

P@SHA

Pakistan Software Houses Association
for IT & ITES

**Working Paper for Sales Tax on IT Services Imposed by the Punjab
Revenue Authority, Government of Punjab, Information Technology
Sector**

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Introduction - P@SHA

P@SHA is a platform for promoting, protecting and developing the software industry in Pakistan. It is the representative trade body for the Information Technology and IT Enabled Services. The majority of companies in this sector interact with P@SHA on industry related initiatives and 120 of them are its paid members. P@SHA works closely with the Ministry of Information Technology (MoIT), Pakistan Software Export Board (PSEB), Punjab Information Technology Board (PITB) and other government departments.

It provides a focal point of representation for outside agencies of various concerns. The main objective is to devise ways to promote the interests and concerns of members of P@SHA for development and growth of IT and IT Enabled Service companies in Pakistan with Government functionaries, organizations and all relevant stakeholders.

Learning through various endeavors over the years; P@SHA has implemented formal policies as rules of the association. These have been further communicated to the Government for the formulation of progressive policies. The culmination of old targets and new aims directed at meeting them fuse to create a new era of providing solutions.

Prelude to Working Paper for Sales Tax on Services imposed by PRA

This Working Paper discusses the modalities with respect to facilitation by the Punjab Revenue Authority to members of P@SHA in the matter of sales tax on IT-Services imposed from 1st July, 2013. It is without any doubt that the individuals running the IT companies owe their responsibility towards the province and the State in particular to pay income tax according to relevant laws of Pakistan. However, the same individuals who are the residents of Pakistan, are also trying hard in the challenging economic situation of Pakistan, to contribute, invest, develop and grow the nascent IT sector.

As of present, the registered members of P@SHA, which represents IT and IT Enabled Services companies in Pakistan are facing dilemma in terms of reduction of sales, due to sluggish economy, reduced investor confidence, law and order situation and challenging tax regime, after imposition of Sales Tax on IT services by PRA. It is in this regard that we have held discussions and meetings with the PRA officials and narrated the problems faced by IT companies in general and members of P@SHA in particular.

Though, the members of P@SHA firmly believes that the imposition of sales tax on IT-Services at this stage, based on the IT sector's performance and growth is harsh, non-negligible and burdensome keeping in view

Karachi: Room 310, 3rd Floor Business Center, Block 6 PECHS, Shahrah-e-Faisal, Karachi Pakistan

Lahore: Room 17, 9th Floor Arfa Software Technology Park, 346 B Ferozepur Road, Lahore Pakistan

Tel: +92-21-3541-8121, +92-21-36061051 Email: secretariat@pasha.org.pk Website: www.pasha.org.pk

the existing returns on investment, so we feel compelled to oblige compliance with the tax imposed on IT-Services sector.

Pertinent to mention here that independent estimates from International Organizations project revenue worth more than \$57 Million that flows to IT service provider free-lancers in Pakistan through financial/non-financial institutional channels; which to the detriment of P@SHA and Government of Pakistan will remain hesitant to formalize their service-structures and register with the representative association and tax authorities, in view of this tax.

Rationale of Working Paper

This Working Paper is being issued at the time, where the members of P@SHA have already lost sales and potential business based on Quarter-on-Quarter (QoQ)/Year-on-Year (YoY) income, after the sales tax has been imposed. It is not that, payment of this 16% sales tax is cannibalizing their profits, rather P@SHA members have lost business at the first phase of bids called by the private and public sector organizations, as they were in compliance with the provincial law and added (consumption) tax in their proposals/bids.

The foremost issues faced by P@SHA members, amongst many, is the lack of clarity in the tax-regime enforced by Punjab Revenue Authority vis-à-vis the Federal Board of Revenue and Sindh Revenue Board respectively which has also contributed in not taxing the transactions completing/terminating within weeks and months after imposition of sales tax, and on the flip-side, the rationale for gauging IT-Services on rule of thumb used for taxing IT-Services in comparison with other established service sectors. The description of these issues will be followed by a list of queries highlighting the practical difficulties being faced by the members of P@SHA, hence the same is sought to be clarified by the Punjab Revenue Authority.

A. Treatment of Sales Tax on IT-Services

The Punjab Revenue Authority is well aware of the fact, that the issue of taxation of IT-Services in Punjab came into limelight and to the knowledge of industry representative associations after it was enforced in the Province of Punjab. It led to series of discussions within the IT-Services sector; sporadic individual consultative process taken by members of P@SHA with Tax advisory firms and with representatives of PRA.

P@SHA feels that no consultation process with IT companies' representative associations or organizations were conducted so as to have knowledge of peculiar dynamics of this business-sector

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before imposition of sales tax, as is usually adopted by the democratic governments in developed and developing countries.

The beginning of the tax-year from 1st July, 2013 was spent by most of the IT-Service companies being uncertain as to its imposition and impact, as has been narrated above and was consumed by follow-up discussions and consultative process. It is in this regard, that tax liability concerns were taken to revenue board of Sindh, owing to cumbersome requirement from Punjab resident companies for paying tax to PRA, even in the event of services sold/consumed in Sindh. It was keeping in view of this anomaly, that Sindh Revenue Board issued **Circular No.8 of 2012** referenced as **SRB-3-4/MTP/23/2012/6792** vide letter dated 24th September, 2012 and stated that,

“SRB has already taken up this matter with the FBR and the PRA and requested the status quo be maintained until any issues arising pursuant to the enactment of section 4 of the PSToS Act, 2012, are clarified.”

Practically impossible to Pay Tax on back-date Transactions

While looking at the pluralistic view of the nature of transactions that are practiced in IT-Sector, it is stated, that

- Majority of the IT companies/vendors have signed 3-5 year and 10 year tenure software development and maintenance agreements with customers in order to ensure continuity of services. But this has been done in most cases with price and costs without inclusion of tax some years back. The companies need time and period to integrate, amend and adjust to the new regime by negotiations and signing of documents afresh.
- Moreover, the IT companies that are receiving payments in the 3-5 year tenure or for that matter any other term-period agreement, have already received some of the payments in installments and are yet to receive rest of the payments in that regard.
- Some of the IT services have been rendered and terminated by IT companies to different customers in Punjab, Sindh and Khyber Pakhtunkhwa respectively, till the month of September and December 2013, respectively, and now at this time, recovering tax from them will not be practically possible. Whereas, on an alternative approach, if IT companies were to pay on behalf of those former customers, this would not only be repressive but will add financial strains on the competitive pricing and profits of companies.
- The members of P@SHA and IT companies in general might not be able to have any tax adjustment,

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having significant impact on their tax payable liability, as there are no significant inputs/raw materials used for the development of software or in rendering of IT software services.

In view of the above considerations apart from which has been conveyed through general informative meetings, we request PRA to adopt a *stop-gap measurement* and waive or declare amnesty for the taxes occurring in last two quarters of 2013-2014 fiscal year, which could have been recovered from end-users/private or public sector organizations had there not been lack of clarity on tax issues and genuine concerns raised by P@SHA members had been addressed.

Additionally, the members of P@SHA who have not been able to register themselves with the tax authorities, irrespective of the discussions that are currently under process, should not be penalized for such delinquency. Therefore, all un-registered members be given a period 25 days to register themselves with PRA after amnesty.

Moreover, the contracts that have been signed by the member P@SHA companies before July 1st, 2013 i.e. before the imposition of sales tax on IT-Services, should be exempted from the cover of tax for their original tenure-period of agreement. However, this exemption shall not be extendable to the renewal of those service agreements.

B. Sales Tax to be used as a Stimulus for Economic Growth

The developed countries all over the world have realized and implemented various measures to bring the cycle of revenue generation trajectories in conformity with the idea/schemes to develop under-developed and innovate new fields of business. It is this realization that "Tax" is now less considered to be the instrument to direct revenue generation and more of it is now referenced to be the instrument for ***stimulating engine of economic growth***.

The PRA is in knowledge of the sluggish economy, dismal number of Tax-to-GDP ratio and tax evasions that is prevalent in Pakistan. Moreover, the official statistics by Federal Government will be helpful in highlighting the fact that a fraction of IT-products and services are part of domestic IT-sales from the Pakistan resident companies, whereas majority of it is exported, which in itself is exempted till the year 2016.

The highlight of this document is also that there is an increasing trend being realized by Pakistani domestic customers to digitize or automate their complete operations. This realization has also led to stimulate local IT service provider's interest to work and offer services within Pakistan. Needless to mention, that foreign web-based solutions are competing easily with Pakistan based companies

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through competitive pricing, based on the tax and infrastructure incentives available in their respective countries. If Government of Pakistan, including Provincial governments of Punjab and Sindh wants to stimulate then there is an important need to provide incentives, in the form of more infrastructure, enablement of IT-sector friendly policies and last but not the least favorable tax regime.

The favorable tax-regime is there, as initiated by the Punjab Revenue Authority, Government of Punjab in terms of facilitation of tax-payers, however, we feel that the tax percentage should be rationalized and subsidized so as to stimulate economic growth in general and IT-Services sector in particular.

The existing percentage-rate of 16% could be narrowed down to at least under 5%, which will be reflective of Government of Punjab's will to generate revenue as well as to become the harbinger of economic growth by promoting incentives to nascent IT-Services sector.

In view of the above considerations apart from which has been conveyed through general informative meetings, we request PRA to adopt attractive reduced rates, so that both P@SHA being the premier nation-wide representative association of IT and IT-Enabled Services along-with the Government of Punjab can run mass enrollment of IT businesses in a formal structure.

Clarifications sought from PRA

In addition to the submissions and recommendations made in this Working Paper, following clarifications are sought from PRA. The table below lists products and services of our members companies and require clarification on whether Sales Tax on Services tax code applies to them and if so, which one.

Clarification	Type	Taxed?	Code?
Description	Product/Service	Y/N	#
Subscription fee or maintenance renewal fee whereby the software is developed outside Pakistan and support is also provided online by the software developer.	Software subscription / maintenance renewal		
If the software is sold as a product and only license is provided then does this fall under the category of services or product? Is there a difference based on the product origin (local or international). What about the upgrades of the products/Licenses?			
If the Software License is provided in the physical form (CD/DVD/USB) as compared to transfer of the software License over the internet, does this has impact on the classification as Product or Service?			
If the company is located in Punjab but delivers services in other provinces and federal capital the sales tax should be deposited to PRA or other revenue collecting authorities. Please clarify against each of the revenue authority			
If the company is located outside Punjab (federal capital, KP, Sindh, Baluchistan) and services are delivered in Punjab then who would be the revenue collecting authority?			
An entity is maintaining a website (Jobs Portal) through which it provides its clients an access to its CV Bank and Software, which is used by them for recruitment of employees. The entity neither develops any software for them, nor issues any licenses whatsoever; rather it only gives access/right to use that software for a limited period			

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<p>of time. Fees charged by the entity to clients are neither for any kind of software maintenance charges. The entity is also not itself engaged in recruitment on behalf of clients. Its services are restricted up to the stage where the recruitment process has yet to be initiated. The clients themselves do all the hiring process by using its software once their job is appeared on the entity's website. The entity is also providing space on its online website to some organizations intending to advertise their brands or products.</p>			
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Recommendations by P@SHA

In lieu of the significant impact of Sales Tax on domestic information technology product and services companies, P@SHA recommends the following:

1. Treatment of Sales Tax on IT-Services

In view of the anomaly and conflicting claims to tax between PRA and SRB due to which Sindh Revenue Board (SRB) issued **Circular No.8 of 2012** referenced as **SRB-3-4/MTP/23/2012/6792** vide letter dated 24th September, 2012 and stated that,

“SRB has already taken up this matter with the FBR and the PRA and requested the status quo be maintained until any issues arising pursuant to the enactment of section 4 of the PSToS Act, 2012, are clarified.”

It is urged to solve this matter on priority and a joint communique be issued by PRA and SRB effectively before 31st March, 2014 to determine the appropriate repository of tax amount, so that IT-companies can accordingly decide as to the nature of future inter-provincial agreements.

2. Practically impossible to Pay Tax on back-date Transactions

a. PRA is requested to adopt a *stop-gap measurement* and waive or declare amnesty for the taxes occurring in last two quarters of 2013-2014 fiscal year.

b. Members of P@SHA who have not been able to register themselves with the tax authorities, irrespective of the discussions that are currently under process, should not be

penalized for such delinquency. And all un-registered members be given a period 25 days to register themselves with PRA after amnesty.

c. Moreover, the contracts that have been signed by the member P@SHA companies before July 1st, 2013 i.e. before the imposition of sales tax on IT-Services, should be exempted from the cover of tax for their original tenure-period of agreement. However, this exemption shall not be extendable to the renewal of those service agreements.

3. Sales Tax to be used as a Stimulus for Economic Growth

PRA is recommended to adopt attractive reduced rates, so that both P@SHA being the premier nation-wide representative association of IT and IT-Enabled Services along-with the Government of Punjab can run mass enrollment of IT businesses in a formalized structure.

4. The queries should be responded in detail, so that over-lapping issues and exact determination of tax under the respective code/heads can be determined.
5. P@SHA Industry Taxation Event(s) with PRA to recruit maximum IT companies to enroll
6. Submission of Sales Tax on the basis of receipts instead of billing, after amnesty of back-date transactions. Currently Sales tax has to be submitted on basis of Invoicing.
7. Most of the IT companies do not have any input sales tax claims. If a company does not claim input tax settlement then tax rate should be different.
8. PRA and other public sector organization must make PRA registration mandatory just like NTN/Sales tax registration for all tenders/bids, so as to remove any disadvantages to the registered members of PRA.
9. PRA/Sales Tax on Services Awareness sessions must also be created at public and corporate sector through relevant trade bodies and forums. Many public sector and corporate sector organizations don't accept Sales Tax on Services is applicable on some specific services that they acquire from IT Industry and eventually P@SHA members end up losing business as non-registered companies have the price advantage.
10. Instead of submitting returns for PRA and FBR separately; there must be one consolidated return to simplify the business process and reduce the efforts required.

We, thank you for your realization of P@SHA's concerns and for you offer to address the issues through mutual consultations and discussions. Timely and effective resolutions of the concerns are much desired in this situation.