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KTBA raises concerns over extended HS codes

KARACHI: The Karachi Tax Bar Association (KTBA) has expressed concern over the use of extended Harmonised System (HS) codes and the absence of standard units of measure (UoMs) in sales tax returns filed through the IRIS system.

In a letter addressed to the chairperson of the Federal Board of Revenue (FBR), the KTBA said that the recent mandate to use eight-digit HS codes, along with the lack of standard UoMs in the sales tax return, is causing significant challenges for both taxpayers and tax consultants. It noted that the HS code system, originally developed for international trade, typically operates on a five-digit structure to identify and categorise goods. Even within this framework, professionals occasionally face disputes with customs over correct classifications -- especially beyond the five-digit level. Therefore, introducing such a detailed system for local trade is impractical, inconsistent with the Sales Tax Act, 1990, and difficult to implement effectively.

According to the KTBA, the Sales Tax Act, 1990 and its relevant rules do not explicitly require the declaration of HS codes in tax returns or invoices. The Iris system's mandate for such declarations lacks clear legislative backing and, as such, places an unjustified compliance burden on taxpayers.

The association also argued that enforcing an eight-digit HS code for local transactions runs contrary to the FBR's stated goals of simplifying tax procedures. It added that the absence of a standard UoM is particularly problematic, as it prevents taxpayers from accurately filing sales tax returns. Local markets often use different UoMs for the same products compared to those used in import documentation.

To reduce confusion and compliance issues, the KTBA suggested limiting the HS code requirement to five digits (eg 6109.1). This, they said, would still allow the FBR to meet its tracking objectives while minimising disputes and easing the compliance burden.

The KTBA further pointed out that the FBR has recently mandated the exclusive use of kilogrammes as the UoM in sales tax returns for both imports and local supplies. However, businesses face significant challenges as the UoMs traditionally used for certain products often vary between domestic and international trade. This could lead to penalties due to discrepancies caused by the FBR's kilogram-based system, which may not align with established industry practices.

To address this, the KTBA proposed allowing greater flexibility in UoM declarations, enabling taxpayers to report supplies in the units most relevant to their industry, rather than being restricted to customs-defined standards.

In addition, to enhance transparency and curb fraudulent transactions, the KTBA recommended restricting the sale of finished goods -- classified under specific HS codes in Annexure-A or Annexure-B -- by manufacturers and commercial importers from being included in Annexure-C. This restriction should also apply to later stages of the supply chain, allowing for better tracking of finished goods.

The KTBA concluded that HS codes should remain a reference tool for customs and international trade purposes. Taxpayers should be permitted to use industry-specific product descriptions without facing penalties for minor discrepancies in HS code selection.

In such cases, the description of goods should take precedence over HS codes for both taxation and regulatory compliance.