

BUDGET PROPOSALS

BY Karachi Tax Bar Association

Section 22. Sub Section (4).

DEPRECIATION

Under the present Ordinance, depreciation has to be computed based on the number of months assets are used. This is a departure from the repealed ordinance where the depreciation was allowed for the entire year, the year of acquisition and no depreciation was allowed in the year the asset was disposed off. The new dispensation has created unnecessary and time consuming calculations and clerical work for large as well as small businesses.

Proposal

It is suggested that if depreciation is allowed for the full year, there would be no loss of revenue since on disposal in terms of subsection (8) to section 22, depreciation is not allowed. The relevant rule 12 accordingly has to be amended to give effect to the above proposal.

Section 22 Sub-Section (14)

In these provisions of law, the entire depreciation allowed on a depreciable asset to a person is recouped in the year asset is exported or transferred out of Pakistan. However for persons who are assessed under Part-I of the Fifth Schedule, only initial allowance is recouped in the year the asset is exported or transferred out of Pakistan according to rule 2(8) of Part-I of Fifth Schedule.

Proposal

It is proposed that same treatment should be given to all taxpayers who re-export or transfer depreciable assets out of Pakistan.

Section 28 subsection (1)

SPECIAL DEDUCTION – PROFIT ON DEBT, FINANCIAL COSTS, LEASE PAYMENTS

Subsection (1) of clauses (a) (b) & (c) allowability of profit on debts in respect of money borrowed is based on the expression of deriving income chargeable to tax under the head of income from business. In the repealed ordinance under section 23(1) (xvii), the allowability of interest (profit on debts) was in respect of capital borrowed for the purpose of businesses which term in our considered opinion was

much wider term.

Proposal

It is, therefore, proposed that in section 28, the following expression “used by the person in deriving income chargeable to tax” be replaced by the expression “used by the person for the purpose of business”.

Section 29 Sub-Section (1) and 2.

(a) For the purpose of allowability of bad-debts in a tax year, one of the conditions required to be fulfilled is that the debt or part of the debt is written-off in the accounts of the persons in the tax year. Claim of bad debts as we all are aware is a common phenomena in the financial sector. It has been observed in the past that due to the discretionary power laid down in sub-clause (c) of Section 29 (discussed below in Part b) the tax authorities have in the past disallowed bad debts on the basis that the claim is not fully matured and there are chances of its recovery in the future. Based on this observation the assessee’s re-claim the bad debts again in subsequent years when the litigation and recovery measures have exhausted and no hope of any recovery remains. In the past department has allowed bad-debts at such later stages.

However, with the requirement to write-off the debt in the accounts in the tax year in which it is claimed, the department has recently held in one or more cases that the claim relating to prior years cannot be entertained since the debt has not been written off in that tax year. This has left the financial institutions in a serious problem as if that is the intention of the legislature then they would hardly be any debts allowable to them under the law as in the year of occurrence the department will most likely reject the claim on the basis of believing that the debts is still recoverable and it claims the debts subsequently on finalization of recovery proceedings the department will simply say that the write-off does not pertain to that tax year

Proposal

In view of the above, it is proposed that in order to undo this hardship clause (b) of sub-section 1 of section 29 may be rephrased as under –

“29(1)(b) the debt or the part of the debt is written-off in the accounts of the person in the tax year or in any previous tax year or assessment year; and ”.

(b) Conditions to be satisfied for allowability of Bad Debts are contained in Section 29(1). One of the conditions for allowability is that there should be “reasonable grounds for believing that the debt is irrecoverable”. The word “reasonable” is a relative generic term difficult of adequate definition. (PLD 1997 SC 582). The word is not susceptible of any precise definition. Etymologically, it signifies according to reason, which expression itself is open to difference of opinion.(1995 SCMR 584). The Clause (c) is, therefore, superfluous, since a debt is written off by a person only when he believes that the debt to be irrecoverable. It is stated that Clause (a) of Sub-Section (3) caters for the situation of taxing any subsequent recovery of debt previously allowed as a bad debt.

Proposal

It is, therefore, suggested that Clause (c) of Sub-Section (1) of Section 29 may be deleted.
Section 34 Sub-Section 5,5A and 6

ACCRUAL BASIS ACCOUNTING

Sub-Section 5 is para materia to Section 25(c) of the Repealed Ordinance, which provides for addition in income and charge of tax under the head Income from business, on account of deductions of any expenditure incurred in deriving income chargeable to tax under the head income from Business where the person has not paid the liability or part of the liability to which the deduction relates within three years of the end of the tax year in which same was allowed.

Similarly under Sub-Section (5A) in respect trading liability where a person has been allowed a deduction and where such person has derived any benefit, the value of such benefit shall be chargeable to tax under the head Income from business for the tax year in which such benefit is received.

Sub-Section (6) provides that where situation under sub-section 5 applies and the person subsequently pays the liability or a part thereof, the person shall be allowed a deduction for the amount paid in the tax year in which the payment is made.

In the Repealed Ordinance, the word trading liability was used instead of Expenditure. The word trading liability is much wider term than the word Expenditure.

Proposal

It is therefore proposed that words used in sub-section 5 "Expenditure" be replaced by word "Trading liability".

Section 35

STOCK IN TRADE

Under this section, concept of determination of the cost of Stock in trade disposed of has been introduced. Generally in the cases of Companies, the valuation has to be mandatorily made on the basis of international accounting Standards.

Proposal

It is, therefore, proposed that in Section 35, wherever word "person" has been used, words "other than companies" may be inserted.

Section 39(3)

INCOME FROM OTHER SOURCES.

(a) Under this section any amount received as loan, advance, deposit for issuance of shares or gift by a person in a Tax year from another person (not being a banking company or financial institution)

otherwise than by a cross cheque drawn on a bank or through a banking channel from a person holding a National Tax Number Card shall be treated as income chargeable to tax under the head Income from other sources for tax year in which it was received.

Sub-section 4 provides that provision of sub-section 3 shall not apply to an advance payment for the sale of goods or supply of services.

Proposal

(b) The words “Card” used after National Tax Number be replaced by word “Certificate”, as through Finance Ordinance, 2002, word “Card” was replaced by word “Certificate” in Section 181 of the Income Tax Ordinance 2001.

There is no cavil to the purported purpose of Section 39(3). However practical difficulties arise in respect of payment received as loan or gift from Non-Resident family members.

Proposal

It is therefore proposed that a proviso be added for dispensing with the condition of NTN Card (Certificate) for amounts received from abroad.

(c) The world is moving very fast. The concept of paper money is being replaced by Plastic money. The normal banking practices are now absorbing concept of Electronic Banking. One may receive loan, gift or advance through other mode of transfers.

Proposed

It is, therefore, suggested that expression “otherwise than by a recognized banking channel” be substituted for words “otherwise than by cross cheque drawn on a bank”.

(d) Sub-section 4 provides that provision of sub-section 3 shall not apply to an advance payment for the sale of goods or supply of services It is stated that an amendment is necessary in sub-section 4 in respect of receipts like Advance Rent. This could be restricted to same reasonable amount looking to the provisions of Section 155(2), the reasonable amount could be annual rent exceeding two hundred thousand rupees.

Proposed

It is therefore, suggested that amendment should be made in sub-section (4) of section 39 to grant relief to advance rent upto an amount of Rs.200,000.