



WWF – A PREDICAMENT FOR THE MUTUAL FUND INDUSTRY

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Mutual funds and pension schemes are pass through investment vehicles where income earned flows through to unit holders/ investors and therefore for tax purposes they have exemption from income tax on distribution of 90% of income to unit holders to avoid double taxation. An amendment in Workers Welfare Fund (WWF) Ordinance, 1971 made by Finance Act, 2008 widened the scope of definition of the term industrial establishments so much that it was interpreted by some that it brought into its ambit mutual funds and pension schemes as well, along with other trusts. Our constitutional petitions are pending before the Honourable Sindh High Court since June 2010, challenging that WWF levy is not applicable to mutual funds and pension schemes as these are pass through investment vehicles and these are not establishments. We also have in this regard, very clear clarifications from the Ministry of Labour and Manpower that WWF is not applicable to mutual funds and pension funds and is only applicable to asset management companies. There is a very detailed judgement of Lahore High Court in which it has struck down the amendments to WWF Ordinance made through Finance Act, 2006 and Finance Act, 2008 regarding them as being unconstitutional. Despite of the above mentioned facts, the Funds of our member institutions have been receiving show cause notices for non-payment of WWF.

In this Article we aim to bring to the knowledge of our readers the technical details of MUFAP's constitutional petitions in this regard, reasons behind our anticipation of a favourable outcome and the Commission's requirement for additional WWF disclosures in Offering Documents, Fund Manager Reports and advertisements.

Amendment of the term 'Industrial Establishment' in WWF Ordinance

An amendment in the WWF Ordinance was made via Finance Act, 2008 by virtue of which the definition of "industrial establishment" stated therein was broadened to include definition of "establishment" as given in West Pakistan Shops and Establishment Ordinance, 1969 (Establishment Ordinance). The definition of "establishment" stated therein includes the definition of "commercial establishment" and the definition of "commercial establishment" includes charitable or other trusts. The tax authorities construed that the new definition has been seemingly widened enough to cover all mutual funds i.e collective investment schemes (CIS) and voluntary pension schemes (VPS) making them prone to likelihood of collection of 2% of their income as contribution to WWF. It is absolutely clear to MUFAP that the intent behind the change introduced in this legislation was not to cover these CIS which are pass through investment vehicles and have exemption from income tax on distribution of 90% of income to unit holders.

MUFAP's decision to approach the Honourable Sindh High Court and Ministry of Labour and Manpower

On behalf of all the mutual funds, MUFAP decided to approach the Sindh High Court and filed a Constitutional Petition No. D – 2764 of 2009 before the Sindh High Court challenging the application of afore – mentioned amendment to CIS. The Court dismissed the petition on technical grounds of filing that MUFAP is not an aggrieved person since the grievance complained of does not directly affect the Petitioner. Fresh petition was filed by a mutual fund, pension scheme and an AMC through Haidermota & Co (HM & Co.) in June 2010. MUFAP meanwhile asked for and received very clear clarifications from the Ministry of Labour and Manpower (the beneficiary) that WWF is applicable on Asset Management Companies but not on mutual funds. To quote "It is clarified that Mutual Fund(s) is a product which is being managed/ sold by the Asset Management Companies which are liable to contribute towards Workers Welfare Fund under Section-4 of WWF Ordinance, 1971. However, the income on Mutual Fund(s), the product being sold, is exempted under the law *ibid*". These clarifications were shared with FBR, but nevertheless, FBR persisted in sending show-cause notices to mutual funds and MUFAP has been able to secure stay orders on these notices.

Grounds of appeal

Our plea with the Honourable Sindh High Court is based on the following grounds: (these are summarised grounds of appeal):

- Mutual funds and pension schemes are not 'industrial establishments' for the purpose of WWF Ordinance because they

are pass through/ flow through investment vehicles where income earned flows through to unit holders/ investors and technically for tax purposes they are treated as non-entities to avoid double taxation;

- Liability imposed under the WWF Ordinance is deemed to be liability of investors who are liable to pay income tax whereas mutual funds and pension schemes are exempt from income tax upon distribution of ninety percent of income;
- The liability will be discriminatory because investors investing directly in stocks through stock exchanges are not liable to pay it;
- In the light of 18th Amendment to the Constitution of Pakistan Federal Legislature is no longer competent to manage WWF and it would be unconstitutional to make payments to WWF administered by the Federal Government.

Progress on the matter

MUFAP actively followed up with HM & Co. for early hearing of our Constitutional Petition. A Full Bench of three judges heard the Petition and reserved the judgement. On our continued follow up after a few months we were informed by our Legal Counsel that the matters will need to be re-heard as one of the judges was not confirmed by the Parliamentary Commission for Judicial Appointments and one of them was due to retire soon. Our Petitions were reheard by a Full Bench in February 2012. Our Legal Counsel intimated us that the petitions relating to WWF have been bifurcated into two separate categories. The Full Bench of the High Court of Sindh has reserved judgment on those cases in which the challenge is only the constitutionality of the amendments to the WWF Ordinance by the Finance Act/ Ordinance. These petitions comprise the first category. The second category is that of the petitions filed by the mutual funds, where we have also challenged the applicability of the WWF Ordinance on the basis of several other points as well. These petitions have not been reserved. There is strong probability that the amendments will be set aside. Once this happens, we would have our constitution petitions heard and decided so that the additional points raised by us can be adjudicated.

One of our member institutions has had a favorable decision in their favor by the Commissioner Inland Revenue against their appeal on the showcause notices received by five of their funds.

Legal opinion in the light of two indirectly related judgements of the Supreme Court and Sindh High Court and one directly related judgement of Lahore High Court

MUFAP has legal opinions from senior and eminent counsels as to why WWF is not applicable to mutual funds. Our Legal Counsel has provided us with a very comprehensive legal opinion on the likelihood of a favourable outcome in our constitutional petitions in the light of following three judgements: The Supreme Court in *Mir Muhammad Idris vs. Federation of Pakistan* reported in PLD 2011 SC 213 (the Supreme Court judgement); The Lahore High Court in *E.P.C.T (Pvt.) Ltd. vs. Federation of Pakistan* Writ Petition No. 8763/2011 dated June 3, 2011 (the Lahore High Court judgement) and The Sindh High Court in *Employer's Federation of Pakistan and other vs. Federation of Pakistan* petition no. D260 of 2008 dated February 26, 2011 (the Sindh High Court judgement). The opinion which is based on detailed analysis of the afore-mentioned three judgements educates us that the money-bills under Article 73 of the Constitution require approval of National Assembly alone and these money-bills can only contain legislative amendments related to subject matter that falls within the purview of Article 73(2)(a) to (g). Legislative Amendments related to all other matters must be approved by both the houses of the Parliament i.e. the Senate and the National Assembly. Therefore amendments introduced vide Finance Acts (money-bills) unrelated to matters listed in Article 73(2) are unconstitutional and have no legal effect.

The Supreme Court Judgement relates to unconstitutionality of the re-appointment of the Chairman, President of National Bank of Pakistan made vide Finance Act, 2007 through an amendment in Banks (Nationalization) Act, 1974. The Supreme Court declared the amendment unconstitutional and further held that the appointment would not remain unaffected as the foundation on which its superstructure rested stood removed.

The Sindh High Court Judgement declared the amendments introduced in Workers Compensation Act 1923, West Pakistan Industrial and Commercial Employees (Standing Orders) Ordinance 1968, Companies' Profit Workers' Participation Act 1968, Minimum Wages for Unskilled Workers Ordinance 1969 and Employees Old Age Benefits Act 1976 via Finance Act 2007 as unconstitutional holding that none of the afore-mentioned labour statutes had any connection with any of the item specified in Article 73(2) of the Constitution and hence by any stretch of logic cannot be treated as money bill.

The Lahore High Court Judgement is entirely related to our case dealing with the constitutionality or otherwise of the amendments in the WWF Ordinance made through Finance Acts 2006 and 2008. It was contended in the Court that since contribution to the WWF was in the nature of tax the subject matter of proposed amendments being financial amendments fell within the purview of Article 73(2) of the Constitution and therefore valid. However The Lahore High



Court in a detailed and well written judgement concluded that the Workers Welfare Fund has a specific purpose and specifically has to be utilised for welfare of workers. Contribution to it is in its nature a fee and not a tax. Moreover, Article 73(3) expressly provides that a bill shall not be deemed to be a money bill if it provides for imposition of fee or charge for any service rendered. The Lahore High Court declared these amendments unconstitutional. Our Legal Counsel on the case has clearly opined that in the light of recent judgements in particular that of Lahore High Court, there are good chances for our constitutional petitions to be decided in favour of the mutual fund industry on the ground that the impugned amendments to WWF Ordinance have been unconstitutionally enacted through Finance Act, 2008.

WWF provisioning/ non-provisioning and SECP's additional disclosure requirements

The question arises about accounting treatment. To provide for WWF or not to provide for WWF is a puzzling question. While there have been arguments that it is prudent to provide for the likely liability, the Principle of Prudence aims at showing the reality "as is". Typically, revenue should be recorded only when it is certain and a provision should be entered for an expense which is probable. The precedents to our WWF constitutional petition as elaborated above are very much in our favour and we can well anticipate a favourable outcome therefore. Our assessment of probability/ likelihood of this liability arising can be low therefore. If successful outcome in litigation is anticipated non-provisioning is justified and cannot be termed as imprudent. In an open end fund where daily offer and redemptions of units are being made at Net Asset Value per Unit, provisioning (if there is a favourable decision of the case) and non-provisioning (if there is an adverse decision of the case) for WWF both have a degree of negative implications for the investors.

In June 2012, SECP has issued a Directive in investor interest for maximum possible disclosure that additional disclosures regarding contingent WWF liability and its impact on NAV/ return of the CIS should be provided in month Fund Manager Report, advertisements and Offering Documents. In case where a provision has been made the disclosure would be "The Scheme has maintained provisions against Workers' Welfare Fund's liability to the tune of Rs.----- if same were not made the NAV per unit / return of the Scheme would be higher by Rs. ----/---- %age. For details investors are advised to read Note----- of the Latest Financial Statements of the Scheme." In case where a provision has not been made or partially made, the disclosure would be "The Scheme has not made provisions amounting to Rs. ----against Workers' Welfare Fund's liability, if same were made the NAV per unit / return of the Scheme would be lower by Rs. ----/---- %age. For details investors are advised to read Note----- of the Latest Financial Statements of the Scheme." These disclosures are now being complied by CIS.

MUFAP understands the significance of the issue for investor and industry interest and is actively following up its resolution through the Court and Government of Pakistan.