

ITD Global Conference

# **Management of Tax Debt Collection**

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# Size & Taxation of SME in Pakistan

# Size of SME in Pakistan

- There are 3.2 million business enterprises in Pakistan of which 99% are SME (based on less than 10 employees criteria);
- Their share in employment is 78% and in value addition about 35 percent;
- About 53% are engaged in wholesale & retail trade business;
- The capital investment of SMEs excluding land and business is generally less than Rs. 1 million (\$16,666);
- In terms of sales, 93 % of the enterprises have sales below Rs. 1 million(\$16,66);

Source ; (Economic Census of Pakistan, 2005)

# Taxation of SME

- In Income Tax Law, small company is defined as the one which has a paid up capital of up to Rs. 25 million (US \$ 416,666), has annual turnover of up to Rs. 250 million and has 250 employees any time during the year;
- The corporate rate of taxation for small companies is 20% as compared to standard rate of 35%.
- Small companies are not required to file electronic return and the bookkeeping requirements are also less stringent for them;

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# Taxation of SME

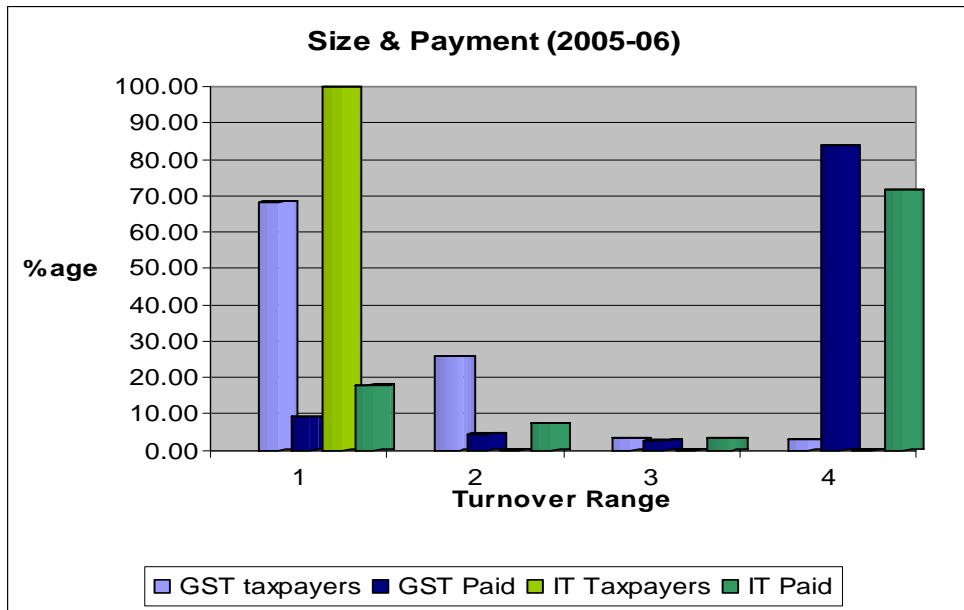
- Sales Tax Law does not define SME distinctly. Businesses having turnover below the threshold level of Rs. 5 million (US\$ 83,000) are generally considered as small;
- For the businesses above threshold level there are no special or different regimes except the retailers;
- A standard rate of 15 % is applicable for all the businesses;
- The bookkeeping and return filing requirements are not different for SMEs either;
- The non corporate businesses are however, allowed to file manual return where as for the corporate taxpayer it is mandatory to file electronic return.

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# Taxation of SME

- For administrative purposes the small & medium businesses are defined as businesses having less than Rs. 500 million turnover and they are dealt separately from large taxpayers in Regional Tax Offices (RTOs);
- Currently there are two LTUs and six RTOs which are likely to increase to three and thirteen respectively in next one year.

# Size & Tax paid by SME



## Turnover Range

- 1=Rs. 0-5 million, micro taxpayers
- 2= Rs. 6-100 million, small taxpayers
- 3= Rs.101-250 million, medium taxpayers
- 4= Rs. >250 million, large taxpayers

- 68% of micro taxpayers in GST & 99 % in IT pay only 9% & 18% tax;
- 3% of large taxpayers in GST & 0.02% in IT pay 83% & 72% tax;

# Debt & Debt collection Strategy

# Debt by Revenue Type

Turnover Range (Rs. Million)	GST (VAT)		Income Tax (IT)	
	Debt (Rs. Billions)	Share (%)	Debt (Rs. Billions)	Share (%)
0-5	5.94	28.10	7.04	25.92
6-100	7.43	35.10	9.28	34.16
101-250	2.25	10.60	5.23	19.26
>250	5.53	26.10	5.61	20.66
<b>Total</b>	<b>21.15</b>	<b>100.00</b>	<b>27.16</b>	<b>100.00</b>

- SME owe 74% of the debt in GST & 80% in IT
- Small businesses (6-100) owe most of the debt

# Debt Collection Policies

The legal framework provides many ways to recover outstanding debts.

- **Deduction:** the tax office deducts the amount payable by a taxpayer from any money which may be at the disposal or in the control of any officer of sales tax, income tax, customs or federal excise.
- **Garnishee Notice:** the tax office can recover the debt by sending a notice to any person who holds or may subsequently hold any money for or on account of the person from whom tax may be recoverable to pay such officer the amount specified in the notice.
- **Penalty:** A person is liable to pay additional tax if an amount of tax assessed remains outstanding after the date it is due and payable. Currently the rate is set at 12 % annual compounding rate.

# Debt Collection Policies

- **Recovery Procedure:** Starting from a recovery notice to attachment and auction of immovable property, it is used as a last resort to recover debt;  
The law also provides some respite to the taxpayer
- **Waiver/Amnesty:** are announced time to time to waive off debt;
- **Debt Write off**

# Challenges faced by the Revenue Administration

# Efficiency

- Total Debt as % age of Current Revenue Collected is quite high, 14% in Sales Tax and 13% in Income Tax. However, 1 year debt as % age of current collection is 6.2% in GST & 3.8 % in IT;
- Debt collected as % age of Debt Collectable is quite low, 7 % in GST and 23 % in IT;

## Reasons:

- The Enforcement Division in tax office is not sufficiently staffed;
- There is no operation document to report debt and lodgement of debt;
- The tax office do not take any risk analysis & do not prioritize collectable debt

# Ineffective Audit

Nearly 67 % of the collectable debt against SME in GST & 71% in IT is more than one year old.

## *Reasons for accumulation of debt:*

- Inability to recover debt due to lengthy litigation process;
- Less focus on settlement of cases referred by Auditor General of Pakistan;
- Ineffective audits;

Resultantly most of the debt more than 1 year old is “Bad Debt” and uncollectible

# Effectiveness

- It is very difficult to keep track of S&M taxpayers;
- Most of the SME are revenue constraint and they have limited access to capital;
- Political lobbying and interference hampers the debt collection process;
- Penalties provided in the law though harsh, but are not implemented effectively;
- The rate of additional tax is low as compared to market rate of capital.

# Transparency & Fairness

Administrative costs of compliance in terms of regulatory framework and corruption have been often cited as the major constraints to development of SMEs in Pakistan

## *Reasons*

- Tax Administration policies are not easily comprehensible by S&M taxpayers;
- Tax office has no mechanism to distinguish the compliant but revenue constraint taxpayer from wilful non compliant taxpayer;
- There is no separate office or phone line to arrange debt payments by S&M businesses

# Choices

- Improve Debt Collection mechanism;
- Improve Communication and taxpayer access to information;
- Strengthen the staff at tax offices & Improve Training of the staff;
- Write off debt more than 5 years old;
- Outsource debt Collection function;

# Recent Initiatives

In the last few years various measures have been taken firstly to minimize the occurrence of debt and secondly to manage debt efficiently:

- Introduction of Self assessment has reduced the number of disputed assessments and thereby incidence of debt;
- Introduction of ADR system and strengthening of litigation process has resulted into quick disposal of cases and is expected to reduce accumulation of debt;
- System of audit has been streamlined to raise genuine tax demands only;

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# Recent Initiatives

- Compliance Management System has been introduced to monitor nonpayment/ short payment and ensure timely enforcement of law to avoid lengthy litigation

The ultimate objective of the Debt Management Policies is to establish systems and procedures that can ensure quick collection of debt

It is hoped that this forum would provide experience and guidance to meet the concerns and achieve objective.

**Thank You**