INTERNATIONAL
THE NEWS

10 February 2014
Back Page

MONEY MATTERS

How will the FBR win the battle it's lost?

The tale of a tax imposed under pressure, its failure and possible withdrawal

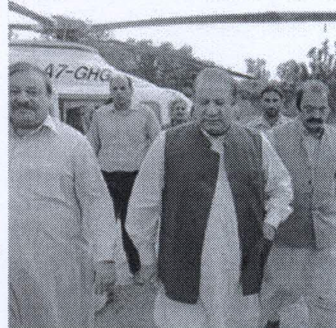
By Shaheen Sehbai

Key PML-N supporters and friends and some top business leaders of the beverage sector are accused of getting tax laws and duties amended in their favour and of minting money in the early days of the present government.

On July 9, 2013, the FBR issued an SRO asking bottlers to pay sales tax and excise duty on the installed capacity of their units, not on actual production as had been the practice previously. While the government claimed it was doing so with a view to nabbing tax evaders, the evidence suggests otherwise.

After a series of exhaustive interviews and a review of many documents, The News is now in possession of substantial evidence showing the government was pressurized to change the tax regime for this particular industry with a view to benefitting the big players. These include an official note sent to the FBR by excise officials on December 24, 2013; a policy note of the Competition Commission of Pakistan; a letter of warning from the Karachi Chamber of Commerce to Finance Minister Ishaq Dar; a case study on the manufacturing of aerated waters (bottles) prepared by the Large Taxpayer Unit of the FBR in Lahore as well as the FBR's estimated data chart for a major bottler, which was looking to pay Rs7 billion less in duties and taxes.

(The tax liability for the bottler, according to the FBR's calculations, was Rs9.6 billion but this number was reduced to just Rs2.6 billion after factoring in exemptions worth Rs7 billion. However, industry players reject these figures because they say there is no bottler big enough to apply for input tax claims or exemptions worth Rs7 billion over a period of just six months.)



Among the list of interviewees were several key players, including former senator Farooq Khan, a personal friend of Prime Minister Nawaz Sharif who was earlier in the running for Punjab Governor and was later named as a member of the all-important Privatisation Commission. Farooq Khan was appointed a PML-N senator in 1997 and, apart from being a large bottler, is also possibly the richest industrialist from Faisalabad division. He is reportedly supposed to have done most of the lobbying for the new system.

Others who came on record include ex-minister and PML-N leader Humayun Akhtar Khan; another member of his business family, KCCI leader Siraj Qasim Teli; a smaller Lahore bottler Ikram Elahi; FBR tax chief Ashfaq Ahmed Tunio and the FBR chief for that period Ansar Javed.

Significantly, while the industry players involved admit to having influenced the amending process, they claim they did so for the betterment of the nation and government since the switchover from a nine percent production-based tax regime to a 17 percent capacity-tax based regime would have given the FBR almost the same amount. However, those who forced the changes now admit they did so in haste and corrections are now being made.

Meanwhile, in the intervening seven months of the current financial year, the government has already been deprived of billions in revenue. The production-based taxation system, say tax officials, threw up a 25 percent annual growth rate. At the time it was replaced by the capacity-based tax, special input exemptions were allowed; audit exemptions were allowed; price increases between 22 percent and 28

VIEW DEALS

exemptions were allowed, audit exemptions were allowed, price increases between 22 percent and 28 percent were allowed and beverage dispensers in tens of thousands at restaurants, coffee shops, cinemas, malls and other public places were left out of the tax net. While the bottlers got a windfall from these measures, the estimated loss to the exchequer is calculated at between Rs5 billion and Rs7 billion on account of unpaid or manipulated tax slabs, duties or special exemptions.

Tax officials now say that since the government views its revenues on a financial year basis, taking a six-month view of revenues is misleading. These officials say they hope to make up the shortfall by either enhancing the spout rate for the latter half of the financial year (as already pointed out in the SRO in July 2013) or, if the FBR decides to eliminate the capacity tax, it will impose 17 percent sales tax and nine percent FED retrospectively. (Industry insiders say this may be another trick as tax laws cannot be made to apply retrospectively. Even if the FBR does so, they argue, the courts will instantly strike down such a law and the beneficiaries will keep smiling.)

However, the considered view of the FBR spokesman on the issue is just a paragraph long. Despite several top-level meetings regarding the issue in the last few days, the FBR seems to lack clarity on the matter and is unwilling to commit to a single policy statement.

In the meantime, the revenue body seems to be laying the grounds for a policy reversal in what seems to be a throwback to the luxury car SROs scandal during the Nawaz regime of the 1990s. (At the time, the laws were changed overnight and cars already parked outside the Karachi Port were cleared on lower duty slabs, following which SROs imposing higher duties were issued again.)

In an interview conducted last week in Islamabad, the FBR spokesman told The News: "The FBR in consultation with the concerned companies had imposed capacity tax on the basis of the agreement that the revenue would be increased by 25 percent [from the level it was] on the eve of budget 2013-14. After six months, these companies have not honoured their commitment and the collected revenue was much less than the 25 percent increase promised. Now the companies, including two multinationals, have been directed to fulfill their commitment otherwise the government will change this mechanism."

But industrialists claim that there was no 25 percent-increase guarantee in the old regime. According to these industry participants, the FBR is actually benefiting from the new system. And as far as the beverage dispensers are concerned, say these industrialists, they account for only 0.01 percent of total sales and their impact on total tax collection is negligible. (Strangely enough, in 1990, when there were hardly any dispensers at McDonald's or Pizza Hut, they were taxable but now that there are thousands, they have been exempted.)

The irony – or the tragedy – is that the flaws of the new system had been identified by the Competition Commission of Pakistan at the time the switchover was made. Denouncing the capacity-based tax as a discriminatory one, the CCP had argued that the tax was not only regressive, it also gave an unfair competitive cost advantage to the manufacturers who had a higher rate of capacity utilization over those who had less demand and were not able to fully utilize their installed capacity.

"Such a discriminatory tax regime stifles the competition in the beverage industry, and as a result, small local manufacturers will be forced to close down because they will no longer be able to compete in a tax environment that overwhelmingly favours large manufacturers," the CCP had argued, reasoning that the move ran counter to "the nation's professed aim of building and growing businesses and encouraging investment."

At the time, however, the bottlers reacted badly to the CCP note and insisted that the body did not have jurisdiction to take cognizance of the issue and that it was erroneously categorizing capacity-based tax as a regressive tax, simply because it was a lump-sum tax.

But the CCP warning has proven prescient. The FBR's December 24, 2013 note concedes that Rs7.7 billion was to be collected in the whole year but only Rs1.6 billion had been realised in the first six months of the current financial year. Till November 2013, a company with 2,062 spouts paid Rs1.2 billion in taxes while another with 3,319 spouts, paid only Rs432 million.

This could have been a fit case for an instant suo moto notice, if the now-retired Iftikhar Mohammed Chaudhry had been the chief justice of Pakistan.

Although industry sources do not agree, sources in government claim that this story began immediately after Nawaz Sharif took oath in June and that the premier's supporters in the Punjab, especially Faisalabad and Lahore, pushed him to change the tax regime. One PML-N supporter is a major player not just in Faisalabad but also in Gujranwala, Multan, Islamabad and Peshawar while another group controls Lahore. And the protests of all others, including smaller players led by Lahore bottler Ikram Elahi, went unheeded.

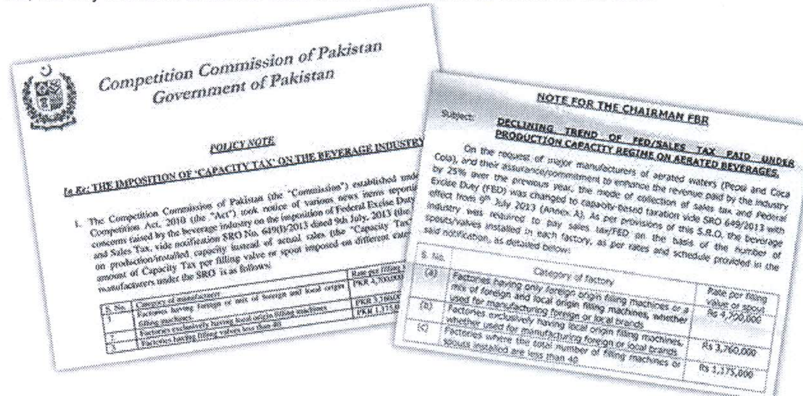
Opponents of the new system say that so many loopholes were left, almost deliberately, in the official notification as if a major loss to the exchequer and profits to the giants was being built in. According to these critics, the changes were made to oblige those PML-N supporters who felt entitled to a 'turn' after

five years of PPP rule.

But Farooq Khan denies this. “A local supplier had stolen Rs3 billion in taxes per year for the five years of the PPP government; this is a documented fact,” he says. “For five years, they earned Rs15 billion, with the connivance of a Grade-19 officer on long leave for five years. We could not do anything. Another party pays tax for only one day in one month. So we thought that capacity tax is the best way out.

“In the 1990s, [capacity tax] was highly successful and the government got the highest growth. In 1994, the system was changed by the PPP. But we have now given a level playing field; [the opponents of this system] do not understand: they are either inefficient or thieves. I asked the FBR chairman to bring a better system, if they had one. [And since they didn't], the decision was made.”

Significantly, tax lawyers also disagree with the assertion that only the big players benefit under the new system and maintain there were separate rates for smaller bottlers who had local machines. These lawyers also claim that the assessments under the new system are the same as the ones under the old; the only difference is that tax evaders can't hide behind the excuse of low sales.



Competition Commission of Pakistan
Government of Pakistan

POLICY NOTE

In Re: THE IMPOSITION OF 'CAPACITY TAX' ON THE BEVERAGE INDUSTRY

1. The Competition Commission of Pakistan (the "Commission") established under the Competition Act, 2010 (the "Act") took notice of various news items reporting concerns raised by the beverage industry on the imposition of Federal Excise Duty and Sales Tax, vide notification SRO No. 649(I)/2013 dated 9th July, 2013 (the "Capacity Tax") on production/installed capacity instead of actual sales (the ... amount of Capacity Tax per filling valve or spout imposed on different categories of manufacturers under the SRO is as follows:

S. No.	Category of manufacturer	Rate per filling ...
1	Factories having foreign or mix of foreign and local origin filling machines	PKR 4,XXX,000
2	Factories exclusively having local origin filling machines	PKR 3,760,000
3	Factories having filling valves less than 40	PKR 1,175,000

NOTE FOR THE CHAIRMAN FBR

Subject: DECLINING TREND OF FED/SALES TAX PAID UNDER PRODUCTION CAPACITY REGIME ON AERATED BEVERAGES.

On the request of major manufactures of aerated waters (Pepsi and Coca Cola), and their assurance/commitment to enhance the revenue paid by the industry by 25% over the previous year, the mode of collection of sales tax and Federal Excise Duty (FED) was changed to capacity-based taxation vide SRO 649/2013 with effect from 9th July 2013 (Annex A). As per provisions of this S.R.O. the beverage industry was required to pay sales tax/FED on the basis of the number of spouts/valves installed in each factory, as per rates and schedule provided in the said notification, as detailed below:

S. No.	Category of factory	Rate per filling valve or spout
(a)	Factories having only foreign origin filling machines or a mix of foreign and local origin filling machines, whether used for manufacturing foreign or local brands	Rs 4,700,000
(b)	Factories exclusively having local origin filling machines, whether used for manufacturing foreign or local brands	Rs 3,760,000
(c)	Factories where the total number of filling machines or spouts installed are less than 40	Rs 1,175,000

However, even Farooq Khan admits the notification was issued in haste. “The documentation required was not there; we did not have information about the capacity so we put a tax which all could sustain. A review was due in August but the FBR did not do so.”

Interestingly, in a departure from the views espoused by the big bottlers, Farooq Khan admits the existence of “written guarantees” from the industry participants to pay 25 percent more in revenues and claims to be worried about the revenue shortfall worth billions. “I gave [the bottlers] hell in the FBR [office]; written guarantees are there and will be honoured.”

While Farooq Khan and ex-FBR chief Ansar Javed agree that the scheduled review of the system should be conducted soon, Humayun Akhtar Khan, another big player in the beverages industry, is also contesting the very basis of this system. “Faisalabad's Farooq Khan did this,” he says. “Farooq Khan had a problem with a local bottler who used to evade between Rs2 billion and Rs3 billion in taxes. We were against [this new system] but we agreed. Now we have lost money in this system and we want the old system back.”

An industry spokesperson, however, claims the change was made on the recommendation of the industry. According to him, representatives of both domestic and foreign bottling companies asked the FBR to rope in the tax evaders and that government functionaries just accepted their stance.

“The FBR came under political pressure and just bought into the new system,” says Siraj Qasim Teli of the Karachi Chamber of Commerce and Industry. “They did not approve of it, as there were flaws in the structure. But the FBR did not verify the declarations in time, it did not increase the rate in time and so did not get the money. Bottlers who were playing tricks thus got a windfall. The previous system was equitable. The new tax is inequitable. It cannot be right and the majority is against it.”

However, industry sources say that the perception that the revenue shortfall is due to the failure of the FBR to revise the rate shortly after the declaration of spouts by the industry is only partially correct. “The reason the industry could not deliver the promised growth in the first six months can be attributed to several factors,” say these sources. “First, some small players and the main tax evaders challenged the basis of the tax in court. Second, since the courts issued stay orders on the petitions, the declarations regarding capacity by the whole industry were not filed in time. On top of this, most of the FBR team which had devised the new system was changed and the new team failed to immediately appreciate the conditionalities set out in the SRO and so, failed to revise the spout rate on the basis of declared and leftover spout capacities.”

Former FBR chief Ansar Javed, under whose watch this new tax was introduced, narrows the issue further to the problem of tax enforcement. “Budget proposals are always for the betterment [of revenue collection] but sometimes, when you move from one mode of collection to another, enforcement issues come and collection may be hit. Enforcement is a complicated issue and you need periodic evaluation.”

However, Ansar Javed denies that politics influenced the decision. "As such, no," he says. "[Even] if it was, the FBR has its own policy evaluations and they are given weight. But the FBR must review the [policy]; they can easily plug the gap."

That said, if remedial measures are not taken immediately, the game may be over. After seven months, most of the industry has now agreed to raise the tax rate from Rs4.7 million per spout to Rs6.5 million – a whopping increase of almost 40 per cent. By inference then, close to 40 percent of potential revenue has been lost in the last seven months. Further, the big players who forced the change in June last year have also agreed to reduce input exemptions by 35 per cent, which would further translate into billions of tax rupees.

While FBR Tax chief Ashfaq Ahmed Tunio confirms that several meetings have been held regarding this complex issue, "no decision has been taken; the matter is still under discussion. We have options; we'll see what to do." Meanwhile, concedes Tunio, while the target is Rs7.7 billion, only Rs1.6 billion have been collected so far. And even he is hoping for a quick resolution.

But industry sources dismiss this assertion and are fearing another drastic change in the tax system. "The cream has already been shaved off and some bottlers are hoarding huge stocks in godowns outside their factories in anticipation," they say. "Some made billions when the first change was forced; others will do that now, at the cost of the taxpayers."

How the FBR handles the situation and wins a battle it has lost already remains to be seen. There are whispers regarding an "All Parties Conference" of stakeholders to be held in the the near future at the FBR, under the chairmanship of Finance Minister Ishaq Dar. The question is, why now and why not in the first place?

The writer is Group Editor of The News. Mehtab Haider contributed to this story from Islamabad

ALKE Heating
www.alke.nl
Infrared heating for domestic and Industrial applications

Jang Group Of Newspapers
All rights reserved. Reproduction or misrepresentation of any material available on this website in any form is infringement of copyright law and is strictly prohibited.
Privacy Policy