



# TAX PAK

NEWSLETTER BY  
TOLA ASSOCIATES

MARCH  
**2021**



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## EDITORIAL NOTE

We bid welcome to our readers to yet another edition of our monthly newsletter for the month of March 2021. Amid the pandemic, the third wave to be exact, we strived hard and by the Grace of the Allah Almighty we have been able to extract, compile and comment on the recent advancements brought forth in the tax as well as corporate world.

Moving forward, we would brief a little regarding what our readers might expect in terms of the context of

newsletter. We start off our newsletter with analysis on the notifications passed by the Tax regulatory bodies including FBR and SRB, etc. What comes next are the brief comments on the corporate notifications issued by the Securities and Exchange Commission of Pakistan and our comments on a recent verdict passed by the Judiciary Body pertaining to tax. The Case Law section for this month pertains to a verdict passed by Lahore High Court on the matter of "Tax Credit not allowed" under section 8 of the Sales Tax Act, 1990.

We wind up our Newsletter with the Topic of the month. This months' topic revolves around the concept of taxability of the "Arthies" or the "Middle Man". The topic was doing rounds in the news as FBR looks forth to tighten the noose on the Income generated by the Arthies and how to include them into the tax ambit.

All our readers are requested to visit our website [www.tolaassociates.com](http://www.tolaassociates.com), or download our mobile application from the links mentioned below, in order to access previously published editions of this monthly issue along with other publications, and to stay updated of future notifications.

1. <https://goo.gl/QDM4ZM> (IOS)
2. <https://goo.gl/LFiWyx> (Android)

Lastly, we request our readers to circulate this e-copy within their circle, as our primary aim is to benefit the masses. Feedback is always welcomed.

**Ashfaq Tola - FCA**  
Editor in Chief



## 1. NOTIFICATIONS/ CIRCULARS

### 1. INCOME ON INTERNATIONAL SUKUK & EURO BONDS

As per Clause 75 of Part 1 of Second Schedule of ITO, any income of an agency of a foreign Government, a foreign national (company, firm or association of persons), or any other non-resident person approved by the Federal Government for the purposes of this clause, from profit on moneys borrowed under a loan agreement or in respect of foreign currency instrument approved by the Federal Government, shall be exempt from tax.

Now FBR has issued SRO 269(I)/2021 dated 1st March 2021, whereby Federal Government has approved exemption to the profit on debt income of an agency of a foreign government, a foreign national company, firm or association of persons or any other non-resident person, on International Sukuk issued under the Government's medium-term note program.

FBR has also issued SRO 268(I)/2021 dated 1st March 2021, whereby Federal Government has approved exemption to the profit on debt income of an agency of a foreign government, a foreign national company, firm or association of persons or any other non-resident person, on Euro bonds issued under the Government's medium-term note program.

### 2. Functions of Directorate General (I&I-IR)

In case of F.M. Textile Mills and others v. Federal Board of Revenue and others (2017 PTD 1875) the Lahore High Court had struck down jurisdiction notification SRO 115(I)/2015, dated 9th February 2015 with directions that FBR to initiate the process of specifying the functions and jurisdiction of the Officers of D.G (I&I) and to complete it within two months. Thereafter FBR may confer powers on officers of D.G (I&I) compatibly with their functions and to accord with the holding by this Court.

The FBR has issued SRO 272(I)/2021 dated 2nd March 2021, whereby functions and jurisdiction of Directorate General (I&I-IR) is provided according to above.

The following functions are covered:

(a) to carry out intelligence activities, access and verification of business premises, access to record/documents or system maintained therein, intelligence gathering on all tax related issues including under-reporting, tax evasion and revenue leakages;

(b) to collect information/record/documents from any person including taxpayer and third party-relating to financial transactions like investment and expenses etc. and details of persons who are involved in such activities;

(c) to process information and take necessary action on the basis of information provided by any other organization, agency or department under the relevant provisions of Income Tax Ordinance, 2001;

(d) to utilize the information obtained through establishment of linkages by the Federal Board of Revenue with all major national, provincial other data bases to collect relevant information;

(e) to identify cases of income tax evasion and carry out inquiry, investigation, whichever is deemed fit, to retrieve the loss of revenue;

(f) to identify, investigate and prosecute cases of tax evasion and/or offences punishable under the Income Tax Ordinance, 2001 and the rules made thereunder;

(g) to share and disseminate actionable information and corroborating evidence, where required, through written reports or information reports or otherwise to authorities or officers in the headquarters and field formations of the Federal Board of Revenue for further proceedings;

(h) to process, investigate and prosecute complaints of tax evasion;

(i) to process, investigate and prosecute information shared by other agencies and

(j) to carry out any other work or function that may be assigned to it by the Federal Board of Revenue

### 3. SOP for Protecting Complaints of Corruption Against Reaction or Revenge- Providing Secure Channel of Lodging of Complaints- Confidentiality & Encoding of Complainants

The FBR has issued Circular no. 10 of 2021 dated 1st March 2021, whereby SOP has been issued to report complaints against corruption and unethical practices. To ensure

protection, complaints will be directly received by Member (IR-Operations) himself on a special dedicated cellphone no. +92-0345-5555507. The SOP will be as follows:

(k) Complaints would be lodged through a text message at Cell no. above

(i) In whatsapp text option, the complainant would identify himself by writing his name, address, CNIC, the case particulars and his cell phone number.

(ii) The Complainant would write the names(s) of the official(s) or officer(s) against whom the complaint is directed along with his/her designation, place of posting, and other particulars, if available.

(iii) The complaint must be supported by some evidence such as audio or video recording, text messages exchanged with the FBR functionary or any other documents, which could be attached with the text message, or subsequently sent by hard mail. If no such evidence is readily available, an affidavit on a legal paper, clearly spelling out the allegation and the person against whom the allegations are levelled would suffice.

(iv) Upon receipt of the complaint, a code number would be allotted to each complaint and his back end identity data would be hidden beyond the access of field officers. This code number would help a complainant track progress on his complaint and the outcomes on it.

(v) Depending on the nature of the complaint and the evidence provided, the matter would be taken to a logical consequence in the shortest possible time.

(vi) Non-specific, unsupported or generalized complaints may not be processed.

#### **4. Mechanism to be adopted for the release of Consignment of FATA/PATA Residents Stuck-up at the Karachi Ports**

The FBR has issued Circular 9 of 2021 dated March 1, 2021 whereby following mechanism is decided for issues of imported goods of FATA/PATA residents stuck-up at Karachi Ports, Consumption/Installation Certificates, Postdated Cheques and Exemption Certificates under Section 148 of the Income Tax Ordinance, 2021:

- The stuck-up containers are to be released by Customs authorities against Postdated Cheques (PDCs) and sent to

their destination (FATA/PATA) under standard tracker mechanism.

- The Collector Customs (Enforcement & Compliance), Peshawar, will issue detention orders of the raw materials effective from day the consignment reaches the manufacturing premise of importers.

- The importer/manufacturer will be responsible to take the import documents along with detention order to the CIR concerned, RTO, Peshawar and make arrangements to have the manufacturing premises/raw material/ machinery /goods imported verified.

- The CIR concerned, RTO, Peshawar will be liable to verify/undertake physical visit as conducted by the importer/manufacturer to the manufacturing premises where the goods are kept under detention, and allow the raw material to be consumed/utilized in writing.

- The CIR, concerned, RTO, Peshawar will ensure the monthly stock-taking of the raw materials to consumed in the production of manufactured goods by these manufacturing units. This stock-taking will facilitate in issuance of the Consumption Certificate under S.No.151 of the Sixth Schedule of the Sales Tax Act, 1990.

- The residents of FATA/PATA will apply for tax exemption certificates under section 159 of the Income Tax Ordinance, 2001 for the import of raw material/machinery in light of the Honorable Peshawar High Court, Mingora Bench, (Darul-Qaza), Swat's decision dated 24.11.2020.

#### **5. Procedure for Issuance of Exemption Certificate for Import of Industrial Inputs/Machinery by FATA/PATA-Resident Tax Persons- Income Tax**

The FBR has issued Circular 13 of 2021 dated March 26, 2021 whereby it is noted that In pursuance to the amalgamation of FATA/PATA regions via 25th Amendment to the Constitution, in order to boost economic development therein, the Government of Pakistan, vide Clause (146) of Part I of 2nd Schedule to the Income Tax Ordinance, 2001 had exempted income "of any individual domiciled or company and association of persons resident in the Tribal Areas forming part of the Provinces of Khyber Palchtunlchwa and Balochistan with effect from the 1st June 2018 to the 30th June, 2023. The provisions of

sections in Division III of Part V of Chapter X and Chapter XII of the I.T.O 2001, pertaining to withholding taxes have also been rendered inapplicable to FATA/PATA-domiciled tax persons vide Clause (110) of Part IV of 2nd Schedule to the I.T.O, 2001.

However, in case of Section 148, the FBR's stated position continues to be that section 148 by reason of its being in Division II (instead of Division III) of Part V of Chapter X of the I.T.O, 2001, it has consciously been excluded from the nexus of Clause (110) by the Legislature as also emphatically articulated by FBR vide letter No.DOC.No.1(1)-M(IR-Ops)/2020/165904-R dated 21-09-2020, yet in view of Hon'ble Peshawar High Court's judgment in W.P.No.442-M of 2020 to the contrary, and till its reversal by the Supreme Court of Pakistan in a CPLA filed by FBR, FATA/PATA-domiciled tax persons could avail exemption u/s 148 of the I.T.O, 2001.

It may be noted the Hon'ble Peshawar High Court in W.P.No.442-M of 2020 titled as Hadi Khan Silk Mills Vs. Federation of Pakistan has also categorically held that FATA/PATA-domiciled tax persons shall be exempt from levy and imposition of advance tax payable under section 148 at import stage, till the period mentioned in Clause 146 of Part 1 of 2nd Schedule to the I.T.O, 2001 i.e. 30th June 2023. The Hon'ble High Court directed that for seeking exemption from payment of advance income tax under section 148 of the Ordinance at import stage, the petitioners shall have to seek exemption from the levy thereof, under section 159 of the Ordinance. The Hon'ble High Court has re-affirmed this mechanism in W.P.No.1219-M of 2020 titled Sohrab Sons & Co. Vs. Government of Pakistan & Others and W.P.No.2009- P of 2020 titled Ms Dawood Steel Vs. Federation of Pakistan & Others.

In view of above Order, the FBR has issued standardized procedure for the issuance of Exemption Certificate on Quarterly basis as follows:

A FATA/PATA-domiciled person appearing on the "active taxpayers' list" instituted by FBR in terms of section 181A of the I.T.O, 2001, and intending to import "plant, machinery, equipment" or "industrial inputs" for installation or consumption at his own manufacturing site would lodge a

written application to the Commissioner Inland Revenue covering following particulars:

- Production capacity of the manufacturing unit, and if the same has increased over time, the month from which the enhanced production capacity was installed along with particulars of the additional manufacturing capacity;
- Month-wise quantity of (a) raw material imported, and (b) purchased locally since July, 2020 (or 1<sup>st</sup> month of the tax year);
- Quantity of stock available from earlier imports;
- Month-wise details of Gas and Electricity consumed since July, 2020 (or 1 month of the tax year);
- Month-wise particulars of goods produced;
- Month-wise details of post-dated cheques (PDCs) deposited earlier with Customs authorities, if any;
- List of buyers of the goods produced;
- Bank statement for the past quarter;
- Electricity/Gas bills for the past quarter; &
- Month-wise proof of Federal Excise paid — only in case of goods covered under the Federal Excise Act, 2005.

The CIR would ensure that particulars supplied by the taxpayer are verified before the issuance of Exemption Certificate. In case any data are not verified, the taxpayer would be given an opportunity to complete the application, provide the required information, and make up the deficiency. The Exemption Certificate issued will be directly mailed to the Collector Customs concerned with a copy thereof being duly marked to Member (IR Operations) and Member (Customs Operations), and under no circumstances will be handed over to the taxpayer. If the CIR decides to reject the application for a Exemption Certificate, the previous PDCs deposited would be encashed.

## **6. Procedure for Issuance of Consumption Certificate for Import of Industrial Inputs by FATA/PATA-Domiciled Industries-Sales Tax/FED**

The FBR has issued Circular no. 5 of 2021 dated March 26, 2021 whereby it has highlighted that in order to earnestly implement and enforce the tax-related incentives and

benefits extended by the Parliament to residents of FATA/PATA, Circular No. 9 of 2021 dated March 1, 2021, has been issued. The Circular takes account of safe arrival of industrial inputs imported by FATA/PATA domiciled industries from the port to the intended manufacturing sites. Section 13(1) read with Serial No. 151 of Table I of Sixth Schedule to the Sales Tax Act, 1990, exempts import of "industrial inputs" to FATA PATA-located industries "on presentation of a post-dated cheque for the amount of sales tax payable and the same shall be returned to the importer after presentation of a consumption certificate in respect of goods imported as issued by the Commissioner Inland Revenue having jurisdiction. This particular benefit is subject to a further condition that if the goods produced from the exempted raw materials are "transferred or supplied outside the tribal areas, the tax exempted shall be paid at the applicable rate."

Now FBR has issued SOP for issuance of Consumption certificate for a FATA/PATA based manufacturer/Registered Person (RP), who is also an "active taxpayer" in terms of section 2(1) of the Sales Tax Act, 1990 (hereinafter "the STA, 1990"), and intending to import raw materials for consumption at his own manufacturing site would make a written application to the CIR concerned providing following –

- (i) Production capacity of the manufacturing unit, and if the same has increased over time, the month from which the enhanced production capacity was installed along with particulars of the additional manufacturing capacity;
- (ii) Month-wise quantity of (a) raw material imported, and (b) purchased locally since July, 2020 (or is' month of the tax year);
- (iii) Quantity of stock available from earlier imports;
- (iv) Month-wise details of Gas and Electricity consumed since July, 2020 (or 1st month of the tax year);
- (v) Month-wise particulars of goods produced; Month-wise details of post-dated cheques (PDCs) deposited with Customs authorities, if any;
- (vi) List of buyers of the goods produced;
- (vii) Bank statement for the relevant periods;
- (viii) Electricity & Gas bills for the relevant period; &

Month-wise proof of Federal Excise paid — only in case of goods covered under the Federal Excise Act, 2005.

The CIR would ensure that particulars supplied by the RP are verified before the issuance of Consumption Certificate. In case any data are not verified, the RP would be given an opportunity to complete the application, provide the required information, and make up the deficiency. The Consumption Certificate issued will be directly mailed to the Collector Customs concerned with a copy thereof being duly marked to Member (IR Operations) and Member (Customs Operations), and under no circumstances will be handed over to the taxpayer. If the CIR decides to reject the application for a Consumption Certificate, the previous PDCs deposited would be encashed.

## **7. Management of Tax Collection and its accounting procedure**

The FBR had issued Circular no.5 of 2011 dated 30th April 2011, whereby it issued detailed procedures to be followed by field formations on following for:

- Procedure for recording cash collections and its distribution
- Deductions/Collection at Source
- Cash Collection of withholding taxes by Provincial Accountants General
- Reconciliation of Collection

In case of collection u/s 231B, 233A/37A, 234, 234A, 236A & 236L the office empowered to account for collection was RTO in whose territorial jurisdiction the Motor Vehicle Registering authority or Stock exchange or Motor Vehicle (renewal) tax collecting authority or the SNGCL or SSGCL or Auctioning authority or person preparing domestic air ticket (respectively) exists. Now through Circular 12 of 2021 dated 10th March 2021 the jurisdiction will be of the Inland Revenue Field Formation, which holds jurisdiction over the withholders prescribed under these provisions.

In case of collection u/s 235 the office empowered to account for collection was RTO in whose territorial jurisdiction the office of WAPDA's Corporatized entity's (e.g. LESCO, HESCO, QUESCO, IESCO or KESC) office exists.

Now through Circular 12 of 2021 dated 10th March 2021 the Inland Revenue Field Formation, which holds jurisdiction over WAPDA's corporatized entity will have jurisdiction.

### 8. Extension in date of furnishing of Taxpayer's profile under section 114A of the Income Tax Ordinance, 2001

The FBR through Circular no. 14 of 2021 dated 26th March 2021 has extended last date of furnishing of Taxpayer's Profile required to be submitted under section 114A ibid up to 30th June, 2021.

### 9. Amendments in Asset Declaration (Procedure and Conditions) Rules 2019

The FBR has issued SRO 369(I)/2021 dated 31st March 2021 whereby amendments have been made in above Rules to avoid any misunderstanding by officers in application of amnesty scheme, as follows:

• **IMMUNITY FROM ANY QUESTION [Rule 8]:** It is clarified that the amount of assets, income and expenditure in a valid declaration for and upto tax year 2018 shall not be included in taxable income of the declarant for any tax year meaning that no question can be raised if source is properly disclosed. No proceedings under any provisions of the Ordinance are tenable.

• **INFORMATION RELATING TO UNDISCLOSED LOCAL ASSETS[Rule 9]:** If any information about any asset, income or expenditure discovered by FBR, no proceedings shall be initiated against that assets, income or expenditure as at 30th June 2018 or any prior period, if in response to Notice u/s 176 the taxpayer submits the declaration made with **irrevocable written statement** along with documentary evidence that the source of discovered income, asset and expenditure was the asset, income and expenditure properly declared in amnesty.

However, Commissioner has power to invoke Section 111 (unexplained income and assets) in following cases on basis of definite information with the prior approval of Chief Commissioner:

- Where the value of asset, income or expenditure, as at the 30<sup>th</sup> June 2018 or before, as per the definite information is in excess of value as per declaration; and
- Where the sources of asset, income or expenditure relates to a person other than the declarant.

#### • INFORMATION RELATING TO FOREIGN ASSETS UNDER CRS [RULE 10]:

If any information about any foreign assets already declared here in amnesty, is received under Common Reporting Standard [CRS] which information obtained and exchanged under Multilateral Convention on Mutual Administrative Assistance in Tax Matters, then before any action FBR shall ensure compliance under requirements of CRS. The following procedures will be followed:

- (a) the Commissioner Inland Revenue of the concerned person or delegate of the Commissioner shall issue a notice under Section 176,
- (b) the notice u/s 176 shall enquire as to whether or not such asset, income or expenditure has been declared under Voluntary Declaration of Domestic Assets Act, 2018 and the Foreign Assets (Declaration and Repatriation) Act, 2018 or Asset Declaration Act, 2019,
- (c) if the taxpayer informs Commissioner IR or his delegate that the asset, income or expenditure, as reported under the CSR has been declared in a declaration, the Commissioner IR or his delegate shall require the taxpayer to provide a copy of the declaration; and
- (d) the taxpayer on receipt of such notice under Section 176 of the Ordinance shall
  - (i) provide a copy of his declaration where such asset, income or expenditure, as the case may be, has been declared; and
  - (ii) provide a copy of the declaration of another person, being the beneficial owner, where the asset, income or expenditure referred to in the CRS has been declared.
- (e) If CRS information and declaration are in agreement, then CIR/his delegate will issue confirmation in writing that asset, income and expenditure to the extent referred to in the letter has been declared under respective law.



- **BENEFICIAL OWNERSHIP [Rule 11]:** In case of matter relating to legal or beneficial ownership of an asset, income or expenditure, the claim of beneficial ownership shall not be questioned unless there is definite information that the asset was created out of sources of a person other than the person claiming the beneficial ownership.

In case of foreign trust the source of contribution to the trust is claimed by any person other than settlor, beneficiary, or the trustees, the person so claiming shall be entitled to declare his contribution under the Act. Such declaration shall not be called in question merely on account that such person is not the settlor, beneficiary or trustees of the trust.

However, where the asset, income or expenditure is reported under CRS in the name of Settlor, beneficiary of the trust or any other person, proceedings shall be initiated against such person in the absence of a declaration by such settlor, beneficiary or other persons. In this case any claim, by a third person as contributor to the asset, income or expenditure, shall only be considered if supported with documentary evidences.

- **HOLDER OF PUBLIC OFFICE [Rule 12]:** The status of a person as to the holder of public office or otherwise and the period during which a person remained holder of public office shall not be questioned or challenged by the Commissioner IR or his delegate if the same is confirmed by the relevant office. No declaration by a person entitled to file a declaration under the Act shall be questioned only for the reason that the declarant is a relative other than spouses and dependent children of the declarant of a person being a holder of public office unless it is confirmed through a definite information that the asset, income or expenditure have been created out of the undisclosed sources of a holder of public office.

- **IMMUNITY FROM PROCEEDINGS UNDER ANY LAW [Rule 13]:** No proceedings in respect of a legally valid declaration shall be undertaken under any other law for the time being in force, including Foreign Exchange Regulation Act, 1947, Protection of Economic Reform Act, 1992 and Anti-Money Laundering Act, 2010 or any other Rules.

- **RULE TO APPLY TO AMNESTY 2018 [Rule 14]:** The Rules shall apply to Voluntary Declaration of Domestic Assets, 2018 and Foreign Assets (Declaration and Repatriation) Act, 2018. Proceeding u/s 122 cannot be initiated unless notice under these rules is issued and the taxpayer will be provided opportunity of being heard.

- **ACCESS TO DECLARATION UNDER THE ACT [Rule 15]:** Member Information Technology and Member IR (Operations) are authorized by the FBR to access the declaration on their own or when a request by the concerned Chief Commissioner IR, supported with reasons, is forwarded to any above Members for provision of copy.

### 10. SOPs for Registration of New Manufacturers for Concessionary Tariff Rates on Supply of Electricity and Gas

The FBR had issued Circular no. 4 of 2020 dated 30th December 2020, as per decision of ECC dated 02.12.2020 whereby it had issued SOP on above subject, in which for new registration of manufacturers for concessionary tariff rates, applicants may apply through respective representative Associations, listed in said circular's **Annexure A**. Now FBR has issued Circular 01 of 2021 dated 30th March 2021, whereby it has added following Associations of the export-oriented sectors:

- (i) Pakistan Tanners Association (PTA)
- (ii) Pakistan Knitwear & Sweater Exporter Association (PAK-SEA)
- (iii) Towel Manufacturers' Association of Pakistan (TMA)
- (iv) All Pakistan Bedsheets & Upholstery Manufacturers Association (APBUMA)
- (v) Pakistan Silk & Rayon Mills Association

The Associations listed above shall follow the procedure for registration of new entrants in Export-oriented Sectors as envisaged in Circular 04/2020 dated 30.12.2020.

## 2. CORPORATE NOTIFICATIONS / CIRCULARS

### A. SRO. 281(1)/2021 – SEC (REINSURANCE BROKERS) REGULATIONS, 2021.

The SECP vide SRO 281 dated 4 March 2021 have now approved the "Security and Exchange Commission

(Reinsurance Brokers) Regulations, 2021, which was previously proposed vide SRO 569 dated 26 June 2020.

The abovementioned regulations will act a principle directive for the person willing to act or perform as a Reinsurance Broker.

### **B. SRO 373(I)/2015 – DELEGATION OF POWERS TO THE ED (SCD).**

The SECP vide SRO 284 dated 5 March 2021 have now approved the “Modaraba Regulations, 2021” previously proposed vide SRO 1417 dated 19 November 2019.

The abovementioned regulations are devised to provide a guideline to the Modaraba and the interested investors willing to invest in Certificates of Musharakah or any other modes or instruments.

### **C. SRO 310(I)/2021 – DRAFT AMENDMENTS TO COMPANIES (FURTHER ISSUE TO SHARES) REGULATIONS, 2020.**

The SECP vide SRO 310 dated 18 March 2021 proposed draft amendments to “Companies (Further Issue to Shares) Regulations, 2020, wherein regulations pertaining to right of shareholders in terms of further issue to shares are proposed to be amended.

Moreover, an addition of a chapter has been proposed namely Chapter VIA “Registration and Valuation”. However, any person likely to be affected by the proposed amendments can communicate so to the SECP within 14 days from the date of placement on the website.

### **3. LAHORE HIGH COURT [LHC] HELD THAT NOTIFICATIONS U/S 8(1)(b) CAN ONLY RESTRICT INPUT GOODS AND NOT CLASS OF TAXPAYERS**

As per Section 8(1) (b) of Sales Tax Act, 1990, input tax paid on any goods or services which the Federal Government may, by a notification in the official Gazette, specify, will not be allowed as tax credit for the period against output liability. The FG has issued SRO 490(I)/2004 dated June 12, 2004 wherein a list of goods is specified which are not allowed as input. The FG also issued SRO 549(I)/2006 dated June 5, 2006 whereby no input tax adjustment was admissible to the registered persons making taxable supply

of locally produced coal (PCT Heading 27.01), however, this restriction was not applicable to registered persons making taxable supply of locally produced coal where value of supply exceeds Rs 5,000 per metric ton.

The Petitioners in New Cherat Coal vs Federation of Pakistan in W.P no. 4214 of 2017, heard on 27th November 2020, challenged SRO 549 in Lahore High Court on following grounds:

#### **1. GROUNDS BY PETITIONERS**

The petitioners were engaged in the supply of locally produced coal falling under PCT Heading 27.01 and are therefore, were not entitled to input tax adjustment as per challenged SRO. The petitioners have been supplying locally produced coal chargeable to sales tax at the rate of 17% and the sales tax liability of the petitioners was determined for a tax period on the basis of input tax adjustment made under Section 7 of the Act, 1990. The issue in these petitions relates to the period commencing from July, 2014 to January, 2016 for which input tax adjustment was duly claimed according to the petitioners.

##### **1.1 The SCN is illegal and without lawful authority**

One of the grounds of the petitioners was that the show-cause notice served on the petitioners is incompetent and illegal on the ground that SRO 549, which is the source of the show cause notice, is itself without lawful authority and has been incompetently issued by exceeding the delegated authority conferred by the Legislature.

##### **1.2 The SRO 549 does not specify goods on which sales tax paid is inadmissible.**

The other ground was that the SRO 549 declares inadmissible the input tax adjustment to a registered person making taxable supply of locally produced coal. The conclusion from plain reading to be drawn from SRO 549 is that in case a person makes a taxable supply of locally produced coal, he will not be entitled to input tax adjustment in respect of that supply. However, SRO 549 does not specify any goods on which input tax has already been paid and which have been used for making taxable supplies and in respect of which the input tax adjustment has been denied. Therefore, the relation in section 8(1) (b) is to the goods on which input tax has been paid and not to

the taxable supplies made by the registered person. The power conferred by section 8(1) (b) on the Federal Government has to be considered in its proper perspective therefore SRO 549 has not been correctly issued.

### **1.3 Creation of Other Class of goods in General Terms is not allowed**

Another ground under the petition was that the legislature has itself given entitlement to a class of goods in respect whereof input tax can be reclaimed or deducted and has further specified a class of goods, the payment of tax whereon, shall not be allowed to be reclaimed or deducted from the output tax. The legislature has not empowered the Federal Government to create any other class of goods in general terms excluding the same from the purview of reclaim or deduction of input tax. It has merely empowered the Federal Government to mention particularly or determine the specific goods, which otherwise entitle the registered person for re-claiming or deducting input tax, to exclude from such concession. Thus, creation of new class of goods in general terms dis-entitling the registered person from reclaiming or deducting input tax paid on such goods is not in spirit of provision contained in section 8(1) (b) of the Sales Tax Act.

## **2. REBUTTAL BY DEPARTMENT**

### **2.1 The SRO 549 properly issued**

The learned counsel for the respondents argued that SRO 549 has been properly issued and the nature of the registered person to whom the input tax adjustment has been denied has duly been mentioned and therefore the exercise of power by the Federal Government was proper and in accordance with the mandate of its delegated powers

## **3. DECISION OF LHC**

### **3.1 FG exceeds its powers**

The LHC held that while issuing SRO 549 the Federal Government has travelled beyond the powers conferred on it which was restrictive in nature and merely allowed the Federal Government to specify the goods on which the input tax had already been paid and in respect of which the adjustment was to be denied.

### **3.2 Notification can only be issued for input goods**

The court further held that the notification can only be in respect of goods on which the registered person has paid input tax and for which deduction is claimed. The SRO 549 fails to meet that standard and is without the jurisdiction of the Federal Government.

Hence, the impugned notification SRO 549 is held to be without lawful authority and of no legal effect.

## **4. TOPIC OF THE MONTH**

### **- TAXATION OF MIDDLE MAN I.E. TRADERS, DISTRIBUTORS, RETAILERS AND ARTHIES**

#### **➤ PREAMBLE**

To the readers who were with us previously know our drill but for the people who have joined right now, we would like to apprise them, that, we conclude our newsletter with our very own Topic of the month which we carefully select while keeping in mind the stake of our reader(s). For this month the topic that we are going to elaborate is "Taxation of middle man i.e. Traders, Distributors and Arthies".

The basic purpose of this topic is to aware the readers regarding the taxability of the Arthies or the Middle Man. Moreover the topic primarily emphasizes on the clarification of the Role of Middle man as "Entrepreneur/Capitalist", so let's begin!

When society is dealing with problem of price hikes or inflation, the Government officials instead of looking at the root cause of problems which created inflation i.e. role of Central Bank in money supply and interest rates, only blame middle man by chanting slogans that they are dealing with Mafia as this mafia controls the supply chain which is causing price hikes. Another reason quoted by government officials for price hike is that these middle man and mafias are not documented and they resist any attempt of documentation therefore the Government cannot determine the true price at each level of value addition.

In this document before we comment on the current tax regime, we find it useful to throw some light on the role of these middleman in development of society and to assign

them correct connotation which they deserve instead of masking them as demons and mafias.

#### **A. ROLE OF MIDDLE MAN AS ENTREPRENEURS**

A middleman plays the role of an intermediary in a distribution or transaction chain who facilitates interaction between the involved parties. Middlemen specialize in performing crucial activities involved in the purchase and sale of goods in their flow from producers to the ultimate buyers. They typically do not produce anything but possess extensive knowledge of the market, thereby charging a commission or a fee for their services.

The middleman is said to be mafia because it has controls in many aspects of value chain. However, in modern economic theory the person having such role is entrepreneur. The government can talk about entrepreneurship and act like it is promoting it, but all of what government does by taxing and regulating impedes the entrepreneur.

The Ludwig von Mises in his book Human Action (1949), p. 300 defines role of entrepreneur as “The entrepreneur hires the technicians, i.e., people who have the ability and the skill to perform definite kinds and quantities of work. The class of technicians includes the great inventors, the champions in the field of applied science, the constructors and designers as well as the performers of the simplest tasks.

The entrepreneur joins their ranks as far as he himself takes part in the technical execution of his entrepreneurial plans. The technician contributes his own toil and trouble; but it is the entrepreneur qua entrepreneur who directs his labor toward definite goals. And the entrepreneur himself acts as a mandatory, as it were, of the consumers. “

Rothbard (1985, 281) explained that “Mises conceives of the entrepreneur as the uncertainty-bearer, who receives profits to the degree that he can successfully forecast the future, and suffers losses to the extent that his forecasting goes awry.” Mises ([1949] 1996) gave a central role to the entrepreneur when he wrote ([1949] 1996, 328) that “the driving force of the market process is provided neither by the consumers nor by the owners of the means of production—land, capital goods, and labor—but by the

promoting and speculating entrepreneurs.” Mises explained that “the business of the entrepreneur is not merely to experiment which new technological methods, but to select from the multitude of technologically feasible methods those which are best fit to supply the public in the cheapest way with the things they are asking for most urgently” (Mises [1952] 2008, 144–45).

But as long as there is some shred of a market available, entrepreneurs find a way. They see opportunity others don't. They take financial risks that most people would consider unfathomable. The government edicts, bureaucratic roadblocks and oppressive taxation that discourage the hardiest of souls only serve to challenge and inspire creative entrepreneurs while weeding out potential competitors. All of the wonderful goods and services that we enjoy are due to entrepreneurship and the firms that are created to carry out the dreams of the entrepreneur and serve customers.

#### **B. EXAMPLE OF MIDDLE MAN - ARTHIE AS ENTREPRENEUR**

Entrepreneurship, in the Misesian sense, is the act of bearing uncertainty. Production unfolds through time, and thus the entrepreneur must purchase factors of production in the present (paying today's prices, which are known), in anticipation of revenues from the future sale of the product (at tomorrow's prices, which are uncertain). Entrepreneurial profit or loss is the difference between these revenues and the initial outlays, less the general rate of interest. As such, profit is the reward for successfully bearing uncertainty. Successful promoters make accurate forecasts of future prices and receive returns greater than their outlays. Those whose forecasts are less accurate earn losses. Promoters who systematically make poor forecasts quickly find themselves unable to secure any further resources for investment and eventually exit the market.

In a paper “Who is the “arthi”: Understanding the commission agent's role in the agriculture supply chain” a study by National Institute of Banking & Finance (NIBAF) & Pakistan Microfinance Network (PMN) Funded through the International Growth Centre – Pakistan March 2013, it was noted that:

“In Punjab, the arthi remains the largest source of informal credit for agriculture. He successfully lends to the segment considered risky and not credit worthy by banks. Not only does he make money but also manages his risk well. In order to generate some outside-the-box thinking on the issue of linking banks to the small farmer, this scoping study take a close look at the arthi system in Punjab to understand the arthi’s role in the agriculture supply chain by mapping his network and linkages, understanding his operations, finances (such as sources of funds, interest rates, costs and profits) and risk management techniques. Lessons from the arthi model are used to propose ideas for pilots and research that can break this apparent deadlock with regards to channeling institutional credit to agriculture in a profitable and sustainable manner.

Based on field interviews with arthis, wholesalers, input dealers and farmers, we find that arthis are not a uniform set but consist of different types offering a range of services depending upon the market they serve. However, commonly they operate out of the province’s 325 commodity markets, which act as the central place where all players in the agriculture marketing chain interact. The arthi provides two major services to the farmer: firstly, he provides inputs on credit at the time of sowing of a particular crop and secondly, acts as the sale agent for the farmer and facilitates the sale of the harvested crop in the market. By taking advance from the arthi, the farmer is bound to sell his produce through the same arthi giving the arthi control over the farmer’s cash flows. The rates charged by the arthi and his portfolio’s risk profile demonstrate that there is money to be made in agriculture lending to small and medium farmers. With operational costs at less than 2.5 percent of total volume of lending, nominal write-offs and interest rates ranging between 62 percent and 80 percent, profit margins for the arthi are quite significant. In addition to earning from credit, the arthi also earns commission from the sale of the produce of his borrower, calculated as a percentage of the sale price of the produce ranging from 2 percent to 4 percent depending upon the crop and his terms with the client.

The arthi manages his risk well while providing a ‘customized’ service as opposed to the ‘cookie cutter’

approach of commercial banks. He does so by first identifying the right borrower and ascertaining his credit needs accurately, and finally controlling the farmer’s cash flows by binding the farmer to sell the produce through him. On average, eight percent of the loans made by the arthi run into problems. Even these do not convert into defaults. The arthi is sensitive to the fact that in case the farmer is facing a crisis (due to crop failure or some personal circumstances, for example) the loan needs to be rolled over if he wants to ever see his money. Discussions with the farmers showed this was clearly a major differentiating factor between banks and arthis: while banks’ processes push them to begin recoveries from farmers even in cases where there is no intentional default and classify loans as soon as repayments falter, arthis provide a customized service to the farmer. The arthi recovers what the farmer can give at the time, reschedules the outstanding amount and also extends a new loan to allow the farmer to plant his next crop.

Entrepreneurs make decisions about resource allocation based on their expectations about future prices, and the information contained in present prices. To make profits, they need information about all prices, not only the prices of consumer goods but the prices of factors of production. Without markets for capital goods, these goods can have no prices, and hence entrepreneurs cannot make judgments about the relative scarcities of these factors. In short, resources cannot be allocated efficiently. In any environment, then—socialist or not—where a factor of production has no market price, a potential user of that factor will be unable to make rational decisions about its use.

Anticipating the later argument for “market socialism,” Mises argued that even if there were markets for consumer goods, a central planner (e.g. Federal Government, Provincial Government or ECC) could not “impute” meaningful prices to capital goods used to produce them. In short, without market-generated prices for both capital and consumer goods, even the most dedicated planner would find it “impossible” to allocate resources according to consumer wants.

In view of above, the allocation of resources and economic planning and minimum prices of agricultural produce and what to produce, how to produce is to be left to free market sources, any interruption to this will create chaos, for which government find a scape goat to blame, the middle man. Further the control by the middle man cannot be resisted as it takes risk of both profit and loss.

### C. TRADERS AS ENTERPRENURES

Time and time again, thought leaders, media and entrepreneurs have been quick to conclude that ‘the middleman’ in business is dead. In the early days of the Internet one might have believed that the new technology allowing direct interaction between individuals would cut out the need for intermediaries. But middlemen haven’t disappeared. Far from it. They’ve actually gained traction and importance.

The middleman’s roles and functions have changed dramatically. They are no longer a travel agent behind a desk, selling you an overpriced flight ticket or hotel room, but rather an online flight or hospitality booking platform such as Expedia or Kayak that provides you with endless choice, price range, and customization. In many industries, such as transportation and retail/e-commerce, the industry as a whole has become redefined by these mega middlemen.

### D. TAXATION OF MIDDLEMAN

#### D.1 Distributors

An advance tax on sales to distributors, dealers and wholesalers in Section 236G is collected by every manufacturer or commercial importer of electronics, sugar, cement, iron and steel products, fertilizer, motorcycles, pesticides, cigarettes, glass, textile, beverages, paint or foam section, at the time of sale to such distributors, dealers and wholesalers, at the rate of 0.1% (0.7% for fertilizers). The rate of tax has been reduced through promulgation of Tax Laws (Amendment) Ordinance, 2021 dated February 12, 2021. The rate of advance tax on sale to distributors, dealers or wholesalers of fertilizer is reduced to 0.25%, if they already are or get themselves registered under the Sales Tax Act, 1990 within 60 days of the promulgation of this Ordinance.

#### D.2 Retailers

In Income Tax Ordinance, FBR has introduced simplified tax forms for retailers having turnover less than Rs 10 million vide SRO 885(I)/2020 dated 17-09/2020 to bring them into tax net. An advance tax on sales to retailer is in place under Section 236H whereby every manufacturer, distributors, dealers, wholesaler or commercial importer of electronics, sugar, cement, iron and steel product, motorcycles, pesticides, cigarettes, glass, textile, beverages, paint or foam sector, at the time of sale to retailers and every distributor or dealer to another wholesaler in respect of the said sectors, shall collect advance tax at the rate of 0.5% for electronics and 1% for others. From the aforesaid person to whom such sales have been made.

As per Clause 24C of Part II of Second Schedule, the rate of tax under clause (a) of sub-section (1) of section 153 in case of dealers and sub-dealers of sugar, cement and edible oil, as recipient of the payment, is 0.25% of the gross amount of payments. Now through Tax Laws (Amendment) Ordinance, 2021 dated February 12, 2021 wholesaler and retailers of fast moving consumer goods, fertilizer, sugar, cement and edible oil, have also been added in the above category as recipient of the payment. However, the benefit of reduced rate shall be available to those dealers, sub-dealers, wholesalers and retailers of above sectors who already are or get themselves registered under the Sales Tax Act, 1990 within 60 days of promulgation of this Ordinance.

In Sales Tax Act, 1990 Retailers are divided into two categories as under:

1. Tier 1 retailers i.e. specified retailers are – section 2(43A):
  - (a) A retailer operating as a unit of national or international chain of stores;
  - (b) A retailer operating in an air conditioned shopping mall, plaza or center, excluding kiosk
  - (c) A retailer whose cumulative electricity bill during the immediately preceding 12 months exceeds Rs. 1,200,000;
  - (d) A wholesaler-cum-retailer, engaged in bulk import and supply of consumer goods on wholesale basis to the retailers as well as on retail basis to the general body of the consumers;
  - (e) Whose shop measure 1,000 square feet or more; and

(f) Any other person as prescribed by the FBR.

2. Retailers other than Tier 1 retailers

### **Tier 1 retailers [i.e. specified retailers]**

Tier 1 retailers are required to be registered and all the provisions shall apply in the normal manner including charge of sales tax, filing of monthly return, input tax adjustment / appointment, debit / credit note, audit and so on.

A retailer opening as a unit of a franchise or any other arrangement of a national or multinational chain of stores shall obtain a separate registration as distinct from his principal.

All Tier-1 retailers shall integrate their retail outlets with FBR's computerized system for real time reporting of sales. In case of default, his input tax claim would be reduced by 15%.

**Clause 66 Table I, 8<sup>th</sup> Schedule:** Supplies from retail outlets shall be charged @ 12% of finished fabric and locally manufactured finished textile and leather articles if supplies are integrated with FBR's computerized system for real time reporting of sale subject to one condition that they have maintained 4% value addition during the last 6 months.

**Cash-back of input tax:** The customers of a Tier-1 retailer shall be entitled to receive a cash back up to 5% of the sales tax involved. The FBR has issued SRO 1339(I)/2020 dated 16th December 2020, whereby it has promulgated Chapter XIV-AB in Sales Tax Rules for Cash Back to Customers.

A registered retailer is required to issue a serially numbered tax invoice containing specified particulars containing specified particulars including name, address and NIC / NTN of unregistered recipient of supply where the value of transaction exceeds Rs. 100,000.

### **Retailers other than Tier-1 retailers**

Retailers other than Tier-1 retailers are not required to be registered and they shall pay sales tax with their monthly electric bills as under:

- 5% where the monthly bill does not exceed Rs. 20,000; and
- 7.5% where the monthly bill exceeds Rs. 20,000.

The above sales tax is the final discharge of their sales tax liability and they are not allowed to claim input tax adjustment. Monthly sales tax return is not required to be filed and they are not subject to audit.

The above sales tax in case of unregistered retailer with electric bill is in addition to the sales tax otherwise chargeable with electric bills which is 17% normal sales tax + 3% further tax + 5% extra tax.

The electricity supplier shall deposit the said sales tax @ 5% or 7.5% directly without adjusting against his input tax.

### **D.3 Arhatis**

In Income Tax Ordinance, 2001, through Finance Act 2013 a new section 236J was introduced requiring every market committee to collect advance tax from its members i.e. dealers, commission agents, arhatis etc. at the time of issuance or renewal of license for membership. The term market committee includes any committee or body formed under any provincial or local law made for the purposes of establishing, regulating or organizing agricultural, livestock and other commodity markets.

The amount of collection of tax under section 236J was as under:

Group or Class	Amount of tax (per annum)
<b>Group or Class A</b>	Rs. 100,000
<b>Group or Class B</b>	Rs. 75,000
<b>Group or Class C</b>	Rs. 50,000
<b>Any other category</b>	Rs. 50,000]

Section 236J was omitted by Finance Act, 2020, whereby now arhatis are now under normal tax regime.

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