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2019-20, FBR shares ST exemption method

ISLAMABAD: The Federal Board of Revenue (FBR) has shared methodology used for calculating sales tax exemptions/concessions worth Rs 518,814 million granted to various sectors / industries/lobbies during 2019-20. According to the FBR report on exemptions-2020, to estimate the tax expenditure, the data of sales tax returns was retrieved from the FBR database. With the help of this data, tax at a benchmark rate of 17 percent was calculated as if these goods were not exempt or zero-rated. The total tax forgone was taken into account as a cost of exemption, and later necessary adjustments were made thereon, to rationalize the estimates.

Adjustments were made on gross estimates to avoid the duplication in the estimations, and include: In case of zero-rated items, the adjustment included leaving out tax expenditure estimation on some items, which if were not zero-rated, the full input tax would have been claimed, such as, crude oil, and machinery for E&P sector. The impact of tax expenditure to the extent of these items was thus deducted from the total estimation of zero rated items. In case of exemption on local supplies, adjustment was made to separate and account for the value-addition part only (of sales volume), instead of calculating tax expenditure on the sales reported by the entire value addition chain.

A critical assumption made is that the average percentage of value addition in case of local supplies is 30 percent. Likewise, in case of exemption on imports, adjustment was made to exclude value of exemption on local supplies to avoid duplication, as otherwise it would have amounted to double-counting because the same products after being imported are supplied locally, FBR added.

In sales tax act, concessions are granted broadly by three ways, i.e. zero rating, exemptions, and reduced rates. The sales tax return of any registered person may not be considered as true and valid return, without mentioning exempt supply, if any. This will help in computing the exemption incidence when exempt supplies are made by various registered persons in supply chain. Industry-ratios and/or standardized minimum value addition formulas may be issued, with the consultation of major industries, to have more accurate and rational estimates, and so that exact extent of value addition in each industry can be estimated, FBR stated.

The FBR stated that out of total exemptions of Rs 518,814 million granted during 2019-20, zero-rating under 5th Schedule to Sales Tax Act 1990 resulted in revenue loss of Rs 13,671million; exemption on imports Rs 255,843 million; exemption on local supplies Rs54,871 million; reduced rates under 8th Schedule (2 percent) Rs 74,008 million; reduced rates under 8th Schedule (5 percent) Rs 8,677 million; reduced rates under 8th Schedule (10 percent) Rs35,452 million other reduced rates Rs 53,138 million and sales tax exemption on cellular phones under 9th Schedule caused a revenue loss of Rs 23,154 million during 2019-20.

The FBR said the benchmark sales tax (ST) base is consumption broadly defined and comprises all taxable goods reported to be consumed in Pakistan. The tax law relates to the levy of tax on the sale, importation, exportation, production, manufacturing or consumption of goods; taxes incurred on the goods exported from Pakistan are refunded. As such, the benchmark for the ST provides that the tax applies on a 'destination basis' — that is, at the point of consumption in Pakistan—and that it applies to goods imported into Pakistan, but not to goods exported from Pakistan.

The scope of calculating sales tax exemption estimates is limited to ST on goods only, as ST on services is a provincial levy and comes under the domain of provinces after the 18th Constitutional amendment in Pakistan. Hence, only tax expenditures of ST on goods are reported.

The benchmark for the ST provides that the tax is imposed using incremental stages of value addition under which tax is imposed at all stages of the production and sales chain. At each stage of production, value addition, or marketing, businesses can claim input tax to recover the ST paid on their business inputs, so that the ST effectively applies only to the value added at each stage. Since the only tax that is not refunded/adjusted is the tax collected on sales to final consumers (output tax), the ST is effectively imposed on final consumption. The benchmark rate structure for the sales tax is the statutory sales tax rate that applies in any given year i.e. 17 percent.