

Income Tax

Definitions

Amalgamation

The bill proposed to enlarge the scope of the definition amalgamation by insertion of companies providing services. This will encourage major merger in near future. However trading companies will not enjoy this benefit.

Eligible Person

The bill proposed to correct grammatical error from words “has obtained” with “holds”.

The bill also proposed to allow CNIC in case of non-availability of NTN for the purpose of voluntary pension system.

Private Equity and Venture Capital Fund

The bill proposed to define private equity and venture capital fund, as a fund registered with Securities and Exchange Commission of Pakistan under private equity and venture capital fund rules 2007.

Small Company

The bill proposed to add one more criteria for determination of small company. Now small company is;

- Registered under Companies Ordinance, 1984 on or after July 01, 2005;
- Paid up capital not exceeding 25 Million;
- No of employees not exceeding 250;
- Annual turnover not exceeding 250 Million;
- Is not formed by splitting up or reconstitution of the company already in existence;

Income from Business (Section 18(4))

The bill proposed to include income from private equity and venture capital fund by banking company or non-banking finance company as a business income.

Federal and Provincial Government and Local Authority Income (Section 49)

The income of Federal and Provincial Government or Local Authority is exempt. However there were major controversies between different Government entities and taxation authorities. Now the bill proposed to add proviso to end all controversial issues.

The proviso is;

- (3) in section 49, sub-section 3, for the full stop, at the end, a colon shall be substituted and thereafter the following new proviso shall be added, namely: -

Provided that exemption under this section shall not be available in the case of a corporation, company, a regulatory authority, a development authority or other body or institution established by or under a federal law or a provincial law or an existing law or a corporation, company or other body or institution setup, owned and controlled, either directly or indirectly, by the Federal Government or a Provincial Government, regardless of the ultimate destination of such income, as laid down in Article 165A of the Constitution of the Islamic Republic of Pakistan.

Set off of Losses of Companies Operating Hotels (Section 56A)

The bill proposes to add new section for allowing set off of losses of companies *operating hotels*. It provides that where a company registered in Pakistan or Azad Jammu and Kashmir operating hotels in Pakistan or Azad Jammu and Kashmir sustain a loss in Pakistan or Azad Jammu and Kashmir for any tax year under the head "Income from Business" shall be entitled to have the amount of the loss set off against the company's income in Pakistan or Azad Jammu and Kashmir as the case may be for the year.

Set off of Business Loss Consequent to Amalgamation (Section 57A)

The bill proposes to exclude brought forward and capital losses for set off of amalgamating company against profit of amalgamated company and vice versa.

Group Taxation (Section 59AA)

The bill proposed to introduce the concept of group taxation of locally incorporated holding company and subsidiary companies of 100% owned group as one fiscal unit if they opt for. Accounts of the group companies shall be prepared and audited by a Chartered Accountant as prescribed for listed companies under Companies Ordinance, 1984.

Group Relief (Section 59B)

The bill proposes to amend provision relating to group relief in the following manner;

- (a) there is continued ownership for five years, of share capital of the subsidiary company to the extent of fifty five percent in the case of a listed company, or seventy five percent or more, in the case of other companies;
- (b) none of the group companies is engaged in the business of trading;
- (c) holding company, being a private limited company with seventy five percent of ownership of share capital gets itself listed within three years from the year in which loss is claimed;

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- (d) the group companies are locally incorporated companies under the Companies Ordinance, 1984 (XLVII of 1984);
- (e) the loss surrendered and loss claimed under this section shall have approval of the Board of Directors of the respective companies;
- (f) the subsidiary company continues the same business during the said period of three years;
- (g) accounts of the group companies are prepared and audited by a Chartered Accountant as prescribed for listed companies under the Companies Ordinance, 1984 (XLVII of 1984); and
- (h) the group companies observe Code of Corporate governance as provided in the Companies Ordinance, 1984 (XLVII of 1984);
- (i) the subsidiary company shall not be allowed to surrender its assessed losses for set off against income of the holding company for more than three tax years;
- (j) where the losses surrendered by a subsidiary company are not adjusted against income of the holding company in the said three tax years, the subsidiary company shall carry forward the unadjusted losses in accordance with section 57;
- (k) if there has been any disposal of shares by the holding company during the aforesaid period of five years to bring the ownership of the holding company to less than fifty five percent or seventy five percent, as the case may be, the holding company shall, in the year of disposal, offer the amount of profit on which taxes have not been paid due to set off of losses surrendered by the subsidiary company;
- (l) loss claiming company may, with the approval of the Board of Directors, transfer cash to the loss surrendering company equal to the amount of tax payable on the profits to be set off against the acquired loss. The transfer of cash would not be taken as a taxable event in the case of either of the two companies;
- (m) the transfer of shares between companies and the share holders, in one direction, would not be taken as a taxable event provided the transfer is to acquire share capital for formation of the group and approval of the Security and Exchange Commission of Pakistan or State Bank of Pakistan, as the case may be, has been obtained in this effect. Sale and purchase from third party would be taken as taxable event.

Investment in Shares (Section 62)

The bill proposes to increase the limit of investment in share for the purpose of tax credit from Rs. 200 thousands to Rs. 300 thousands.

Principles of Taxation of Association of Persons (Section 92 & 93)

The bill proposes to bring taxation principle of AOP of professionals at par with commercial AOPs. Earlier member of professional firms were taxed separately from AOPs, but now AOPs are taxable and member will enjoy tax free share from AOP.

Disposal of Assets under a Scheme of Arrangement and Reconstruction (Section 97A)

The bill propose to make necessary provision by adding new section for making disposal of assets from one company to another company a non tax event if the same is done under scheme of arrangement and reconstruction under the provision of Companies Ordinance, 1984.

Special Provision Relating to Banking Business (Section 100A)

The bill proposes special provision for taxation of banking companies from tax year 2008 to onward in the following manner.

RULES FOR THE COMPUTATION OF THE PROFITS AND GAINS OF A BANKING COMPANY AND TAX PAYABLE THEREON

1. Income, profits and gains of a banking company shall be taken to be the balance of the income, from all sources before tax, disclosed in the annual accounts required to be furnished to the State Bank of Pakistan subject to the following provisions, namely: -

- (a) Deduction shall be allowed in respect of depreciation, initial allowance and amortization under sections 22, 23, and 24 provided that accounting depreciation, initial allowance or amortization deduction shall be added to the income. No allowance or deduction under this rule shall be admissible on assets given on finance lease.
- (b) Section 21, sub section (8) of section 22, section 68 and Part III of Chapter IV shall, *mutatis mutandis*, for computation of a banking company apply.
- (c) Provisions for classified advances and off balance sheet items shall be allowed as claimed in the accounts, provided a certificate from the external auditors is furnished by the banking company to the effect that such provisions were in line with the requirements of the Prudential Regulations.
- (d) The amount claimed as expense, on account of “irrecoverable debt” classified under the Prudential Regulations issued by the State Bank of Pakistan as “substandard”, shall not be allowed.
- (e) Where any addition made under paragraph (d) is reclassified by the taxpayer as ‘doubtful’ or ‘loss’, under the Prudential Regulations issued by the State Bank of Pakistan, a deduction shall be allowed in computing the income for that tax year.
- (f) Where any addition made under paragraph (d) is reclassified by the taxpayer in a subsequent year as ‘recoverable’, a deduction shall be allowed in computing the income for that tax year.

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- (g) Adjustment made in the annual accounts, on account of application of international accounting standards 39 and 40 shall be excluded in arriving at taxable income.
 - (h) An adjustment shall be made for exclusions from income on account of paragraph (g) for determining the cost of related item in the financial statement in the year of disposal of such item or asset or the discharge of the liability, as the case may be.
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- (1) Where a deduction is allowed for any expenditure (other than on account of charge for irrecoverable debt) in the manner referred to in rule 1 and the liability or a part of the liability to which the deduction relates is not paid within three years of the end of the tax year in which the deduction was allowed, the unpaid amount of the liability shall be chargeable to tax under the head “Income from Business” in the first tax year following the end of three years.
 - (2) Where an unpaid liability is chargeable to tax as a result of the application of sub-rule (i) and such liability or a part thereof is subsequently paid, a deduction shall be allowed for the amount paid in the tax year in which the payment is made.
 - (3) Loss on sale of shares of listed companies shall be adjustable only against gain on sale of share of the listed companies. Where such loss is not fully set off against gain of a tax year the unadjusted loss shall be carried forward to the following tax year and set off against such gain. No loss shall be carried forward for more than six years immediately succeeding the tax year for which the loss was first computed.

3. Treatment for ‘shariah compliant banking’: -

- (1) Any special treatment for ‘Shariah Compliant Banking’ approved by the State Bank of Pakistan shall not be provided for any reduction or addition to income and tax liability for the said ‘Shariah Compliant Banking’ as computed in the manner laid down in this schedule.
- (2) A statement, certified by the auditors of the bank, shall be attached to the return of income to disclose the comparative position of transaction as per Islamic mode of financing and as per normal accounting principles. Adjustment to the income of the company on this account shall be made according to the accounting income for purpose of this schedule.

4. Head office expenditure: -

- (1) In case of foreign banks head office expenditure shall be allowed as deduction as per the following formula, namely:-

$$\text{Head office expenditure} = (A/B) \times C$$

Where—

- A is the gross receipts of permanent establishment in Pakistan;
B is the world gross receipts; and
C is the total Head Office expenditure.
- (2) The head office expenditure shall have the meaning as given in sub-sections (3) and (4) of section 105.
- (3) The head office expenditure shall only be allowed if it is charged in the books of accounts of the Permanent Establishment and a certificate from external auditors to the effect that the claim of Head Office expenditure has been made in accordance with provision of this rule is provided and are reasonable in relation to operation of the Permanent Establishment in Pakistan.

5. Advance tax: -

- (1) The banking company shall be required to pay advance tax for the year under section 147 in twelve equal installments payable by 15th of every month. Other provisions of section 147 shall apply as such.
- (2) Provisions of withholding tax under this Ordinance shall not apply to a banking company as a recipient of the amount on which tax is deductible.

6. Tax on income computed: -

Income computed under this Schedule shall be chargeable to tax under the head “income from business” and tax payable thereon shall be computed at the rate applicable in Division II of Part I of the First Schedule. The income under the head “dividend” and “capital gains on sale of shares of listed companies” shall be taxed at the rate of ten per cent.

Provided that where the shares of listed companies are disposed of within one year of the date of acquisition, the gain shall be computed under section 37 and taxed at the rate provided in Division II of Part I of the First Schedule.

7. The provisions of section 113 shall apply to banking companies as they apply to any other resident company.

8. Exemptions: -

- (1) Exemptions and tax concessions under the Second Schedule to this Ordinance shall not apply to income of a banking company computed under this Schedule.
- (2) The provisions relating to group relief as contained in section 59B shall be available to the banking companies provided the holding and subsidiary companies are banking companies. The accounts of the group companies shall be audited by the chartered accountants firm on the panel of auditors of the State

Bank of Pakistan. The surrender and claim of loss would be subject to the approval of the State Bank of Pakistan.

- (3) The holding and subsidiary companies of 100% owned group of banking companies may opt to be taxed as one fiscal unit as per the provisions of section 59AA relating to group taxation subject to the approval of the State Bank of Pakistan.

9. Provision of Ordinance to apply: -

The provisions of the Ordinance not specifically dealt with in the aforesaid rules shall apply, *mutatis mutandis*, to the banking company.

35. Amendment of Ordinance LV of 2001: -

In the Microfinance Institutions Ordinance, 2001 (LV of 2001), the following further amendments shall be made, namely:-

- (1) In section 6, in sub section (2),-
- (a) in clause (a), after the word, “transactions”, at the end, the comma and words “,except as provided in this Ordinance” shall be added; and
 - (b) after clause (p), the following new clause shall be inserted; namely:-

“(pa) to receive remittances from abroad, payable only in Pakistan Rupees to beneficiaries in Pakistan subject to rules and regulations and authorization issued by State Bank of Pakistan from time to time”.

Tax on Income of Certain Persons (Section 113A)

Retailer being individual or AOP was taxable if they had turnover upto 5 Million at the rate of 0.75% of the turnover, as the same was final tax on their income. However withholding taxes were allowed as tax credit. The bill proposed, disallows any claim of adjustment of WHT and rate is reduced to 0.5% of the turnover.

This section was added by Finance Act 2005. Vide Finance Act 2006 the scope of this section was further widened. This is “Sales Tax” in substance under the garb of income tax. In the name of broadening of tax base the government is giving free hand to traders / retailers to just pay 0.5% to 0.75% of this turnover and no question will be asked. They are being induced not to maintain any accounts and even conceal their colossal turnover. Now they are being further rewarded by Government for their malpractices.

Return of Income (Section 114)

The bill proposes to make necessary provision for electronic e-filing of returns, monthly statement and documents.

Advance Tax paid by the Tax Payer (Section 147)

The bill proposes that tax liability U/S 113 i.e. turnover tax shall also be taken into account while working out payment of advance tax liability. The bill also proposes to pay advance tax in the first year of business on estimate basis, based on quarterly accounting profits of the company after taking into account tax payable U/S 113.

Salary (Section 149)

The bill proposes to authorize employers to adjust tax withheld from employees under other heads and also to give tax credit admissible on donations and investments in shares. However he is required to get evidence for such tax credits.

Payment for Goods and Services (Section 153)

The bill proposes to exclude the following from presumptive tax regime;

- i) service providers to exporters;
- ii) the tax withheld on payments on account of advertisements services by owners of newspapers and magazines;
- iii) payments on account of sale of goods and execution of contracts by listed public company;

The bill also proposes to withdraw 2% further withholding tax over and above the prescribed rate for non disclosure of NTN or CNIC to withholding agents.

Purchase of Motor Car (Section 231B)

The bill proposes to levy adjustable WHT on purchase of motor car at the rate of 5%.

CNG Stations (Section 234A)

The bill proposes to collect WHT at the rate of 6% on CNG Stations on the amount of gas bills by gas companies. The WHT % would be treated as final discharge of tax liability of CNG Stations.

Electricity Consumption (Section 235)

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The bill propose that the tax collected under this section shall be minimum tax on the income of person other than company and no refund of tax collected under this unless the tax payer is company.

Transition of Federal Board of Revenue

The bill proposes to change the name of Central Board of Revenue to Federal Board of Revenue. One has heard a phrase, “old eggs in new basket”