

# BUDGET PROPOSALS 2009

## Sales Tax & Federal Excise

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# SALES TAX

## EXPORT REFUNDS

At present, huge genuine export and non export refunds are blocked with the department resulting in liquidity problems for the taxpayer and resultant litigation. The following are the core issues in refunds:

- ✓ For refunds not replicated over STARR, the department desires the refund claimant (buyer) to furnish seller's returns, accounts, statements, summaries. This requirement does not find place in Rule 38 of Sales Tax Rules 2006
- ✓ In the absence of any legal support, the seller declines to share / furnish his returns, summaries and other statutory declarations with the buyer (refund claimant)
- ✓ In certain cases, the department directly contacts the respective supplier to verify the genuineness of the refund claim; however in other cases, the onus of verification is transferred upon the refund claimant
- ✓ The Large Taxpayers' Unit (LTU) Karachi has recently discontinued manual over ruling of STARR objections

### *Proposal*

To streamline the entire refund verification and sanctioning process, it is proposed that a comprehensive refund mechanism may be put in place for the whole country in the light of the Section 10 and Sales Tax Rules 2006. Further, Rule 38 may be amended to include list of supplier's documents for cross verification of payment of output tax by seller

## REFUND ON BUILDING MATERIALS, STEEL, ETC

After the suppression of SRO 578(I)/98 dated 12 June 1998 through SRO 490(I)/2004 dated 12 June 2004, sales tax paid on building materials has become eligible for refund / adjustment purposes. However, the Regional Tax Office, Karachi has placed certain other conditions attached to the refund claim such as filing of Approved Building Plan, BOQ, Counter Confirmation from respective Trade Association, etc. Such requirements are not spelled out either in the statute or the rules.

### *Proposal*

In line with the statute and the related judgments of the superior courts, it is proposed that the relevant Standing Order issued by RTO, Karachi may be withdrawn and refunds may be allowed on building materials without any exception.

## REFUNDS UNDER SECTION 66

### **Legal Position:**

“ No refund of tax claimed to have been **paid** or over paid through inadvertence, error or misconception .....shall be allowed, unless the claim is made within one year of the date of payment...”

### **Departmental Interpretation**

“ No refund of tax **claimed** .....shall be allowed, unless the claim is made within one year of the date of payment...”

### *Proposal*

In line with an identical case law pronounced by the High Court, the FBR should clarify that where the tax claimed as refund was not paid due to inadvertence, error or misconception, the time limit of 1 year will not be applicable. Accordingly, all claims not falling under the above, should be admissible and entertained without any time limit. The Supreme Court has already held that no limitation of time can be placed upon filing and sanctioning refunds.

## ACCOUNTING FOR REFUNDS

In recent cases, the tax authorities have started rejecting refund claims where such claims were not booked as receivable in the taxpayers' audited accounts. In support of such contention, the tax authorities contend that non recording of refund as receivable from government tantamount that the sum of claimed was charged off in cost of sales; thus becoming part of selling price which was ultimately recovered from the customers. Therefore, such claims were rejected under Section 3B of the Act.

### *Proposal*

The explicit provisions of the Act makes no distinction between corporate and non corporate taxpayers. In quite a few cases, because of the contingent nature of refunds due to interpretational / legal issues and in line with internationally accepted and practiced accounting convention, the taxpayer could not book it as receivable in the accounts. It is, therefore, suggested that refund cases may be examined only in the light of books required under section 22 of the Act.

## RECORD KEEPING & AUDIT

During the audit exercise, sometimes the tax authorities call for documents like Audited Accounts, Cost Audit Report, Minutes of BOD, Income Tax Records, etc which are not prescribed records in section 22 of the Act. In certain cases, cases have been established out of the information so sought and show cause notices issued to the taxpayers.

### *Proposal*

The FBR and Federation of Pakistan Chamber of Commerce & Industry (FPCCI) have already agreed upon records which may be sought by the tax administration during tax audit. This agreement was also made public vide FBR's letter dated 17 November 2001. It is suggested that the suitable amendments made be made in section 22 of the Act by incorporating the above FBR letter as part of the statute.

## MULTIPLE AUDITS

The tax authorities conduct multiple audits of same tax period under different names, i.e., investigative audit, desk audit, audit for abnormal profile, etc. Under section 25, the tax department may conduct audit of registered person only once a year. Also, the terms 'Desk Audit', 'Investigative Audit' 'Abnormal Tax Profile' have not been defined in the statute. In a recent case, the Federal Tax Ombudsman (FTO) has also held that 'abnormal tax profile' is not defined in the Law and thus no scrutiny may be made by the department on this account.

### *Proposal*

It is proposed that all audits or scrutiny, other than the usual audit prescribed under section 25, may be withdrawn.

## AUDIT BY DIRECTORATE OF REVENUE RECEIPT AUDIT (DRRA)

The jurisdiction and legality of audit conducted by DRRA is a matter of debate and concern for a long time. Numerous cases have been framed against taxpayers out of audits conducted by DRRA. However, in recently pronounced judgments, the Sales Tax Appellate Tribunals and Peshawar High Court have held that DRRA has no powers of audit of taxpayers' records.

### *Proposal*

In terms of section 30 of the Act, no officer of Auditor General of Pakistan is empowered to conduct audit of taxpayer' records. It is, therefore, proposed that the Federal Board of Revenue may clarify that henceforth DRRA shall not undertake any audit of taxpayers' sales tax and excise records. Further, section 25 may also be amended and reference of DRRA Audit may be deleted there from.

## WORK BACK ASSESSMENT

In terms of section 11(5), where the taxpayer fails to file the return, the officer of sales tax is empowered to determine his minimum (presumptive) tax liability based on work back basis. However, in many cases, the department creates tax demands based on work back method in violation of the scope of section 11(5).

### *Proposal*

The superior courts have held in numerous judgments that unless supply of taxable goods is established, no tax can be levied. The Supreme Court has also held that work back assessment under Rule 226 of (repealed) Central Excise Act 1944 is illegal.

It is, therefore, proposed FBR should clarify no assessment may be made on presumptive basis except in case of section 11(5) read with Para D of Sales Tax General Order 3/2004.

## MARKET VALUES

In case where there is sufficient reason to believe that value of supply has not been declared correctly, the dispute is resolved by forming valuation committee comprising representative of business community and the tax department. Nevertheless, in most of the cases, the department continues to dispute valuation on the basis of available market price with adjudication orders passed without forming valuation committees.

### *Proposal*

It is proposed that, identical to ADRC, a panel comprising of business community may be formed by FBR and all disputes regarding the value of supply may be referred to such committees under 2(46)(e).

## WASTAGE

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

### *Proposal*

To address this critical issue, it is proposed that Industrial Notes may be drawn by the FBR in consultation with trade, industry and tax consultants encompassing business processes of significant sectors and standard ratios of wastage occurring during such processes.

## CONSUMPTION OF PROCURED GOODS VS. TAXABLE ACTIVITY

Prior to Finance Act 2008, the act of putting to private, business or non business use of goods acquired or manufactured in the course of business was treated as "supply". Vide Finance Act 2008, 'goods acquired' was taken out of the definition meaning thereby no sales tax is leviable on non business consumption of purchased goods. However, the present definition is in conflict with the term "taxable activity" which also includes anything done during commencement or termination of economic activity.

### *Proposal*

It is proposed that clause 2(33)(a) should be brought in harmony with section 2(35) to avoid unnecessary litigation on this account.

## RECOVERY OF ADJUDGED TAX

Section 48 read with Rule 71 empower initiation of recovery proceedings at the end of 30 days from the date of order in which government dues are adjudged against the taxpayer. On the other hand, section 45B allows the taxpayer to file an appeal with the Office of Collector (Appeals) within 30 days from the date of receipt of order. Thus, Rule 71 is in conflict with section 45B of the Act.

### *Proposal*

Due to secretarial formalities, adjudicating orders are served to the taxpayer long after their pronouncements. It is, therefore, proposed that Recovery Rules may be amended and recovery proceedings may only be enforced after 30 days of service of order to the taxpayer. This amendment is also required in the best interest of natural justice.

## MISMATCHING OF PENAL INTEREST

A registered person can be penalized with default surcharge @18% p.a if he fails to pay off the tax liability by due date. On the other hand, failure of the department to pay off the due tax refunds in time only costs it 6% p.a

### *Proposal*

Keeping in view the rate of inflation, cost of funds and natural justice, it is proposed that interest on delayed refund may be enhanced to atleast 12% p.a.

## REVISED RETURN

Section 26(3) allows the registered person to file a revised return with the permission of the Collector to rectify any omission or wrong declaration made in his monthly tax return. However, there is no mechanism for revising the monthly special return, which is filed by 42 sectors of the economy.

### *Proposal*

It is suggested that necessary amendments may be made and reference of section 27 may also be incorporated in section 26(3) of the Act.

## INPUT TAX CREDIT ON FIXED ASSETS

Under Section 8B, input tax attributed on fixed assets is adjustable in 12 equal monthly installments. However, the term 'fixed assets' has not been defined in the statute.

Capitalisation policy of businesses differs from each other. Especially in case of non corporate taxpayers, due to non availability of audited accounts, disputes may arise as to what constitutes fixed assets. Consequently, cases could be established where the taxpayer had claimed the entire sales tax in a single return instead of prorating it over 12 months time.

### *Proposal*

It is proposed that the term 'fixed assets' may be defined in the same fashion as plant and machinery is defined in the Customs Act 1969.

## APPORTIONMENT OF INPUT TAX ON EXPORTS

Tax attributed to exports and zero rated supplies is refundable to the registered person. However, the law does not prescribe any formula / method of proration of input tax between exports and local supplies.

### *Proposal*

A formula / mechanism identical to the 'Apportionment of Input Tax Rules' should be introduced in the statute. Alternatively, the exporter may be allowed to carry forward entire excess input tax to the next tax period without any exception.

## VERIFICATION OF TRANSACTIONS

- ❑ Section 73 fails to address cases where payments are knocked off through contra book entries between buyer and sellers.
- ❑ The provision does not cater 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.

### *Proposal*

We understand that 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.

# FEDERAL EXCISE DUTY

## ADJUSTMENT OF DUTY

FED is adjustable if the taxpayer holds a valid proof of payment and receipt of purchase price and sales proceeds respectively including duty thereon. On the other hand, SED is adjustable on payment basis.

### *Proposal*

To bring harmony among the two duties, it is proposed that both FED and SED should be made adjustable on accrual / paid basis in line with section 7 of Sales Tax Act 1990. Further FED adjustment should not be made subject to receipt of sale proceeds and related duty.

## VALUE OF SERVICES FOR DUTY PURPOSES

In terms of section 12(2), the value of dutiable services is the total amount of charges for the services. However, in few instances e.g., banks / NBFIs, a major chunk of income on non fund services like credit cards, etc. is accrued on every single day of default. Such income is seldom realized to the bank and ultimately becomes irrecoverable. The present law does not cater peculiar situations like this.

### *Proposal*

It is proposed that duty on dutiable services especially for banking sector, which involve public money, may only become payable to the state when the same is recovered by the taxpayer (bank / NBFI).

## 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. Moreover, due to lack of carry forward facility in excise regime, the net excess input duty is not adjustable in subsequent tax periods.

### *Proposal*

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.

## DUTY ON FRANCHISE / TECHNICAL FEE & ROYALTY

In terms of Rule 43A(7), the bank is responsible to withhold duty on every remittance being made by it as royalty / technical or franchise fee, 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.

### *Proposal*

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.

THANK YOU !