



Neglected tax harmonisation may be the only way forward

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FOR a provincial revenue authority (PRA) to be simultaneously effective and sustainable, it is important that it work in sync with a well-defined provincial tax policy — using taxation as a tool for development and revenue generation by widening the tax base.

To that end key questions regarding the performance of these authorities need to be addressed.

First and foremost, what future do the provinces see for their respective revenue authorities? Will the PRAs meet a different fate than the Federal Board of Revenue (FBR) in consolidating a larger tax base?

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Further, rather than constraining its growth, can PRAs contribute positively towards the services sector? And, are the PRAs working strategically to raise revenue or just responding to rampant need through unsustainable means?

It is important, for the reader to understand, that a province's services taxation can affect multiple sectors, such as manufacturing and agriculture, owing to an increase in the cost of doing business.

A preliminary analysis across all provinces shows that each PRA is still a long way off from introducing a well-thought out tax policy. This indicates a lack of harmonisation of taxes between provinces and the FBR.

The consequences of not introducing a cohesive taxation policy are inconsistent tax rates between jurisdictions; different classification of taxable services; confusion on whether the tax liability calculation is based on origin or consumption, and withholding of sales tax, amongst others.

A glance at how different jurisdictions are taxed highlights the issue of inconsistent tax rates: Sindh taxes services related to businesses at 13 per cent, Punjab charges 16pc and Federal territory charges one per cent.

A direct consequence of varied taxation is the forced migration of businesses between provinces to reduce exposure of taxes. This would imply that businesses will face a de-investment and re-investment cost along with a mobility issue for its employees.

The problem is further aggravated as provinces use different definitions and descriptions for the same services. It is mandatory that all services categories be consistently defined for taxation purposes.

Another critical issue is the considerable overlap in the definition and scope of taxable services. At times, disputes arise due to confusion regarding the appropriate classification of services as companies try to avail exemptions on a service which appears to fall under two or more categories simultaneously.

Therefore classification rules are important as they allow the tax authority to apply taxes knowledgeably, identify a service that need not be taxed, or allow a business to avail tax exemptions specific to it. It also enables a service to determine the date from which a tax may be due in cases where one category attracts taxes from an earlier date than that of the other.

All PRAs, hence, need to come together and stream line the classification of taxable services.

A third issue is that all PRAs state that a service provided by an individual from their registered office or place of business in a province is taxable in the same province.

At the same time, it is provided that if a service is rendered by a resident of one province and consumed by the resident of another province, the person residing in the province where consumption is made is required to pay tax in that province. But as sales tax is a value-added tax it should be properly paid to the province where consumption is made.

At the moment, since there is a lack of clarity on this issue, in most cases the businesses are facing the brunt by receiving duplicate notices from different PRAs. There is thus a strong need to correctly enforce correctly the

rights of the provinces and establish taxes on the basis of consumption to avoid double taxation and keeping cost of doing business low.

Coordination and harmonisation between provinces is not the only issue; there is also an ongoing problem of classification and value addition with the FBR imposing an additional sales tax on goods.

For example if a garment factory receives an order of 10,000 shirts and decides to sub-contract with another factory, it gets charged a service tax on the entire value of the goods under the sub-contract. In addition, the FBR will levy a sales tax for goods on the same contract resulting in double taxation. The cost of doing business therefore increases.

The existing rate of sales tax at 16pc is one of the highest in the region with an average of around 12pc in Asia (15pc in Bangladesh, 10pc in Indonesia and just 6pc in Malaysia). A sales tax should be used to broaden the tax base and not as a replacement for direct taxation.

Furthermore, under the third schedule of Sales Tax Act, GST has been charged on retail price rather than the ex-factory price. There should also be uniformity and certainty of an affordable GST on service rate.

The above examples are just a few of many inconsistencies that currently exist in the provincial services tax regime in the country.

It is extremely important that all the provinces move towards a more harmonised system of taxation and each PRA work towards developing a holistic provincial tax policy. If appropriately managed there is an immense scope for raising provincial revenue.

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