PRE BUDGET SEMINAR 2017-18

KARACHI TAX BAR ASSOCIATION

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Building a better working world

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 policy changes in the tax laws (e.g. Super tax, income support levy, tax on undistributed reserves, Alternative Corporate Tax etc.) has left a bad taste for investment planners, result is slow down in industrialization.

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 2017-18 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.

Suggested Immediate Remedies

- Concerted steps need to be taken to revive confidence of existing taxpayer in FBR
- The tax department needs to be pulled out of the mad rush of tax collection, solely focusing of existing taxpayers which has created **blind folded and deaf tax assessments** just creating undue tax demands
- Multiplicity of tax proceedings is creating serious unrest among tax filers. Audit, amendment of assessment and Monitoring of withholding tax proceedings should be harmonized to create one effective proceedings for both taxpayer and tax officer
- Controversy on selection of cases for audit needs to be resolved by taking all stakeholders in confidence
- The current spate of raids at **tax filer business houses** is resulting in fear among taxpayers and needs to be stopped forthwith

POLICY ISSUES

Tax credit to registered persons – Section 65A

- To provide incentive for documentation of economy and increase in the tax base, in 2009 tax credit to those manufacturers registered under the Sales Tax Act, 1990, making 90% of their sales to persons registered under the Sales Tax Act, 1990 was introduced. The amount of tax credit was 2.5% of the tax payable, which was increased to 3% by Finance Act, 2016.

- It is suggested that –

  - The restricted benefit of this tax credit to manufacturers only be extended **to all persons** registered under the Sales Tax Act, 1990;

  - The restricted application of this tax credit of making 90% sales to sales tax registered persons be extended to **persons making 90% of purchases from persons registered** under the Sales Tax Act, 1990; and

  - The rate of this tax credit be enhanced from 3% to 5%.

Inter-Corporate Dividend

- Inter-corporate dividends within the group companies that are entitled to group taxation under section 59B were exempt from tax.

- The Finance Act, 2016 removed the words “or section 59B” from the Clause 103A, Part I, Second Schedule of the Income Tax Ordinance, 2001 and withdrew the exemption to inter-corporate dividend to such companies that fall within the scheme of section 59B availing group relief.

- In order to promote group formation and consolidation in Pakistan, it is eminent to exempt inter corporate dividends. However if entire exemption is not affordable at this stage the aforesaid amendment in Clause 103A to withdraw exemption to eligible groups under section 59B should be reverted.

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

- In order to encourage payment of dividend to the shareholders, tax on the undistributed 'Reserves' of a public company (excluding Scheduled bank or a Modaraba) is imposed at the rate of 10% of the undistributed reserves in excess of paid up capital under section 5A of the Ordinance.

- However, there seems to be a discrepancy in the drafting of this section as a result of which the undistributed reserves will again and again be taxed in subsequent tax years, if the conditions of section 5A are not fulfilled.

- In order to remove the discrepancy, it is suggested that the term 'Reserves' should be defined as 'undistributed profit for the year'. In this manner, the yearly undistributed profits will be subject to tax rather than cumulative reserves every year.

- Since bonus shares now have been made taxable under section 236M and 236N of the Income Tax Ordinance, 2001, it is suggested that bonus shares issued by companies may also be treated as distribution made during the year for the purpose of section 5A.

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 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 that –
  - Corporate sector should be excluded from final tax regime unconditionally;
  - The scope of opting out of final tax regime be expanded to cover all incomes falling under final tax regime.
  - The rates of minimum tax for opting out of final tax regime be reduced to raise the difference between final tax and minimum tax by at least one percent.

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**.

Exports – Section 154

- Exports of goods, foreign indenting commission and sale of goods to an exporter under an inland back-to-back letter of credit and export of goods from Export Processing Zone are subject to deduction of tax at source, which is also the final tax.

- However, exporters and foreign indenting commission agents have been given an option for exclusion from final tax regime, from tax year 2015, subject to the following conditions:

  - submission of option at the time of furnishing of return of income; and
  - tax deducted shall be the minimum tax.

- If the tax deducted is minimum tax, the taxpayers will not opt for exclusion from final tax regime. Accordingly, it is suggested that the sub-section (5) of section 154 be deleted.

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.

Foreign tax credit

- 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.

- 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 income in some cases is extra-ordinary delayed beyond the time period of two years.

- In such case, the taxpayer 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.

- It is suggested that the above sub-section (7) be deleted.

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.

REMOVAL OF HARDSHIPS

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.

Penalties under section 182

- Penalty for non-furnishing of statements under section 115, 165, 165A or 165B within the due date prescribed under Section 182 is Rs.2,500 for each day of default subject to a minimum penalty of Rs.10,000.

- The quantum of penalty worked on above basis is too harsh and highly un-reasonable. In many cases, practically, the quantum of penalty is much more than the actual tax liability itself.

- It is recommended that penalty for failure to furnish statements u/s 115, 165, 165A or 165B should be reduced to Rs.500 per day subject to a maximum penalty of Rs.10,000; and

- In case of continuation of default after the imposition of first penalty a further penalty of Rs.1,000 per day be prescribed.

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.

- The taxpayer is required to deposit tax demand within 30 days of the service of the assessment order. In case, additions made by the assessing officer are deleted in appeals, the taxpayer is not provided any compensation.

- This leads to a perceived unjustness where under payment is aggressively pursued but the interest of the taxpayers are not adequately accommodated.

Recovery of tax v/s Refund of tax

- 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.

- Further, the taxpayer be allowed a compensation for disputed tax demand recovered and later deleted in appeals.

Powers of CIR(A) to grant stay

- Currently, the CIR(A) is divested with the powers to grant stay against recovery of tax for an aggregate period of 60 days.

- The stay is granted only in such cases, where it is considered that recovery of tax shall cause undue hardship to the taxpayer. Further, such stay is granted only after hearing the taxpayer and the tax officials and in such cases where he considers that taxpayer prima facie has a good case.

- In such cases, limiting the period of stay for 60 days is not justified and it is required to be enhanced till the issuance of appellate order.

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.

Taxation of association of persons

- Proviso inserted vide Finance Act, 2014 requires a company being member of an AOP to be taxed separately from AOP.

- This created a hardship in cases where income of AOP falls under FTR because the withholding rate prescribed for companies and AOP under Section 153 varies. Further such company could not claim credit of tax withheld in the name of AOP.

- In order to facilitate taxpayers, it is suggested that an explanation be added in Section 92 for clarifying position of FTR cases, applicable tax rates thereon and to allow such company to claim proportionate credit of tax withheld in the name of AOP.

Deduction of tax from payment of salary

- 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.

- To align the provisions of section 149 with newly inserted sections, the scope of adjustments needs to be expanded to:

  - "Deductible allowances" i.e., 'Zakat' under section 60, 'Profit on debt' under section 64A and 'Educational expenses' under section 64AB; and

  - "Tax credits" under section 62A (Health insurance).

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

- The exemption limit of provident fund contribution of Rs.150,000 by an employer under Rule 3 of the Sixth Schedule. Any contribution by the employer above the amount of Rs.150,000 is taxable.

- It is suggested that the entire amount of contribution by employer should be exempted, as the same is ultimately exempt in the hands of recipient at the time of retirement or leaving employment.

- Alternatively the threshold of Rs.150,000 needs to be further increased.

Availability of information on web portal

- Currently information relating to goods declaration and tax deducted and deposited from a taxpayer are not visible to the taxpayers on FBR web portal.

- It is recommended that information regarding Goods Declaration (GD) and tax deposited in government treasury should be available on web portal with CPR numbers, for both tax withholding agent and for the person whose tax is withheld and deposited.

- This will significantly reduce efforts and time wastage to collect and produce tax Challans/ certificates to the tax officers. Also this will facilitate in making compliance to the tax notices especially notices u/s 161 or under any other provision of income tax law, the evidence would be readily available.

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**.

Issues in e-filing monthly statements

Revision of withholding statements

- Earlier an option was available for the withholding agents to revise the monthly statement under Section 165 in case there was an omission or incorrect declaration in the original statements. However, such option is not available in the withholding format on IRIS.

- It is recommended that the withholding agent should be given a right to make necessary amendments to report any omission or incorrect declaration in monthly withholding statement.

Issues in e-filing monthly statements

Bifurcation of filing requirements

- In almost all medium and large organizations, previously the statement for salary was being uploaded by HR department whereas the remaining data was filed by the Finance department, however, due to the merger of the two separate statements under the IRIS portal, it is now required to file the entire withholding data on the same module.

- It is recommended that the withholding statement for deduction of tax from salary and for reporting deduction of tax from other than salary should be bifurcated as secrecy of salary data is a prime concern for all organization.

Issues in e-filing monthly statements

c) Requirement to determine finality or adjustability of taxes withheld

- While reporting the taxes withheld by a withholding agent, the IRIS portal requires the withholding agent to declare in the statement whether the tax collected / deducted by him is a final tax or an adjustable tax.

- It needs to be appreciated that finality or adjustability of the tax withheld cannot be determined by the tax withholding agent and he should not be burdened with the responsibility to determine tax liability of the person from whom he is deducting the tax.

- It is suggested to remove the icon in the withholding statement format that requires the withholding agent to declare whether the tax collected / deducted is a final tax or an adjustable tax.

THANK YOU