

***KARACHI TAX BAR ASSOCIATION
PRE-BUDGET SEMINAR***

INDIRECT TAXES

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A. STRUCTURAL REFORMS

1. Single authority for administration of all taxes

- Presently, there are five tax collecting authorities including four provincial sales tax authorities and the FBR who collects income tax, sales tax and Federal Excise Duty (FED).
- Under the present structure, taxpayers are required to deposit sales tax with different tax authorities including withholding tax and their tax matters are administered by different tax authorities. Resultantly, notices for audit / monitoring are received from different tax authorities.

A. STRUCTURAL REFORMS

- The KTBA therefore, suggests that a new structure should be introduced whereunder there should be:
 - (i) A Single return form which covers all applicable federal and provincial sales taxes and FED.
 - (ii) A single “collecting authority” (*distribution of taxes should then be decided amongst Federal and provinces under a mutually agreed formula*).
 - (iii) Single audit authority.

A. STRUCTURAL REFORMS

- Guidance from India:
 - (i) Uniformity in Federal / Provincial Laws.
 - (ii) GST council.
 - (iii) Common registration number.
 - (iv) Single return / common filing portal.

A. STRUCTURAL REFORMS

2. Resolution of issues between Federal and provinces

- Presently, there is a conflict between the Federal and provinces regarding right of taxation of certain services, like, toll manufacturing, franchise restaurants etc. Further, there are also conflicts in between provinces regarding right of taxation on the basis of 'origination' or 'destination' etc.
- The Bar feels that these issues causing lot of mistrust and confusion among taxpayer and therefore, it is necessary to constitute a fully empowered commission to resolve the issues between the Federal and provinces and in between provinces and to bring harmony in sales tax laws . This step would be in a right direction to promote stable tax regime and trust between the taxpayer and tax authorities.

A. STRUCTURAL REFORMS

3. Consequential measures after introduction of 'STRIVE'

- STRIVE ensures collection of tax from seller ***before*** allowing the buyer to claim input tax.
- The Bar, therefore, suggests that sales tax withholding in case of registered persons should be done away with and such withholding should be restricted to payments to unregistered persons with an aim to identify them and bring them into tax net.

A. STRUCTURAL REFORMS

Further, following anti-avoidance provisions require reconsideration for withdrawal, after the introduction of STRIVE:

- **Section 8 (1) (ca)**-----Goods or services in respect of which sales tax has not been deposited in the Government treasury by the respective supplier.
- **Section 8 (1) (caa)**-----Purchase in respect of which a discrepancy is indicated by CREST or input tax of which is not verifiable in the supply chain
- **Section 8 (1) (d)**-----Fake invoices
- **Section 8 (A)**-----Joint and several liability of registered persons in supply chain where tax unpaid
- **Section 8 (B)**-----Restriction of claiming input tax upto 90% of the output tax

A. STRUCTURAL REFORMS

4. Publication of list to whom sales refunds issued

- Refunds are sometimes issued on fake and flying invoices whereas genuine / honest taxpayer suffer due to delaying tactics. The Bar, therefore, suggests that the FBR should publish on quarterly basis, a list of persons to whom refunds were released and the date when such refund was applied. This would be a right step towards transparency and will act as a deterrent to corrupt people / practices.

A. STRUCTURAL REFORMS

5. Concept of Group Taxation in sales tax law

- A section, on the lines of income tax, to this effect should be incorporated in the Sales Tax Act, 1990 whereby group companies should be allowed an option to be taxed as one fiscal unit for the purposes of Sales Tax.
- As a result, sales tax refund / excess input tax of one Group Company would be adjustable against the sales tax payable by another group company.

A. STRUCTURAL REFORMS

6. Sales tax exemption for goods supplied under Islamic mode of financing

- Under the S.R.O 445 (1)/2004 dated June 12, 2004 goods delivered under a Murabaha financing arrangement to or by a bank or a financial institution does not constitute supply and therefore not chargeable to sales tax.
- The Bar suggests that Goods delivered under other Islamic modes of financing approved by the SBP and SECP should also be excluded from the purview of sales tax.

A. STRUCTURAL REFORMS

7. Sales tax on 'Retail Price Basis' under the Third Schedule is against the principles of VAT

- The sales tax on items listed in the Third Schedule of the Sales Tax Act, 1990 is recovered from the manufacturer on the basis of the retail price. This structure of taxing the retail items, is against the fundamental concept of VAT.
- The Bar suggests that sales tax on Third Schedule items should be gradually deleted and the concept of VAT should be restored by making all persons in supply chain subject to sales tax.

A. STRUCTURAL REFORMS

8. Presumptive/value addition/fixed sales tax regimes

- In line with VAT International Best Practices, all Presumptive / Value Addition/ Fixed Tax Schemes should be abolished and all such sectors/ goods may be brought under the uniform tax regime. This step will provide a level playing field for all registered persons and restore their confidence.

B. REVENUE MEASURES

1. Requirement of NTN for commercial electricity connections

- At present, large number of persons is doing business, either as retailer/wholesaler or manufacturer on small scale are not registered.
- In order to bring such persons into the tax net, it is suggested that the condition of obtaining the NTN should be made mandatory before obtaining a new commercial electricity connections and three phase electricity connections used for manufacturing purposes.

B. REVENUE MEASURES

2. Utilization of data obtained at the time of income tax withholding or sales made to unregistered persons

- Under section 236G the Income Tax Ordinance, 2001, every manufacturer and commercial importer is required to collect advance income tax from distributors, dealers and wholesalers at the time of sales made to them. Similarly, 236H provides collection of advance income tax from retailers.
- These withholding provisions should be expanded to all types of goods, but restricted to non-filers / un-registered person. The data of such non-filer / un-registered dealers, wholesalers and retailers reported by manufacturers and importers can be used to bring unregistered distributors, dealers, wholesalers and retailers into tax net.

B. REVENUE MEASURES

- Data reported in respect of ‘non-filers’ by withholding agents under income tax law, and ST withholding of un-registered person should also be utilized for proper enforcement, and expanding the tax net.
- Further, sales to unregistered person should also be reported party-wise in ST returns.

B. REVENUE MEASURES

3. Industry-wise input/output standard ratio

- Industry-wise standard input – output ratios should be determined and finalized in consultation with all stake holders. Immunity from audit may be allowed to registered persons if they meet prescribed input-output ratios. This would be also help in curbing inadmissible refunds.

4. Increase in value addition tax in case of commercial imports

- The value addition tax applicable on commercial imports at the rate of 3% should be enhanced to 5% to 7% for luxury goods.

C. RELIEF MEASURES

1. Standard Sales Tax Rate of 17%

- Present rate of Sales Tax @ 17% with an additional 3% value addition tax on commercial imports is too high.
- Sales Tax Rate should be brought down to a single digit. As a first step we propose the rate of Sales Tax of 10%.
- The reduced tax rate will encourage the unregistered persons to get themselves registered, resulting in broadening of tax base and documentation of economy and discourage under invoicing, corruption and smuggling.

C. RELIEF MEASURES

2. Adjustment of 'Further Tax' @ 2% against excess input tax

- Presently, Further Tax at the rate of 2% on sales made to unregistered persons is not adjustable against the excess input tax of the registered person (supplier) for the month and he is required to make payment of further tax even if he has excess input tax for the month.
- The Bar recommends that Further Tax should be made adjustable against excess input tax of the registered person so that his refunds are not accumulated and cost of doing business is reduced.

D. SIMPLIFICATION / REMOVAL OF IRRITANTS

1. Extra Tax on items/goods used by manufacturers

- Extra tax levied on certain specified goods is not allowed as input tax.
- To reduce the cost of doing business, the KTBA recommends that extra tax should not be levied on goods sold to ‘manufacturers’ for their own use. Through the Sales Tax General Order 27 of 2014, the FBR has exempted the supply of parts and accessories to the automobile manufacturers from the levy of extra tax, however, other manufacturers have not been granted similar exemption. The bar recommends that similar exemption should also be extended to all manufacturers who are using goods subject to extra tax as industrial input.

D. SIMPLIFICATION / REMOVAL OF IRRITANTS

2. Sales tax is charged on the basis of advances

- Sales tax is chargeable on the earlier of supply of goods or advance received for supply of goods. Sales tax on advance was withdrawn by Finance Act 2007 but was restored through the Finance Act, 2013.
- To avoid hardship and hassle for registered persons, the Bar recommends that sales tax on advances should be withdrawn and sales tax should be charged on the basis of actual delivery of goods. By this amendment, there would be no loss to the revenue except slight timing difference in deposit of sales tax.

D. SIMPLIFICATION / REMOVAL OF IRRITANTS

3. Refund of excess input tax

- Presently, excess input tax has to be carried forward for consecutive twelve months' period before it can be claimed as refund by filing a refund application.
- To facilitate registered persons, the Bar proposes that the time limit of twelve months for carry forward of excess input tax should be reduced to six months.

D. SIMPLIFICATION / REMOVAL OF IRRITANTS

4. Time period for claiming input tax

- Section 7(1) of the Act allows input tax adjustment up to 6 months (from the month in which invoice was issued). This time limit was previously up to 12 months. Resultantly, a registered person is not able to claim input tax if the invoice is received by him after 6 months.
- The Bar recommends that time limit of 6 months should be increased to 12 months so that the registered person will not be deprived off his legitimate input tax without causing any loss of revenue to the Government.

D. SIMPLIFICATION / REMOVAL OF IRRITANTS

5. Time limitations in the sales tax law

- The Bar recommends that to facilitate taxpayers following time limitations should be extended to one year:
 - ***Time limit for issuance of Debit and Credit Notes - 180 days of the relevant supply***
 - ***Time limit for submission of refund claim under section 10 - 120 days of filing the return***
 - ***Time limit for compliance of proof under section 73- payment is made by a buyer within 180 days***

D. SIMPLIFICATION / REMOVAL OF IRRITANTS

CONDONATIONS

- Registered persons are not able to make entries/adjustments in their return on FBR portal even though they are allowed condonation for delay by the Board / Commissioner.
- To facilitate taxpayers, the Bar suggests that a detailed mechanism may be laid down by the Board regarding condonation cases. Moreover, it is also proposed that powers given to the Commissioner for condonation should be extended to three years from the existing one year.
- Further, in order to bring transparency, the list of condonations, whether pending or allowed, should be displayed at FBR's web-site.

D. SIMPLIFICATION / REMOVAL OF IRRITANTS

7. Provision for appeal effect and consequential relief

- Presently there is no provision for appeal effect under the Sales Tax Act, 1990. Consequently, no relief is provided by tax department in case of reduction in tax demand at appellate stage. This creates hardship for taxpayers and causes multiple litigations.
- It is proposed that relevant provisions for appeal effect and consequential relief, as provided under the Income Tax Ordinance, 2001 should be introduced in the Sales Tax Law.

E. ADMINISTRATIVE REFORMS/ENFORCEMENT ISSUES

1. Initiation of recovery action

- Rule 71 of the Sales Tax Rules, 2006 should be amended to clarify that recovery of demand shall not be made within 30 days from date of receipt of order. Further, in line with amendment made in section 140 of the Income Tax Ordinance, 2001 no recovery shall be made if the taxpayer has paid 25% of the amount of tax payable as per the order appeal against.

E. ADMINISTRATIVE REFORMS/ENFORCEMENT ISSUES

2. Show Cause Notices

- Show cause notices are often issued under section 11 of the Sales Tax Act, 1990 on frivolous and intangible basis.
- The Bar proposes that an amendment should be made in section 11 to the effect that no show cause notice shall be issued unless the definite information of tax evasion, illegal input tax adjustment or refund is available with the tax officer.

E. ADMINISTRATIVE REFORMS/ENFORCEMENT ISSUES

3. Registration / De-Registration Issues

- Registration process should be streamlined and de-centralized. The Bar further proposes that the process of de-registration should be completed within three months. If the application for de-registration is not disposed of within the prescribed time period then applicant be considered as de-registered automatically.
- Manufacturer who are issued temporary registration should be allowed to issue sales tax invoice as well.
- The temporary registration mechanism should also be extended to manufacturers who purchase machinery from local market.

E. ADMINISTRATIVE REFORMS/ENFORCEMENT ISSUES

4. Multiple Sales Tax Audit

- As per Section 25 of the Sales Tax Act, 1990, there can only be one audit per year. However, it has been observed that multiple audits are conducted under different names, i.e., investigative audit, desk audit, audit for abnormal profile, etc.
- The Bar proposes that there should be a single comprehensive annual audit within fixed parameters by only one agency and be completed within specified time frame.
- If the audit observation is not submitted within 60 days, it will be deemed that no contravention/short payment/non-payment has been detected.
- Provisions of section 38, 40 and 40B should be streamlined in consultation with Industry and Tax Bar, and its enforcement should be monitored with transparent mechanism.

E. ADMINISTRATIVE REFORMS/ENFORCEMENT ISSUES

5. Appellate Forums

- Commissioner - Appeals should be brought under the administrative control of Federal Ministry of Law and the Appellate Tribunal under the control of the High Court of the respective jurisdiction. No recovery of tax demand till the decision of Commissioner-Appeals.
- Amendment made through the Finance Act 2013 allowing officers of the tax department to be appointed as judicial members of the Appellate Tribunal be withdrawn.

E. ADMINISTRATIVE REFORMS/ENFORCEMENT ISSUES

- Appointment of members of tribunals should be of permanent nature so that they should not have any encouragement to work for Inland Revenue in future.
- ADRC should be activated and its decision should be binding on FBR. In case of serious reservations, FBR may be empowered to appoint another Committee to review the decision of the previous ADRC.

E. ADMINISTRATIVE REFORMS/ENFORCEMENT ISSUES

6. Approval for Destroy of Goods

- Presently, under the sales tax rules, when the goods are returned from the buyer on the ground that the same are misfit for consumption, the same are to be destroyed after obtaining permission from the Commissioner. This results in unnecessary delay in obtaining the permission due to prolong administrative procedures
- To expedite the procedural requirement, the Bar proposes that taxpayers should be allowed to incinerate obsolete inventory after obtaining a certificate from an independent professional e.g. Chartered Accountant instead of approval from the tax department.

E. ADMINISTRATIVE REFORMS/ENFORCEMENT ISSUES

7. Adjustment of sales tax refund against income tax liability

- Registered person's funds are often stuck with the Inland Revenue in the form of sales tax refund and at the same time the taxpayer is required to pay income tax at the time of assessment of his income tax liability.
- FBR vide letter C.No. 3(70)STM/99 dated: 20th December 1999 has already devised a procedure of inter-tax refund / adjustment; but tax authorities are not following the aforesaid procedure for the reason best known to them.
- It is proposed that a very simple and unambiguous procedure may be notified for adjustment of sales tax refunds against income tax liabilities in order to alleviate the unnecessary cash flow problems faced by registered persons.

THANK YOU