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World Bank advises harmonised sales tax system

ISLAMABAD: The World Bank has advised Pakistan to introduce harmonised sales tax system across the country to avert incidences of double taxation and reduce compliance costs for businesses.

The World Bank Group, in its latest report, said the current sales tax regime fragments Pakistan into five competing tax jurisdictions. The base is broken up into goods and services with the federal government taxing the former and provincial governments the latter. The base is further broken up spatially, as each province has the power to tax services supplied within its jurisdiction and levy its own tax rates on these services.

"This fragmented nature of the base has caused inter-provincial and federal provincial jurisdictional conflicts resulting in potential double taxation, exporting of taxes to other provinces, and consequently high costs of compliance for businesses," the World Bank said in the report, titled 'South Asia Economic Focus Fall 2019: Making Decentralisation Work'.

"Unfortunately, no common legislative or administrative forum exists to address these issues. It is therefore important that a harmonised sales tax is introduced, along with a national forum that has the power to legislate and address these issues."

The sales tax has always been a shared tax in the country, but after the 18th constitutional amendment in 2010, provinces have established their own tax collecting agencies to collect sales tax on services without systems or procedures to effectively coordinate with one another.

Constitutionally, the sales tax on goods is a federal tax while the sales tax on services is a provincial tax.

Until 2010, both taxes were collected by the federal government, through the Federal Board of Revenue (FBR) for a nominal fee, and the sales tax on services was remitted back to the provinces. After the 7th national finance commission award in 2009 and the 18th constitutional amendment, all provinces established their own revenue authorities to collect sales tax on services and claimed a substantial increase in collection.

"Yet, total sales tax collection by all provinces is still only 0.5 percent of GDP," the World Bank said. "On the other hand, the fragmentation of the base and resulting complexity and jurisdictional issues have significantly raised the costs of compliance for businesses."

The World Bank said three issues: fragmented bases, different taxation principles and high administrative and compliance costs have emerged in the country with five different revenue collecting agencies on sales tax on goods and services. The tax bases are different in each province. Issues also arise between the federal and provincial governments on tax bases, as the definition of goods and services is not clear, and complaints have been raised by both the federal and provincial governments that other agencies are impinging on their tax bases.

The World Bank further said Sindh charges sales tax on many services on the origin principle, while the rest of the provinces charge the tax on the destination principle.

“Given the nature of Sindh as the province with a developed port, taxation at origin of services has led to substantial double taxation when other provinces levy the sales tax on the same service according to the destination principle,” the bank said. “Retaliation by other provinces, either by also using the origin principle selectively or not providing an input tax credit on cross-border purchases have also been reported.”

The World Bank said businesses working across different geographical areas within the country must file up to 60 different tax returns – one per month for each agency.

“This increases compliance costs for firms, hampering overall economic activity. All these issues significantly reduce the incentive for businesses to purchase from other provinces or sell to other provinces, essentially fragmenting Pakistan into five markets,” the World Bank said. “To address these issues, Pakistan could consider converting the current sales tax into a harmonised sales tax on goods and services that allows for effective revenue raising, while not negatively impacting economic activity and investments in the country.”