

Budget Proposal 2010

Indirect Taxes & VAT

Adnan Mufti FCA

Partner, Shekha & Mufti

The Institute of Chartered Accountants of Pakistan
15 April 2010

SHEKHA & MUFTI
CHARTERED ACCOUNTANTS

An independent member firm of
Moore Stephens International Ltd.

Contents

SALES TAX

- Taxability of Toll Manufacturing
- Verification of Transactions
- Tax Fraud
- Wastage
- Input Tax Credit
- Post Supply Adjustments
- Refunds
- Presumptive Tax Assessment
- Black Listing & Suspension of Registration
- Revised Return

Contents

EXCISE DUTY

- Adjustment of Duty
- Special Excise Duty on Plant & Machinery
- Duty on Franchise / Technical Fee & Royalty

Contents

VALUE ADDED TAX

- Registered Person
- Time of Supply of Goods
- CNIC of Buyer
- Value of Imported Goods
- Retail Priced Goods / Goods under Special Procedures
- Inadvertence / Excess Tax Payment
- E-intermediaries
- Discretionary Powers

SALES TAX

TOLL MANUFACTURING

Previously, the definition of the term 'supply' included the term "Other Disposition" as part of supply. In terms of Para 1(E) of Sales Tax General Order (General Order) No. 2/2004 dated 12 June 2004, the Board had opined that return of goods processed by the vendor back to the principal tantamount to "Other Disposition" and accordingly liable to sales tax. The present definition has brought 'other disposition' out of the definition of 'supply'.

Recommendation

Since now toll manufacturing appear to be out of 'supply', it is suggested that Part I(E) of General Order may also be withdrawn to avoid potential problems for the taxpayers during audit. If this is not the intention, then the term "Other Disposition" should be inserted in the definition of 'supply'.

SALES TAX

VERIFICATION OF TRANSACTIONS

The following practical issues emanate vis.a.vis verification of the genuineness of transactions which are not addressed under Section 73:

- ❑ No provision exists to cater instances where payments are knocked off through contra book entries between buyer and sellers.
- ❑ The law does not accommodate situations where payments become doubtful or eventually turns irrecoverable for the supplier.
- ❑ The law does not take into account transactions where payments are made by creditors / guarantors / 3rd parties on behalf of the buyer.

Recommendation

The basic intent of section 73 has been to document the economic and business transactions. This objective may well be achieved within sophisticated accounting and corporate environment and the growing business realities. It is, therefore, proposed that section 73 may be amended to cater the inter company (book) transactions and the issue of bad debts.

SALES TAX

TAX FRAUD

Supply of taxable goods without getting registration is treated as 'tax fraud' on the part of supplier. Therefore, a genuine business faces problems in commencing business till the time it is awarded his Sales Tax Registration No. On the contrary, supply of taxable goods without getting actually registered could penalize him with the most serious offence of 'tax fraud' under the Act.

Recommendation

It would be more business friendly to encourage a new entity to start the commercial activity immediately by issuing Provisional Registration No. subject to furnishing of bank guarantee for a requisite amount. Accordingly, necessary modification may also be brought in the definition of tax fraud.

SALES TAX

WASTAGE

There is no provision in the statute governing both visible and non visible wastage which occurs during any manufacturing process. The audited accounts also do not separately disclose wastages; rather the same is reported as part of stock consumed. However, quite often, cases are established against the taxpayers on account of difference in stock figures which usually is due to the element of wastage.

Recommendation

To address this critical issue, it is proposed that industrial notes may be drawn by the Board in consultation with trade, industry and tax fraternity which provide business processes of significant sectors and standard ratios of wastage occurring during such processes.

SALES TAX

INPUT TAX CREDIT

In the year 2008, the adjustment time for prior unadjusted input tax in monthly tax return was curtailed to 6 months from 12 months. This resulted in piling of refunds pertaining to beyond last 6 months' time.

Recommendation

Due to on going liquidity crunch, the government is finding it difficult to maintain a balance between refunds and revenue targets. To address this issue, it proposed that adjustment of last 12 months' inputs may be allowed thereby easing up refund pressures upon the Board.

On the legal touchstone, the Appellate Tribunal has already held that the taxpayer may claim input tax in any subsequent tax period without any time limitation(s).

SALES TAX

POST SUPPLY ADJUSTMENTS

Presently any post supply adjustment which leads to reduction in output tax or increase in output tax is permissible in 180 days of the relevant supply. This period is extendable to another 180 days subject to Commissioner's permission. However, this causes serious problems in case adjustment is warranted for perishable goods like food and cooking stuff carrying an expiry date of over 1 year or so. Resultantly, such events result in double taxation for the supplier.

Recommendation

In the present era where technology checks can be placed, as long as the taxpayer is able to prove the genuineness of original and revised transaction, no time limits may be imposed upon him under the rules for issuing credit and debit note or availing related tax credit /adjustment.

SALES TAX

REFUNDS

Apart from the list of supportive documents prescribed in Rule 38 of Sales Tax Rules 2006, the tax department requires the refund claimant to furnish records, returns, accounts, statements, summaries pertaining to his suppliers to cross match the payment of output tax with the refund claim. Such departmental requirements are not backed by the statute or the rules as the supplier is not legally bound to share his returns, summaries and other statutory declarations with his buyer. This situation has sent innumerable refunds cases into litigation / disputes.

Recommendation

To streamline the entire refund verification and sanctioning process, it is proposed that the Board should device necessary mechanism for the whole country in the light of the Section 10 and Sales Tax Rules 2006 thus ending practical hassles, liquidity problems for refund claimants and frivolous litigation pertaining to refunds. Moreover, STARR checks and ancillary requirements may also be incorporated in Rule 38 of Sales Tax Rules 2006 to provide due legal protection to such exercise.

SALES TAX

PRESUMPTIVE TAX ASSESSMENT

The provision of section 11(5) provides for a presumptive assessment in case the taxpayer fails to file the return. The parameters of presumptive assessment are defined in Para (I) of Part II of Sales Tax General Order 3 of 2004. Recently, the tax authorities have started making presumptive assessments by creating frivolous demands thereby resulting in counter litigation by the taxpayers.

Recommendations

In numerous cases, the superior courts have held that any assessment on the basis of assumptions is not legal and permissible under the law. It is, therefore, suggested that this section 11(5) and the related Para I of Sales Tax General Order 3 of 2004 may be deleted altogether from the statute book.

SALES TAX

BLACK LISTING & SUSPENSION OF REGISTRATION

At present, any taxpayer may be suspended on mere suspicion of tax fraud, etc. This results in immediate blockage of refunds accruing to corresponding buyers.

Recommendation

To curtail the abuse of such provision, it is proposed that before declaring any person as blacklisted / suspended, the charge for issuing fake invoice or committing tax fraud should also be established in the Order-in-Original. Further, input tax credit on account of purchases by a genuine buyer (from a subsequently declared blacklisted person) should be allowable to the extent of purchase until date of suspension.

SALES TAX

REVISED RETURN

To correct any omission or wrong declaration made in the monthly tax return filed under section 26, a revised return may be filed by the taxpayer within 120 days of filing the original return. However, no such provision exists to facilitate revision of special return filed under section 27 of the Act.

Further, while examining the application for revision of return, the department often solicits unnecessary records, accounts, information, etc. In few cases, audit notices have also been issued against revision application.

Recommendation

It is proposed that necessary amendments may be made and reference of section 27 may also be incorporated in section 26(3) of the Act so as to enable the taxpayer to rectify any omission in the special return.

In addition, parameters enlisting information to be furnished by taxpayer in respect of revision of returns may also be framed. It is also proposed that in case of revision of return not warranting any monetary change in tax liability or claim of refund, the requirement of prior approval from Commissioner may be waived.

EXCISE DUTY

ADJUSTMENT OF DUTY

FED is adjustable only if the registered person holds a valid proof to the effect that he has paid the price of goods purchased by him including FED and received the price of goods sold by him including FED through banking channels. The condition of payment and receipt is creating lot of problems for the taxpayers. On the other hand, SED is also adjustable on payment basis.

Recommendation

To bring harmony among Duty Regimes, it is suggested that both FED and SED should be made adjustable on accrual / paid basis as per section 7 of Sales Tax Act 1990. Further the duty adjustment should not be made subject to receipt of sale proceeds and related duty.

EXCISE DUTY

ADJUSTMENT OF DUTY (cont...)

FED paid on excisable goods, which are used directly as input goods for the manufacture of dutiable goods, is adjustable against the final liability. On the other hand, SED paid on “industrial inputs” is adjustable against the SED chargeable on the goods manufactured there from. The term ‘industrial input’ has not been specified under the law.

Recommendation

In the absence of any definition of ‘industrial inputs’, it could be construed to include everything consumed for the business activity like machinery, spares, printing, stores, equipment, etc. In order to avoid litigation on this account, it is suggested that the term ‘industrial inputs’ may be defined in the law.

EXCISE DUTY

SPECIAL EXCISE DUTY ON PLANT & MACHINERY

Import or acquisition of plant and machinery is zero rated for sales tax purposes. However, exemption from Special Excise Duty (SED) is not extended to such plant and machinery. Further, in the absence of clarity regarding duty adjustment on plant and machinery, such SED is added to the cost of business.

Recommendation

Capital items should also be exempted from SED. It is, therefore, proposed that amendment may be made in SRO 655(I)/2007 dated 29 June 2007 and SRO 715(I)/2008 dated 03 July 2008 to provide duty exemption on acquisition / import of plant & machinery.

EXCISE DUTY

DUTY ON FRANCHISE / TECHNICAL FEE & ROYALTY

In terms of Rule 43A (7), the bank remitting royalty, franchise fee or technical fee is responsible to withhold duty on every such remittance if it is satisfied that duty thereon has not been paid by the franchisee. However, in view of the vague and wider ambit of the term “franchise”, the banks are virtually disputing every remittance as royalty / technical or franchise fee and accordingly deducting duty thereon.

Recommendation

In view of the practical difficulties being faced by both banks and its customers, it is proposed that a mechanism should be laid down in the rules whereby banks may verify the actual nature of remittance and no duty is deducted except in cases where the remittance is in the nature of royalty / technical or franchise fee.

VALUE ADDED TAX

REGISTERED PERSON

The draft Federal VAT Act 2010 (FVAT) defines a registered person as one who is actually registered under the law or who is liable for registration but has not applied for registration.

Recommendation

In view of the proposed definition, the previous issue cropped up under section 2(25) of Sales Tax Act 1990 especially for sugar, cement, etc sectors may again be energized thereby leading to undocumented sector enjoying benefit of legal lacunas. Therefore, it is proposed that the definition may be amended and a person who is not awarded VAT Registration Certificate / VAT Provisional Certificate may not be treated as a registered person.

VALUE ADDED TAX

TIME OF SUPPLY OF GOODS

Time of Supply is defined to be earliest of the following event:

- ✓ Goods delivered
- ✓ Goods made available to recipient
- ✓ Invoice issued by the supplier
- ✓ Partial advance payment received

Recommendation

It is suggested that in line with accounting standards, the time of supply may be prescribed to be the time when goods are delivered. This would avoid accounting, reporting and practical issues which were faced under section 2(44) of Sales Tax Act 1990.

VALUE ADDED TAX

CNIC OF BUYER

Section 49 makes the taxpayer obliged to acquire and mention the CNIC No. of the unregistered buyer on the face of tax invoice. An identical proposition was made vide Finance Bill 2009 which was finally withdrawn upon demands by the business community. Finally, the government introduced the scheme of withholding tax under SRO 603 / 2009.

Recommendation

The proposed requirement may not again be implemented as the buyers would not willing to share their CNIC with the supplier of goods, particularly, in sectors where almost entire supply chain remains undocumented. Thus, it is proposed that this proposition may be revisited and rationalized.

VALUE ADDED TAX

VALUE OF IMPORTED GOODS

Under the proposed mechanism, all services ancillary to import of goods, e.g., Custom Agents', Ship Chandler / Container Terminal / Stevedore, etc. are to be taxed as part of imported goods. It, therefore, appears that addition to the extent of Royalty, Franchise Fee or Technical Fee which is subsequent paid to the exporter might also be added back to the cost of imported goods. This may trigger identical litigation as is under section 25 of Customs Act 1969.

Recommendation

In view of the subjective nature of the proposed mechanism, it is suggested that the proposed valuation scheme may be revisited and valuation method envisaged under section 2(46) of Sales Tax Act 1990 may be put in place to assess the value of imports.

VALUE ADDED TAX

RETAIL PRICED GOODS / GOODS UNDER SPECIAL PROCEDURES

At present, around 17 items are taxed @ consumer / retail price. Such tax is recovered by the manufacturer while the remaining supply chain remains immune from further tax liability. The proposed FVAT aims to withdraw the Retail Price Regime thereby bringing the entire chain under the tax net. However, it is not clear what treatment would need to be vetted to existing stock of tea, detergents, cosmetics, beverages, etc lying with distributors / retailers on the date FVAT becomes effective.

Recommendations

It is suggested that all tax paid stock lying with distributors, wholesalers and retailers as on the 1st day of FVAT becoming effective should be made exempt from any further tax liability. For this purpose, necessary saving provisions may be incorporated in section 96 of FVAT.

VALUE ADDED TAX

INADVERTENCE / EXCESS TAX PAYMENT

At times, a taxpayer may make an inadvertence or excess payment of tax to the exchequer. In terms of section 66 of Sales Tax Act 1990, such excess tax is refundable to the taxpayer with a time limitation of 1 year from the date of payment thereof. On the contrary, no such provision exists in FVAT.

Recommendations

It is proposed that Chapter V of FVAT may be amended to provide for repayment / refund of excess tax inadvertently paid by the registered person into the government treasury. It is also proposed that time limit of 1 year for claiming such refund, as is stipulated in the existing law, may be done away with in FVAT in line with the dictum of Supreme Court of Pakistan which has held that no limitation of time can be placed upon filing and sanctioning refunds.

VALUE ADDED TAX

E-INTERMEDIARIES

The FVAT provides for joint and several liabilities of e-intermediaries for any non compliance with the Act made by the taxpayer. On the contrary, in terms of Rule 150N(3) of Sales Tax Rules 2006, legal protection has been provided to e-intermediaries in all cases where they have acted upon the instructions of the taxpayer.

Recommendation

E-intermediaries facilitate electronic filing of tax returns, declarations or statements on behalf of the taxpayers. Such provision would hinder appointment and registration of e-intermediaries on a large scale at a time when FVAT proposes registration and consequent e-filing across the board.

It would be business friendly if immunity from all liabilities may be provided to e-intermediaries where he has retained a printed copy of the return electronically transmitted by him duly signed by the representative of the taxpayer.

VALUE ADDED TAX

DISCRETIONARY POWERS

The FVAT proposes the following harsh discretionary powers for tax officials and certain ancillary provisions.

- ❑ The IRS may cancel registration of any person on “improper record keeping “ or filing “unreliable tax returns”
- ❑ For recovery of tax, all officer of IRS to enjoy powers of a Civil Court under Code of Civil Procedure 1908 (Code). In case of any conflict between Code and FVAT, the latter shall prevail

VALUE ADDED TAX

DISCRETIONARY POWERS (cont...)

- Subject to the approval from the Board, an Assistant Commissioner may arrest any person including a Director of a company who is suspected or believed to have committed tax fraud
- No order(s) of tax officer regarding order passed, assessment made, tax levied, penalty imposed, or audit / enquiry / investigation conducted by him is challengeable in any Court including High Court
- Commissioner (Appeals) liable to follow departmental instructions in all quasi judicial proceedings, e.g., appellate matters before him

Recommendation

The foregoing discretions / powers are harsh and are likely to be misused by the tax machinery. Therefore, we would suggest that such provisions may be revisited and modified in the light of cardinal principles of equity and natural justice.



Thank You