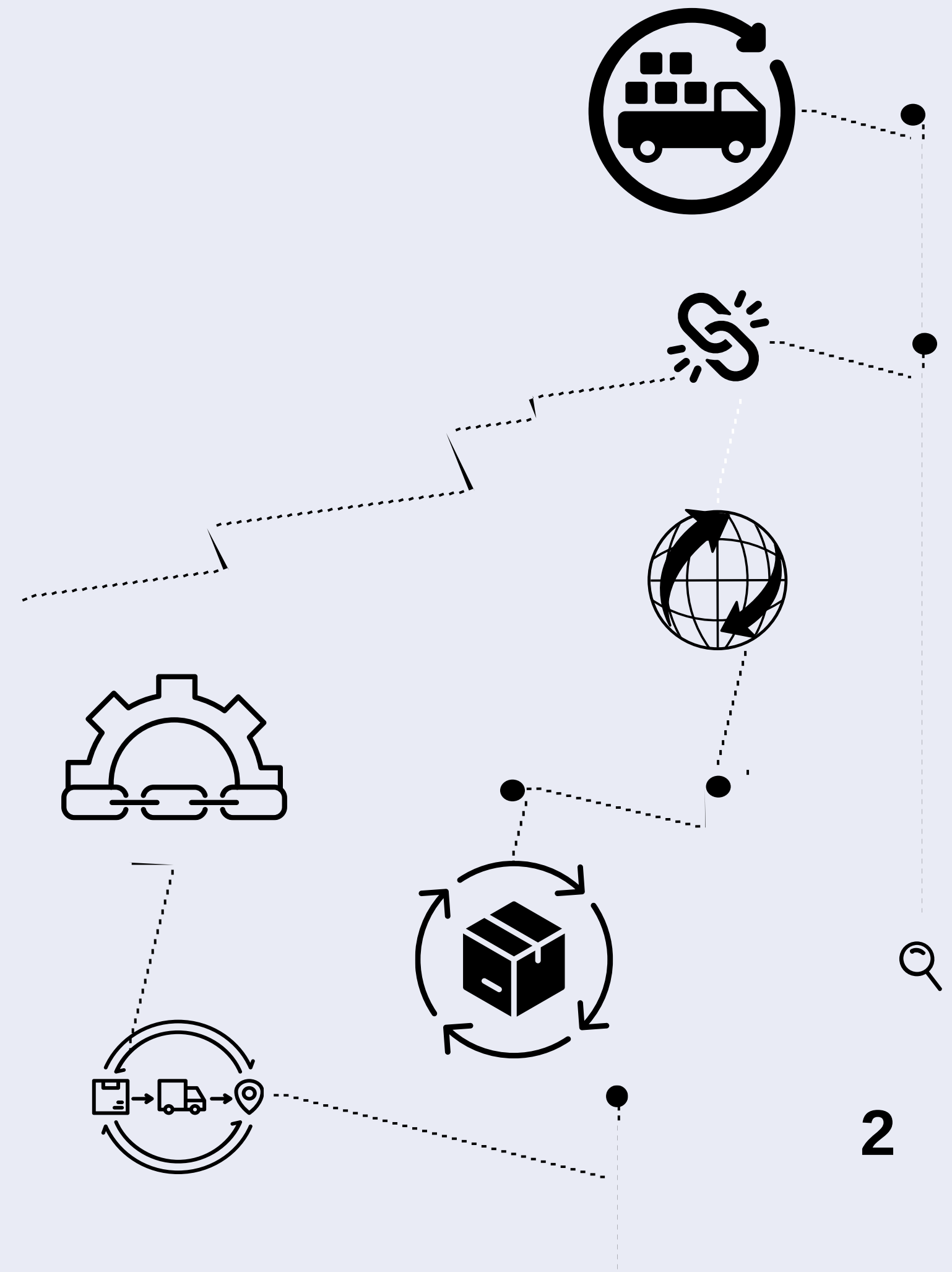


KARACHI TAX BAR ASSOCIATION



Supply Chain Distribution & Delivery Services

Presented by
Saad Salman Arif





WHY WE ARE HERE?

- Implication of SHC judgment on Distribution services
- Sindh Sales tax rules
- Invoice Methodology
- Cross border transactions
- Income Tax deduction
- Advance Tax 236G & 236H of the ITO, 2001



BACKGROUND OF THE CASE

THE SUPPLY CHAIN

A 5-STEP PROCESS



BACKGROUND OF THE CASE

- Order of Appellate Tribunal, Sindh Revenue Board [ATSRB] 22nd November 2018
- One of a local distributor M/s Mubashir Traders was assessed by ATSRB on the basis of agreement he had with his principal.
- ATSRB issued a ruling against Mubashir Traders. The ruling determined that Mubashir Traders is engaged in providing distribution services.





KEY ISSUES IDENTIFIED IN THE JUDGMENT

Order of Sindh High Court 06th September 2021

- The Sindh High Court (SHC) confirmed the question of law raised by ATSRB, which was later upheld by the Supreme Court of Pakistan (SCP).
- SHC ruled that distributor activities qualify as "distribution services" when the arrangement requires the distributor to perform specific tasks related to goods on behalf of or under the instructions of the manufacturer.
- According to the SHC, distributors are limited in exercising full control over the goods, despite the sales and transfer of legal ownership by the principal.
- The courts based their ruling on the provisions of the Sales of Goods Act, 1930, without considering applicable Taxation laws.





KEY ISSUES IDENTIFIED IN THE JUDGMENT

- SRB has classified distribution services under "**Supply chain management or distribution (including delivery) services**" with tariff heading "**9845.0000.**"
- This classification was introduced through the Sindh Finance Act, 2016, in the Sindh Sales Tax on Services Act, 2011 (the Sindh Act).
- Similar services are taxable under other provincial laws as well. However, the Sindh Act does not define these services explicitly.
- The Supreme Court of Pakistan's ruling is not limited to Sindh and is now applicable nationwide.

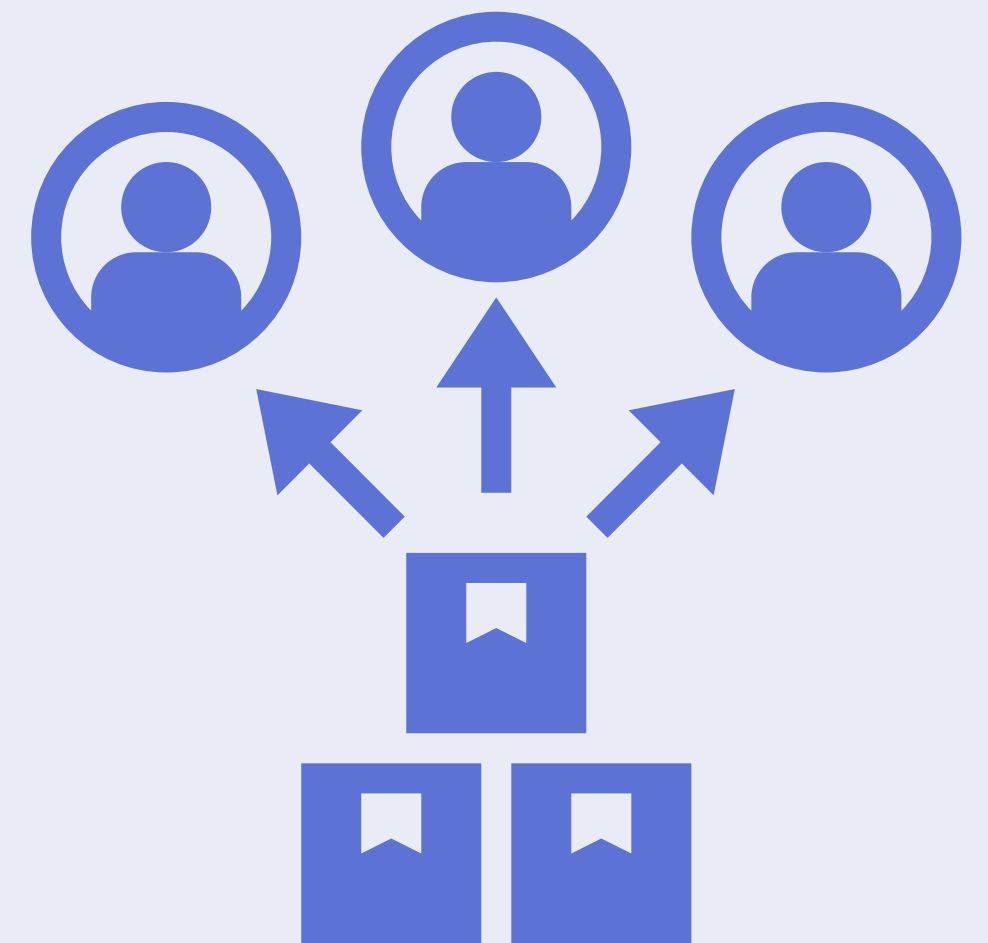




KEY ISSUES IDENTIFIED IN THE JUDGMENT

While reaching to the conclusion, the Court upon examining the distributor agreement made following observations:

- The distribution can only sale the products in the area which is allowed by the manufacturer
- The manufacturer directs the distributor on matters like sales, pricing (i.e., margin), and the designated sales territory.
- The agreement emphasizes the distributor's role in delivering the manufacturer's products, using the term "deliveries" rather than referring to outright "sales."





KEY ISSUES IDENTIFIED IN THE JUDGMENT

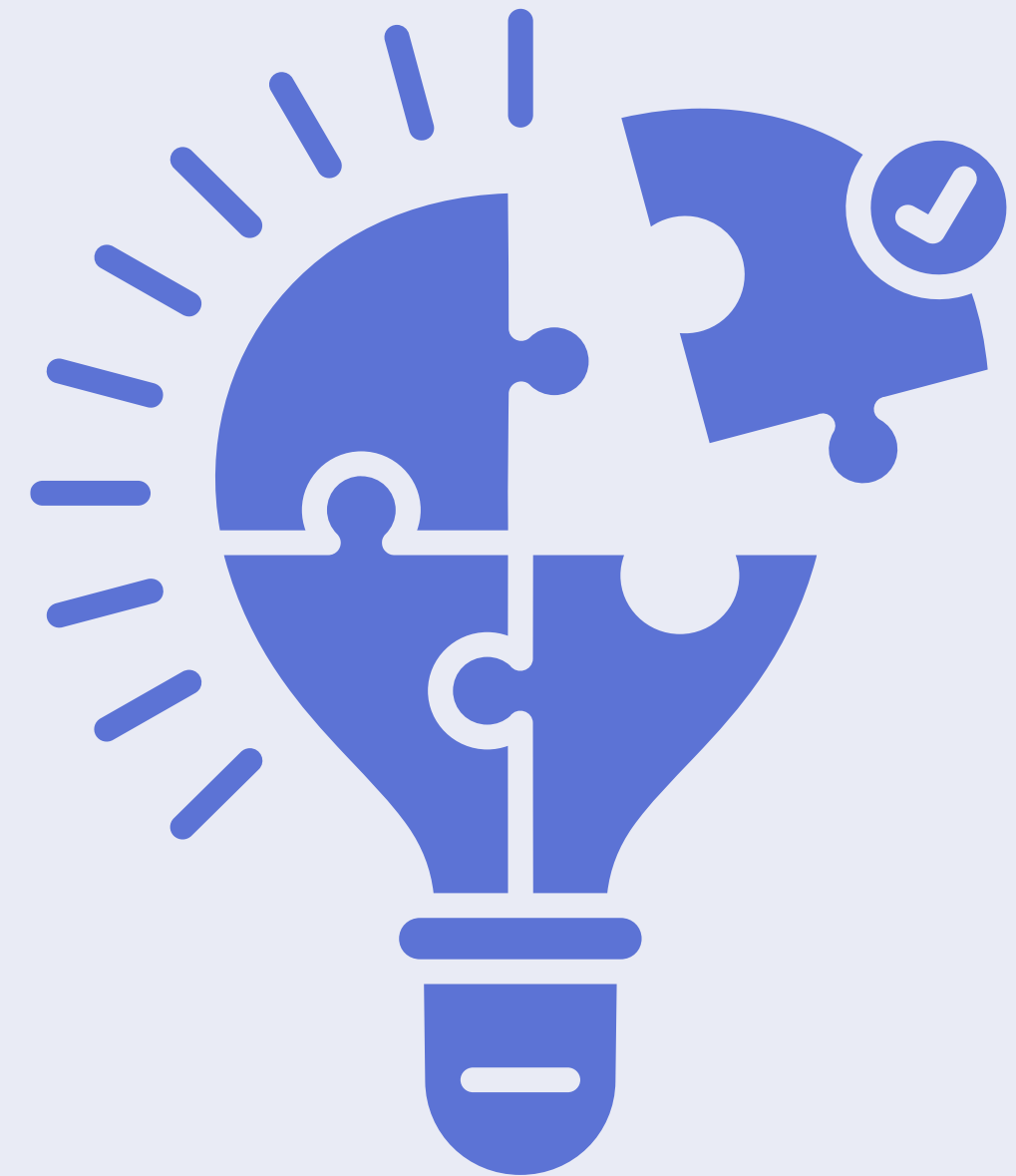
- The manufacturer continuously monitors the distributor's performance.
- The distributor must maintain sufficient stock to ensure timely deliveries and provide periodic stock reports to the manufacturer.
- Upon contract termination, the manufacturer has the right to reclaim any unsold stock.
- The distributor is expected to actively promote and increase sales of the manufacturer's products.





PROPOSED SOLUTIONS

- Change of Agreement in back date (which is incorrect)
- Identification of Service element and make a separate agreement
- Start paying tax on Gross margin





IMPLEMENTATION CHALLENGES

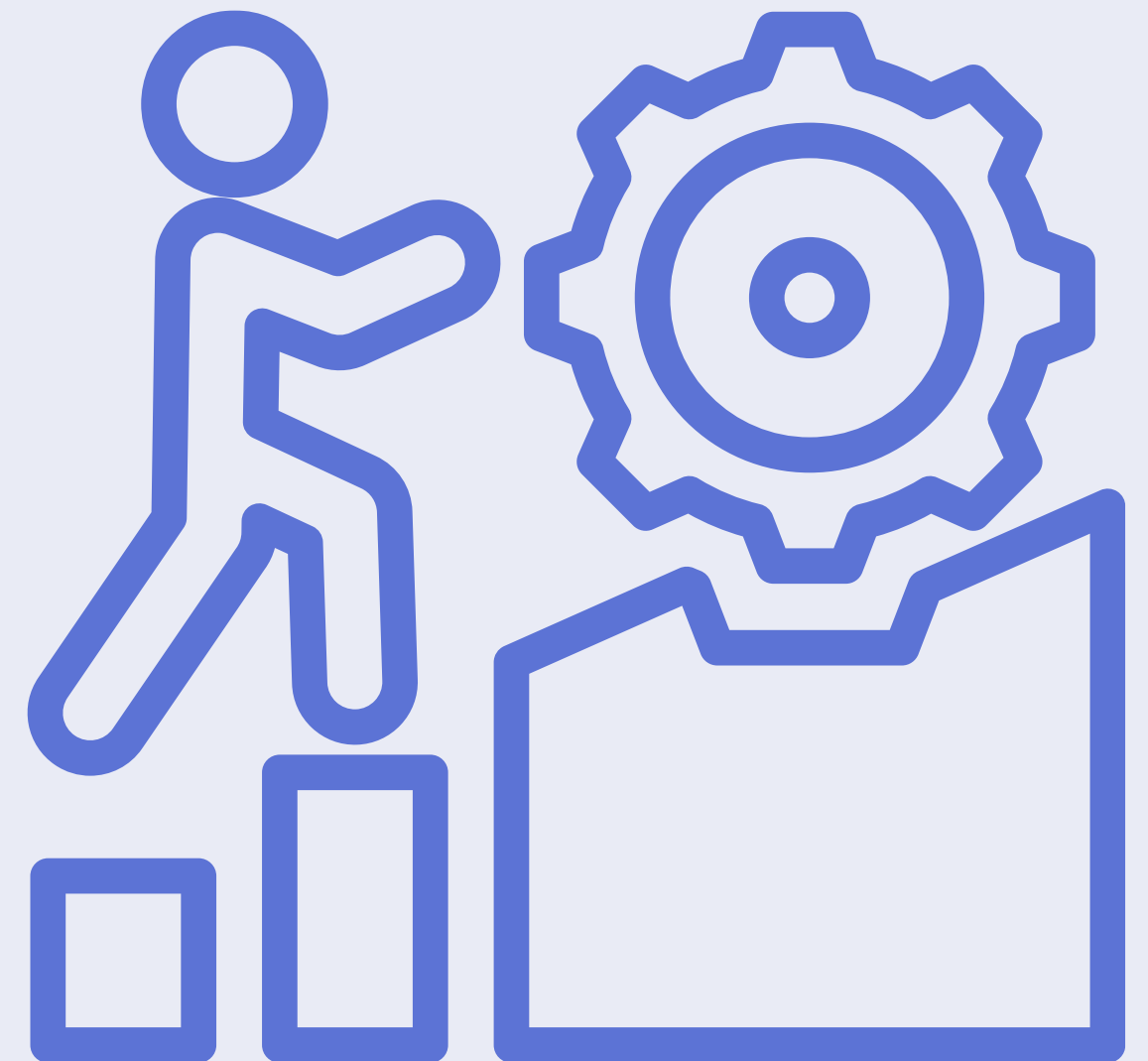
- International Accounting Standards
- The manufacturer will record the sales directly in its books under the retailer's name.
- International transactions





CHALLENGES OF DISTRIBUTORS WITH PROVINCIAL TAX AUTHORITIES

- Pressure by the Tax authorities on payments
- Price fixing by the distributors
- Income Tax withholding on payment of distributors





INSIGHTS OF DISTRIBUTION P&L

- The distributor margin is fixed by the Manufacturers
- Distributors is a high turnover low margin business
- They operate on a net profit which is less than 1% in the prevailing economic condition





DISCUSSION WITH SRB

- The big distributors have collectively urged the SRB to implement a hybrid model.
- The proposed model includes identifying the notional value of the service component in distribution activities.
- After extensive discussion with the SRB, distributors have agreed to Initiate SST payments based on the notional value of the deemed service component and started applying a rate of 8% on the gross profit or margin earned from product sales under distribution agreements on secondary sales.





DISCUSSION WITH SRB

- The Company started issuing notional tax invoice (only for the purpose of Sindh Sales on Services Act, 2011) whereby charging SST on deemed services component.





CALCULATION OF SERVICE CHARGES FOR PAYMENT OF

Calculation of Service charges for payment of Provincial Sales tax – Single Margin							
Province	Principal Name	Value of Supply	Standard Gross Margin %	Standard Gross Margin Value	8% service charges of gross Margin	Applicable Sales Tax rate	Provincial Sales Tax Payable
		A	B	C	D	E	F
				A x B	C x 8%		D x E
Sindh	ABC (Pvt) Limited	10,000,000	9%	900,000	72,000	15%	10,800
Calculation of Service charges for payment of Provincial Sales tax – Multiple Margin							
Province	Principal Name	Value of Supply	Standard Gross Margin %	Standard Gross Margin Value	8% service charges of gross Margin	Applicable Sales Tax rate	Provincial Sales Tax
		A	B	C	D	E	F
				A x B	C x 8%		D x E
Sindh	ABC (Pvt) Limited	10,000,000	9%	900,000	72,000	5%	3,600
Sindh	ABC (Pvt) Limited	10,000,000	5%	500,000	40,000	5%	2,000



INVOICE

Sindh Sales Tax invoice	
Invoice No: 123	
Dated: April 30, 2024	
TO:	
ABC (Pvt) Limited	
A-23 Clifton	
Karachi.	
NTN: 1234567-8	SNTN: 0987654-3
Description	Amount (Rs.)
Deemed service component being 8% of gross margin earned on sale/distribution of goods (Deemed service component is provided only for the purposes of Sindh sales tax on Services Act, 2011)	72,000
Sindh Sales Tax @ 13%	9,360
Amount Payable	9,360
Note:	
This Tax invoice issued only for the purposes of Sindh Sales Tax on Services Act. 2011 and should not be use for anv other legal purposes.	



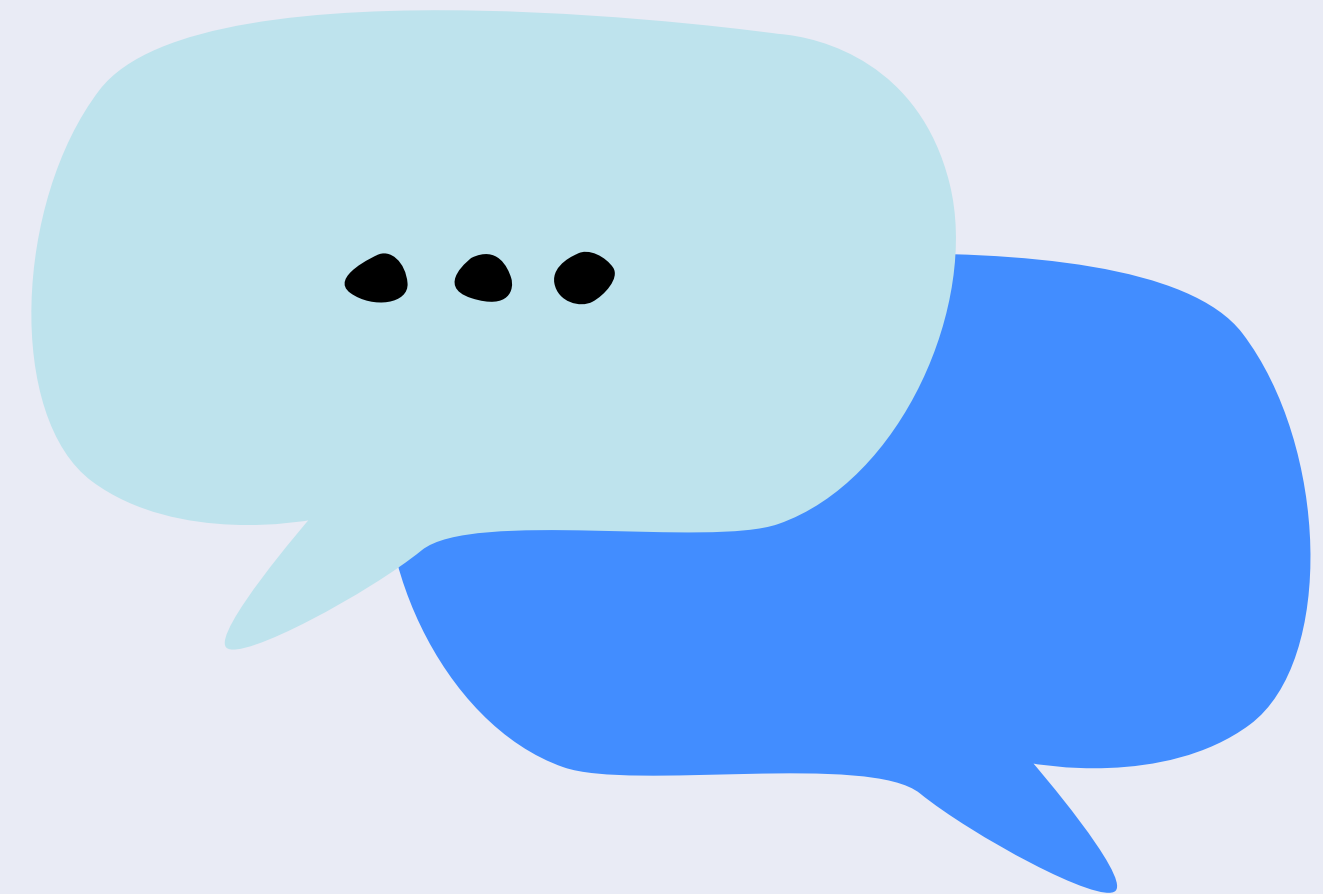
PAYMENT RECEIPT

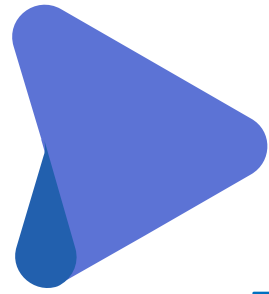
<u>Illustration for payment receipt</u>	<u>Amount</u>
(Deemed service component is provided only for the purposes of Sindh sales tax on Services Act, 2011)	72,000
Sindh Sales Tax @ 15%	10,800
Amount Payable	10,800
Sindh Sales Tax withholding @20% of 15%	2,160
Receivable to the Distributors	8,640
<u>Note:</u>	
Section 153(1)(b) required income tax withholding on gross amount payable for rendering of services. As there is no any amount payable against rendering of services, therefore, principally no income tax. withholding is applicable.	



FAQs

- What would be the method to determine the Sindh Sales tax? Will it be calculated on primary sales or secondary sales?
- What about cross border transactions?
- Is the same rule followed in other provinces?





Application of Section 236G and 236H of the Income Tax Ordinance, 2001 [ITO, 2001]

- Previously, advance tax under Sections 236G and 236H of the ITO, 2001, was limited to specific sectors.
- As of July 1, 2024, this tax applies to all sectors, excluding petroleum dealers.
- This extension requires advance tax to be collected at the point of sale for all sectors.
- There is an urgent need to revise these sections, as taxpayers are encountering challenges at the time of sale, leading to potential sales losses.



Application of Section 236G and 236H of the Income Tax Ordinance, 2001 [ITO, 2001]

Below is a concise summary:

Section 236G

Collecting Agent: Manufacturer, Commercial Importer

Persons from whom tax is required to be collected: Distributors, dealers, wholesalers

Section 236H

Collecting Agent: Manufacturer, Distributor, Dealer, Wholesaler, Commercial Importer

Persons from whom tax is required to be collected: Retailers, every distributor or dealer to another wholesaler



Application of Section 236G and 236H of the Income Tax Ordinance, 2001 [ITO, 2001]

The current tax framework presents several challenges in the roles of collecting agents and the entities from whom tax is required to be collected.

Duplication in Tax Collection:

There is redundancy in the roles of collecting agents and the individuals from whom tax is collected under Sections 236G and 236H of the ITO, 2001, causing anomalies during sales.

Recommendation: Consolidate and redefine the roles of collecting agents and the categories of taxpayers to minimize redundancy and eliminate ambiguity.



Application of Section 236G and 236H of the Income Tax Ordinance, 2001 [ITO, 2001]

Non-Filer Retailers:

Many retailers are non-filers and not enrolled in IRIS, making status verification challenging. They often request lower tax charges.

Proposal: Establish clear guidelines for dealing with non-filer retailers not enrolled in IRIS, specifying the correct section for advance tax collection.



Application of Section 236G and 236H of the Income Tax Ordinance, 2001 [ITO, 2001]

Exemptions for Certain Taxpayers:

Taxpayers such as non-profit organizations, hospitals, doctors, restaurants, end consumers, and service providers frequently claim exemption from advance tax under Sections 236G and 236H.

Recommendation: Define explicit exemptions for these sectors to prevent potential litigation during the monitoring of withholding taxes.



Application of Section 236G and 236H of the Income Tax Ordinance, 2001 [ITO, 2001]

Tier-1 Retailer Definition:

According to SRO 1842(I)/2023 dated December 21, 2023, a Tier-1 retailer is defined as one whose deductible withholding tax under Section 236H exceeds Rs. 100,000.

Recommendation: For Tier-1 retailers with withholding tax exceeding Rs. 100,000 under Section 236H, registration for sales tax should be triggered only by taxable supplies, excluding exempt or non-taxable supplies.



Application of Section 236G and 236H of the Income Tax Ordinance, 2001 [ITO, 2001]

Advance Tax Collection in Gilgit-Baltistan:

There is currently no specific exemption for advance tax collection in Gilgit-Baltistan.

Proposal: Provide clear guidelines on advance tax collection in Gilgit-Baltistan to remove existing ambiguities.



Thank you for your time & attention

**I am deeply honored and grateful to the
Karachi Tax Bar**

**Association (KTBA) for this invaluable
opportunity.**

**THANK YOU
QUESTION &
ANSWERS**