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FBR detects revenue loss due to misuse of tax expenditures

ISLAMABAD: The Federal Board of Revenue (FBR) has detected revenue loss due to misuse of tax expenditures through potential frauds committed by certain companies/ individuals, wrongly claiming tax exemptions.

According to an FBR report on exemptions 2020, the advantages of tax expenditures are that they promote the private sector participation in the economy and reduce the costs associated with the management of the public spending. Well-targeted tax incentives have been argued to be effective in promoting investment and growth. Among disadvantages, the foremost is the revenue loss for the State and erosion of tax base. Other disadvantages are inefficient allocation of resources in the economy and inequity that the tax expenditures may sometimes promote.

Recent research carried out by the International Monetary Fund, the Organization for Economic Cooperation and Development, the United Nations and the World Bank shows that investors usually do not consider tax incentives to be a decisive factor when considering investments in developing countries.

Tax incentives were often found to be redundant, meaning that investment would have taken place without them. This suggests that even well-designed tax incentives may not be an effective way to address underlying problems that are not tax related, the FBR stated.

There may also be revenue loss due to misuse of tax expenditures through potential fraud. For instance, during compilation of data, FBR has observed that a resident film company is incorrectly declaring its sales proceeds from export of films, on which 1% tax on gross receipts is due, as export of IT services which are exempt. Similarly, many misuses of exemption claims under Section 65D of the Income Tax Ordinance 2001 by industrial undertakings have been detected in recent years, where an existing industrial undertaking takes the guise of a new industrial undertaking to claim tax credit, the FBR added.