TheNetwork
for Consumer Protection

TaxWatch Tax Justice Campaign

September 2014

- Penalty may be imposed FBR to declare incomplete income tax returns as 'invalid'
- Brief recordings"Take the big move, do away with SROs,"
- Charge sheets issued to two-dozen of customs officers
- Shopping malls FBR tells RTOs to compulsorily register retailers
- Incorrigible elites
- FBR BIC takes major administrative decisions, approves Audit Policy 2014
- Misuse of Pak-China FTA Rs3.4bn tax evasion unearthed in clearance of fabrics
- Chaos and complexities in international taxation
- Democracy and taxes
- 5pc levy Nmber of cos paying bonus shares declines: FBR
- On tax cuts and long-term growth
- New return form Taxpayers bound to declare agri tax paid to provinces
- Compulsory convertible debenture and their status under income tax laws
- FBR picks 77,500 cases for audit in six categories
- Compulsory convertible debenture and their status under income tax laws
- Issues in tax returns, wealth statement highlighted
- Number of non-filers to be reduced: New benchmarks set for LTUs, RTOs
- New rules for filing of tax returns notified
- Rs2,810bn revenue target too ambitious: report
- Tax reforms body constituted
- Pakistan can seek data from Swiss banks in revised treaty
- Govt collects Rs600bn from oil, gas sector

The government has constituted a tax reforms commission in September 2014 with a mandate to give proposals within four months for upgrading the current taxation system and resolving issues to facilitate taxpayers. The 20-member commission will also review, among other crucial issues, the scaling down of sales tax rate to single digits and changes in the field formation of the income tax department by reverting to the old circle based system from the current functional lines. The commission shall undertake, review and rationalise direct and indirect taxes; rationalise customs tariff; review autonomy and administrative structure of FBR and create border force to deal with illegal movement of persons and goods across the international borders. However, government constitutes reforms commission, but it could not implement its recommendations in litter and spirit. Most of the recommendations of the past commissions remained only on papers. With the falling tax compliance, Federal Board of Revenue has selected 77,500 income tax returns for audit for the tax year 2012-13. The selected cases comprise eight per cent of the total of 970,537 returns filed during the tax year 2013. This seems to be a major administrative decision by selecting cases for audit, which was suspended for the past many years. In September 2014, FBR has taken several measures for encouraging people to file tax returns for the tax year 2014. These measures include establishment of 200 tax facilitation kiosks for filing of income tax returns across the country, where maximum number of taxpayers can avail the facility. In this background to improve enforcement of the tax laws, FBR has also set new benchmarks for the Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs) to reduce the number of non-filers/short-filers of returns below one percent in LTUs, less than 10 percent medium size non-filers and below 25 percent small size non-filers in RTOs. This bench marking was made to broaden the tax base. The plan aiming to increase the number of income tax and sales tax return filers during 2014-15. FBR is all set to increase the number of return filers this year to over one million marks, but it has yet to remove the deficiencies in the income tax return and wealth statement for the year 2014 uploaded on FBR's website. Tax returns on the FBR`s website also have many columns missing needed to give basic information about taxpayers, like date of birth, gender identification, name of employer, and column for exempt income. Instead of removing these deficiencies, FBR has decided to declare income tax returns for Tax Year 2014 as 'invalid' on which National Tax Number (NTN) or computerised national identity card numbers (CNICs) are missing or incorrect and penalty would also be imposed in case of 'invalid' returns. At the same time, FBR has also made it mandatory for the taxpayers to declare agriculture income tax paid under the new income tax return form issued for individuals and association of persons to grasp issue of the agriculture income tax paid in respective provinces. Withholding agents are facing difficulties in withholding different rates of taxes from return filers and non-filers clients. FBR and banks have failed to resolve the issue of withholding tax on cash withdrawal from income tax filers and non-filers despite lapse of three months. Banks are facing problems in identifying the persons who had filed income tax returns during the last year. As per decision, banking companies are required to deduct 0.3 percent on cash withdrawal of Rs50, 000 from a person who had filed income tax return in the last tax year. However, the rate is 0.5 percent from a person who is a non-filer. As part of the much-awaited decision, Pakistan and Switzerland have pencilled a revised Avoidance of Double Taxation treaty in September 2014 that will allow Islamabad to seek information for tax purposes about money deposited in Swiss banks. Finance Minister Ishaq Dar told the National Assembly that at least $200 billion of `Pakistani money` was stashed away in Swiss banks. Although, the amended treaty would be formally signed in the first quarter of next year and it would take at least one more year to enforce it. The major difference between the July 2005 treaty and the revised one is the adoption of updated Article 26 of the Model Tax Convention of the Organisation for Economic Cooperation and Development (OECD). According to the Article 26, competent authorities of contracting states will exchange such information as is foreseeably relevant for applying provisions of the Model Tax Convention or to the administration or enforcement of domestic laws concerning taxes of every kind and description imposed on behalf of the contracting states. So far, Pakistan has no legal instrument available to ask Swiss banks to provide information about tax evasion.

Table on Audit for the tax year 2012-13

Type	Total cases	Selected	Percent
Income Tax(corporate)	25,046	1,876	7.49
Income Tax(non-corporate)	840,675	63,050	7.58
Sales Tax(corporate)	11,757	1,410	12
Sales Tax(non-corporate)	92,455	11,095	12
FED(corporate)	402	45	11.2
FED(non-corporate)	202	24	11.89

Penalty may be imposed FBR to declare incomplete income tax returns as 'invalid'

RECORDER REPORT

ISLAMABAD: The Federal Board of Revenue (FBR) has decided to declare income tax returns for Tax Year 2014 as 'invalid' on which National Tax Number (NTN) or computerised national identity card numbers (CNICs) are missing or incorrect and penalty would also be imposed in case of 'invalid' returns.

In this regard, the FBR has issued new Income Tax Return/Wealth Statement Forms for Individual/AOPs for Tax Year 2014, directing the taxpayers to file separate Reconciliation Statement in case Wealth Statement is filed for the first time.

Under the new return form, five kinds of errors/omissions shall render a Return invalid & make the taxpayer a non-filer & liable to penalty under section 182(1) of the Income Tax Ordinance, 2001. The invalid return forms include those on which NTN or CNIC is missing, incorrect or invalid; return on which mandatory fields marked by '*' are empty; return which is not signed by the taxpayer or representative (as defined in section 172 of the Income Tax Ordinance, 2001) of the taxpayer; return that is not filed on the prescribed Form and return which is not filed in the prescribed mode.

According to the instructions for filling in Return Form and Wealth Statement issued by the FBR, the individuals deriving income under the head Salary have to file one page IT-1A Form with Annex-F & Wealth Statement if required to be filed.

The individuals deriving income under the head Salary, Property, Capital Gains & Other Sources (excluding Business) & Income subject to fixed / final tax have to file one page Return in IT-1B Form with Annex-A, Annex-F & Wealth Statement if required to be filed.

The FBR said that individuals deriving income under the head business or falling under Final Tax Regime (FTR) such as Commercial Importers, Exporters, Contractors, etc. have to file two-page Return in IT-2 Form with Annex-A, Annex-B, Annex-F & Wealth Statement if required to be filed. Annex-C, Annex-D & Annex-E are required only where Depreciation / Amortization, Admissible/ Individuals, including members of AOPs or directors of Companies, whose last declared or assessed income or declared income for the current tax year is equal to or more than Rs 1,000,000 or the final tax paid is equal to or more than Rs 35,000, must file Wealth.

The AOPs deriving income under the head business or falling under Final Tax Regime (FTR) such as Commercial Importers, Exporters, Contractors, etc. have to submit IT-2 Form with Annex-A & Annex-B. Remaining Annexes (C, D, E) are required only where Depreciation / Amortization, Admissible / Inadmissible Deductions & Minimum Tax Chargeable / Option out of Presumptive through the following modes: AOPs deriving income under any head other than business have to file one page IT-1C Form with Annex-A.

Electronically at FBR Portal (https://e.fbr.gov.pk) which is mandatory for all AOPs, Sales Tax Registered Persons, Refund Claimants & Salaried Persons having annual income of Rs 500,000 or more. However, all others are also encouraged to file the returns electronically; manually on paper at Taxpayer Facilitation Counter of the respective Regional Tax Office. Paper Return Form can be downloaded from FBR Website http://www.fbr.gov.pk.

Taxpayers may seek guidance through the following modes: By calling Helpline 0800 00 227, 051 111-227-227; by visiting the nearest Taxpayer Facilitation Centre (TFC), list of which can be downloaded from FBR website at http://www.fbr.gov.pk

The tax can be paid in any authorised branch of NBP & SBP at any time before filing of return. List of authorised braches of NBP & SBP can be downloaded from http://www.fbr.gov.pk.

The FBR said the arrears of salary are to be included in amount declared in Col 'A' and again included in amount declared in Col 'B'.

Flying / Submarine Allowance is to be included in amount declared in Col 'A' and again included in amount declared in Col 'B'. Transport Monetization for Civil Servants to be included in amount

declared in Col 'A' and again included in amount declared in Col 'B'. Employment Termination Benefits to be included in amount declared in Col 'A' and again included in amount declared in Col 'B'.

The FBR said that only Foreign Income (Not Loss) should be declared. Only Agriculture Income (Not Loss) should be declared.

Tax Credits include Tax Credits for the following:- Share in Taxed Income from AOP and charitable Donations u/s 61.

The investment in Shares of Public Companies listed on a Stock Exchange in Pakistan (only for Original Allottee other than a Company) u/s 62; contribution to Approved Pension Fund (only for Pakistani Individual registered with FBR / NADRA deriving income from Salary / Business) u/s 63; property u/s 64.

The FBR said taxpayers wanting to opt out of Presumptive Tax Regime (PTR) u/c (41A), (41AA) or (41AAA), Part IV, Second Schedule, must file Annex-E.

The FBR said only Personal / Household (Non-Business) expenses should be declared.

Expenses borne by more than one person must be declared in total by each person. For example, if in one family more than one member are contributing to expenses or if more than one family are living jointly & within each family more than one member are contributing to expenses, total expenses under each head must be declared by each member of each family, FBR said.

If rows provided in any segment are inadequate, additional rows may be inserted.

All assets must be declared at cost, including ancillary expenses. If an asset is acquired under a Hire Purchase Agreement, total price should be declared as asset under the appropriate head & balance payable amount should be declared as liability.

If Wealth Statement is filed for the first time, separate Reconciliation Statement must be filed for each previous year.

The FBR said the equipment, Plant, Machinery (Non-Business) must be declared with description, for example, Generator, Tubewell, Harvestor, Tractor, Trolley, etc.

The FBR added that assets created in the name of spouse(s), children & other dependents should be declared only if acquired by them with funds provided by you (Benami Assets), according to the new return form.

Business Recorder
2nd September, 2014

Brief recordings"Take the big move, do away with SROs,"

Dr Hafiz Pasha

Ever since the ongoing political crisis began, day to day economic decision making by the government seems to have taken a backseat. So has all the talk of reform. Yet the need for taxation reforms remains an uber-important agenda that should be on the government's things-to-do list as soon as it comes of the current crisis, whenever that is.

Below are the edited transcripts of a recent sit down with Dr Hafiz Pasha, former finance minister and a renowned economist. In this interview with BR Research, Pasha sheds light on taxation, putting SROs, presumptive tax regime under a close lens. BR Research: You were one of the brains behind the presumptive tax regime. Tell how and why you originally conceived it.

Hafiz Pasha: It was a part of the reform process that began in the first tenure of Nawaz Sharif. It was run through a commission called Resource Mobilization and Tax Reform Commission, and then in Sharif's second tenure, we carried it a bit further.

The basic idea was to achieve two results. One, to reduce the transaction cost of taxpayers in terms of filing returns and so forth, and that is why some of the reform was oriented towards presumptive taxes which are fixed and final. Secondly, and most importantly, the idea was to capture the unearned income i.e. capital income, which had essentially been escaping the tax net
Under the original plan, this was seen as a transitional arrangement, the idea was that through the various sources that we were able to tap through WHT, we were hoping to build up a database which would then act as collateral evidence at the time of assessment, so that we would know who has earned how much from which source.

Therefore, we set up an organization called the Pakistan Revenue Automation Ltd, which was a kind of a subsidiary of the FBR, charged with a mandate of building the database. The idea was that we would gradually move from a WHT regime to a documentation-based, return-based regime. Meanwhile we would collect all the evidence and know who is getting unearned income and all.

The second stage came in the second tenure of Nawaz Sharif, where it was decided that we tax the 'proxies for income' not necessarily streams of income, so that we would get further evidence about it. The first major move that was made was the WHT on electricity only on large industrial and commercial consumers, because electricity is a good indicator of volume of production.

BRR: How and why it has morphed into present shape then?

HP: What has happened is that we have carried this too far beyond taxation of unearned income and income proxies. We have carried it to the point where every transaction is now being subjected to WHT. We have the largest WHT regime in the world, in terms of number of points of taxation. This year they have gone further and complicated it by creating a differentiation between so called compliant tax payers and non- compliant tax payers. This is had made life difficult for WHT agents.

I am in favour of transiting now to move to a more sophisticated WHT regime so that we get more documentation. Instead what they have done this year is a 180 degree turn from last year's strategy.

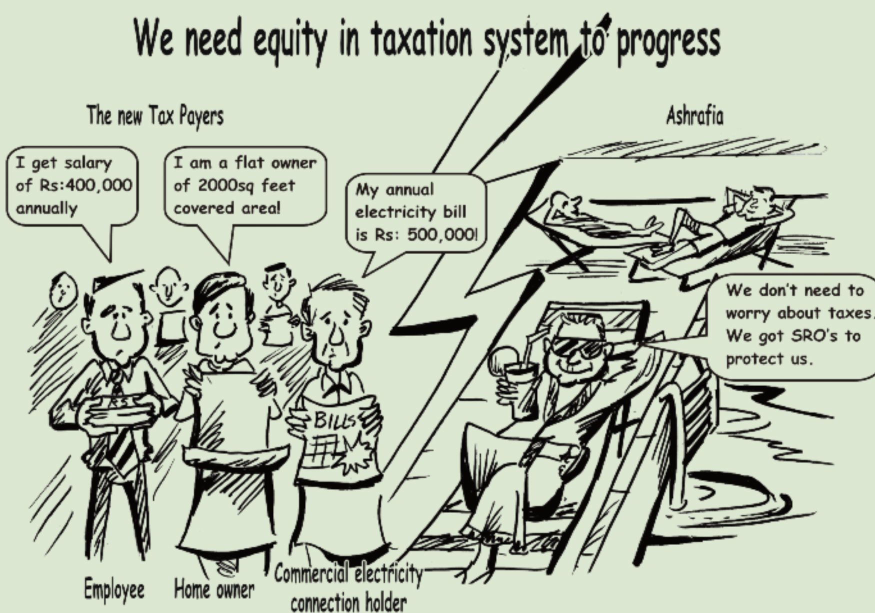
The last year's strategy's was that we had identified about 3 million taxpayers, from collateral evidence from NADRA and other sources, who should be filing returns but are not. Many of these actually also had NTNs. Later, however, a campaign was launched that was an abysmal failure. The end result is that they have completely abandoned that strategy and shifted to this new strategy of using the WHT regime with higher rates, penal rates to induce to induce non-filers to compliance.

BRR: How exactly is it hurting the economy?

HP: We are at a point where the WHT regime has become regressive. The old first generation part of the WHT regime remains extremely progressive. So for instance, taxation of unearned capital income is not regressive, because the poor man is not getting any dividends or profits etc. because he doesn't have the wealth to generate unearned income.

It's the subsequent developments where we started using proxies to get a handle on income. For example, one very regressive part of the WHT regime is the 15 percent WHT on telephones. That is completely unacceptable because today in Pakistan, we have over 130 million phones. Even the common man has it, so charging 15 percent on it is absurd.

The regime is also becoming regressive, because of very high rates. When we first brought this on electricity, it was rupee amounts with different slabs, it was not at ad valorem, it was just like 30, 40, 50 rupees etc. Now they have made it ad valorem and on industry particularly it is regressive because it gets shifted from them.



BRR: Let's talk about the SROs. How bad are these SROs?

HP: The real problem is not so much in the SROs as in the law. In particular, the Income Tax Ordinance is replete with hidden exemptions and concessionary treatments; the entire second schedule is devoted to giving concessionary exemptions.

For example, and it's a sensational example, take the case of capital gains on shares at the time of General Musharraf, when we exempted capital gains on shares when in fact the market was booming. And guess what happened, we created a new class of capitalists. Historically the capitalists in Pakistan in the 60s came from trade and industry. We have now created a new class of capitalists which comes from the stock market from various sectors because they made a killing. According to my estimates, exemption on capital gains cost us Rs100 billion, and that is a very conservative estimate.

Then there is issue of big breaks in direct taxes. In mid-90s, when the IPPs were being attracted, they gave a lifetime income tax exemptions to the entire IPPs set. Have you ever heard of this? There could be a tax holiday for 5 years, 10 years but here we gave them an indefinite holiday. Do you know how much that are costing us: Rs60 billion!

Or take the case of the second schedule where allowances of corps commanders are exempted! Why are the army chiefs, and the corps commanders, and the Supreme Court/High Court judges and the President of Pakistan, the PM, the federal ministers are all getting special tax treatments! This is a violation of equality of citizens in law. They should be the first ones to pay.

BRR: How much do these exemptions cost? The government's last economic survey puts the number at Rs477 billion. What's your assessment?

HP: The number they have mentioned is grossly underreported. The composition of that is incorrect. Eighty percent of those tax expenditures that they have reported are indirect taxes and only 20 percent are direct taxes. The actual position, based on research by my students, is that the total tax expenditure in Pakistan is at least Rs600 billion and out of that Rs600 billion, about Rs325 billion, or about more than 50 percent, is direct taxes. I have already explained how they are understated and how they have

missed out on the direct tax benefits which benefit the rich and the powerful.

BRR: Coming back to SROs. When did the culture become institutionalized and where does it hurt the most?

HP: The loss of revenue due to SROs is less in customs duty due to zero duty items, i.e. the non-dutiable component of imports is larger than dutiable component.

The peak in SROs came during the period of PM Shaukat Aziz. In 2006, three or four concessionaries were introduced in which there were up to 600-800 items. In each SRO, there were hundreds of concessionary items. And what did they proudly call this: 'umbrella SROs', implying we are institutionalizing SROs. We have carried SROs to the point that the law has become redundant. Sales tax act has so many holes. The sales tax act of 1990 has become a piece of paper, while the SROs dominate. The largest number of SROs is in import sales tax.

BRR: These umbrella SROs that Shaukat Aziz introduced, can you please give some examples of these?

HP: Basically, there was one SRO 655 which dealt with the automobile sector, and then there was another with the number 756, which dealt with a very wide assortment; there were about 38 industries in that.

BRR: Which sectors enjoy the most benefit in terms of SROs?

HP: Textile, pharmaceutical and automobile sector. The latter is the single most pampered sector in Pakistan in SROs.

First of all, the government has set their statutory duty very high and then concessionary duty on sub components, assembly, raw material, parts and so on so forth. The difference between the statutory duty and the concessionary duty is the largest in the automobile sector. And what we see in Pakistan is the quasi-licensing regime. Who licenses the imports of the automobile sector? An organization, which I created and I've regretted ever since then, an organization called the Engineering Development Board. They have to certify these imports.

BRR: Which type of SROs should go away first and what should be the next logical step?

HP: First, the essential foods, i.e. chapters 1-23 of the Harmonized Codes should not be touched. For the rest, we have to take the big move and remove all of them and bring down the tariffs.

BRR: How are these exemptions in the second schedule and SROs distributed across sectors, services, agriculture, and manufacturing?

HP: There are two things which have gone wrong. One is that under law you don't give exemptions by name; you give exemptions to a class of persons or to a category of persons. For instance, you do not give an exemption to XYZ Hospital or ABC firm; you give exemptions to a category so everybody who qualifies that criterion heeds it. The defect with the second schedule is that at many times it has given exemptions to specific firms with names. So the law has to be changed; instead of names we need to have classes.

Second, in the SROs and sometimes in the income tax law, changes have been made arbitrarily by the executive. That is a violation of parliamentary approval. Any exemption, if so granted, ought to go through the parliament. And then in the law, there is a provision that even if you don't take it to the parliament, then at the end of the year all SROs promulgated have to be put together and placed before the legislature. But they have never done that before either, except for this last year. So in order to make the process more transparent and accountable, the single most important job of the parliament is the money business, which relates to taxation matters and expenditure. This function cannot be taken away by the executive.

BRR: What kind of implication the withdrawal of SROs might have? Would it lead to capital flight?

HP: Well you have to look at the phenomenon of FDI in this country. Unlike most other countries, Pakistan has had FDI almost entirely in import substituting activities. Pharmaceutical, telecom, and so on. So the bottom line is that because of our import duty structure and the fact that to attract FDI we gave too high a protection wall either by raising the taxes on domestic production or by reducing the import duty on inputs, we made FDI profitable in import substituting activities. How much FDI has come in our export sectors, particularly textiles? Virtually nothing.

Business Recorder
8th September, 2014

Charge sheets issued to two-dozen of customs officers

MUHAMMAD ALI

KARACHI: The Federal Board of Revenue (FBR) has issued charge sheets to around two dozens customs officers for their alleged involvement in the wrong clearance of over 50,000 vehicles under Amnesty Scheme, 2013;

According to sources, the Directorate General of Post Clearance Audit (DGPCA), which had initiated the inquiry against these customs officers, expressed suspicion over their role in the clearance of over 50, 000 vehicles under the scheme. A two-member committee has also been constituted to investigate further in the case.
Moreover, sources said the FBR had now

issued charge sheets to these customs officers including three collectors, three additional collectors and four assistant collectors for their alleged involvement in the wrong clearance of vehicles during amnesty period.

They said that it had been notified that motor vehicles having non-tampered engine or chassis numbers, which had been seized or voluntarily presented to customs department, shall not be allowed release without physical inspection and payment of redemption fine along with duty and taxes.

However, applicants, who were required to get physical inspection of the vehicle done for availing tax amnesty, were allowed to regularize their non-duty paid smuggled vehicles without said requirement against undue gains, they maintained.

Sources further said that customs officers were accused of doing 'under the table settlement' for granting tax amnesty on those vehicles, which were physically not present in the country during amnesty period.

When contacted, official sources on a condition of anonymity confirmed that charge sheets had been issued to the customs officers for their negligence in the clearance of vehicles during Amnesty Scheme 2013.

Official sources informed that these customs officers had been accused of clearing ghost vehicles during amnesty period and also involved in system manipulation to get undue gains. They further said that they had now been asked to submit their reply by September 10, 2014 and clarify their position.

Business Recorder
3rd September, 2014

Shopping malls FBR tells RTOs to compulsorily register retailers

RECORDER REPORT

ISLAMABAD: Expressing serious concern over sales tax registration of only 83 retailers in July-September (2014-15), the Federal Board of Revenue has directed all Regional Tax Offices (RTOs) to compulsorily register retailers, resisting special teams of tax officials in shopping malls/commercial centres across Pakistan.

In this connection, the FBR has issued instructions to the Chief Commissioners of RTOs on sales tax registration of tier-I retailers.On the conclusion of a meeting held at the FBR House on Monday, the FBR noted with serious concern over the pathetic performance of certain RTOs regarding sales tax registration of retailers (tier-I retailers) during first quarter of 2014-15. Out of total identified over 7,500 potential retailers for registration by the RTOs, the total registration stood at 83 during first quarter of 2014-15.

Some of the RTOs which failed to even register a single retailer (tier-I retailers) July-September (2014-15) are RTO Islamabad, RTO-II, Karachi, RTO-III, Karachi, RTO-Hyderabad and RTO Quetta during first quarter of 2014-15, sources said.According to the FBR, following is the RTO-wise retailers registered during July 1, 2014 to September 2: RTO-I, Karachi, registered 13 retailers; RTO-II, Karachi zero registration; RTO-III, Karachi, zero registration; RTO-I, Lahore, registered 12; RTO-II, Lahore, registered 5; RTO-Hyderabad zero registration; RTO, Sukkur, registered 10; RTO, Quetta zero registration; RTO, Multan, registered 14; RTO, Faisalabad, registered 4; RTO, Gujranwala, registered 1; RTO, Sialkot, registered 2; RTO, Rawalpindi, registered 1; RTO, Islamabad zero registration; RTO, Abbottabad, registered 5; RTO, Peshawar, registered 2; RTO, Sargodha, registered 3 and RTO, Bahawalpur, registered 11 retailers during first quarter of 2014-15.

The FBR has directed the RTOs that refer to the Sales Tax & Federal Excise Budget Instructions dated 01 .07.2014, specific instructions as well as Sales Tax General Order No. 66/2014 and to say that in the meeting held in FBR, a very serious view was taken of the performance of the RTOs with reference to sales tax registration of Tier-I retailers.

The statement showing RTO-wise registration of retailers during the period from July 1, 2014 to September 2, 2014, which shows that in many RTOs having jurisdiction over major commercial centres, the pace of registration is very slow. On the other hand, the RTOs themselves have identified over 7,500 potential retailers for registration.

In view of this, the RTOs are, therefore, required to expedite their efforts, send teams to the shopping malls and commercial centres, hold meeting with the concerned associations or trade bodies, gather information, persuade the retailers and ultimately register them within the shortest possible time. Retailers who avoid or resist sales tax registration are to be registered compulsorily under section 14 of the Sales Tax Act, 1990 read with rule 6 of the Sales Tax Rules, 2006.The updated RTO-wise position of registered retailers will be considered by the Board in the next meeting. It is, therefore, requested to take all necessary steps to present a better position by then, FBR's instructions added.

Under new tax regime, the first tier comprises of retailers of the categories specified in rule 4 of the Rules as indicated, who are required to be registered, shall charge sales tax at the standard rate (or on other prescribed rates such as those provided in SRO 1125(1)/2011), and otherwise observe the provisions of the normal regime of sales tax. These included a retailer operating as a unit of a national or international chain of stores; a retailer operating in an air-conditioned shopping mail, plaza or centre, (excluding kiosks); a retailer who has a credit or debit card machine; a retailer whose cumulative electricity bill during the immediately preceding twelve consecutive months exceeds rupees six hundred thousand and a wholesaler-cum-retailer, engaged in bulk import and supply of consumer goods on wholesale basis to the retailers as well as on retail basis to the general body of consumers.

The remaining retailers fall within the second tier, and shall be charged sales tax at rates specified in section 3(9) of the Act through their electricity bills.

Business Recorder
9th September, 2014

Incorrigible elites

Huzaima Bukhari and Dr Ikramul Haq

The overwhelming majority of poor and helpless voters—many of them victims of worst floods this year as well after listening for days to marathon speeches of their representatives in the joint sessions of Parliament have come to the conclusion that the present system favours and protects the privileged classes alone. There is no doubt left in their minds now that resources of this country are not meant for them. What really has offended them is apathy of Parliament members towards their plight, looking down upon demonstrators and even referring them as ghussbathhiay (infiltrators) and khanabadosh (gypsies).
Our ruling elites—indomitable militro-judiciary-civil complex, inept public office holders, greedy businessmen-turned-politicians and powerful absentee landowners in the name of democracy and constitution blatantly usurp rights of the people and enjoy a lavish life at the expense of taxpayers' money. They indulge in self-righteousness, self-praise and infighting for acquiring more and more power and money by all means. They are captives of self-interest and victims of self-aggrandisement. The concentration of power and wealth in their hands, coupled with lust for control, frequently give rise to institutional confrontations and civil commotion. The confrontation between Nawaz Sharif and duo of Imran Khan and Tahirul Qadri should be seen in this perspective it is not at all for change of system assuring empowerment of the people which is conspicuous by its absence in Khyber Pakhtunkhwa where Pakistan Tehreek-e-Insaf is ruling in collaboration with Jamaat-e-Islami and to date, local body elections are not held.

The politics of dharnas (sit-ins) has at least highlighted important issues like grabbing of public property and non-payment of taxes by the elites. They get many tax-free perks and benefits while the poor die of hunger, floods and diseases. Imran and Tahir have rightly highlighted these facts in

their daily sermons. Hopelessly, the members of Parliament have been trying to refute the incontrovertible facts by resorting to rhetoric and self-claimed defenders of democracy and constitution. How can they deny the fact that bulk part of taxes is shamelessly wasted on their luxuries? They enjoy palatial bungalows, fleets of cars, army of servants, foreign tours and what not, but pay meagre income tax. Despite clear instances of corruption and misuse of powers, no action is taken against them by any agency or court of law. This has discredited the entire system and people are totally disillusioned with the present system of governance and dispensation of justice.

Millions not chargeable to tax under the income tax law are paying 14% income tax at source as prepaid mobile subscribers. Funds unlawfully extorted from their hard earned money are spent on the elites—the daily/travelling allowances and benefits in kind of members of Parliaments annually run in billions. The civil-military-bureaucracy, ministers, state ministers, advisers, senators, MNAs and MPAs together squander billions every year on perks and perquisites alone. Not only this, the elites do not pay a single penny tax on plots and benefits they receive in utter violation of section 13(11) of the Income Tax Ordinance, 2001 ["the Ordinance"], which says:

"Where, in a tax year, property is transferred or services are provided by an employer to an employee, the amount chargeable to tax to the employee under the head "Salary" for that year shall include the fair market value of the property or services determined at the time the property is transferred or the services are provided, as reduced by any payment made by the employee for the property or services".

Section 2(22)(c) of the Ordinance defines words "employment" to include public office holders as well. It says:

"employment" includes–

(a) a directorship or any other office involved in the management of a company;

(b) a position entitling the holder to a fixed or ascertainable remuneration; or

(c) the holding or acting in any public office.

Section 14(b) of the Ordinance defines "services" to include the provision of any facility" and the concept of "fair market" is defined in section 68 as under:

"68. Fair market value.– (1) For the purposes of this Ordinance, the fair market value of any property or rent, asset, service, benefit or perquisite at a particular time shall be the price which the property or rent, asset, service, benefit or perquisite would ordinarily fetch on sale or supply in the open market at that time.

(2) The fair market value of any property or rent, asset, service, benefit or perquisite shall be determined without regard to any restriction on transfer or to the fact that it is not otherwise convertible to cash.

(3) Where the price referred to in sub-section (1) is not ordinarily ascertainable, such price may be determined by the Commissioner".

Section 39(1)(j) of the Ordinance is also attracted which declares the following as income chargeable to tax:

"The fair market value of any benefit, whether convertible to money or not, received in connection with the provision, use or exploitation of property".

It is worth mentioning that during the time of PPP government, an ex-Member of Board wrote a letter to the then Finance Minister that massive tax evasion/loss of revenue had occurred due to non-taxation of benefits given to some powerful elements in violation of law. As expected, no action has been taken on his letter as of today. It is sad to note that elites not only thrive on taxpayers' money but also blatantly violate tax provisions. The solution is consolidated pay package for all after deduction of tax instead of tax-free perks and benefits. This will save billions and also bring millions more to national kitty.

The unholy alliance of privileged classes is the main cause of our maladies. The worst thing is that no system of accountability exists that could take them to task. The judiciary and institutions that are supposed to take cognizance and punish them are themselves party to this ugly game of enjoying a number of benefits that are taxable under section 13(11) of the Ordinance but no tax is paid. National Accountability Bureau and Federal Board of Revenue (FBR) are not at all interested in recovering tax from the powerful elites as their top notches are beneficiaries of tax-free benefits as well. Ruling elites tax the weaker sections of society, but are not paying due taxes on their unprecedented and exorbitant perquisites and benefits, which they should not even get. No such precedent exists in any true democracy of

the world.

Like his predecessors, the present Chairman FBR on assuming charge in 2013 pledged to tax three million rich people who never filed tax returns. However, he has failed to recover tax even from elites in respect of benefits taxable under section 13(11) of Income Tax Ordinance, 2001. He has, thus failed to convince citizens that FBR means business and nobody is above law. Since the rich and mighty are not taxed, the common people argue as to why they should discharge their tax obligations, especially when the State has failed to protect their lives and property, what to talk of providing basic facilities of education, health, housing and transportation.

(The writers, tax lawyers and partners in law firm, HUZAIMA & IKRAM, are Adjunct Faculty at Lahore University of Management Sciences)

Business Recorder
12th september, 2014

FBR BIC takes major administrative decisions, approves Audit Policy 2014

SOHAIL SARFRAZ

ISLAMABAD: The Board-in-Council (BIC) of the Federal Board of Revenue (FBR) taking a major administrative decision empowered the Collectors of Customs and Chief Commissioners to initiate disciplinary proceedings against corrupt customs and Inland Revenue officers up to Grade 16 without prior approval of FBR.

Sources told that the Board-in-Council chaired by FBR Chairman Tariq Bajwa has also approved the Audit Policy 2014 for Tax Year 2013/Tax Period 2013.

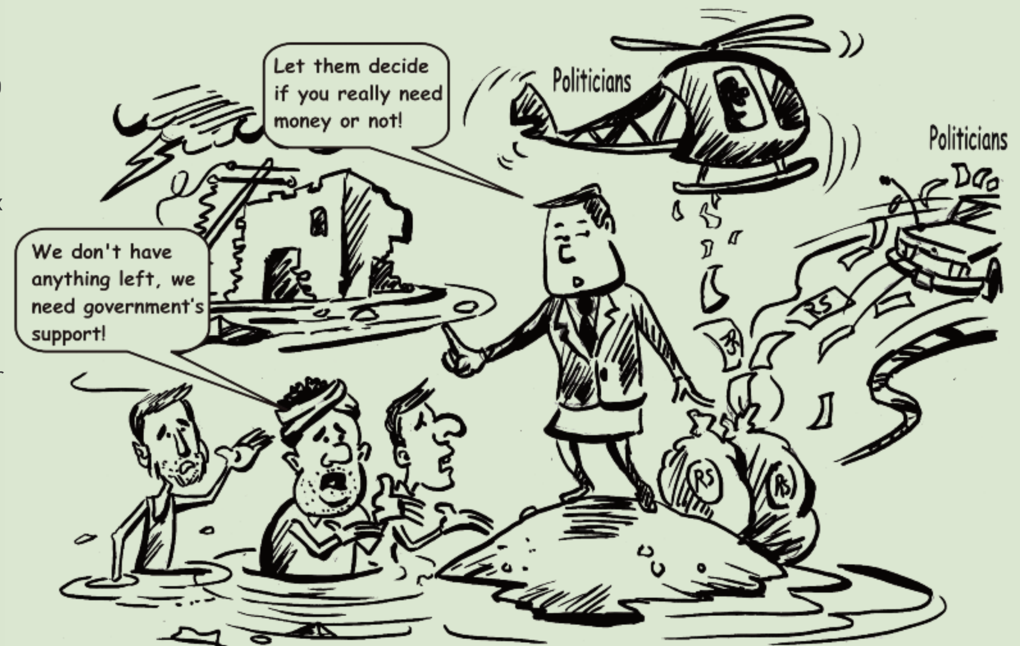
According to sources, Board-in-Council approved enhancement in the administrative powers to Collectors of Customs and Chief Commissioners after a detailed discussion on the actions to be taken against the corrupt tax officers in the field formations. Collectors of Customs and Chief Commissioners would be empowered to take administrative action against all designations up to Grade16. Collectors of Customs can now take disciplinary action against the customs officers up to Superintendents of Customs. Similarly, Chief Commissioners would have the authority to take action against the officers of IR up to Grade-16.

Explaining the impact of the decision, sources said that the Collectors of Customs and Chief Commissioners would have the legal authority to suspend any corrupt officer, conduct inquiry and even impose major penalty of dismissal from services under E&D Rules 1973, if necessary. Now, the heads of the field formations can timely complete disciplinary proceedings against the corrupt tax officers up to grade16.

The Board-in-Council approved procedure for carrying out computerized random balloting for selection of audit cases for Tax Year 2013. The FBR Member (Taxpayers Audit) gave a presentation on the "Audit Policy 2014 for Tax Year 2013/Tax Period 2013".

The Board-in-Council also approved renaming of the post of Chief Coordinator of Data Processing Centre as Director General and renaming of post to director general (broadening of tax base).

Business Recorder
11th september, 2014



Misuse of Pak-China FTA Rs3.4bn tax evasion unearthed in clearance of fabrics

SOHAIL SARFRAZ

ISLAMABAD: The Directorate General of Customs Intelligence has unearthed glaring illegalities/irregularities in the clearance of imported fabrics through misuse of Free Trade Agreement (FTA) between Pakistan and China and SRO 1125(1)/2011 involving evasion of duties and taxes worth Rs 3.4 billion.

Sources told that the detection made by Lutfullah Virk Director General Customs Intelligence is an eye opener for the Federal Board of Revenue (FBR) to immediately rectify the systems and procedures. Lutfullah Virk also gave some viable suggestions including policy changes, directing that the import of fabrics under notification SRO 1125(1)/2011 should be subjected to quantitative restrictions. The proposed amendments to the tax laws and incorporation of suggestions of DG Customs Intelligence might have saved billions spent on the import of fabrics. The analysis of import/export trade statistics between Pakistan and China by the DG Intelligence has also promoted the authorities to take measures for checking misuse of facility.

According to a report of Virk submitted to FBR Chairman Tariq Bajwa that the Directorate General has detected large scale illegalities/irregularities in clearance of different commodities from various ports during the last quarter of the previous financial year. However, the most glaring illegalities/irregularities, involving evasions of revenue to the tune of several hundred million rupees, were detected in clearance of fabrics having various descriptions.

In pursuance of specific information, imports of fabrics made under notification SRO 1125(1)/2011 were closely monitored and, subsequently, a number of consignments lying at Karachi Port and Lahore Dry port were blocked. Special teams were constituted to ascertain whether the importers of the consignments had the requisite manufacturing facility because the exemptions from payment of Additional Sales Tax and Withholding Tax were available to only those importers-cum-manufacturers whose manufacturing premises are equipped with the requisite facilities. However, it was reported by the special teams, after physical verification of the impugned premises, that the manufacturing facilities were not available at the notified premises of the importers who had imported the fabrics under claim for exemption from payment of Additional Sales Tax and Withholding Tax. It was, therefore, apparent that exemptions from payment of Additional Sales Tax and Withholding Tax had been unlawfully granted on the basis of materially incorrect documents. Revenue loss was estimated at Rs.700 million in respect of the imports made by twenty (20) importers. Swift action taken by the Directorate General resulted in recovery of more than Rs.88 million, relating to the consignments that had been detained at the port premises as well those that had been previously cleared, Lutfullah Virk said. It is also pertinent to point out that with the intervention of the Directorate General the benefit claimed under SRO 1125 by dummy manufacturers has declined substantially. Comparative analysis for the months of July-August 2014 to July-August 2013 reveals a 24 percent decline in the quantity on which benefit of SRO was claimed.

Business Recorder
11th September,2014

Chaos and complexities in international taxation

Zafar Azeem

In recent years, tax practitioners have had little interest in the question whether or not a relationship exists between structural changes in a country's economy and the level of taxation. About 20 years ago, this question did attract some attention especially in connection with the tax system of developing countries. A small group of fiscal economists, including Professor Richard Musgrave, tried to determine inter se relationship between economic policy and its influence on the level and the structure of tax system. Tax experts used this experience to advise policy makers on changes that they could bring to the tax systems. However, forecasting about the future of tax policies is dependent on the relationship between economic structures and taxation. One may pose a question how structural changes will influence the international tax system? This article proposes answers to the posed question and explains the likely scenario as a consequence of changes in economic policies and the emerging trends in tax processes. Many countries believe that mega businesses are illegally shifting their profits to countries where there are low rate of taxes to address basic erosion and profit shifting (BEPS). Recently OECD did make a call for coordinated action; however, individual countries failed to pay any heed to this call and initiated individual actions. These actions included audits, new legislation and re-drafting of policies and procedures. As a consequence the arm's length principle

(an important concept of international taxation) is under greater focus and there are divergent views amongst the global community whether or not to rely on it. These directions are also posing questions in respect of the power of tax authorities to re-characterize the bona fide arrangements including disregarding the binding contracts and of the legal entities emerging from legally-enacted regulations1.

The complex regulatory regime has given rise to the problem of double taxation, since nations are taking diverse positions in an aggressive manner. The tax litigation is thus on the rise and emerging challenges are re-structuring the International Tax environment.

The current rules on international taxation were developed and implemented when cross-border transactions were not so prominent. But now the role of multi-national corporations is under scrutiny in many developing countries and their administrations are being advised to plug the gaps that allow such institutions to gain benefit through tax planning and thereby reducing the taxation by shifting of profits to locations where there exists more favourable tax regime.

To address the problem of base erosion and profit shifting (BEPS), OECD has issued procedural guidelines. These steps are the cause of existing turbulent environment and the same has led to adoption of coercive methods by the tax authorities in the shape of intensified enforcement actions. However, the truth is that in order to fill the revenue gaps and to address austerity drives such actions are not going to help. Efficient tax authorities are implementing coercive policies to please their bosses and making the political governments more unpopular2.

These coercive policies include demand for onerous documents and information requests, conducting raids, targeting specific industries, issuing unwanted summons, use of outside experts and to initiate the criminal enforcement actions. These actions, at times, result in agitating of demands due to significant increased assessments and criminal liabilities3. Tax policy as such is developing in a void where no one knows the right direction hence this newly emerging environment is fraught with unknown dangers.

In this regard, OECD released a coordinated action plan to address the issue of base erosion and profit shifting. The action plan did caution the administrations to review their policies, since the emerging trends in taxation may cause harmful effects resulting in chaos and double taxation.

At Global level, many countries, for example, India, are enacting general anti -avoidance rules. India has recently introduced rules for transfer pricing and methodology is being worked out to implement the purpose of rules. Similar efforts are also being made by Australia and Canada.

The aforesaid measures are being taken to combat the tax evasion based on tax planning. But for international businesses these actions are causing difficulties and hurdles. These unilateral measures of individual states will to deter the set-up of international businesses in many developing countries4.

There are growing differences among the nations in respect of International tax standards. The issues of residence and source based income are already causing a difference of opinion on basic taxing rights and fundamental tax principles, and this conflict may lead to more cross-border disputes.A well established principle of International taxation namely, arm's length is now at the verge of being abandoned. The new OECD plan in this regard calls for country by country reporting, that means, the global businesses would be under an obligation to provide information on their global allocation of income, economic activity and taxes paid. Though it may be useful for risk assessment, but practically it will amount to denial of arm's length principle5, and purposes for increased audit activity. Be that as it my, it is obvious that OECD's support for arm's length principle is diminishing.

Ability of re-characterization of valid transactions by a tax authority is another area of concern for the businesses. The new OECD guideline directs that re-characterization should only be made where authorities detect unusual circumstances6.

On the name of poverty elevation, many countries are proposing that local businesses should be given a preferential tax treatment at the cost of well established rule of arm's length dealings.

That is why many practitioners are proposing that OECD should avoid destabilizing the established principles into vague concepts. Existing conflicting opinions on the understanding of well established standards and government's directions to interpret taxpayer's business Judgments in their own way is another controversy, which may add to difficulties and complexities.

Tax harmonization is another area, which is being jeopardized by states in the name of incentives to local businesses thereby causing a conflict in the uniform application of tax laws. Even at times, such preferences may lead to double taxation. Another leading problem is that of triangular cases, that is, where more than one jurisdiction lays claim to the same item of income. In such cases tax assessments made by one country do affect or can affect the tax assessment of the other countries7. These are the issues which are leading the MNC's to opt for alternative dispute resolution (ADR) option.

The businesses in these circumstances may prefer bilateral or multilateral advance pricing agreements and opt for the issuance of advance rulings on complex issues. The fact is that these agreements and rulings are not being accepted and admitted by the tax authorities particularly when the tax authorities are confronted with the difficult choice of applying the agreements or rulings to jeopardize their revenue.

In many countries taxpayers are resorting to opt for the judicial process of appeals against the disputed tax assessments and the option is gaining popularity.

Where the complexity of procedures is not simplified, one should not forget that the rate of litigation will increase by adding unnecessary costs. For example, transfer pricing is the accepted norm of international taxation law and in many countries issues emerging from transfer price are for final settlement it is hoped that states will not take hasty decision of our abandoning the transfer pricing concept of international taxation before the superior judiciary for final settlement.

1 These changes are thus redefining the arena of dispute settlement, hence arbitration is gaining popularity.

2 The recent turbulent voices in Italy, Greece and Spain emerged from consequences emanating from market failure due to bad fiscal policies.
3 Many developed and developing countries are resorting to risk assessment approaches to enforce such rules to protect the tax base and so called perceived national interest.

4 These unilateral steps will also contribute to the risk of double taxation.
5 The action plan provides that it may be appropriate to go beyond the arm's length principle and employ special measures making arm's length principle meaningless.

6Concern is growing that there may be modification to the international tax rules and the OECD's impending work on the allocation of profits for intangibles will likely add fuel to this debate. Until an international consensus is reached on the ability of tax administrations to recharacterise transactions, tax authorities will assert the power to ignore risk allocations, to recharacterise bona fide arrangements, disregard of legal entities, and to invalidate binding legal agreements. This approach will lead to uncertainty.
7 In these cases, bilateral income tax treaties do not operate effectively to resolve the tax controversies because those treaties generally do not facilitate the direct involvement of other affected countries.

8 These pre-litigation approaches to dispute resolution require more transparency and robust disclosures by taxpayers, but they also provide an opportunity to create a cooperative environment between the parties and the resolution of matters in a more effective and efficient manner.

9 These include treatment to pricing, domicile and source.10 For many, this dispute resolution options looks appealing.

(The writer is an advocate and is currently working as an associate with Azim-ud-Din Law Associates Karachi)

Business Recorder
18th September, 2014

Democracy and taxes

Huzaima Bukhari and Dr Ikramul Haq

In Pakistan, a heated debate is going on about democracy, constitution and rule of law. Government and Opposition are busy countering what they call "onslaught of Tehreek-e-Insaf (PTI) and Pakistan Awami Tehreek (PAT) against elected parliaments." Both sides are accusing each other of violating constitution and laws. While PTI and PAT claim that vast majority of parliamentarians are tax cheats, the government's media coordinator has alleged that 82% of PTI elected members, including Imran Khan, have "evaded taxes."

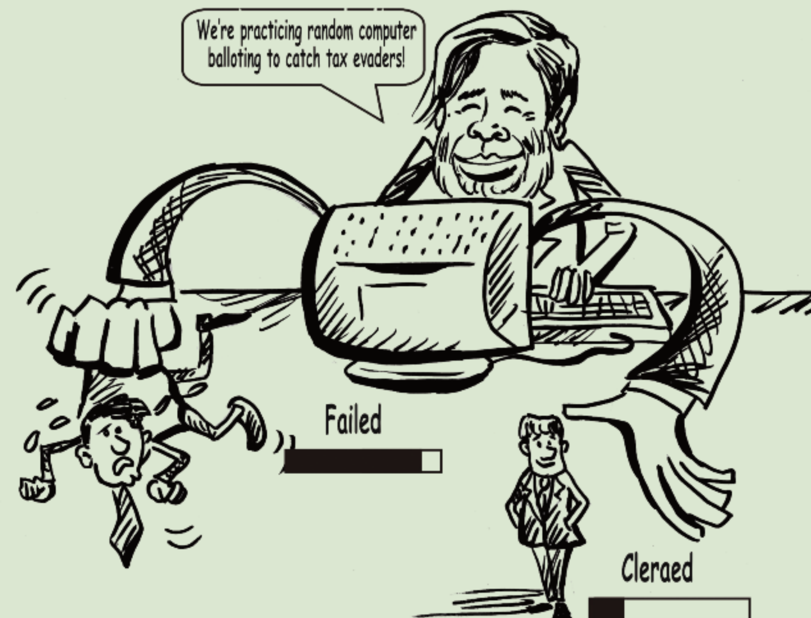
Imran Khan on September 17, 2014 during his routine 'dharna speech' blamed the Sharif brothers for "taking the country to the brink of destruction". He alleged that they had "stolen money from this country, evaded tax and destroyed democracy to save their money". He said: "I dare Nawaz Sharif to declare all his assets and all the assets he has in the name of his children and other relatives, if he does this I will end this sit-in".
On the same day Salman Shahbaz, son of Chief Minister Punjab Shahbaz Sharif, said that Secretary General of PTI, Jahangir Tareen, "is the head of sugar

mafia in Pakistan". He called him "the biggest manipulator of sugar prices in Pakistan". He questioned how Imran Khan "uses bullet-proof car worth Rs 30 million and pays only Rs 150,000 as tax". He said that Imran Khan "calls himself as Nelson Mandela but Mandela did not live in a 300 kanal palace". He alleged that "Lahore's land-mafia head stands on the container along with Imran Khan".

Now the question is who will verify these allegations and take action under the law. The Federal Board of Revenue (FBR) that is supposed to verify these claims and take action against evaders and avoiders remains a silent spectator. This is our real dilemma! The State institutions are politicized. They are not enforcing laws but are serving their political masters and powerful elites. So it is not surprising that democracy has failed to take its roots. No country can claim to be democratic if law favours the rich and penalises the poor. This is what is happening in Pakistan since decades under successive governments—military and civilian alike. The Chairman of FBR has recently admitted that millions are outside tax net. He conceded that out of 2.5 million retailers, only 8,000 are registered under sales tax law. Our successive governments have been taxing the poor and giving extraordinary benefits to the rich. Abuse of taxpayers' money for personal comforts and luxuries of the ruling elite is the main cause of commotion in society. The government's yearning for "more and more taxes" has become a source of irritation for the citizens who argue that they get nothing in return and their plight is worsening every day.

Heavy taxes have failed to solve any problem—debts, both internal and external, are rising and inflation is crushing the poor. We need all-out reforms and complete overhauling of the system. Voicing this concern, Nadeem Ul Haque, former Vice-Chancellor of Pakistan Institute of Development Economics (PIDE) and ex-Deputy Chairman of Planning Commission, in Reform or face fundamental ascendency, emphasized, "The State must first provide the social contract i.e. good law and order and security of life. It must dismantle the rent seeking that protects the rich. Rent seeking relies on three main components: state subsidies, licensing and regulation; special perks and privileges for ministers and army and civil service employees and land distribution system that allows the poor man's land to be acquired for the elite especially the army and civil service."

An equitable tax system is one under which tax payments are based on the amount of benefits received from government services the Scandinavian social democracy model is a good example to quote and follow. In social democracies, the cost of government services are apportioned amongst individuals according to the relative benefits they enjoy. In economic terms, this is called "benefit principle" that presupposes determination of the incidence of public expenditure before deciding distribution of tax burden.



To achieve the cherished goal of distributive justice, the government should tax the rich and launch programmes for rapid growth and generation of employment to ensure socio-economic justice. It is State's responsibility to provide fundamental facilities such as health, education, housing etc. Once there are tangible benefits of paying taxes, the people will be motivated to comply. Irrational taxes produce negative results. It is evident from the fact that FBR despite resorting to all kinds of highhandedness has failed to improve tax-to-GDP ratio. It declined to 8.2% in 2013-14 from 9.2% in 2007-08. Despite tax collection of Rs 2266 billion in 2013-14, fiscal deficit was of Rs 1800 billion, while in fiscal year 2009-10, total collection was Rs 1328 billion and the fiscal deficit was just Rs 777 billion. Our total debt is now over 70% of GDP and debt servicing takes away 79% of revenue collected by FBR.

In 2004, FBR promised 0.2 percent per annum growth in the tax-to-GDP ratio for the next five years while submitting 'tax projections' and 'revenue-to-GDP ratio' to the International Monetary Fund (IMF) on the conclusion of the 9th review under the Poverty Reduction Growth Facility (PRGF). In 2008-09, there was a decline instead of improvement even though the World Bank extended US$ 100 million for Tax Administration Reforms Programme (TARP). After TARP, tax-to-GDP ratio decreased substantially but debt burden and fiscal deficit increased monstrously, inflation skyrocketed and tax compliance nose-dived.

Our leaders speak about democracy and plight of the poor but at the same time, evade and avoid taxes and then whatever

they extort from masses is mercilessly wasted on perks and benefits of those who matter in the land. The elites thrive on taxpayers' money and then befool them by claiming themselves as guardians of their rights. The government's kitty is empty because of unwillingness of the rich to pay taxes, colossal wastage of taxpayers' money on unproductive expenses and non-exploitation of vital natural and human resources. Main leaders, in government and opposition, have billions of dollars lying abroad but their contribution in terms of taxes in Pakistan is just peanuts!

Chairman FBR has said that if we increase tax-to-GDP ratio to 16% there would be no need of borrowing. We have given complete roadmap [Budget 2014-15; challenges before Chairman, Business Recorder, May 30, 2014] to increase it to 25%, but government wants to establish Tax Commission which will be another futile effort—a sheer wastage of time and money. The issue is that those in power are not ready to tax the rich and mighty as it would expose them. Can FBR Chairman tell the nation why expensive cars and residences of the parliamentarians is not probed vis-à-vis their partly income declarations? Can he tell how many rich doctors and lawyers file tax returns declaring their correct incomes? Why has FBR not taken any action against them and other tax evaders? The State is not at all interested in withdrawing huge tax-free benefits available to the militro-judicial-civil complex. On the contrary, protection is given to untaxed money through section 114(4) of the Income Tax Ordinance, 2001.

Pakistan cannot become a democratic welfare State unless the rich and mighty are taxed and billions spent on tax-free benefits of the President, Governors, Prime Ministers, Chief Ministers, Ministers, Advisers, judges and high-raking military-civil officers, are saved by giving them Composite Packages. Money so saved and taxes collected from the rich can be used for the benefit of masses. Board-based, single-stage sales tax at a lower rate of 5% should replace the present 16% complicated regime to give relief to low-income groups and boost business growth. The government should immediately withdraw all exemptions and immunities and pass asset-seizure law to counter money laundering, tax evasion and rent-seeking.

It is admitted by FBR that even after "great efforts" (sic) only 840,000 filed income tax declarations for tax year 2013. Thousands of non-filers included FBR's own employees, high-ranking civil-military officials, judges, rich professionals and businessmen remained unpunished. FBR has failed to take action against them under the law. This is the sordid story of rule of law in Pakistan where those who impose taxes on others, and those who are paid to collect these avoid their own obligations.

There are 130 million mobile users in the country, out of which two million pay hefty bills and must be compelled to file tax returns. Non-filing of returns by them and others possessing huge assets testifies FBR's inefficiency and ineffectiveness. FBR is taking credit of extra few thousands declarations filed after issuance of notices. However, it is completely silent about its failure to force all taxable persons to file tax returns. This failure is now admitted by the Chairman FBR but he has not outlined any strategy to remedy the situation, except oft-repeated rhetoric. As suggested in Budget 2014-15: challenges before Chairman, Business Recorder, May 30, 2014, FBR can easily generate taxes of Rs 6 trillion—collection at this level will not only eliminate dependence on domestic and foreign loans but also help in launching programmes for rapid growth and employment as well as providing all the fundamental facilities of education, health, housing and transport. (The writers, tax lawyers and partners in law firm,

HUZAIMA & IKRAM, are Adjunct Faculty at Lahore University of Management Sciences)

Business Recorder
19th September, 2014

5pc levy Nmber of cos paying bonus shares declines: FBR

SOHAIL SARFRAZ

ISLAMABAD: The Federal Board of Revenue (FBR) witnessed a sharp decrease in the number of companies that issued bonus shares in 2014 to avoid payment of a 5 percent tax imposed through the Finance Act, 2014.

the FBR is compiling data of the corporate sector on issuance of bonus shares to shareholders. So far, the FBR has observed a decline in trend of bonus shares issuance to shareholders on the imposition of a 5 percent tax on these shares under Finance Act 2014. The exact data of companies which issued bonus shares would be compiled in due course of time.

Sources said that the companies have the option to pay a 5 percent tax on issuance of bonus shares or pay a 10 percent tax on dividends or increase their accumulative profits by not declaring dividends. It depends on a case-to-case basis keeping in view the functions and operations of companies.

FBR's trend analysis shows that a few companies which were declaring issuance of bonus shares every year have now stopped issuing the same due to the imposition of a 5 percent tax on such shares under the Finance Act, 2014.

When a 5 percent tax was imposed on bonus shares in budget (2014-15), budget makers analyzed that bonus shares worth Rs 1500 billion were issued previous year, but no tax was collected. Around Rs 75

billion could be generated in the form of tax through bonus shares worth Rs 1500 billion. During previous year, a huge amount of bonus shares was issued in lieu of dividends; however, no tax on dividends or capital gains was received.

At the same time, the FBR apprehended that the imposition of a 5 percent tax on bonus shares would force certain companies to stop issuance of bonus shares.

According to the Finance Act, 2014, every company, quoted on stock exchange, issuing bonus shares to the shareholders of the company, shall withhold five percent of the bonus shares to be issued.

According to the procedure on deduction of tax on bonus shares issued through Finance Act 2014, bonus shares withheld shall only be issued to a shareholder, if the company collects from the shareholder, tax equal to five per cent of the value of the bonus shares issued to the shareholder including bonus shares withheld, determined on the basis of day-end price on the first day of closure of books. Notwithstanding anything contained in any law for the time being in force, every company, quoted on stock exchange, issuing bonus shares to the shareholders of the company, shall withhold five per cent of the bonus shares to be issued.

Finance Act said that the tax shall be collected by the company, within fifteen days of the first day of closure of books. If the shareholder fails to make the payment of tax within fifteen days or the company fails to collect the said tax within fifteen days, the company shall deposit the bonus shares withheld in the Central Depository Company of Pakistan Limited or any other entity as may be prescribed. The bonus shares deposited in the Central Depository Company of Pakistan Limited or the entity prescribed shall be disposed of in the mode and manner as may be prescribed and the proceeds thereof shall be paid to the Commissioner, by way of credit to the federal government.
The issuance of bonus shares shall be deemed to be the income of the shareholder and the tax collected by the company or proceeds for the bonus shares disposed of and paid shall be treated to have been paid on behalf of the shareholder. Tax paid under this section shall be a final tax on the income of the shareholder of the company arising from issuance of bonus shares.

Finance Act 2014 had also issued procedure for bonus shares issued by companies not quoted on stock exchange.

Business Recorder
21st September, 2014

On tax cuts and long-term growth

With an abysmally low tax-to-GDP ratio, calls for urgent taxation reforms have taken a front seat in policy debate in Pakistan. In that vein, a recent study by the Brookings Institution is instructive. The study, by Senior Brookings Fellow William Gale and Dartmouth Professor Andrew Samwick, suggests that that there is no guarantee that tax cuts would raise the rate of economic growth over the long-run. The authors try to assess the effects of income tax changes on long-term growth patterns.

With an empirical investigation on the US economy, the study concludes that tax rate cuts may encourage individuals to work, save and invest and thereby stimulate the economy in the short-run; however, in the absence of corresponding spending cuts, deficits would inflate and reduce national savings in the long-run, leading to higher interest rates and lower investment.

By any means, this is not a novel finding. However, the catch lies in the way growth figures and corresponding economic phenomena are assessed by commentators and analysts alike, since the study focuses on implications for the supply-side of the economy, in contrast to the short-term phenomenon called 'economic growth'. One can then assume that higher growth rate figures suggested by the government may not always indicate a path to progressive recovery, as over the longer-run implications could be rather different.

This becomes all the more important to consider in terms of political power play, whereby short-term populist measures may not always be useful for structural changes that lead to progressive growth over a longer period. Granted, tax cuts may be necessary at times to stimulate the economy (the recent reduction in corporate tax comes to mind).

But, let's explore the study a bit further. In order to achieve long-term growth, it goes on to suggest that such cuts should be carefully targeted toward new economic activity, rather than providing windfall gains for previous activities, and that there should be levelling of the playing field across economic sectors and across different types of income and consumption (the infamous SROs in favour of highly protected sectors immediately sprout in mind).

Further, large positive tax incentives should be able to encourage work, saving, and investment, while increases in the budget deficit should be kept minimal. "Reforms that improve incentives, reduce existing subsidies, avoid windfall gains and deficit financing, will have more auspicious effects on the long-term size of the economy, but in some cases may also create trade-offs between equity and efficiency," the authors note.

With the kind of uncertainty that exists in Pakistan, it is becoming increasingly important to initiate structural reforms that establish a long-term growth pattern, rather than one-off populist measures.

Business Recorder
23rd September, 2014

New return form Taxpayers bound to declare agri tax paid to provinces

SOHAIL SARFRAZ

ISLAMABAD: Taxpayers would be bound to declare agriculture income tax paid to the provinces in the new income tax return form issued by Federal Board of Revenue (FBR) for individuals and Association of Persons (AoPs) for Tax Year 2014.

In this regard, the Federal Board of Revenue (FBR) has issued SRO.819(I)/2014 to issue the new income tax return form.

The FBR has made it mandatory for the taxpayers to declare 'Agriculture Income Tax Paid' under the new income tax return form issued for individuals and Association of Persons (AoPs) to grasp issue of Agricultural Income Tax paid in respective provinces and comparison of agricultural incomes declared in the provinces and income disclosed in the annual income tax return to the Federal Government. Under the new income tax return form, the return of total income/statement of final taxation under Income Tax Ordinance 2001 (IT-2) for individuals/AoPs deriving income under the head business and any other head has been issued. It has specified the Agriculture Income and Agriculture Income Tax Paid'.

Experts said that through the Finance Act, 2013 a proviso has been added to sub-section (1) of Section 111 of the Income Tax Ordinance, 2001 providing that where a taxpayer explains the nature and source of the amount credited or the investment made, money or valuable article owned or funds from which the expenditure was made, by way of agricultural income, such explanation shall be accepted only to the extent of agricultural income worked back on the basis of agricultural income tax paid subject to furnishing of proof of payment of agriculture tax under the relevant provincial law.

The following errors/omissions shall render a Return invalid & make the taxpayer a non-filer & liable to penalty under section 182(1): Return on which NTN or CNIC is missing or incorrect or invalid; return on which mandatory fields marked by * are empty; return which is not signed by the Taxpayer or Representative (as defined in section 172 of the Income Tax Ordinance, 2001) of the Taxpayer; return which is not filed in the prescribed Form and return which is not filed in the prescribed mode.

Business Recorder
17th September, 2014

Compulsory convertible debenture and their status under income tax laws

Zafar Azeem

Convertible Debenture is a type of loan issued by a company that can be converted into stock by the holder and, under certain circumstances, the issuer of the bond. By adding the convertibility option the issuer pays a lower interest rate on the loan compared to if there was no option to convert. These instruments are used by companies to obtain the capital they need to grow or maintain the business.

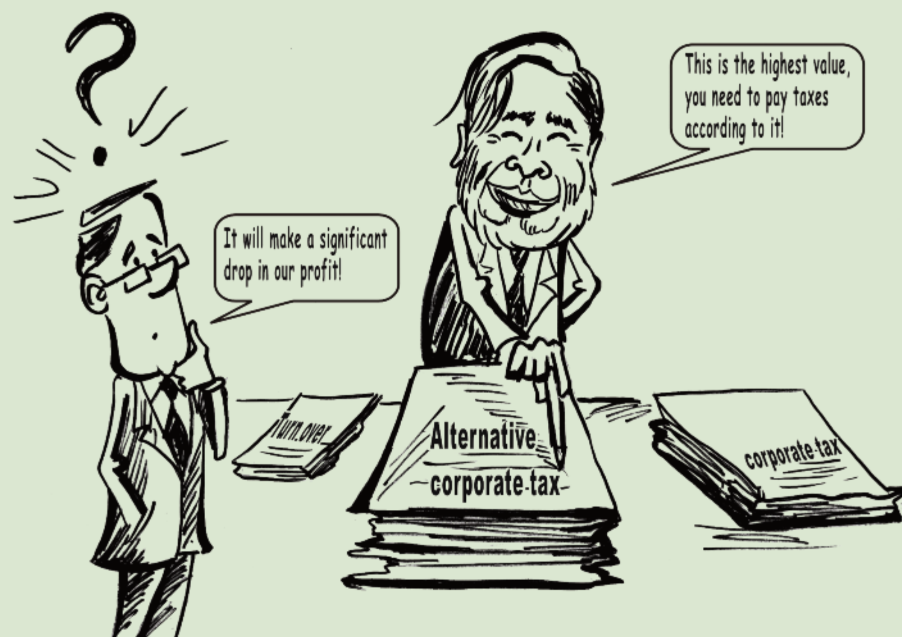
Convertible debentures are different from convertible bonds because debentures are unsecured; in the event of bankruptcy the debentures would be paid after other fixed income holders. The convertible feature is factored into the calculation of the diluted per-share metrics as if the debentures had been converted. A transaction of Compulsory Convertible Debentures (CCD's) gave rise to a legal battle between a Mauritius based company and the Indian Income Tax Department. In order to comprehend this legal battle, it would be appropriate to understand the facts which gave rise to this controversy.

As per facts available a company stood incorporated under the laws of Mauritius having a tax residence status in Mauritius. The Company was engaged in the business of investments in India. The

Company entered into a Securities subscription Agreement ("SSA") and a Shareholder's Agreement ("SHA") with an Indian company and its subsidiary ("JV"). The Company agreed to acquire 35% ownership interest in the JV. The company thus agreed to subscribe to 46,307 equity shares having a par value of Rs 10 each and 882,585,590 zero percent CCDs having a par value of Re 1 each in a planned and phased manner. SHA recorded the terms of this relationship and rights and obligations of the parties inter se including matters relating to transfer of equity shares and management and operation of the JV. SHA also provided for call and put options to the subsidiary by the acquiring company. Subsidiary company (JV) partly exercised the call option and purchased equity shares along with CCDs from Mauritius-based company. Mauritius company accordingly transferred equity shares and CCDs to the purchaser.

This Mauritius-based company, after the deal, approached the income tax authorities under Section 197 of the Income Tax Act 2012 requesting for "nil" withholding certificate. The certificate was required to receive the total consideration from the buyer.

The income tax officer held that the entire gain on the transfer of equity shares and CCD; is to be treated as an interest and is liable to the taxed @ 20%.



The order of the income tax officer was challenged by Mauritius-based company through a constituted petition before the Delhi High Court1.

The petition was contested by the Income Tax Department. The Deptt contended that entire gains on the sale of equity shares including CCDs held by the petitioner are not exempt from income tax in India by virtue of the Double Taxation Avoidance Convention ("DTAA") with Mauritius and that the gains arising on the sale of CCDs are 'interest' within the meaning of Section 2 (28A) of the Income Tax Act, 1961 and Article 11 of the 2012 DTAC and are taxable as such.

As a consequence, the Court was confronted with the following issues

1. Whether the gains arising in the hands of Mauritius-based company from transfer of its investments in the JV is 'interest' or 'capital gains'.

2. Whether the corporate veil ought to be lifted and that the JV and Indian company were essentially the same entity.

On behalf of the Mauritius based company, it was contended that amount of gains received/ receivable by Mauritius-based company resulting from transfer of the investments held by Mauritius based company in the JV, was NOT 'interest' under Section 2(28A) of the IT Act. There was no debtor and borrower relation between Indian company and Mauritius based company and therefore transaction entered into between Mauritius-based company, Indian company and its subsidiary was NOT a load transaction. The CCDs were held as capital assets by Mauritius-based company and the transfer of the investment was a transfer of a capital asset and any gains arising there from were liable to be treated as capital gains. Therefore, such gains could not be subjected to income tax in India in terms of the DTAA between India and Mauritius.

The Deptt on the other hand contended that: the transaction was essentially in the nature of an external commercial borrowing and Mauritius-based company was entitled to receive a fixed rate of return and that the duration of the investment would determine the quantum of return receivable by the company. The transaction was a load transaction and the returns on the investment were simply interest, liable to be taxed in India. The corporate veil ought to be lifted and in proceeding on the basis that subsidiary company and the JV were, essentially, a single entity. Therefore, debt owed by JV was in reality Company's debt and the amount received by Mauritius-based company in excess of the investment made by them would amount to 'interest' paid or payable by subsidiary company for borrowed funds.

The Department on the other hand contended that: The transaction was essentially in the nature of an External Commercial Borrowing Mauritius-based company and was entitled to receive a fixed rate of return and that the duration of the investment would determine the quantum of return receivable by Mauritius-based company. The transaction was a loan transaction and the returns on the investment were simply interest, liable to be taxed in India. The corporate veil ought to be lifted and in proceeding on the basis that subsidiary company and the JV were, essentially, a single entity. Therefore, debt owed by JV

was in reality subsidiary company's debt and the amount received by Mauritius-based company in excess of the investment made by them would amount to 'interest' paid or payable by subsidiary company for borrowing funds.

The court after reviewing the arguments of the parties concluded that as regards issue no 1, the legal position is as under:

I. Gains arising from sale of capital assets would not be in the nature of interest. The expression 'interest' as defined under Section 2(28A) of the Income Tax Act cannot apply to all gains that are received by a debenture holder (lender) irrespective of the transaction resulting in such gains.

II. Whether a Compulsorily Convertible Debenture is a loan simply or whether it is in the nature of equity, is not material in determining whether the gain on the sale of the debentures by its holder is a capital gain or not. This depends entirely on whether the debentures are capital assets in the hands of its holder.

III. Call and Put Options in the Share holder's agreement cannot be read to mean that Mauritius-based company was only entitled to a fixed return on the investments made by it in the equity and CCDs issued by JV. The Call option also contemplated that if the option is exercised after the expiry of three years from the First Closing Date, the price to be computed would also include a component of "equity payment" (10% of the project value).

IV. SHA only provided for options either to Indian company to buy out the stake of Mauritius-based company in JV, or to Mauritius-based company, to exit the JV by calling upon Indian company to buy its shares. It was not necessary that either Indian company or Mauritius-based company exercise the options as available to them. By the very definition, call and put options were only options that were available to the contracting parties. In the event none of the options were exercised, the CCDs held by Mauritius based company would mandatorily be convertible into equity shares and Mauritius based company would be entitled to the benefits that would accrue to an equity shareholder in respect of the equity shares issued by the JV on conversion of the CCDs.

V. The SHA was essentially a joint venture agreement and it is common in any joint venture agreement for the co-ventures to include covenants for buying each-others' stakes.
VI. Although, the SHA enabled Mauritius-based company to exit the investment by receiving a reasonable return on it, and in that sense it assured a minimum return, the same cannot be construed to mean that the CCDs were fixed return instruments, as Mauritius based company also had the option to continue with its investment as an equity shareholder of JV. Merely because an investment agreement provides for exit options to an investor, would not change the nature of the investment made.

VII. The rights with regard to options as well as additional rights under the SHA were the mutual rights and obligations between Indian company and Mauritius-based company and not the JV.
VIII. Assuming that the gains were payment of interest by Indian company, the same would also mean that the quantum of interest is a deductible expenditure in the hands of Indian company and viewed from this perspective, it would be erroneous to conclude that the whole transaction had been structured to ensure avoidance of tax on income.

On issue No 2, the Court was of the view that notwithstanding the JV being managed as a joint venture between Mauritius-based company and by the Indian-based company, the affairs of JV were to be managed separately and distinctly from that of Indian company and therefore JV was not an alter ego of the said company alone. There were clean and sufficient indications in the agreements that all transactions with related parties were to be conducted on an Arm's Length basis. All decisions that could be considered important required the consent of both Mauritius-based company as well as Indian company. In certain matters where there could have been possibility of a conflict of interest between Indian company and JV, the nominee directors of Indian company were obliged to refrain from participating or influencing the decision of JV. Mauritius based company was entitled to participate in the management and affairs of JV, not only by appointing its nominee directors but also by ensuing independent auditors and an independent Asset Manager. Since Indian company was also involved in the project, the Shareholder's agreement ensured that no payments could be made by JV to its parent company under the relevant contract without the authority of an independent Asset Manager. (The writer is an advocate and is currently working as an associate with Azim-ud-Din Law Associates Karachi) 1 Zaheer Mauritius V Director of Income Tax. W.P no C 1648/ 2013 decided by Delhi High Court on 30.7.2014.

Business Recorder
25th September, 2014

FBR picks 77,500 cases for audit in six categories

RECORDER REPORT

ISLAMABAD: The Federal Board of Revenue (FBR) has selected as many as 77,500 cases for audit in six categories for Tax Year 2013 through random computer balloting as compared to 41,727 cases selected last year, reflecting an increase of 35,773 cases.

Random computer ballot was conducted here on Thursday at FBR for selection of audit cases for Tax Year 2013 and Tax

Period 1st July 2012 to 30th June, 2013 in respect of Income Tax, Sales Tax and FED at FBR House, Islamabad.

The random computer ballot was conducted in respect of six categories i.e. corporate cases of Income Tax, Sales Tax, FED and non-corporate cases of Income Tax, Sales Tax and FED.

Minister for Finance Ishaq Dar was the chief guest whereas representatives of Chambers of Commerce and Industry, Tax Bars and FBR officers attended the ceremony. Minister for Finance and Chairman, FBR addressed the audience.

However, the FBR has not invited journalists at the computer balloting function and they were unable to witness the process adopted for selection of audit cases through computer ballot. As compared to past tradition of regularly inviting reporters to witness ballot every year, the FBR has not invited them due to reasons best known to them.

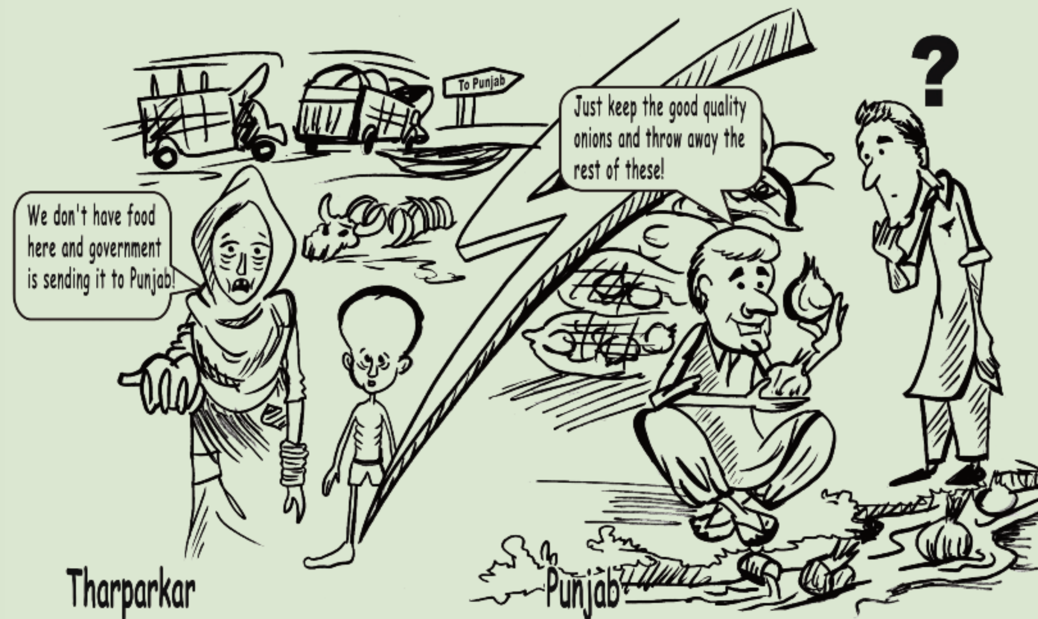
Category-wise Breakup revealed that out of 25,046 cases of Income Tax (Corporate), a total of 1,876 cases were selected for audit. Out of Income Tax (Non-Corporate) 840,675 cases, a total of 63,050 cases have been selected. Within the category of Sales Tax (Corporate), out of 11,757 cases, a total of 1,410 cases were selected for audit.

Out of 92,455 Sales Tax (Non-Corporate) cases, a total of 11,095 cases have been selected for audit. Out of 402 FED (Corporate) cases, 45 have been selected for audit. Out of 202 cases falling within the category of FED (Non-Corporate), a total of 24 cases have been selected for audit.

Ishaq Dar initiated the ballot process by pressing the computer button. Representatives of various chambers and tax bars also participated in the ballot process. Around 77,500 returns have been selected for audit in six categories. National Tax Numbers of cases selected for audit have been displayed on the official website of FBR.

The FBR has displayed the category-wise lists of cases selected for audit through computer random ballot for Tax Year 2013 for Income Tax Non-Corporate Taxpayers; Sales Tax (Non-Corporate) taxpayers; Income Tax Corporate Taxpayers; Sales Tax (Corporate) taxpayers; FED (Corporate) cases and FED (Non-Corporate) cases.

The FBR has conducted computer ballot and selected Large Taxpayer Units (LTUs) and Regional Tax Office (RTO)-wise lists of 77,500 cases of registered persons selected for audit. However, the FBR has not displayed the LTU/RTO-wise list on its website. The FBR has only displayed the category-wise National Tax Numbers (NTNs) of cases selected for audit on the official website of FBR. In the absence of LTU/RTO-wise lists, taxpayers are unable to check/verify whether their cases are falling within the jurisdiction of relevant LTU or RTO. The RTO/LTU-wise jurisdiction of cases selected for audit is not known to the taxpayers. If the LTU and RTO wise-lists have been displayed on the website, taxpayers can easily verify their names on specific list of the LTU or RTO where they are registered. Now, the whole business community along with non-corporate taxpayers' have to search for their names to check as far as selection for audit is concerned. The FBR's move to only display category-wise lists of the registered units selected for audit has created confusion among the taxpayers. It would have been more appropriate to display the LTU or RTO wise lists to facilitate the taxpayers. As the FBR has not displayed the LTU/RTO-wise lists, it is not clear number of taxpayers selected in a specific LTU or RTO for audit. Moreover, percentage wise selection of cases in different LTUs and RTOs is also not available, sources said.



In his address, Finance Minister highlighted the economic and tax policies of the government. There has been far improved revenue collection of Rs319 billion by FBR in the first two months of current financial year as compared to corresponding period of last year when Rs279 billion were collected. Foreign remittances have also been on the up for which overseas Pakistanis deserve commendation. The minister also added that he had approved constitution of the Tax Reforms Commission which would put up recommendations for further boosting and improving the tax collection system.

Business Recorder
26th September, 2014

Compulsory convertible debenture and their status under income tax laws

Zafar Azeem

Convertible Debenture is a type of loan issued by a company that can be converted into stock by the holder and, under certain circumstances, the issuer of the bond. By adding the convertibility option the issuer pays a lower interest rate on the loan compared to if there was no option to convert. These instruments are used by companies to obtain the capital they need to grow or maintain the business.

Convertible debentures are different from convertible bonds because debentures are unsecured; in the event of bankruptcy the debentures would be paid after other fixed income holders. The convertible feature is factored into the calculation of the diluted per-share metrics as if the debentures had been converted. A transaction of Compulsory Convertible Debentures (CCD's) gave rise to a legal battle between a Mauritius based company and the Indian Income Tax Department. In order to comprehend this legal battle, it would be appropriate to understand the facts which gave rise to this controversy.

As per facts available a company stood incorporated under the laws of Mauritius having a tax residence status in Mauritius. The Company was engaged in the business of investments in India. The Company entered into a Securities subscription Agreement ("SSA") and a Shareholder's Agreement ("SHA") with an Indian company and its subsidiary ("JV").

The Company agreed to acquire 35% ownership interest in the JV. The company thus agreed to subscribe to 46,307 equity shares having a par value of Rs 10 each and 882,585,590 zero percent CCDs having a par value of Re 1 each in a planned and phased manner. SHA recorded the terms of this relationship and rights and obligations of the parties inter se including matters relating to transfer of equity shares and management and operation of the JV. SHA also provided for call and put options to the subsidiary by the acquiring company. Subsidiary company (JV) partly exercised the call option and purchased equity shares along with CCDs from Mauritius-based company. Mauritius company accordingly transferred equity shares and CCDs to the purchaser.

This Mauritius-based company, after the deal, approached the income tax authorities under Section 197 of the Income Tax Act 2012 requesting for "nil" withholding certificate. The certificate was required to receive the total consideration from the buyer.

The income tax officer held that the entire gain on the transfer of equity shares and CCD; is to be treated as an interest and is liable to the taxed @ 20%.

The order of the income tax officer was challenged by Mauritius-based company through a constituted petition before the Delhi High Court1.

The petition was contested by the Income Tax Department. The Deptt contended that entire gains on the sale of equity shares including CCDs held by the petitioner are not exempt from income tax in India by virtue of the Double Taxation Avoidance Convention ("DTAA") with Mauritius and that the gains arising on the sale of CCDs are 'interest' within the meaning of Section 2 (28A) of the Income Tax Act, 1961 and Article 11 of the 2012 DTAC and are taxable as such.

As a consequence, the Court was confronted with the following issues

1. Whether the gains arising in the hands of Mauritius-based company from transfer of its investments in the JV is 'interest' or 'capital gains'.

2. Whether the corporate veil ought to be lifted and that the JV and Indian company were essentially the same entity.

On behalf of the Mauritius based company, it was contended that amount of gains received/ receivable by Mauritius-based company resulting from transfer of the investments held by Mauritius based company in the JV, was NOT 'interest'

under Section 2(28A) of the IT Act. There was no debtor and borrower relation between Indian company and Mauritius based company and therefore transaction entered into between Mauritius-based company, Indian company and its subsidiary was NOT a load transaction. The CCDs were held as capital assets by Mauritius-based company and the transfer of the investment was a transfer of a capital asset and any gains arising there from were liable to be treated as capital gains. Therefore, such gains could not be subjected to income tax in India in terms of the DTAA between India and Mauritius.

The Deptt on the other hand contended that: the transaction was essentially in the nature of an external commercial borrowing and Mauritius-based company was entitled to receive a fixed rate of return and that the duration of the investment would determine the quantum of return receivable by the company. The transaction was a load transaction and the returns on the investment were simply interest, liable to be taxed in India. The corporate veil ought to be lifted and in proceeding on the basis that subsidiary company and the JV were, essentially, a single entity. Therefore, debt owed by JV was in reality Company's debt and the amount received by Mauritius-based company in excess of the investment made by them would amount to 'interest' paid or payable by subsidiary company for borrowed funds.

The Department on the other hand contended that: The transaction was essentially in the nature of an External Commercial Borrowing Mauritius-based company and was entitled to receive a fixed rate of return and that the duration of the investment would determine the quantum of return receivable by Mauritius-based company. The transaction was a loan transaction and the returns on the investment were simply interest, liable to be taxed in India. The corporate veil ought to be lifted and in proceeding on the basis that subsidiary company and the JV were, essentially, a single entity. Therefore, debt owed by JV was in reality subsidiary company's debt and the amount received by Mauritius-based company in excess of the investment made by them would amount to 'interest' paid or payable by subsidiary company for borrowing funds.

The court after reviewing the arguments of the parties concluded that as regards issue no 1, the legal position is as under:

I. Gains arising from sale of capital assets would not be in the nature of interest. The expression 'interest' as defined under Section 2(28A) of the Income Tax Act cannot apply to all gains that are received by a debenture holder (lender) irrespective of the transaction resulting in such gains.

II. Whether a Compulsorily Convertible Debenture is a loan simply or whether it is in the nature of equity, is not material in determining whether the gain on the sale of the debentures by its holder is a capital gain or not. This depends entirely on whether the debentures are capital assets in the hands of its holder.

III. Call and Put Options in the Share holder's agreement cannot be read to mean that Mauritius-based company was only entitled to a fixed return on the investments made by it in the equity and CCDs issued by JV. The Call option also contemplated that if the option is exercised after the expiry of three years from the First Closing Date, the price to be computed would also include a component of "equity payment" (10% of the project value).

IV. SHA only provided for options either to Indian company to buy out the stake of Mauritius-based company in JV, or to Mauritius-based company, to exit the JV by calling upon Indian company to buy its shares. It was not necessary that either Indian company or Mauritius-based company exercise the options as available to them. By the very definition, call and put options were only options that were available to the contracting parties. In the event none of the options were exercised, the CCDs held by Mauritius based company would mandatorily be convertible into equity shares and Mauritius based company would be entitled to the benefits that would accrue to an equity shareholder in respect of the equity shares issued by the JV on conversion of the CCDs.

V. The SHA was essentially a joint venture agreement and it is common in any joint venture agreement for the co-ventures to include covenants for buying each-others' stakes.

VI. Although, the SHA enabled Mauritius-based company to exit the investment by receiving a reasonable return on it, and in that sense it assured a minimum return, the same cannot be construed to mean that the CCDs were fixed return instruments, as Mauritius based company also had the option to continue with its investment as an equity shareholder of JV. Merely because an investment agreement provides for exit options to an investor, would not change the nature of the investment made.

VII. The rights with regard to options as well as additional rights under the SHA were the mutual rights and obligations between Indian company and Mauritius-based company and not the JV.

VIII. Assuming that the gains were payment of interest by Indian company, the same would also mean that the quantum of interest is a deductible expenditure in the hands of Indian company and viewed from this perspective, it would be erroneous to conclude that the whole transaction had been structured to ensure avoidance of tax on income.

On issue No 2, the Court was of the view that notwithstanding the JV being managed as a joint venture between Mauritius-based company and by the Indian-based company, the affairs of JV were to be managed separately and distinctly from that of Indian company and therefore JV was not an alter ego of the said company alone. There were clean and sufficient indications in the agreements that all transactions with related parties were to be conducted on an Arm's Length basis. All decisions that could be considered important required the consent of both Mauritius-based company as well as Indian company. In certain matters where there could have been possibility of a conflict of interest between Indian company and JV, the nominee directors of Indian company were obliged to refrain from participating or influencing the decision of JV. Mauritius based company was entitled to participate in the management and affairs of JV, not only by appointing its nominee directors but also by ensuing independent

auditors and an independent Asset Manager. Since Indian company was also involved in the project, the Shareholder's agreement ensured that no payments could be made by JV to its parent company under the relevant contract without the authority of an independent Asset Manager. (The writer is an advocate and is currently working as an associate with Azim-ud-Din Law Associates Karachi) 1 Zaheer Mauritius V Director of Income Tax. W.P no C 1648/ 2013 decided by Delhi High Court on 30.7.2014.

Business Recorder
25th September, 2014

Issues in tax returns, wealth statement highlighted

KARACHI: The Karachi Tax Bar Association (KTBA) has identified some deficiencies in the income tax returns and wealth statement for the year 2014 uploaded on Federal Board of Revenue`s (FBR) website.

The KTBA raised a number of issues pertaining to return form (IT-1A) for individual, deriving income under the head salary and profit on debt subject to final tax.

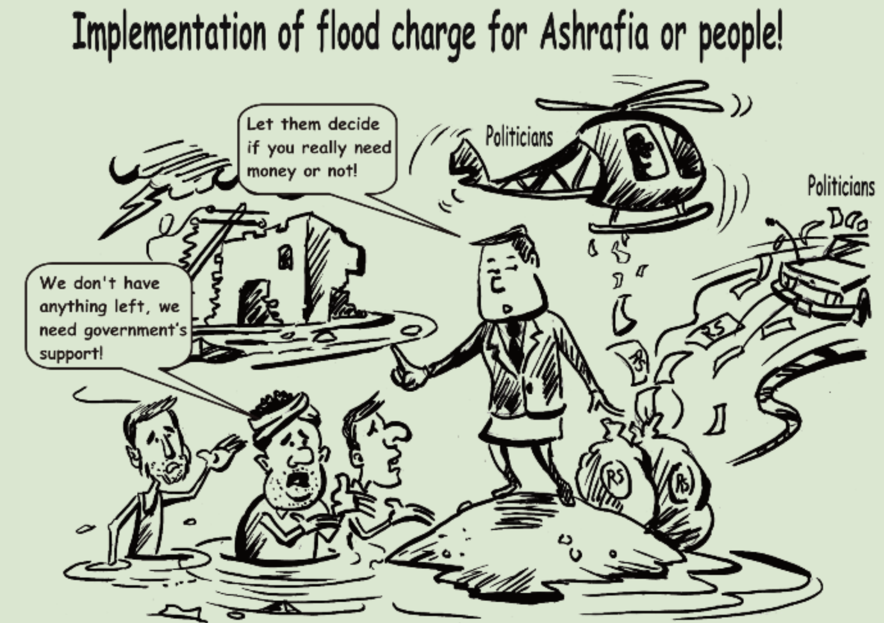
Tax returns on the FBR`s website also have many columns missing needed to give basic information about taxpayers, like date of birth, gender identification, name of employer, and column for exempt income.

With regard to return form (IT-1B) for individual, deriving income under any head other than business, the bar complained that here too column for date of birth is missing whichis necessary to judge and examine the 50 per cent reduction in tax to be claimed by senior citizens.

Referring to annex-A, the KTBA stated that as per serial No.31, it requires mentioning of opening date of the bank account. However, the bar views this demand will create unnecessary hardship for taxpayers as the said information is not related to the requirement since account number and bank description is already required to be furnishe d which is more than suf ficient.

The tax bar also detected a number of deficiencies and demand for irrelevant information for taxpayers in return form (IT-C) for Association of Persons (AOP) deriving income under any head other than business.

Similarly, the format of wealth statement on FBR`s website also needs improvement as it lacks proper space to furnish necessary information demanded by the board.



Dawn
9th September, 2014

Number of non-filers to be reduced: New benchmarks set for LTUs, RTOs

SOHAIL SARFRAZ

ISLAMABAD: The Federal Board of Revenue (FBR) has set new benchmarks for the Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs) to reduce the number of non-filers/short-filers of returns below one percent in LTUs, less than 10 percent medium size non-filers and below 25 percent small size non-filers in RTOs.

the Annual Integrated Enforcement Action Plan-2014 prepared by the FBR for the LTUs and RTOs revealed a new enforcement strategy for 2014-15 to broaden the tax base. The plan would be implemented at national level to increase the number of income tax and sales tax return filers during 2014-15.

According to the FBR's enforcement plan 2014-15, since the launching of tax reform process number of registered persons and the quantum of revenue have increased, yet the level of voluntary compliance is still below the acceptable level. In other words there exists a big Tax-Gap. The concept of tax gap is a measure to determine the extent to which taxpayers do not file their complete tax returns, and likewise pay due taxes voluntarily on time. The gap can be divided into five components including un-registered non-filers, registered non-filers, registered stop-filers, registered short-filers (including late-filers) and non-payment/short payment of taxes.

For the enforcement effectiveness, the FBR said that the tax gap of both existing and non-existing taxable entities is also a measure to gauge the departmental effectiveness in its enforcement activities for filing of complete tax returns by existing taxpayers, registering non-existing taxable entities and enforcing filing of tax returns by them and payment of due tax on time. It is, therefore, essential to quantify and evaluate the performance of Enforcement Divisions in the 3 Large Taxpayers Units and 18 Regional Tax Offices, FBR said.

The FBR said that the enforcement activities need to be geared up to reduce the Tax Gap by enforcing compliance with registration, filing and payment etc.

The objectives of the enforcement plan revealed that the FBR will enhance effectiveness of Enforcement by devising comprehensive enforcement procedures to ensure compliance in a systematic way.

Under the plan, the FBR would enforce filing of Income Tax, Sales Tax & Federal Excise returns by un-registered non-filers, registered non-filers/registered stop-filers and registered short/late/null-filers.

The FBR will set priorities to identify revenue potential sectors and to broaden tax base and define enforcement procedures. It is also necessary to set performance standards for Enforcement Divisions in LTUs and RTOs and devise Performance Reporting System and analysis thereof.

The end result of effective enforcement activities is to reduce the non-compliance ratios to the acceptable levels so that Tax Gap is narrowed. Accordingly, the following performance rating benchmarks in terms of non-compliance ratios are laid to be achieved by June 30, 2015 for the Financial Year 2014-2015: Less than 1 percent non-filers/short filers in LTUs; less than 10 percent medium size non-filers in RTOs and less than 25 percent small size non-filers in RTOs.

Business Recorder
30th September, 2014

New rules for filing of tax returns notified

By Mubarak Zeb Khan
ISLAMABAD: The Federal Board of Revenue has notified new rules for filing of tax returns for the tax year 2014.

The amendments in the rules were notified through SRO-819 of 2014 by amending the SRO-618 of 2014.

According to details, the following errors and omissions would render a return invalid and make the taxpayer a non-filer and liable to penalty under section 182(1).

These include return on which NTN or CNIC is missing or incorrect or invalid; return on which mandatory fields marked by * are empty; return which is not signed by the taxpayer or representative (as defined in section 172 of the Income Tax Ordinance, 2001) of the taxpayer; return which is not filed in the prescribed form; and return which is not filed in the prescribed mode.

Individuals deriving income under the head of salary have to file one pageIT-1A Form with Annex-F and wealth statement if required to be filed.

Moreover, individuals deriving income under the head of salary, property, capital gains and other sources (excluding business) and income subject to fixed / final tax have to file one page return in IT-1B Form with Annex-A, Annex-F and wealth statement if required to be filed.

Association of Persons (AOPs) deriving income under any head other than business have to file one page IT-1C Form with Annex-A.

Individuals deriving income under the head business or falling under Final Tax Regime (FTR) such as commercial importers, exporters, contractors, etc. have to file two-page Return in IT-2 Form with Annex-A, Annex-B, Annex-F and wealth statement if required to be filed. Annex-C, Annex-D & Annex-E are required only where depreciation / amortisation, admissible / inadmissible deductions and minimum tax chargeable / option out of Presumptive Tax Regime are involved.

Individuals, including members of AOPs or directors of companies, whose last declared or assessed income or declared income for the current tax year is equal to or more than Rs1,000,000 or the final tax paid is equal to or more than Rs35,000, must file wealth statement.

AOPs deriving income under the head business or falling under FinalTax Regime (FTR), such as commercial importers, exporters, contractors, etc. have to submit IT-2 Form with Annex-A and Annex-B.

Remaining Annexes (C, D, E) are required only where depreciation / amortisation, admissible / inadmissible deductions and minimum tax chargeable / option out of presumptive tax regime are involved.

Taxpayers may file return of total income / statement of final taxation and wealth statement through the following modes: electronically at FBRportal which is mandatory for all AOPs, sales tax registered persons, refund claimants and salaried persons having annual income of Rs500,000 or more.

However, all others are also encouraged to file the returns electronically; manually on paper at Taxpayer Facilitation Counter of the respective RTO. Paper Return Form can be downloaded from FBR website.

Tax can be paid in any authorised branch of NBP and SBP at any time before filing of return. New rules for filing of tax returns notified

Dawn
17th September, 2014

Pakistan can seek data from Swiss banks in revised treaty

A SHAHBAZ RANA
Information will be used for tax purposes, will not help bring back hidden wealth

Pakistan and Switzerland have pencilled a revised Avoidance of Double Taxation treaty that will allow Islamabad to seek information for tax purposes about money deposited in Swiss banks.

The documents were inked at the conclusion of three-day talks held in Geneva last week to renegotiate the July 2005 Convention for Avoidance of Double Taxation with respect to tax on income, according to Pakistani authorities.

The amended treaty would be formally signed in the first quarter of next year and it would take at least one more year to enforce it, they added. On behalf of Pakistan, Ashfaq Ahmed, Chief International Taxes of the Federal Board of Revenue (FBR), signed the agreement.

The major difference between the July zoos treaty and the revised one is the adoption of updated Article 26 of the Model Tax Convention of the Organisation for Economic Cooperation and Development (OECD).

According to the Article 26, competent authorities of contracting states will exchange such information as is foreseeably relevant for applying provisions of the Model Tax Convention or to the administration or enforcement of domestic laws conceming taxes of every kind and description imposed on behalf of the contracting states.

Furthermore, in no case shall the provisions permit a contracting state to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

Article 26 will allow Pakistani authorities to seek information from Swiss banks. So far, Pakistan has no legal instrument available to ask Swiss banks to provide information about tax evasion.

The Swiss government has no issue about signing Article 26 as before seeking any information the other country has to lodge a formal complaint and give evidences;' said Dr Dtramul Haq, an expert in international tax laws.

Although the revised treaty will provide the FBR with a legal instrument, its successful application will depend on the revenue body's ability to present its case to the Swiss authorities, say tax experts.

Pakistan has similar clauses in domestic tax laws but the FBR has been unable to successfully apply these for the recovery of taxes. Article 165A and 176 of the Income Tax Ordinance 2001 allow the FBR online access to bank accounts besides seeking a range of information.

Under Article 165A, banks are bound to give online access to its central database containing information about all accountholders. However, the present government has reduced the scope of the article by inserting a clause that if a person files income tax return, banks will not be bound to provide information about his accounts.
Even if the person declares no income in the tax return, the bank is not legally bound to share his accounts' information, according to Haq.

The federal government, particu-larly Finance Minister Ishaq Dar, has given an impression that the revised treaty will allow the country to bring back $200 billion said to have been stashed in Swiss banks. However, Switzerland Ambassador to Pakistan and Afghanistan Marc George has dismissed any such perception.

The Avoidance of Double Taxation treaty will not facilitate the recovery of any ill-gotten money presumably kept in Swiss banks. For that purpose, there is a separate treaty on sharing of confiscated assets signed on May 18, zoos.

The ambassador also denied that the Pakistanis had parked $2oo bil¬lion in Swiss banks.

Express Tribune
9th September, 2014

Rs2,810bn revenue target too ambitious: report

ISLAMABAD: The revenue collection target of Rs2,810 billion for the fiscal year 2014-15 is too ambitious, says a government report.

The projected increase of 24.3 per cent in tax collection target will largely be missed because historically the highest growth in tax collection that Pakistan has ever achieved was 22pc, said a report of the Pakistan Institute of Development Economics (PIDE) .

The over-projection of revenue collection target also has a cost in terms of transfer of money to provinces, but the government did not take into account this cost at the time of finalisation of budgetary projections.

One problem in setting the ambitious tax collection target was that estimates of transfers under the NFC to provinces were based on tax collection budgeted at the federal level.
`The non-realisation of the federal government`s revenue target by a wide margin disturbsthe provincial budget,` the report said.

Under the 7th NFC award, it was stipulated that Balochistan will receive its provincial share on the basis of the budgetary projections instead of actual collection of the Federal Board of Revenue (FBR).

Shortfall, if any, due to lesser collection by FBR was to be borne by the federal government. As a result of this law, an additional amount of Rs39bn has been transferred to Balochistan from 2010-11 to 2013-14 on account of shortfall in collections of the FBR with reference to the collection budgeted at the time of framing the budgets. The problem of actual projection was not confined to revenue, but it was also reflective in other departments of the government. In fiscal year 2013, the PSDP of Rs2bn was allocated to the Cabinet Division, but the division spent as much as Rs21bn.

For the current fiscal year, a budget of Rs2bn has again been allocated for the Cabinet Division. This clearly suggests that more sophistication is required in developing thebudget estimates.
Capital gains tax, corporate tax rate, excise duty on telecom sector and customs duty have been rationalised in the last budget. The nat rate capital gains tax on trading in securities has been replaced with a cascading structure, with those holding the securities for a longer period paying less.

The budget envisages various incentives for the textile industry, though the expected impact of GSP+ on the industry is yet to materialise.

The poor state of energy supply must be constraining production, therefore, fresh incentives to textile industry, will partly add to the margins of the existing producers, if energy situation remains more or less unchanged during fiscal year 2015. Collection of sales tax from small retailers through electricity bills, though commendable, has implementation challenges. This would require correct identiñcation of retailers. For example, problems would emerge where electricity connection was not in the name of retailer operating the business.

Dawn
24th September, 2014

Tax reforms body constituted

ISLAMABAD: Federal Finance Minister Ishaq Dar constituted a tax reforms commission with a mandate to give proposals within four months for upgrading the current taxation system and resolving issues to facilitate taxpayers.

The 20-member commission will also review, among other crucial issues, the scaling down of sales tax rate to single digits and changes in the field formation of the income tax department by reverting to the old circlebased system from the current functional lines.

The formation of the commission was unveiled in the budget 2014-15.

The commission shall undertake, review and rationalise direct and indirect taxes; rationalise customstariff;reviewautonomy and administrative structure of FBR and create border force to deal with illegal movement of persons and goods across the international borders. The commission may also take up any other related issue.

The commission will review the existing laws, procedures and tax rates to recommend its simplification and plugging of loopholes in the tax administration.

The commission will comprise 20 members and may coopt any other person with prior approval of the competent authority.

The members of the commission are: Senator Usman Saifullah; MNA Mian Abdul Manan, representative of traders; Bashir Ali Mohammad, industrialist;

Chairman, FPCCI or his nominee; presidents or nominees of Karachi, Lahore, Peshawar, Quetta chambers; presidents of ICAP and ICMA; Mirza Qamar Baig, ex-federal secretary representing Balochistan; Prof Azhar Akram, academician; President, All-Pakistan Tax Bar Association; Ashfaq Tola, FCA; advocates Abid Shahban and Farrukh Jawad Pani; Ramzan Bhatti (Customs); Farooq Malik (IRS) and FBR chairman. [TOP]

Dawn
26th September, 2014

Govt collects Rs600bn from oil, gas sector

By Khaleeq Kiani

ISLAMABAD: The government was able to collect around Rs600 billion revenues on oil and gas during financial year 2013-14.

According to data release d by the ministry of finance, the government collected about Rs306bn as non-tax revenues and a special tax (petroleum levy) during the last fiscal year ending on June 30 compared with about Rs280bn of the same period the previous year, showing an increase of more than nine per cent.

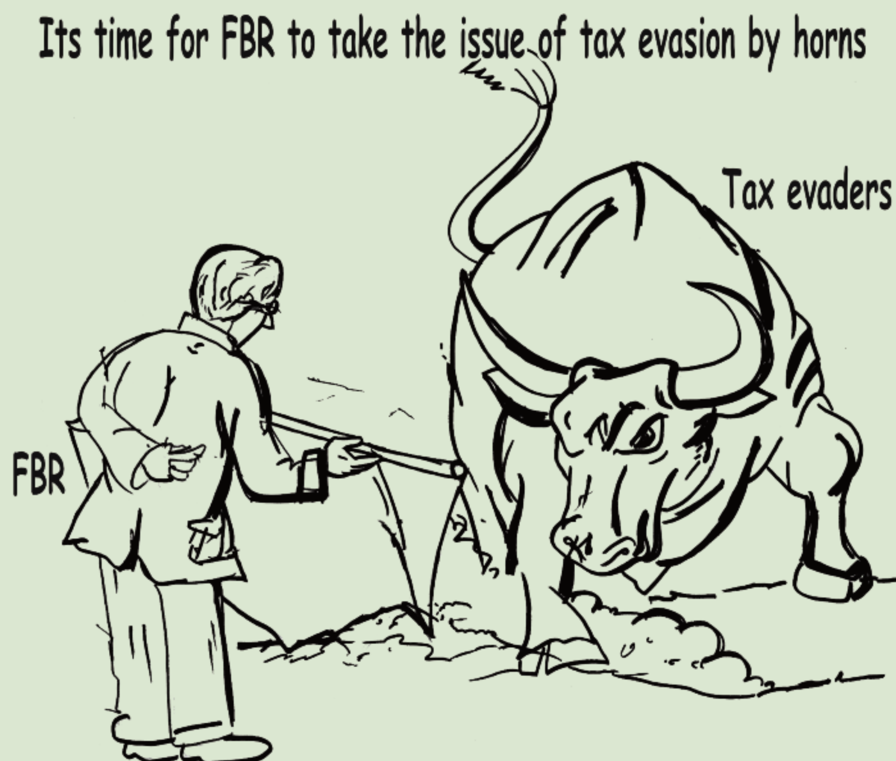
In addition, the government also collected about Rs220bn as sales tax on oil and gas during Escal year 2013-14.

Interestingly, the collection on account of petroleum levy on oil products posted a decline over the previous year.

During the fiscal year 2013-14, collection of petroleum levy amounted to Rs103.5bnagainstRs109.66bn in 2012-13, showing a decline of 5.6pc.

During fiscal year concluded in June 2014, the collection of development surcharge on natural gas amounted to Rs38.5bn against Rs32.2bn of the previous year, showing a healthy increase ofabout20pc. A major contribution of Rs41bn came on account ofdiscount retained on crude oil during fiscal year 2013-14 compared to Rs15.5bn of a year before, showing a substantial 165pc improvement.

This was mainly because of higher international oil prices and improved crude oil production at home. Likewise, the collection on account of royalty on oil and gas during 2013-14 amounted to Rs76.44bn compared with Rs65.2bn of the previous year, showing an increase of more than 17pc.



The government was also able to earn Rs14.5bn during last fiscal year as windfall levy against crude oil compared with Rs23.75bn of previous year, showing a reduction of about 39pc.

On top of that, the collection on account of gas infrastructure development cess during fiscal year 2013-14 amounted to Rs32bn compared with Rs33.56bn of a year before, showing a decline of 4.6pc.

The government`s total revenue collection in 2013-14 amounted to Rs3.637 trillion compared with Rs2.982tr of previous year, showing an increase of 22pc.

Taxrevenue,however, amounted to Rs2.564tr last year compared with Rs2.199tr, showing an increase of 16.6pc.

Therefore, the government was able to end up last fiscal year with a budget deficit of 5.5pc compared with 8pc of the GDP during 2012-13.

Dawn
5th September, 2014