**Withholding of taxes & related aspects**

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The tax culture in the developing countries is not that much encouraging, due to which it has been observed that the taxpayers are reluctant to pay tax on the income they generate, which is generally termed as Income Tax. Even the taxpayers try to avoid obtaining registration under Income Tax laws. While, the tax from those who are liable would generally be due after the close of the tax year. Due to all the aforesaid mentioned reasons, the law makers have inserted provisions making those liable for collection of tax who are making the payments to the recipients. These persons have been classified as Prescribed Persons or in other words they are also the Withholding Tax Agents, who collect the tax from the payment made to the recipients and deposit same in the national treasury. The tax being collected or deducted is of the recipients only, they are just the intermediary.

In order to monitor the withholding tax agents, whether the compliance is appropriately being made or not, section 165 of the Income Tax Ordinance, 2001 [the Ordinance] requires every person who is collecting or deducting tax from a payment shall furnish to the Commissioner a quarterly statement in the prescribed form. The statement generally comprises of the name, National Tax Number, Computerized National Identity Card and address of person from whose payment the tax is being collected or deducted in each half year, along with the taxable amount and the amount of tax. The statement shall also mention the details where the tax could have been collected or deducted but have not been done as the recipient presented exemption certificate for non-withholding of tax, undertaking as the tax was for instance collected at import stage as commercial imports or the amount of which the payment is being made pertains to the re-imbursement.

There are many unattended aspects and measures of monitoring proceedings of withholding of taxes which if implemented can result in increase in justified tax revenues and the number of active taxpayers

Now, the ambiguity remains, whether every person who has actually collected or deducted tax from any payment is liable to furnish withholding tax statement and the person who has not collected or deducted tax from any payment by any reason is not liable to furnish same or every person who is liable to collect or deduct tax but for whatever reason has not collected or deducted tax is also liable to furnish withholding tax statement. The later one is correct. Meaning thereby, any person who is liable to collect or deduct tax shall also be liable to furnish withholding tax statement. In case, if this person fails to do so, it will be termed as doing non-compliance and will ultimately be subject to the penal provisions of the Ordinance.

If the withholding tax agent doesn’t file, the withholding tax statement at all or doesn’t file same on time then the person shall be subject to the penalty under sub-section 1 of the section 182 of the Ordinance. Per the provisions of the Ordinance, the person shall pay a penalty of PKR 5,000 if the person had already paid the tax collected or is withheld by him within the due date for payment and the statement is filed within ninety days from the due date of filing of statement. Whereas, in all other cases, a penalty of PKR 2,500 for each day of default from the due date subject to a minimum penalty of PKR 10,000 shall be charged.

It is crystal clear from the preceding paragraph, that if a person is not liable to collect or deduct withholding tax then he shall not be liable to file withholding tax statement and thus cannot be subject to any penalty by revenue authorities for non-filing of withholding tax statement.

The question however remains, that if a person who was liable to file withholding tax statement but either doesn’t files on time or files at all, but simultaneously have collected or deducted tax which is timely deposited to national exchequer will also be liable to the penalty provisions. It has been observed that the revenue authorities are charging huge penalties in these cases and generating revenue. Although, the taxpayer disagreeing to it then takes it to next appellate forum. The matter has remained subject of discussion in various judgements of superior courts which have been decided on the principle of “mens rea”. This principle states that regardless of the actual action of the person the intention behind that action needs to be checked in order to conclude that person has committed a willful default. The onus in case of penalty proceedings is on the tax department to prove regarding intent, knowledge, recklessness and negligence.

In the light of the said principle, the intent of legislation in respect of provisions laid under section 182 of the Ordinance are to penalize only where the person has made a willful default and it has also resulted into loss of revenue. The intent of section 182 however, is not to make money or generate revenue rather to penalize a person. The tax authorities cannot use it as a source of achieving their budgetary targets. These provisions are used for the improvement of the taxpayer for the subsequent compliances not to give them an undue hardship. These undue penalties are not only a reason of incurring excess compliance cost and administrative cost creating a burden to the economy, but it also affects the taxpayers time in pursuing the cases further.

The above issue can be resolved if tax department abides by mens rea principle to avoid dispute at later stage. Alternatively, it can also be resolved by insertion of a single penalty for instance of Rs. 25,000 to Rs. 50,000 in case when taxpayer has collected or deducted tax appropriately but files the withholding tax statement any time before the commencement of monitoring of withholding tax proceedings. However, in case if withholding tax statement is not filed till the initiation of monitoring proceedings then Rs. 1,000 to Rs. 1,500 per day of default should be levied as ensuring compliance is also essential based on the time limitation specified in subsequent paragraphs. While, this amount should be double for the taxpayer who is liable for filing of withholding tax statement and has not filed same and the tax collected or deducted have also not been deposited to the National Treasury.

Apart from this it has also been observed that monitoring of withholding proceedings is not subject to time limitation as per existing law. Although, an aid is taken from the record keeping time of minimum six years under section 174 of the Ordinance. The time limitation should be clearly and explicitly mentioned under the Ordinance so that it doesn’t become an issue of dispute at later stages as it has also been observed that the tax department is carrying out proceedings beyond record keeping time giving an argument that monitoring proceedings are nowhere subject to time limitation. Again, the pressure then comes to the Hon’ble High Courts where the stay for proceedings are obtained resulting in the increase in number of cases without attaining the finality of the case.

In continuation of above, the limitation of the time for these proceedings should be of not more than two years from the end of the tax year to which it relates. The reason being, it is easier for the taxpayer to reconcile the payments with the financial statements in form of movements when the reconciliations are demanded in shorter period from closure of the tax year. The problem arises when reconciliations are demanded several years after the end of the tax year when it becomes a cumbersome exercise for the taxpayer to reconcile. The purpose of these proceedings in general is to monitor the compliance, thus, the ideal time to monitor and rectify should be the time near to the period when transaction takes place so that correction is done on timely basis and the same mistakes are not repeated in the future.

Furthermore, a concept of materiality should be introduced for the purpose of reconciling the withholding tax statement with the financial statements considering it is not practically possible for the huge entities having thousands of transactions in a year to reconcile with the withholding tax statements file after lapse of many years. It has been witnessed that department never challenges the rate applied which could also be incorrect, rather, the entire focus in creating demand under these proceedings are from the unreconciled amount provided by the taxpayer or documentation.

In order, to further make this process transparent and beneficial, Information Technology (IT) should be introduced. For instance, as the taxpayer uses the opening and closing balances of the vendors to reconcile the movement, the system should automatically select the material transactions based on risk and amount and an external confirmation to the related parties for opening and closing balances should be sent without human intervention. This will help the department to check whether the amounts being given for the purpose of monitoring proceedings, by taxpayers are correct or not.

Presently, after the introduction of Tenth Schedule of the Ordinance which is a commendable measure to bring In-Active taxpayers in list of the active taxpayers, but the same is not being fully utilized. For instance, IT systems shall be used to detect where the withholding tax agent has collected a tax at a rate for In-Active taxpayers that is twice of the usual rate, then the person shall automatically be sent a notice of non-filer of return of income seeking justification, again without human intervention, after system checks that the NTN / CNIC on which tax have been withheld is actually In-Active. However, the subsequent response of that person shall definitely be evaluated by the concerned department and then onward decision should be taken. This will help increasing the number of active taxpayers to a greater extent.

To conclude, there are many unattended aspects and measures of monitoring proceedings of withholding of taxes which if implemented can result in increase in justified tax revenues and the number of active taxpayers. Only, the way of carrying out is to be given a correct direction if the positive results are to be obtained.

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