Subject: **IMPLEMENTATION OF REFORMED GST IN PAKISTAN.**

Pakistan is in dire need of increasing its tax revenues by implementing a broad-based modern form of sales tax on goods and services. The Sales Tax Act, 1990, was originally designed on the basis of accepted value added taxation doctrines but due to political compromises and revenue exigencies, it increasingly became distorted and narrow-based because of ever-expanding exemptions, special regimes, multiplicity of rates and several other deviations from international best concepts and practices. Resultantly, not only the tax base of sales tax and income tax has been eroded but also lack of documentation of the national economy has proved a big hindrance in the development of effective tax policy options.

2. Under the existing constitutional framework, the Federal government can impose taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed. The Federal government has been levying excise duty on services. After passage of the 18th Constitutional Amendment, taxation of services now wholly falls within the domain of Provincial governments.

3. Presently, apart from **sales tax** on the supply and import of goods, **Federal excise duty** is chargeable on communication (including telecom) services, certain categories of advertisements, insurance services other than life, marine, health and crop, banking services, franchise services and services provided by property developers/promoters, stockbrokers and port/terminal operators. Besides, **Provincial sales tax** is chargeable on services provided by hotels/clubs/caterers, custom agents, ship chandlers and stevedores, courier services and advertisements on TV & radio. Except franchise services, Federal excise duty and Provincial sales tax on all the aforesaid services is being collected under GST mode with backward and forward cross-crediting (inter-tax adjustment) with Federal sales tax.

4. Tax-to-GDP ratio on account of the said sales taxes has stagnated on lower side although internationally, the standard rate of 17 percent sounds on higher side. The

principal reason of lower tax to GDP ratio of sales taxes has been widespread and unbridled concessions and waivers on both local supply and import stages including zero-rating on several categories of domestic supplies, besides non-coverage of the services sector in general.

5. The consultations with tax professional circles have over the passage of time convinced that there is an overdue need to thoroughly reform and revamp the whole existing sales tax system to bring it closer to international standards. The new GST system will change the mindset of the public at large as well as of the tax machinery and will strengthen government's efforts to formally depart from excise-style of sales taxation on goods and services.

6. The GST Bill, 2010 will replace the present Sales Tax Act, 1990. While the issues of collection and administration of sales tax on services are being separately negotiated with the Provinces in the light of recent NFC award, a provision has been included in the Federal Bill to integrate Provincial sales tax on services with the Federal sales tax on goods as and when the Provinces authorize FBR to collect and administer sales tax on services.

7. Under the new GST law, exemptions have been kept intact in respect of basic food items including wheat, rice, pulses, vegetables, fruits, live animals, meat and poultry etc. Edible oil chargeable to Federal excise duty will remain exempt from GST as before. Exemptions earlier available for philanthropic, charitable, educational, health or scientific research purposes or under international commitments/agreements including grants-in-aid will also continue. Moreover, life saving drugs, books and other printed materials including newspapers and periodicals have been kept exempt.

8. Local consumption of sectors like textile (including carpets), leather, surgical and sports goods has however, been subjected to tax. Similarly, defence stores, stationary items, dairy products, pharmaceuticals (other than lifesaving), agricultural inputs, agricultural machinery and implements, aviation/navigation equipments including ships & aircrafts etc. have also been proposed to be taxed. Acquisition of capital goods will be facilitated through expeditious adjustment/refund of input tax involved therein.

9. GST will be chargeable only on value added component of each stage of the supply chain. Due to the provision for **set-off** of the tax paid at earlier stages in the chain, net tax incidence remains as a **single stage levy**. Due to automatic input tax adjustment facility, businesses are attracted towards voluntary registration so that they may avail such adjustments and improve their cash flows. For this reason, GST always promotes documentation and encourages self-compliance.

10. Other salient features of the new GST system are as follows.

- GST will replace the existing regimes of sales tax and excises on services.
- GST will apply on both at import and local supply stages.
- Standard rate of 15% has been proposed instead of the present rate of 17% or multiple other rates going upto 25%.
- There shall be no fixed tax, reduced tax, enhanced tax, retail price-based tax or special tax scheme under the new GST system.
- A uniform enhanced annual exemption threshold of Rs.7.5 million (which is presently Rs. 5 million) shall be applied to keep small businesses including small traders/retailers/cottage industry out of mandatory tax compliance.
- All exports shall be zero-rated.
- Input tax adjustment of both direct and indirect constituents shall be allowed on "totals" basis (excluding entertainment and non-business use passenger vehicles).
- Sales tax on goods and services where so authorized by the Provinces shall be mutually adjustable so that double taxation does not occur.
- No general zero-rating shall be admissible on any commercial form of domestic supply or on any local consumption.
- The GST system will work purely on "self-assessment and self-policing" basis.
- Cash flow of businesses shall be facilitated through expeditious centralized (**Electronic**) refund payment system.

- Tax compliance shall be encouraged through transparent and fair audit system with increased use of modern information technology.
- Adjudication, appeal and alternative dispute resolution (ADR) systems have been provided as before.
- FBR will issue simplified rules to regulate the GST procedures and processes.
- The GST Bill 2010 shall take effect from such date as may be notified by the Federal government.
- The new GST system will be applied in FATA/PATA, the Province of Gilgit-Baltistan and AJ&K in due course.

11. The proposed GST system will certainly not generate any sudden increase in revenue yield. It will however, increase the overall tax-to-GDP ratio from the present below 10% to about 12% in next 3-5 years. Pakistan has a strong potential to implement such value added tax type sales tax because of the reason that besides having a properly-reformed collection infrastructure, it has a long-operating sales tax system and substantial hidden sales taxation on inputs of exempt outputs (exempt supplies are input taxed) is already being borne in the aggregate national consumption.

12. The proposed GST system is expected to operate without any serious inflationary impact. It will rather promote economic equity and enable the country to direct national resources towards more productive goals of national development. Reformed GST is also likely to progressively minimize the grey component of the national economy and facilitate fair income redistribution. It will eventually cast healthy impact on income tax receipts and enhance fool-proof tax culture in the country.
