

**FEDERAL TAX OMBUDSMAN SECRETARIAT
5-A, CONSTITUTION AVENUE
ISLAMABAD**

Subject: **STUDY REPORT ON INTEGRATION OF TIER- 1 RETAILERS UNDER THE SALES TAX ACT 1990 AND RECOMMENDATIONS FOR SYSTEMIC IMPROVEMENTS IN THE SCHEME**

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A. INTRODUCTION

According to the statistics issued by the Bureau of Statistics (GoP), the retail sector in Pakistan is amongst the fastest growing sectors of the economy. It is contributing almost 19% to the national GDP. It is the third largest sector of the economy and the second highest employer, employing 15% of the labor force. Pakistan has around 2 million retailers, including kiryanas, general stores, supermarkets, hypermarkets, etc. Chainstore Association of Pakistan is the largest trade body of organized retailers and represents over 200 of high-end retail businesses in the country.

Despite the huge size of the retail sector the total tax contribution from the sector has remained low. The reason behind this is that, a considerable number of taxable transactions are made without any documentation and resultantly without any tax deduction. In order to enhance the effectiveness of the tax enforcement at retail stage, in many economies there have been precedents to monitor the retail sector through tracking the taxable transactions by recording the purchase invoices (a case is Brazil's Nota Fiscal Paulista Program) and third-party reporting ((Turkey's prize scheme on retail invoices)

B. Rationale for Integration of the Tier-1 Retailers to the POS System

Keeping in view the evidence that recording the invoices or e-transactions improve compliance and revenue, the policy makers at FBR felt that the monitoring the sale invoicing at retail stage can help to ensure tax compliance from this untapped sector, not only for raising the revenue but also for documentation of the economy and broadening of the tax base. Therefore retail sale monitoring in Pakistan, focusing on Tier-1 Retailers was introduced in financial year 2021-22. Although introduced after thorough discussions and agreement between FBR and the Retailers Association of Pakistan.

There were many ambiguities and difficulties for the taxpayers who were notified without individual consent through the issuance of Sales Tax General Orders.

Resultantly, since the introduction of the scheme in financial year October 2021-22, a constant stream of complaints is being received in the office of Federal Tax Ombudsman and its regional branches seeking/redressal of complaints regarding the scheme. Keeping in view the constant inflow of complaints its was deemed necessary to conduct a detailed study on the introduction of the scheme by FBR and problems for the taxpayers in its implementation. The study has the following objectives:

- To comprehend the concept of “Integration of Tier-1 Retailers” under the Sales Tax Act 1990.
- To make recommendations to FBR ways and means to remove the Complaints of the taxpayers due to inclusion in the list of Tier-1 Retailors and implementation of POS system.

Legislative changes in the sales tax 1990 and sales tax rules 2006

Legislation to introduce invoice recording was initiately brought in vide SRO.608(I)/2014 dated 02.07.2014, and latter Section 2(43A) of the Sales Tax Act, 1990 was inserted by Finance Act, 2017 as amended from time to time. Amendments were also made in Chapter XIV-AA of the Sales Tax Rules, 2006 vide Notification No.SRO.1360(I)/2018, dated 12.11.2018 under the new legislation, the registered persons, if falling in any of the categories of aforesaid law, were liable to integrated as Tier-1 retailer and pay their sales tax liabilities accordingly. This law created various categories of Tier-1 retailers, who were bound to be linked to integrated Points of Sale (POS), the categories are mentioned below:

- (a) a retailer operating as a unit of a national or international chain of stores;
- (b) a retailer operating in an air-conditioned shopping mall, plaza or centre, excluding kiosks;
- l a retailer whose cumulative electricity bill during the immediately preceding twelve consecutive months exceeds twelve hundred thousand Rupees;
- (d) a wholesaler-cum-retailer, engaged in bulk import and supply of consumer goods on wholesale basis to the retailers as well as retail basis to the general body of the consumers;
- l a retailer, whose shop measures one thousand square feet in area or more; and
- (f) any other person or class of persons as prescribed by the Board.

Integration Tier-1 Retailers with FBR's POS System Section

To ensure the integration of Tier-1 Retailers with FBR's POS System Section 8B(6) was introduced in the Sales Tax Act 1990, that conditioned, that if a Tier-1 Retailer "(T-IR)" did not integrate its retail outlet in the manner prescribed under subsection (9A) of section 3 of the STA, 1990 during a tax period, its adjustable input tax for that period was to be reduced by 15%. The figure of 15% was raised to 60% vide Finance Act, 2021.

Publication of the lists of identified Tier-1 Retailers

In order to operationalize this important provision of law, Sales Tax General Order No.1 of 2022 was issued where a system-based approach was adopted whereby all T-IRs liable to be integrated but not integrated, with effect from July 2021 (Sales Tax Returns filed in August, 2021) had to be dealt with as per the procedure laid down below:-

- I. A list of all identified T-IRs was to be placed on FBR's web portal at www.fbr.gov.pk by 5th of every calendar month allowing them to integrate with FBR system by 10th of the month.
- II. In case a notified T-IR claims that it is not liable to integrate, it shall apply to the Commissioner concerned for exclusion from the list by 10th of the calendar month, and the Commissioner would make a decision in this regard by 15th of the month.
- III. The Chief Commissioners would forward all exclusion certificates issued by the Commissioners to Chief (POS) for giving effect in the ITMS by 16th of the month. The exclusion certificates not forwarded by the due date would not be entitled to the T-IR to relief as per this order.
- IV. Upon filing of Sales Tax Return for the month of July 2021 by all notified T-IRs not integrated, the input tax claimed would be disallowed without any further notice or proceedings, creating tax demand by the same amount.

POS Linkages with the FBR's computerized system

An online real-time system for documentation of sales has been introduced to connect the 3ncentivizin sales system of Tier-1 retailers to FBR's system through the internet. A barcode or QR code automatically gets printed on the invoice generated through a sale by the retailer. According to FBR the integration of POS is the exercise to record the

purchase invoices to ensure transparency and accountability by identifying the movement of goods and incentivizing the customer to collect receipts to improve compliance against tax evasion. The system can help retailers in the automatic preparation of sales tax returns and thereby reducing their expenditure.

Number of Tier-1 Retailers integrated with FBR's POS System up to April 2022

While introducing the scheme in July-2021, FBR stated that it intends to integrated 50,000 to 60,000 retailer in the fincial year so far 7000 to 8000 retailer have been linked with the system. The details are tabulated below:

STGO No.	Date	Number of T-lrs
STGO 2/2022	6 th Sep/2021	977
STGO 3/2022	5 ^h Oct/2021	1230
STGO 4/2022	4 th Nov/2021	608
STGO 6/2022	3 rd Dec/2021	482
STGO 7/2022	5 th Jan/2022	1284
STGO 9/2022	4 th Feb/2022	1358
STGO 10/2022	3 rd March/2022	1421
STGO 11/2022	5 th April/2022	185
STGO 16/2022	6 th May 2022	297
Total:		7842

Prize Scheme as an Incentive to Customers

Prize scheme are third party reporting mechanism used by many tax administrations. In FBR's integrated system customers can verify the sales tax payment through the Tax Asaan App. An amount of approximately Rs.5 million is distributed monthly among winning customers who verify their invoice via the 'Tax Asaan App' or by sending invoice numbers to FBR via SMS. According to FBR customers are incentivised to achieve maximum transparency and reduce evasion via real-time tracking of sales receipts.

TIER-1 INTEGRATION: COMPLAINTS, ISSUES, AND SYSTEMIC PROBLEMS

As soon as the Tier-IR integration scheme was rolled out by FBR in October 2021, complaints started pouring in from different cities pointing out arbitrary decision making and systemic glitches that hampered the smooth flow of the retailer business. Issues and problems brought to the notice of the Federal Tax Ombudsman are enumerated below:

Problems faced by Retailers, due to FBR'S Faulty Sales Tax Portal

The Hon'ble Federal Tax Ombudsman has taken 'Own Motion' notice on the basis of a newspaper appeal by the Chainstore Association of Pakistan (CAP) and ordered FBR to probe into the matter. Main issues taken up in the complaint were:

- National Sales Tax Return (NSTR) portal was complicated and erroneous processes, resulting in disruptions in business operations, resulting in unsustainable backlog of commercial risks not only for small and medium-sized chain stores with limited resources but for large enterprises with sufficient resources too, due to capacity limitations of FBR's IT setup;
- retailers have had to pay extra sales tax for consecutive two months due to disallowance of genuine credit invoices by the NSTR portal;
- once the portal is fixed, hundreds of businesses will need to revise their returns and seek adjustment of extra sales tax paid which is a cumbersome process;
- fully compliant businesses were yet not able to reconcile thousands of sale invoices, synced with the FBR system during the preceding month, with their own records as FBR's ITMS System report did not allow identification of individual invoices. As a result, integrated businesses have no choice but to calculate their payable sales tax on a lump sum-basis, with the risk of paying extra sales tax, which adds to the cost of doing business;
- NSTR Portal does not accept manual sale entries due to discrepancy in Annexure-C. Tier-I retailers were unable to upload sales tax withholding using the template provided;
- POS service fee of Rs.1 per invoice does not appear in return. While challan was accessible, banks were unable to fetch it in record;

- NSTR Portal shows a figure "purchase from unregistered person" on main page whereas tracking of this entry was unavailable in the whole sales tax return;
- FBR portal did not accept Annex-A and Annex-I uploaded files but accepts only manual entries;
- NSTR portal did not provide purchase type for unregistered purchases alongside provisional invoices in their entirety;
- when Tier-1 retailers claim input, return does not indicate inactive parties;
- it is not possible to upload sales tax withholding using the template provided by the FBR System;
- it was suggested by CAP that, in Annex-C of the sales tax return, POS identification number needs to be declared as it will help the Tier-1 retailers to reconcile at the time of audit;
- many unclaimed provincial service invoices and goods invoices do not appear in Annex-A and Annex-I;
- sales amount against reduced rate of 12% and standard rate of 17% was not appearing separately on the main page of the return;

According to CAP due to the above issues, after filing returns for January and February 2022, huge liabilities of sales tax have started appearing as payable in the next month's return. As a result, Tier-1 retailers were facing difficulties and delays in submitting their sales tax returns.

SPECIFIC ISSUES RAISED IN COMPLAINTS BY INDIVIDUAL RETAILERS

Apart from the above own-motion case, taken up the Hon'ble Federal Tax Ombudsman more than a hundred individual complaints were filed with the FTO by the newly integrated Tier-1 Retailers. Highest number of complaints were received from taxpayers based in Lahore (50%) then from Islamabad (20%) and Karachi (18%). These specific complaints related to the followings issues:

A. Exclusion certificate: delays, penal procedure

- There were complaints for delay in exclusion by the retailers who do not fall under any single category in the Section 2(43)A to F.
- Despite claims and application by the notified Tier-1 Retailer that they are not liable to be notified, proceedings were Initiated by FBR against the taxpayers

while request for issuance of exclusion certificate remained pending before the department for months.

- Exclusion Certificate request were filed to FBR Islamabad for redressal of Complainant's grievance, but no action was taken over exclusion, to save the Complainant from disallowance of 60% input of Sales Tax and to enable it to file his Sales Tax Return within time which had already been delayed due to pending application.

B. Penal action against taxpayers who had already removed the POS machines.

In many cases, POS machine was admittedly installed by a retailer but removed. However, Deptt. did not bother to conduct on spot enquiry or to verify from the relevant bank regarding the current status of installation of POS machine at the store and without affording opportunity of explanation, registered the entities when POS had already been removed and, further, despite the fact that Deptt. had been duly apprised about overall status of Complainants, exclusion certificates were delayed for weeks. due to systemic issues between the RTO's and FBR.

C. Arbitrary integration by overstretching clause A to F of Section 2(43A)

- Retailors were registered compulsorily due to proximity of the businessman name being similar to a famous chain store and request for denotifying was not accepted until redressal was vehemently supported by the office of the FTO.
- Arbitrary attachment of Bank Accounts by FBR of the family members of the registered person having POS was reported.
- Furniture business with very low sales coming under the yard stick of 1000sqft. Area, latter extended to 2000 sq ft. by FBR, but the integrated units with 1000 sq ft. area were still being shown as Tier-1 Retailer.
- Retailers with areas less than 1000sqft, but notified.
- Small shop's in malls registered arbitrarily, as the law did not exclude even low turnover shops from inclusion in the lists under the STGO's, as they were situated in a mall.

D. **Manufacturers or wholesalers, registered as Tier-1 Retailer without physical verification.**

Many complainants had no retail outlet and all the sales were made to registered persons only on wholesale basis, therefore, requirements, mentioned in Rule 150ZEA of Sales Tax Rules, 2006, were not attracted. However the Department passed impugned penalty orders instead of deciding exclusion application, imposing penalty without establishing first whether Complainant's business was liable to be registered under the said system or not. Retailers integrated with FBR system, were unable to file correct tax return, due to such departmental proceedings.

GENERAL COMMENTS

- a. The legislature, in its wisdom, had deemed it fit to lay down certain conditions one of them being shop area as a yardstick to identify person whose taxable activities were significant enough to require documentation. Correlation of retailer shop area with sales tax registration is still unfair and arbitrary as Sales Tax is applicable on turnover and not on area. The taxpayers protested that comparison of size of shop with turnover was irrational as size of shop did not reflect quantum of business turnover in true sense. Complainants prayed that FBR may be directed to delete retailers, having single shop irrespective of their shop area, from the condition to get integrated with FBR's POS System. Complainant feared that such integration would increase their already increasing cost of doing business as they could not fulfill the strict conditions of abiding sales tax laws/provisions.
- b. Taxpayers proposed that rules and regulations should be revisited whose applicability, in practice, was difficult for any person, community or group of persons as in case with certain categories of Tier-1 retailers, based on area, amount of electricity bill and condition of air-conditioned mall.
- c. A common issue raised was that POS integration is bound to increase expenditure on running the business which small shopkeepers could not afford. Legal understanding of statute/regulatory procedure, in automated environment, was big hurdle for shopkeepers as generally they are illiterate.
- d. It was also brought to the notice of the FTO that bracketing certain retailers in Tier-1 category while allowing other categories of retailers out of the ambit of

POS integration, would create extremely disabling/discriminatory environment, discouraging retailers to integrate with POS System.

- e. It was also reported that buyers are preferring to visit non-integrated outlets to avoid paying 17% Sales Tax hence effecting turnover volume of the integrated retailers.
- f. There were Problems being faced by the taxpayers due to the companies operating Point of Sales who were new to the business.
- g. It was proposed by the Retailer associations that electricity bill limitation of Rs.1.2 million should be re-assessed afresh keeping in view current rates of electricity bill;
- h. Anjuman-e-Tajran in big cities KCCI and LCCI further asserted that government should focus on broad basing of tax revenue in other potential areas of economy instead of only squeezing retail business.

RECOMMENDATIONS

After analysis of the complaints received by the office of the FTO during past seven months, and after due interactions of the Hon'ble Federal Tax Ombudsman with the office bearers of various Retailors Association and Anjuman Tajran Pakistan, recommendation to facilitate the integrated Retailors or those not liable to be integrated were also discussed. Based on the following recommendations to address the anomalous situation and create a level playing field for all the retailers have been agreed upon the policy wing of the FBR may consider the same for the budget 2022-23.

The Recommendation are:

A. Definition of Retailer - Section 2(43A)

Section 2(43A) of the Sales Tax Act, 1990 defines the persons/business liable to sales tax registration as retailers. This definition contains Categories A to F, whereas Clause "F" states "any other person or class of persons as prescribed by the Board." However, the Board has not yet issued rules under this clause.

Complaints are being received before this forum stating therein that the field formations are compulsorily registering the persons/shops that do not fall in any category mentioned in A to F and after registering them compulsorily, they issue demand notices and pass order imposing penalties

etc on account of non filing. When the position was confronted with field formations, they simply stated that FBR has been sending them lists of persons/businesses on the basis of income declared by them in their income tax returns. In pursuance of the lists, they issue notices to the persons and on no response, they make them compulsorily registered under the sales tax law. It is therefore recommended that in case FBR intends to enlarge its scope, it should make rules under Clause "F" of Section 2(43A) specifying persons or class of persons required to be registered other than the categories mentioned at Clause A to E of Section 2 (43A) *ibid*.

B. Fix reasonable deadlines to issue exclusion certificate and filing of correct return, minimize discretion through automation

Keeping in view the fact that the registered persons have to file the return by 15th of the calendar months. It is proposed that all lists of taxpayers to be integrated be issued on first of each calendar month. Respectively all registered T-IR if not liable to integrate may be allowed to apply for exclusion certificate by 5th of the calendar month. Scrutiny by Commissioner should be completed by 8th of each month and Administrator ITMS should enter the exclusion by 10th of each month so that the registered person is able to file the return as per his status by the 15th of the Calendar month. Administrator of the ITMS would ensure that requisite change is made before 10th of each month, so that taxpayers who are not excluded from the notified list can file their return on time.

FBR should introduce an electronic monitoring mechanism to ensure that the officials entrusted with discretionary powers to approve or reject an application for exclusion are made to follow the deadlines, given by FBR itself, through the standing orders.

C. Withhold issuance of STGO on further integration till revenue budget 2022-23

FBR may withhold, registration of retailers for POS integration whose twelve months bill of any period is more than twelve lakh rupees till the electricity values are determined as per current rates or raise the limit to 20 lakh. Conditions for registration of low turnover retailers located, in air-conditioned malls be

redefined. In order to provide enabling environment to retailers, condition of area should be eliminated.

D. Resolve systemic issues between RTO's and Chief (POS) FBR

FBR should address the issue of input adjustment after due correction of departmental data and record, and resolve the systemic issues between RTO's and Chief (POS) FBR, resulting in inordinate delays, to enable the taxpayers to claim admissible input tax credit in their monthly Sales Tax Returns. Amendment may be made in sales tax Act 1990 for automatic allowance of refund application in case of no correspondence by the officer concerned within the stipulated period of 60 days.

FBR may lay out an online procedure for issuing exclusion certificate in 5 days time to the retailers who claim that they have no POS System installed. Due verification of installation of POS system at the premises may be done, (as it is also a pre-requisite for sales tax registration) and after providing due opportunity of being heard to the Complainant, decisions may be made. So that delay and corrupt practices are tackled through this automated procedure.

E. Disallowance of 5% Input Tax Adjustment Under Section 8B of the Sales Tax Act, 1990

It is provided under section 8B regarding (adjustable input tax) of the Sales Tax Act, 1990 read with SRO 1190(I)/2019 dated 02.10.2019 that input tax adjustment shall not be allowed in excess of 95% of the output tax in a tax period to Tier-I retailers who have integrated all their POS with the FBR. In case any portion of this input tax remains unadjusted against the output tax, the registered person shall be allowed refund after a year subject to audit. The intention of the legislature behind this arrangement is based on the perception that suppliers at each stage, throughout the supply chain, expect a minimum value addition of 5%. Therefore, the suppliers should be allowed to adjust the input tax to the extent of 95% of their output tax and pay the minimum sales tax @ 5% of the output tax. While this is a logical arrangement in case of majority of retailers who are working under normal ad-valorem regime, it is resulting in double taxation to the

retailers of daily use items whose more than 50% supplies consist of items of 3rd Schedule of the Sales Tax on which sales tax at retail price already stand paid by the manufacturers/importers. Therefore, some portion of the 5% input tax of such retailers remains unadjusted due to which they are forced to file refund claim for this amount. But such refund claims generally remain unattended by the department causing severe liquidity crunch for the retailers.

In order to resolve their genuine problem with a view to facilitating the normal business and to avoid double taxation, it is proposed that supplies of 3rd Schedule items by the POS integrated retailers should be excluded from the application of section 8B by adding it in Table-I of SRO 1190(I)/2019 dated 02.10.2019.

F. Harmonization of Provisions in Sales Tax Regarding Person's Liable to Registration

Provisions relating to persons, liable to be registered under Section 14, are contrary to provision related to be persons, liable to be registered under Section 3 (9) of Sales Tax Act, 1990. If the provisions, under Sub-Section (9A), relating to Tier-1 Retailers, read with Section 2(43A), are perused there is clear discrimination between Section 3(9) and Section 3(9A) as it created disabling environment for Tier-1 retailers in the wake of huge undocumented economy. In order to create fair and equal environment for retailing business, a well-considered framework needs to be put in place.

G. Comprehensive Automated Infrastructure for End to End Integration

Ensuring taxpayers friendly automated regulatory regime through level playing environment and without creating discrimination is critical for effective success of regulatory regime. It is observed that, FBR needs to raise a comprehensive infrastructure, based on automated environment, through which all persons, liable to be Sales Tax registration are brought under tax net without discrimination/without exemption brackets. It should upgrade the system, remove capacity limitations, streamline the systemic support for revision of returns and adjustment of extra sales tax period, allowing identification of individual invoices in the ITMS.

H. Pre Budget Discussion with Retailers Association and Chain Store Association

FBR needs to hold an exhausted pre-budget session with the stakeholders to reach out to common point of facilitation of taxpayer alongwith documentation of economy under automated environment without creating discrimination amongst different tiers of stakeholders. Traders/retailers also need to come to the fore to accept this national challenge and assist state authorities in devising a mechanism to document the economy which equally serves public interest as well as interest of the taxpayer.

CONCLUSION

The expansion of the tax base in Pakistan is recognized as an essential policy goal to increase domestic sources to reduce foreign aid dependence. However the integration of businesses with POS is a big challenge for both the FBR and businesses alike for multiple reasons. First is the complexity of legal provisions for POS integration. Second, are glitches and delays in the automated system of Federal Board of Revenue..

Overall, the integration process is fraught with procedural delays and systemic limitations. It is yet to be analyzed whether the scheme has made a sizeable contribution to raising the revenue and how successful is the process of monitoring the taxable activities through point of sale integration. It is recommended that while carrying on with the aim of more integration, FBR should ensure a taxpayer friendly Automated System removing the flaws pointed out in the study, and doing away with the discretion by more and speedy automation systemic improvement.