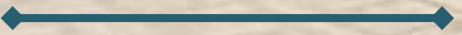


COMMENTS ON KHYBER PUKHTUN KHUWA FINANCE BILL 2020



Wednesday, 24 June, 2020



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1. PROLOGUE

The KPK Budget 2020-21 ("the Budget") estimates were announced by the Provincial Finance Minister for KPK on the 19th of June 2020 with a total outlay of Rs. 979 Billion (A 9% increase when compared to the previous fiscal year which saw an outlay of Rs. 900 billion) with allocations for settled as well as merged areas. The budget has set a Rs. 56 billion worth revenue target for the province of KP for the fiscal year 2020-21, 5.6% more than from the previous year's (2019-2020) estimates. The current expenditure for the settled areas is provisioned to be increased by 9%, whereas, for the merged areas the provision is increased by 10%. Certain amendments have been proposed in the Bill regarding construction services and services provided by contractors in the second schedule, whereas, the services are brought back under the ambit of 5% Tax, that was brought down to 0% earlier through a Notification dated 2nd April, 2020. Our comments on the Khyber Pakhtunkhwa Finance Bill 2020 have been presented hereinbelow.

2. POWERS AND FUNCTIONS OF THE AUTHORITY – SECTION 5

Section 5 of the Khyber PukhtunKhuwa Finance Act 2013 ("the Act") enlists the powers available with Khyber PuhkhtunKhuwa Revenue Authority ("KPRA"). Now through the KPK Finance Bill 2020 ("the Bill"), the following powers of KPRA have been delegated to the Director General of KPRA:

- To manage, conduct or perform and supervise all day to day or other regular work.
- Exercise quasi-judicial powers in case of suspension of registration, de registration and revision of any orders by officers of KPRA.
- Transfers, postings, delegation, of powers, assignment of duties and functions, changes of jurisdiction or transfers of cases etc.

3. APPLICATION OF PRINCIPLES OF ORIGIN AND REVERSE CHARGE IN CERTAIN SITUATIONS – SECTION 20 OF THE ACT.

The sales tax on services is levied and collected by the respective provincial authorities on the basis of the principle of origin. As per the KPRA and Punjab Revenue Authority ("PRA"), the sales tax on services is based upon the consumption doctrine, i.e. tax will go to the province where service is consumed, and incidence of tax is borne irrespective of the place of its rendition. As per Section 20(1) of the Act, where a person is providing taxable services which originates in a Province other than KPK but the recipient of such services is a resident of KPK and has charged tax accordingly, the person providing such services shall pay the amount of tax so charged to the KPRA.

In case, the enforcement of such principal of origin is difficult due to jurisdiction issues, the law lays down principal of reverse charge whereby the liability of sales tax collection and deposit is on recipient of service and not on service provider. Before Finance Act 2019, where a recipient of taxable service was **registered as a service provider with KPRA** was liable to deduct the whole amount (100%) of tax in respect of the service received and pay same to KPRA in line with provisions of PRA. Through FA 2019, the amount of deduction is required to be made as per rates mentioned in Khyber Pakhtunkhwa Sales Tax on Service Special Procedure (Withholding) Regulation, 2015 which is same as was previous i.e. 100% for services other than advertisement.

The Bill now proposes that if the person receiving the service is resident in KPK and service originates outside KPK and the service provider does not discharge its liability according to principal of origin as discussed above, the person receiving service shall be liable to deduct and deposit the tax, even **he is not a registered service provider with KPRA**.

4. SCOPE OF TAX AND ALLIED MATTERS – SECTION 20 OF THE ACT

As per Section 20, only those services are liable to sales tax that are mentioned in the Second Schedule to the Act, viz a viz, only those services are taxable which are specified. The rate of tax is specified in the Second Schedule to the Act, which is generally 15% for most of the services. After Second Schedule, the Act lays down principals of application and interpretation inserted by FA 2019, which uses the words 'standard rate' in various principals relating to restriction of input, performance of more than one service etc. Further, the newly

proposed Section 26A also states provisions relating to Standard or general tax rate application choice. Now, the Bill proposes to **define** standard or general rate used above to be fifteen percent for all purposes of the Act.

A person shall be entitled to deduct from the payable amount, the amount of tax already paid by him on the receipt of taxable services used exclusively in connection with taxable services provided by such person. In normal circumstances, the tax on input is paid to service provider on payment of service invoice, however, in case of reverse charge the input tax is paid directly to KPRA. Now bill proposes to add an explanation that the amount paid relating to input tax, directly to government will also qualify for adjustment although it not paid in normal mode of VAT.

5. STANDARD OR GENERAL TAX RATE APPLICATION CHOICE – SECTION 26A OF THE ACT

A new Section 26A is proposed to be inserted, whereby, a registered person is allowed to apply the standard rate of tax after taking permission from KPRA in respect of services which are chargeable to reduced rate under the Second Schedule or any SRO, and can claim input tax adjustment as admissible from date of permission. However, he cannot on his own, switch to the reduced rate unless prior permission is obtained from the KPRA, after inquiry or audit. If a person applying the standard rate switches to a reduced rate and has unadjusted input tax accumulated in books, he will not be adjustable unless the person switch to standard rate again and obtain permission from KPRA for such adjustment.

6. ASSESSMENT OF TAX – SECTION 40 OF THE ACT

Section 40 lays down provisions for proceeding of assessment along with penalty and default surcharge, which can be commenced if officer found any short payment of tax paid by registered person. Now, the Bill proposes to amendment the said Section in such a manner so as to include inadmissible adjustment of input tax as a ground to initiate such proceedings also.

7. REGISTRATION – SECTION 40

In line with the proposed amendments for resident unregistered persons in Section 20 of the Act as withholding agent, an explanation is proposed to be inserted, whereby, it is clarified that any person who is not a service provider and hence not require to be registered with KPRA, but is liable to act as withholding agent, shall be deemed to be a registered person. Moreover, the Rules regarding registration, enrolment or other obligation or formalities shall be applicable regardless of his place of residence, business or other activities.

8. INFORMATION DECLARATION OR RETURN – SECTION 55A OF THE ACT

A new section 55A is proposed to be inserted, whereby, the persons dealing in the provision of exempt services are now under a legal obligation, if KPRA requires so, to regularly file monthly or periodical declarations or returns, and any failure in this regard will invoke **only** penalty provisions with respect to non-filing.

9. PRINCIPLES OF APPLICATION AND INTERPRETATION – SECOND SCHEDULE

Through FA 2019, principals of application and interpretations were added in the Second Schedule. Clause 16 provides that in cases where tax is to be calculated on the basis of fraction, the following formula shall be used. However, the formula was provided after clause 17 which caused confusion. This drafting error is now proposed to be corrected by placing formula below Clause 16.

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