancement in the scope of “prescribed persons”, tax is being withheld @ 4.5% from distributors on account of supply of goods, which is way high than the net margins of distributors, making it impossible for them to supply goods to prescribed persons.
- ▶ It is proposed to amend section 153(1)(a) to bring the rate of tax deduction in line with the minimum tax rate on FMCG distributors i.e. 0.2%.

Recovery of tax v/s Refund of tax

- ▶ The Commissioner is empowered to recover tax due from a taxpayer under various modes including attachment and sale of property, seizure of bank accounts, imposition of penalties, additional taxes, rights to arrest of the taxpayer and taxpayer detention in prison etc.
- ▶ On the contrary, the mechanism of obtaining refunds of excess tax paid is not adequately taken care of.
- ▶ This leads to a perceived unjustness where under payment is aggressively pursued but the interest of the taxpayers are not adequately accommodated.
- ▶ Ease in obtaining refunds would assist in combating the negative perception of the taxpayers towards the tax authorities and the number of taxpayers would substantially increase.

Recovery of tax v/s Refund of tax

- ▶ It is therefore proposed that the time period under section 170(4) be reduced from 60 days to 15 days within which the Commissioner shall be required to pass the order. In case of failure to do so, the refund application be deemed to have been accepted by the Commissioner.
- ▶ Stringent procedure may be adopted to ensure issuance of refunds after passing of refund order under section 170.

INCENTIVIZING INCREASED INDUSTRIALIZATION

Tax credits

- ▶ Period for tax credits under sections 65B, 65D and 65E proposed to be enhanced from 30 June 2016 to 30 June 2020.
- ▶ Tax credit under section 65E should also be extended for extension and balancing, modernization and replacement of the plant and machinery.
- ▶ Currently, tax credits under sections 65D and 65E are available for a period of 5 years.
- ▶ Due to substantial capital investment involved in commencing new projects, taxpayers are unable to realize taxable profits in 5 years' time and as such the tax credits are effectively wasted.
- ▶ It is proposed to extend the period of tax credits to 10 years which will act as an incentive to new investment since the investors foresee tax benefits which they may practically be able to utilize.

Tax credits

- ▶ The rationale behind these tax credits is not only for promoting purchase of plant and machinery but industrial expansion and increased economic activity, which cannot be achieved from plant and machinery in isolation and for all practical purposes, need appropriate support structure.
- ▶ Accordingly, tax credit under section 65E should also be extended to investment in factory building and manufacturing related infrastructure.

REDRESSING INEQUITY IN THE TAX LAW

Deductions not allowed u/s 21

- ▶ Section 21 restricts any cash expenditure under a single account head to Rs.50,000 with a limit of Rs.10,000 per transaction. Furthermore, cash payment of salary is limited to Rs.15,000.
- ▶ Practically, it needs to be acknowledged that certain transactions must be undertaken on a cash basis. Further, in view of increasing costs and inflation over the years, the limits are devoid of any practical use to the taxpayers.
- ▶ It is therefore proposed that a single account limit be enhanced to Rs.250,000.
- ▶ Further, limits of Rs.10,000 [section 21(l)] and Rs.15,000 [section 21(m)] may be enhanced to Rs.25,000 for both payments.

Taxation of notional income of employees

- ▶ Under section 13(7) of the Ordinance, interest on loan from employer worked out on the basis of difference between benchmark rate and the actual rate of interest, is taxable in the hands of the employee.
- ▶ The taxation of above notional income is against the basic principle of taxation since the notional income will never be received by the taxpayer.
- ▶ The above notional income should be exempted from tax similar to the exemptions available in respect of perquisites available to the employees of educational institutions, hotels, restaurants, hospitals, clinics etc.
- ▶ Alternately, the threshold of loan on which section 13(7) does not apply (presently Rs.500,000) may be enhanced to Rs.2,000,000.

Benefits to salaried individuals

- ▶ Child education and medical expenses may be allowed to be offset against salary income of the individual provided that proper documentary evidences are made available for such expenses.
- ▶ The exemption limit of provident fund contribution of Rs.100,000 by an employer under Rule 3 of the Sixth Schedule is considerably low in the current economic situation.
- ▶ It is suggested that the deeming of income may be restricted to 10% of salary (already available under the law) and the limit of Rs.100,000 may be removed.

Penalties under section 182

- ▶ Penalties for non / late filing of return of income, statement of final tax, wealth statements and withholding statements are very harsh and excessive and imposition of such huge penalties may create harassment among the taxpayers.
- ▶ Through the Finance Act, 2011, the expression “tax payable” was declared to mean tax chargeable on the taxable income without taking into account tax payments already made by the taxpayer.
- ▶ The penalties in this regard need to be rationalized since the main purpose of levying penalty is to educate the taxpayers and instill a sense of compliance rather to create huge tax demands or to achieve revenue targets through such penalties.

Recovery of tax from private company shareholders

- ▶ In terms of section 139 of the Ordinance, a director, (other than employed director) or a shareholder owning not less than 10% shares, of a private limited company, is jointly and severally liable for payment of any tax due by the company (of which he is a director or shareholder).
- ▶ In case of limited liability companies, the above provision of law is inconsistent with the provisions of the Companies Ordinance, 1984 and the international norms in this regard.
- ▶ It is proposed that every shareholder should be made responsible to pay the tax payable in accordance with his percentage of shareholding and to the maximum of his share capital in the company.

Selection of persons for audit

- ▶ Explanations inserted in sections 177 and 214C, through the Finance Act 2013, provides that both sections are independent of each other and that the Commissioners are empowered to call for records of the taxpayer and conduct audit.
- ▶ This power is being abused at field offices which not only creates a bad image for the FBR but also hampers the drive to expand the tax net.
- ▶ In order to achieve conduct of audit without facing undue litigation and eliminate undue harassment of existing taxpayers, a uniform policy of selection should be adopted by the FBR under which cases should be selected within 30-60 days of filing the return of income to allow ample time for conduct and finalization of audit.
- ▶ For tax year 2015, the Board should carry out selection of cases for audit. Moreover, till such time, manual selection of cases by the Commissioners may be held invalid.

Filing of monthly statements

- ▶ The dates of filing monthly statements under the income tax law and payment of monthly sales tax coincide with each other (i.e. 15th of each month). Further, filing date for sales tax returns is 18th of every month.
- ▶ This creates a lot of burden on the taxpayers as the two filing dates are close together.
- ▶ In order to provide ample time for preparation and filing of withholding statements, it is proposed to change the date of filing of such statement to **25th day of the month** following the month to which the withholding pertains.
- ▶ Since, relevant tax is already deposited, there will be no loss of revenue to the tax authorities from this proposed change.

Payment of tax collected / deducted

- ▶ Clause (b) of Rule 43 provides that tax collected or deducted by a person shall be deposited into the Government treasury within 7 days from the end of each week ending on every Sunday.
- ▶ This provision of law has enhanced the work load of tax collecting agent manifold.
- ▶ To reduce the burden on withholding tax agents, it is proposed that the taxpayers be allowed to deposit all withholding taxes collected within 7 days of the **end of each fortnight**.

Appointment of the Appellate Tribunal

- ▶ Under section 130(3)(c) of the Ordinance, a judicial member of the Tribunal could be a person who is an officer of Inland Revenue Service in BS-20 or above and a law graduate.
- ▶ This provision is inconsistent with other criterion provided under section 130 for becoming a judicial member of the Tribunal, since a person capable of becoming a judge of a High Court cannot be equated with an IRS officer [as provided in section 130(3)(c)].
- ▶ At present, a decision given by the Appellate Tribunal on facts is not challengeable before the High Court or Supreme Court therefore it is deemed to be a final fact finding authority under the tax appellate system of the country.
- ▶ Accordingly, it is proposed to omit sub-clause (c) of sub-section (3) of section 130.

Powers of the Appellate Tribunal

- ▶ In terms of section 132 of the Ordinance, the Tribunal is empowered to dismiss an appeal in case of any default on the date of hearing by any of the parties to the appeal.
- ▶ The above power is unjustified since ATIR is the last fact finding authority and accordingly the decision of the ATIR in respect of the facts is final.
- ▶ It is therefore proposed that the condition of dismissal of appeal should be eliminated from section 132 in order to provide the taxpayer an opportunity to get justice even in the ex parte decision.

Revision by Chief Commissioner / Commissioner

- ▶ Currently, no power is available for Chief Commissioner to call for revision of audit / amendment of assessment cases on an application filed by the taxpayer.
- ▶ It is proposed to amend section 122B to empower the Chief Commissioner for the revision of audit / amendment of assessment cases in order to provide speedy remedy to the taxpayer in hardship cases.
- ▶ Section 122A empowers the Commissioner to carry out suo moto revision of any order passed under the Ordinance. It is proposed to allow the taxpayer a right to approach the Commissioner for revision of an assessment to seek redress against grievances as was available under section 138 of the repealed Ordinance.

Powers of CIR(A) to set-aside

- ▶ Under the revised law, the CIR(A) is divested with the powers to set-aside orders framed by the assessing officers and therefore, in order to give relief, the CIR(A) is now required to examine the evidences.
- ▶ Due to paucity of time and shortage of staff, it is not possible for the CIR(A) to verify and dispose of all cases judicially and on equitable basis.
- ▶ It is therefore proposed that the power to set-aside the issue in appeals should be re-introduced in the law.
- ▶ It is also proposed to include order passed under section 122C in the list of orders provided under section 127 against which an appeal can be made before the CIR(A).

Appearance before the authorities

- ▶ Currently, words “income Tax Practitioner - ITP” is provided in Clause (f) of sub-section (2) of section 233 of the Ordinance.
- ▶ Since, all taxes have been integrated, the words ITP may not be appropriate.
- ▶ Accordingly, it is suggested to replace the above expression with the words “Federal Tax Practitioners” to allow ease in representing a taxpayer before all the tax authorities working under the FBR.

THANK YOU