



Sale to Unregistered Persons (Tax Case)

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PROLOGUE

Over the years Federal Board of Revenue has been vouching for ways to bring the informal and unregistered sectors into tax net. The measures for this purpose are taken through changes in both direct tax or indirect tax laws. Upkeeping the same objective this year as well, the Federal Budget for 2020-21 has introduced yet another initiative under the Income Tax Ordinance, 2001 whereby sales to unregistered persons will be taxed at gross amount @ 29% without any deductible allowance, expense or expenditure.

Though the ulterior objective of bringing every one's business into tax net cannot be held objectionable undoubtedly, the manner in which, the same is being contemplated to be undertaken, however, is highly questionable.

This update is being given to explain the details on the subject along with and its implication under the income tax law.

A new sub-section 21(q) has been introduced which entails that any expenditure incurred against the sales, which are made to a customer who was liable to be registered under the Sales Tax Act, 1990 but was not registered, at the time of sales, will be disallowed. The disallowance, however, will be made if the sales to that unregistered customer was made up to Rupees 100 million or more in a year. The disallowance will be made on proportionate basis as per the given formula.

ILLUSTRATION:

	<u>Before 21(q)</u>	<u>After 21(q)</u>
Sale to registered persons	400 M	400 M
Sale to unregistered person	100 M	100 M
Total sales	500 M	500 M
Total expenditure	450 M	405 M
Taxable Income	50 M	95 M
Tax @ 29%	14.5 M	27.55 M

Disallowance

(i)

$$\frac{\text{Total Exp.}}{\text{Total Sales}} \times \text{Sales to unregistered person} = \frac{450 \text{ M}}{500 \text{ M}} \times 100 \text{ M} = 90 \text{ M}$$

of expenditure will be disallowed for tax purposes

(ii) Disallowance will be made up to a maximum of 10% of the total expenditure i.e. 10% of 450 M is 45 M.

IMPRECISE PARAMETERS

We understand that the provision of law still needs some consideration as observed in the ensuing notes;

A) Nature of Disallowance

The disallowance of bonafide expense due to a fault of not one's own is a novel concept with which, the Board has attempted to enforce registration. It is disdain for a genuine taxpayer to take a hit of taxes due to non-compliance and non-registration of his customer which is entirely an other party to the transaction. A person cannot be held

responsible and punishable for non-compliance of the other and that too under a complete and separate law i.e. Sales Tax Act, 1990.

It is unthinkable on normal plains as to why the data of these unregistered persons cannot be picked up from the monthly sales tax returns which are filed by hundreds of thousands of registered taxpayers in the country every month and that as to why the much desired registration cannot be enforced directly on them (the unregistered) by the regulator.

It is unthinkable to think as to how the regulator can possibly fail to catch the unregistered with all the data available electronically and that too with the clear distinction of 3% extra tax. A full-scale drive for country wide registration cannot be ruled out on the basis of very data of sales to unregistered which is being poured in by registered tax payers. This could inevitably resolve the concern to a greater extent.

It, however, appears that instead, an irrational law has been introduced for the very purpose by inflicting the business and constraining the trade in a very unwarranted fashion that goes straight against to one's veritable constitutional right of doing business.

The basis of disallowance, therefore, is no less than inherently flawed and misplaced.

B) Regulator at Ease

It is not only the burden of non-compliance of the other, which the compliant taxpayer has to bear but introduction of this law also shifts the consequence of failure of the government to get the unregistered as registered, to the same taxpayer. In both the cases he is not at fault at all, in the first place.

It is neither his fault that the other party is not registered nor that the very regulator, which is also his regulator, could not, register the defaulter, the other party.

This is also in sharp contrast to any concept of facilitation taxpayer.

C) Discrimination with Manufacturers with Industrial undertakings

Surprisingly, it is only the manufacturers who are meant to suffer the repercussions of this new ruling. Traders, dealers, distributions or the commercial importers have all been spared with. A very glaring prejudice has been exercised and that too with that class of taxpayer i.e. manufactures, which already ranks the highest in terms of its contribution to the tax revenue of the country. No explanation or rationale has been offered as to why manufacturers have been singled out for imposition of this law and that as to why other taxpayers can still continue doing their business with the same unregistered persons.

No basis of any reasonable clarification or any intelligible differentia could be found to get hold of any sound understanding of this conjecture.

D) Limit of Rupees 100 M Per Customer Per Year is Unrealistic

Even if the new law is taken to meant for addressing the non-registration issue, as contemplated, the high limit of Rupees 100 M per customer per year does not seem to sink in with the desired objective to catch more and more number of unregistered persons.

Annual turnover of Rupees 100 M is, by any measure, considered a considerable and a significant turnover for any sales business in Pakistan, which generally fall into a category of medium size to big sized business.

This, therefore, implies that the authorities have not yet been able to mend ways with small-sized business which count for hundreds of thousands in members.

E) Effective Date Of 1st October, 2020

Since, for the 1st quarter of the fiscal year (July 2020 – Sep 2020) the law was held in abeyance, the calculation of Sales limit of Rupees 100 M shall be considered based on the sales made in the remaining nine (09) months (Oct 2020 – June 2021).

In case of Special Tax Year ending on December 2020, the same shall be considered based on the sales of three (03) months only.

F) What If Unregistered Person Gets Registered

There has not been given any guideline as to the implication where the unregistered get itself registered before the year closes.

There has not been given any guideline as to the implication where the unregistered get itself registered after sales has been made but before second sale is made to him.

There has not been given any guideline as to whether implication of add back of expenses will have to considered by the taxpayer itself voluntarily in the payment of advance tax made every quarter or that the same is left for the taxpayer at the time of assessment or audit.

WHERE TO GO FROM HERE

There seem to be no reflection of any extra administrative efforts, or allocation of extra resources or any other drive for the expansion and broadening of tax net, behind this new provision of law, on the part of the regulator.

We understand it will be a wait and see game as to whether the vires of this provision stay hold and good if challenged in the court by genuine and compliant taxpayers or that they would choose to execute the regulator job, de bono, by convincing and training the teeming millions of unregistered tax payers in order to save their business from trimming.

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