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Glass half empty!

LAHORE: Half cooked tax reforms have stalled automatic increase in revenues. The federal government collects sales tax on goods to tabulate the gross revenues for income tax purposes. It has no record of services tax collected by provinces, denying automatic tabulation.

The spirit value-added tax regime introduced in 1987 was destroyed the year it was introduced because the traders accounting for 16 percent GDP were exempted from the regime, and asked to pay one percent of their annual turnover as total tax liability, (this turnover tax rate continues to fluctuate from 0.5 percent to 1.50 percent).

Even the determination of annual turnover was left to each trader and the then Central Board of Revenue was forbidden to peek into their accounts. The VAT regime is adopted world over to document the economic activity at every step of the value chain.

In textiles, for instance, sales tax on cotton is adjusted when it is converted into yarn. The yarn producer pays sales tax only to the extent of value addition. The weaver then pays sales tax on the value it adds on the yarn. The retailer collects sales tax from the buyer on the profit it earned on actual purchase of fabric.

Similarly, the garment producer pays sales tax on the value addition it achieved on the fabric purchased. There are intermediary stages such as processing of fabric or yarn and a few other minor activities performed by the cottage industry.

They are also required to pay the sales tax on the value they earned through processing. In the same way, the garment retailer is required to pay sales tax on the profit it earned from the customers.

This VAT process is in vogue in documented spinning and weaving industries, but there are missing links in the chain on activities performed by some cottage industries. The fabric to the garment and knitwear industry has all traces of sales tax paid and the garment industry complies with the sales tax laws as far as exports are concerned, but there are gaps or evasion when they stitch or knit apparel of domestic industries.

There is no concept of sales tax at the retail level. The suppliers add the deemed sales tax when they supply their product to retailers / wholesalers. The retailer as such is exempted and the earnings from retail remain obscure.

When a documented industry pays the required sales tax, the Federal Board of Revenue could evaluate the gross revenue of the industry. For instance, if in the textile chain a weaver bought yarn worth Rs100 million that after value addition is converted into Rs300 million it would pay Rs34 million (the spinner had already paid sales tax on Rs100 million) as sales tax value addition at the rate of 17 percent.

The FBR, having the sales tax record, could calculate the gross sales of Rs300 million even before the industry files tax returns. This data effectively eliminates the chances of tax concealment.

The industry would, of course, be allowed duly documented fair manufacturing and administrative expenses for calculating the final income tax liability.

Coming to traders, the impact of sales tax on them would be nominal and that too they would collect from the consumer. For instance, an item sold by a registered company for Rs100 (inclusive of sales tax paid at all stages of production).

If the retailer sells that item for Rs110, the net profit comes to Rs10 and 17 percent sales tax on that amount would only be Rs1.70. The retailer should charge Rs111.70 from the consumer and deposit the sales tax of Rs1.70 to the national exchequer.

The tax has to be deposited on cumulative sales of one month. Retailers know this rule, but to frighten the customers they propagate that sales tax must be collected on Rs110 (sales price) that would increase the price to Rs128.70 from Rs111.70. This way they have aligned consumers (general public) in their support.

Successive governments in the past 33 years had failed to educate the masses about the actual VAT process that is in vogue around the world without any protest or confusion.

The trader would have to pay full 17 percent sales tax on all non-documented purchases. The informal suppliers would cease to exist if the retailers are brought into the sales tax regime. Tax potential in Pakistan is over Rs8,000 billion provided all economic transactions are documented.

Another glaring flaw is in the sales tax collected by the provinces for services. The federal government is mostly in dark about the sales tax on services collected by provinces from each entity.

The FBR could not calculate the gross revenue of a service providing company, if it does not have the record of service tax paid by it to the provinces. This is the reason that though the weight of services in our GDP is 54 percent, the quantum of income tax paid by services is not even 1/4th of the manufacturing sector that has a weight of only 19 percent in our GDP.

A simple law would suffice making it mandatory for all service providers to provide documentary proof of service tax they paid to each province.

Moreover, the federal government should be authorised to instruct service providers such as doctors, lawyers, architects and numerous others to register in their respective services and provide the documentary proof of services sales tax paid by them.