

VAT FAQs

Q 1. *What is difference between VAT and Sales Tax?*

Answer: VAT is levied on goods and services while sales tax is imposed generally on goods. Contrary to sales tax VAT has no cascading effect. VAT is a multistage tax, levied only on the value added at each stage in the chain of supply of goods and services with the provision of a set-off for the tax paid at earlier stages in the chain. Thus, VAT eventually becomes a single point tax.

Q 2. *What will be scope of VAT?*

Answer: VAT will cover supply (including import) of both goods and services at uniform rate of 15 percent unless exempted under the VAT law. The businesses whose annual turnover is less than Rs.7.5 million will be out of VAT net.

Q 3. *How VAT will be helpful in documentation of economy and improve revenue collection?*

Answer: Generally, all the commercial activities involving production and distribution of goods and provision of services are brought under tax net giving tolerance for a pre-fixed registration threshold level. This results in documentation of every body in the supply chain. Those who are not registered in the chain are not in a position to claim or deduct tax paid at purchase levels. VAT promotes economic documentation with the help of its in-built invoice-based credit mechanism. Tax invoice is blood line of VAT-induced documentation. VAT has self-enforcing features and documents business transactions through tax invoicing.

Q 4. *What will be impact of VAT on food prices?*

Answer: In Pakistan, most of the processed packaged/branded food items are already chargeable to sales tax. Basic food items being out of VAT net, there will be no tangible price increase in food items usually sold in processed packaged/branded form. Consumer prices of the food items which are currently being charged to sales tax on retail price basis are likely to fall because VAT will be

charged on actual sale or open market price, not on printed retail price basis. Retailers will be in position to discount their prices to attract consumers.

Q 5. *What is difference between goods and services?*

Answer: Goods are tangible supplies (materials, commodities and articles) and services are intangible supplies. VAT will regulate mixed supplies on the basis of their contractual character. Under VAT, services means anything that is not goods, immovable property or money. However, actionable claims, money, stocks and securities are not included in goods.

Q 6. *How general public responding to VAT*

Answer: Since standard rate is being decreased from 16% to 15% and registration threshold is being increased from Rs.5 million to Rs.7.5 million and most of the exemptions are being withdrawn, people are generally expecting that VAT will bring economic equity and price stability in the market.

Q 7. *What is reaction of Trade Bodies on introduction of VAT?*

Answer: Numerous VAT briefings have been given to the trade and industrial bodies and professional circles. After understanding the nature and dynamics of VAT and benefits to the nation of withdrawal of exemptions, opinion of the business lobbies is fast changing in favour of VAT.

Q 8. *Why VAT is preferable over GST?*

Answer: VAT is more broad-based, equitable and efficient and is without cascading (tax over tax) and hence, is preferable to narrow-based and cascading-ridden traditional sales tax.

Q 9. *What is IMF and World Bank stance regarding implementation of VAT?*

Answer: VAT will enable Pakistan to generate and mobilize domestic resources to meet its economic development and social welfare needs.

Q 10. What is cost of exemption at national level?

Answer: Tax expenditure (cost of exemptions) under existing sales tax system is estimated over Rs.200 billion. VAT will generally curtail exemptions to basic food items, charities, public sector education/health and international commitments as per international best practices.

Q 11. How VAT will protect vulnerable groups of the society?

Answer: By increasing exemption threshold, decreasing standard tax rate and continuing exemption on basic food items, charities, public sector education and health besides withdrawing imposition of tax on retail price basis, vulnerable groups will continue to be protected. Through acceleration of development process with new VAT receipts, employment opportunities will increase and the overall income level of the low strata of society will progress. Besides, with increase in revenue income, state will be in better position to promote social welfare/wellbeing of the masses.

Q 12. What will be impact if rate of VAT is reduced from 15% to 12.5%?

Answer: Transactional loss from sales tax to VAT is roughly estimated at Rs.50 billion which will proportionally increase if VAT rate is further reduced at this early stage. It is however, understood that with the broadening of tax base, VAT rate in Pakistan will be gradually reduced in time to come.

Q 13. Is VAT prone to Tax frauds?

Answer: Every tax is prone to fraud. VAT however, has edge over other consumption taxes as that VAT fraud cannot escape detection sooner or later. Proper monitoring always reduces opportunities for tax fraud. The world experience shows that VAT induces a strong tax culture.

Q 14. What will be role of e-intermediaries in VAT?

Answer: E-intermediaries, appointed by FBR under section 92 of the Federal VAT Bill, 2010, will electronically file tax returns, statements,

declarations and other documents specified under VAT law on behalf of and under authorization from the registered persons.

Q 15. *What is level of preparedness of FBR in VAT implementation?*

Answer: Introduction of VAT in Pakistan being already overdue, FBR is fast preparing itself to replace the existing sales tax system with VAT with effect from 1st July, 2010. In this regard, necessary measures are being taken to increase FBR's infrastructural and operational capacity to undertake its VAT-related functions and responsibilities. Pakistan is a fortunate country that it has a over 20 years' experience of VAT-like sales tax management and adoption of pure VAT in Pakistan in lieu of existing sales tax is not likely to pose any unforeseen problem for its tax machinery.

Q 16. *Will the VAT implementation increase cost of compliance?*

Answer: There will be no increase in compliance cost of those who are already registered and operating under sales tax regime and will automatically switchover to VAT. The new taxpayers will however, have to incur nominal expense on VAT compliance. Due to IT-based VAT processes, VAT compliance cost usually remain low for the taxpayers who discharge their tax obligations regularly on fair lines.

Q 17. *What is response of provinces regarding VAT?*

Answer: The Provinces have already tabled the Provincial VAT Bills in their respective assemblies.

Q 18. *What is plea of Sindh regarding VAT collection on services?*

Answer: Entrustment to Federal Government (FBR) of the functions to collect and enforce Provincial VAT alongside Federal VAT under an integrated tax regime, may not be construed to transfer of taxing powers in respect of services covered under Provincial VAT. Collection and enforcement does not amount to imposition. The Federal Government too is very clear on this constitutional question.

Q 19. *Would VAT implementation result into high inflation rate?*

Answer: Because of absence of tax cascading and in-built invoice-based input-credit mechanism, VAT is almost non-inflationary as compared to traditional sales tax, VAT is neutral to production and consumption choices. It eventually stabilizes prices in the market.

Q 20. *Would exports be zero rated in VAT regime.*

Answer: All exports of goods and services shall be zero-rated under VAT. The input tax involved therein shall be refunded expeditiously.

Q 21. *Would there be any exemptions under VAT.*

Answer: Upfront VAT exemptions are available under the First Schedule each of the Federal and Provincial VAT Bills. Exemptions will generally cover basic foods items, charities, public sector education and health and international commitments.

Q 22. *How exempt goods are different from zero-rated goods?*

Answer: Exempt supplies are input-taxed and zero-rated supplies enjoy effective exemption because the input tax involved therein is creditable/refundable.

Q 23. *What are meanings of the forensic audit in VAT?*

Answer: Forensic audit involves a specialized examination of (mostly documentary) evidence to determine the accuracy or truthfulness of any assertion for judicial or quasi-judicial determination of any fact. VAT Rules will explain the concept of forensic audit under VAT regime.

Q 24. *Don't you think that discretionary powers of VAT officials regarding recovery and raiding business premises are prone to misuse?*

Answer: Under section 61 read with section 90 of the Federal VAT Bill 2010, recovery process commences only after the undischarged tax liability has been adjudged or determined through adjudication observing all the principles of natural justice. Detailed recovery

rules shall be included in the VAT rules. There is no concept of physical raids under the proposed VAT system. Section 75 of the Federal VAT Bill 2010 speaks of the lawful access of the authorized VAT functionaries to records and premises only for tax matters.

Q 25. *How VAT refunds will be made by FBR?*

Answer: VAT refunds will be paid through Expeditious Refund Payment System. This system has already been installed for industrial exporters from the tax period April, 2010 onwards. This system will be upgraded to make electronic refund payments directly in the bank accounts of the taxpayers. The scope of this new refund system will be expanded to cover all other categories of refund claimants in due course.

Q 26. *Would VAT result in increase of cost of doing business?*

Answer: Reduced VAT rate instead of multiple higher sales tax rates will in fact ease out the cash flow of compliant businesses.

Q 27. *Inflation may promote smuggling what are FBR plans in this regard?*

Answer: FBR is already working on formulating and implementing an effective anti-smuggling strategy so that economic equity guaranteed by VAT is not distorted by smuggling. Increase in business documentation under VAT will rather discourage smuggling and motivate transfer of investments from irregular to regular business regimes.

Q 28. *What is concept of consideration?*

Answer: As provided under section 4 of the Federal VAT Bill, 2010, "consideration" means the total of the following amounts:

- (a) the amount in money paid or payable by any person, whether directly or indirectly, in respect of, in response to, or for the inducement of the supply; and
- (b) the open market price of anything paid or payable in kind, whether directly or indirectly, by any person in respect of, in response to, or for the inducement of the supply.

Consideration includes the amounts of Federal and Provincial taxes (including VAT) paid or payable by the supplier. However, price discounts/rebates available under open market conditions are permissible under VAT.

Q 29. *What is concept of input and output adjustments?*

Answer: The actual concept is input tax adjustment, which means that to work out net tax liability, the amount tax paid on the purchases is deducted from the amount of tax charged on sales of taxable goods or services. This is also known as tax credit. Sections 25 to 34 of the Federal VAT Bill, 2010 relate to adjustments under different circumstances.

Q 30. *Would imposition of VAT result in cultivating multiple taxation?*

Answer: No. VAT does not provide for tax over tax (cascading). VAT will replace the whole existing sales tax and Federal excise duties on services.

Q 31. *What are businesses that are not supposed to charge VAT?*

Answer: The businesses who deal in exempt goods or services as well as those whose annual turnover falls below Rs.7.5 million shall not be required to be registered or charge VAT.

Q 32. *How a VAT registration can be verified?*

Answer: On its website, FBR will, as required under section 48 of the Federal VAT Bill, 2010, regularly maintain an updated list of active registered persons under VAT regime. Such information is even currently available under sales tax regime.

Q 33. *How VAT is worked out.*

Answer: Under section 18 read with clause (xiv) of section 2(1) of the Federal VAT Bill, 2010, VAT can be calculated as follows:-

$$\frac{R}{100+R} \times \text{Value of supply}$$

Where “R” is the tax rate

Q 34. What are tax rates under VAT?

Answer: VAT has only one standard rate i.e. 15%. The other rate is zero percent which is applicable on exports or zero-rated supplies.

Q 35. If the Input is used partly for making taxable goods and partly for exempted goods, will input tax credit will be available?

Answer: In such cases input tax adjustment shall be apportioned and be available only to the extent of taxable supplies (creditable purpose) as laid down in section 27 of the Bill. Apportionment formula in this shall be given in VAT Rules.

Q 36. What will be tax implications on sale of old and used goods or scrapped machinery?

Answer: If not sold to another registered person as ongoing economic activity, such machinery and goods shall be charged to VAT on tax fraction basis as laid down in section 21 of the Federal VAT Bill, 2010.

Q 37. What should be done in case goods are returned from purchaser to seller?

Answer: Input tax adjustment is admissible in cases where supply is cancelled as laid down in section 29 of the Federal VAT Bill, 2010.

Q 38. What are the circumstances in which refund of input tax credit is permissible?

Answer: Where supplies are exported or zero-rated in terms of section 12 of the Federal VAT Bill 2010 and if the part of any adjustable input tax amount remains carried forward without being deducted against any output tax as laid down in section 37(3) of the Bill. Procedures for all categories of VAT refund shall be prescribed in VAT Rules.

Q 39. What treatment will be meted out if a business or a part of business is transferred?

Answer: In terms of section 20 of the Federal VAT Bill, 2010 read with entry at S.No.1 of the Second Schedule thereof, where any business or part thereof is transferred as ongoing concern, to another registered person, it shall be treated as zero-rated supply, otherwise the buyer shall first pay applicable VAT and shall then be entitled to adjustments on his registration in terms of section 33.

Q 40. What is turnover threshold for VAT registration?

Answer: As laid down in section 41 of the Federal VAT Bill, 2010, registration threshold is Rs.7.5 million per annum.

Q 41. What is cash basis for accounting for VAT?

Answer: Under section 26(4) of the Federal VAT Bill, 2010, input tax deduction on cash purchases is available only if the value of such a purchase including VAT amount is equal to or below Rs.50,000/-.

Q 42. What is invoice basis for accounting for VAT?

Answer: Tax invoice is required to be issued for every taxable supply made by a registered person to another registered person. The mandatory particulars of a tax invoice are given in section 49(1) of the Federal VAT Bill, 2010. However, under section 50, a registered person may issue a sale receipt for a supply to a person not required to be registered provided the value of such supply does not exceed Rs.25,000/-.

Q 43. How long a registered must keep record?

Answer: As provided in section 54 of the Federal VAT Bill, 2010, period for keeping VAT records is at least six years. However, in case of audit, recovery proceedings, dispute, prosecution or other proceedings, this period extends till such time final decision is made.

Q 44. *What is a VAT audit and how a tax payer will be selected for audit?*

Answer: Statutory provisions for VAT audit are available in sections 69, 70 and 71 of the Bill. These provisions are to be read with section 54. VAT audit is thus an examination of the records and accounts of a registered person for ascertaining the accuracy of the tax liabilities and other obligations discharged by such person. Detailed audit-related procedures shall be given in VAT Rules coming risk-based audit selection criteria.

Q 45. *What happens when a person registered in VAT does not submit returns?*

Answer: VAT liability increases due to addition of default surcharge under section 88 of the Federal VAT Bill, 2010. Besides a penalty of Rs.5,000/- is invoked and if the return is not filed within fifteen days of the due date, a penalty of Rs.1,000/- for each day of default is payable under Serial No.2 of the Third Schedule of the Bill, read with section 89 thereof.

Q 46. *Am I supposed to pay VAT on gifts and promotional material?*

Answer: Yes, if you are engaged in carrying on any economic activity that involves or intended to involve the supply of taxable goods and services. Economic activity is defined under section 5 of the Federal VAT Bill, 2010, which may be read with sections 9, 10 and 41 thereof.

Q 47. *What is treatment when a person liable to registered in VAT is not registered?*

Answer: He is registered compulsorily under section 43 of the Federal VAT Bill, 2010. Procedure for compulsory registration on objective lines shall be given in the VAT Rules.

Q 48. *When and how registration of a person is cancelled?*

Answer: Procedure for cancellation of VAT registration is given in sections 46 and 47 of the Federal VAT Bill, 2010. Registration can be cancelled in the following events:

- (i) where a registered person ceases to make taxable supplies;
- (ii) where a person is no longer required to be registered (e.g. falling below registration threshold);
- (iii) where the supplies made by a registered person otherwise become exempt from VAT despite that a person continues making such exempt supplies. However, a person who is making taxable as well as exempt supplies is required to be registered; and
- (iv) where a person has failed to comply with the VAT obligations or is otherwise not entitled to be registered.

Q 49. *What are the books and record kept for VAT?*

Answer: Under section 54 of the Federal VAT Bill, 2010, VAT records include tax invoices (both for purchases and sales), credit/debt notes and customs documents relating to imports and exports. Details for simplified VAT records and book keeping shall be provided in VAT Rules.

Q 50. *Who is a retail dealer?*

Answer: VAT law as such does not differentiate between retailer/retail dealer and wholesaler/dealer. Nor it defines manufacture or manufacturer. Every person of whatever business category is required to get VAT registration if he is engaged in carrying out an economic activity of making supplies of taxable goods and services.

Q 51. *When tax becomes payable on supplies?*

Answer: As per section 24 of the Federal VAT Bill, 2010, tax is payable at the time of filing a return. However, non-filing of a return does not absolve a person of the obligation to discharge his tax liability under the VAT law. A complete procedure for filing of VAT returns and payment of tax shall be given in VAT Rules.
