Taxation of Foreign Income In Pakistan

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Objectives

- The Objective of this presentation is to discuss:
  - the taxability of foreign source income in Pakistan of a resident person
  - the availability of foreign tax credits and foreign losses if any
  - the implications of Double Tax Treaty viz a viz foreign source Income derive by a resident person

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Concept of Taxability of Foreign Source Income

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Extent of Income Liable to Tax

- The extent of a person's income which is liable to tax is dependent on its residential status in Pakistan.
- A resident persons is liable to tax in Pakistan both in respect of Pakistan source as well as foreign source income.
- Non-resident person is liable to tax in Pakistan only in respect of Pakistan source income.
- A resident person for a tax year is:
  - A resident Individual
  - A resident Company
  - A resident Association of Persons
  - The Federal Government

How to Determine Residents

- An individual shall be a resident individual for a tax year if the individual
  - is present in Pakistan for 183 days or more, in aggregate in a tax year;
  - is an employee or official of the Federal Government or a Provincial Government
- A company shall be a resident company, if:
  - It is incorporated in Pakistan
  - It is a Provincial Government or a Local Government
  - if the control and management of the affairs of the company is situated wholly in Pakistan at any time in the year, even if it is not incorporated in Pakistan.
- An association of person shall be resident in Pakistan if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year.

Pakistan Source verses Foreign Source Income

- Section 101 and 101A identify Geographical Source of income vis Pakistan Source and Foreign Source:
- Broadly Speaking, Income, pursuing to the two sections is classified as Pakistan Source either as:
  - Absolute-having actual source in Pakistan; or
  - Fictional-based on the status of the payer in Pakistan
- Any income that is not classified as Pakistan source would be treated as foreign source income for the purposes of taxation.

Absolute Income

Section	Character of Income	Comment
101(1)	Salary	From employment exercised in Pakistan; or paid to a Government employee wherever such employment is exercised
101(2)	Business Income of a resident person	When income is derived from business carried on in Pakistan
101(3)	Business Income of a nonresident person	When income is directly or indirectly attributable to a permanent establishment or any other business connection in Pakistan
101(5)	Gains on disposal of capital assets	Disposal of Business Assets in Pakistan

Absolute Income (Cont'd)

Section	Character of Income	Comment
101(6)	Dividend Income	When paid by a resident company; or remittance of after tax profit of a branch of a foreign company operating in Pakistan
101(9)	Rental Income	When it is derived from the lease of immovable property in Pakistan or from any other interest in or over immovable property, including a right to explore for, or exploit, natural resources in Pakistan.
101(10)	Alienation or disposal of immovable property	Refereed to in 101(9)
101(13)	Disposal of shares	Gain on disposal of shares of a resident company

Fictional Income

Section	Character of Income	Comment
101(4)	Independent Services rendered by a nonresident person	If paid by a resident person or born by the permanent establishment of a nonresident person
101(7)	Profit on Debt	If paid by a resident person or born by the permanent establishment of a nonresident person
101(8)	Royalty	If paid by a resident person or born by the permanent establishment of a nonresident person
101(11)	Pension or annuity	If paid by a resident person or born by the permanent establishment of a nonresident person

Fictional Income (cont'd)

Section	Character of Income	Comment
101(12)	technical fee	If paid by a resident person or born by the permanent establishment of a nonresident person
101(12A)	fee for offshore digital services	If paid by a resident person or born by the permanent establishment of a nonresident person
101(13A)	Insurance/reinsurance Premium	Paid by an insurance company to an overseas insurance or re-insurance company.
101(14)	Any other amount	Paid by a resident person or borne by a permanent establishment in Pakistan of a non-resident person

Gain on Disposal of Assets Outside Pakistan

- Section 101A as introduced by Finance Act 2018, deems gain from the disposal or alienation outside Pakistan of an asset located in Pakistan of a non-resident company as Pakistan-source.
- Where the asset is any share or interest in a non-resident company, the asset shall be treated to be located in Pakistan, if —
- the share or interest derives, directly or indirectly, its value wholly or principally from the assets located in Pakistan; and
- 10% or more of the share capital of non-resident company are disposed or alienated;

Gain on Disposal of assets Outside (Cont'd)

- The share or interest shall be treated to derive its value principally from the assets located in Pakistan, if the value of such assets exceeds one hundred million Rupees and represents at least fifty per cent of the value of all the assets owned by the non-resident company.
- Where the assets of the non-resident company are not wholly located in Pakistan, only income to the extent that is reasonably attributable to such assets as are located in Pakistan, and is determined as may be prescribed, would be taxable;
- Where the assets in Pakistan are held through a resident company, such company shall be required to provide the prescribed information to the Commissioner within 60 days of the transaction;

Gain on Disposal of assets Outside (Cont'd)

- The buyer would be required to withhold tax at the rate of 10 percent of the fair market value
- Where the buyer has not withheld tax, the resident company is required to collect the requisite tax from the non-resident seller at an amount being the higher of :
  - 20% of the gain (i.e. fair market value less cost of acquisition of the asset); or
  - 10% of the fair market value of the asset; and

Gain on Disposal of assets Outside Pakistan (Cont'd)

- Where the tax has been withheld by the buyer or collected by the resident company, no tax shall be payable by the non-resident company in respect of the gain under the head "Income from Business" or "Capital Gains".

Exempt Foreign Source Income

Section	Income	Comments
Section 50	Foreign-source income of short-term resident individuals	who is a resident individual solely by reason of the individual's employment; and who is present in Pakistan for a period or periods not exceeding three years, Who does not derive any income from a business established in Pakistan; or does not receive or bring any foreign-source income in Pakistan
Section 51	Foreign-source income of returning expatriates	Any foreign-source income derived by a citizen of Pakistan in a tax year who was not a resident individual in any of the four tax years preceding the tax year in which the individual became a resident shall be exempt from tax on his/her foreign source income in the tax year in which the individual became a resident individual and in the following tax year.
	Citizens leaving Pakistan	Where a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during that tax year, any income chargeable under the head "Salary" earned by him outside Pakistan during that year shall be exempt from tax

Exempt Foreign Source Income

Section	Income	Comments
Section 102	Foreign source salary of resident individuals	if the individual has paid foreign income tax in respect of the salary.

Foreign Losses and Foreign Tax Credits

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Foreign Losses

- Deductible expenditures incurred by a person in deriving foreign-source income chargeable to tax under a head of income shall be deductible only against that income.
- Expenses incurred to earn foreign source income, taxable under a particular head of income can only be claimed against that income
- The foreign loss shall be carried forward to the following tax year and set off against the foreign source income chargeable to tax under that head in that year, and so on, but no foreign loss shall be carried forward to more than six tax years immediately succeeding the tax year for which the loss was computed.
- Where a taxpayer has a foreign loss carried forward for more than one tax year, the loss for the earliest year shall be set off first.

Foreign Tax Credits

- Foreign tax credit is available only against the foreign source income chargeable to tax
- Foreign Tax credit is allowed to the extent of lesser of:

  (a) the foreign income tax paid; or
  (b) the Pakistan tax payable in respect of the income.

- Pakistan tax payable in respect of foreign source income derived by a taxpayer in a tax year shall be computed by applying the average rate of Pakistan income tax applicable to the taxpayer for the year against the taxpayer's net foreign-source income for the year.
- Foreign tax credit shall be calculated separately for each head of Income

Foreign Tax Credits (Cont'd)

- Any unutilized foreign tax credit or part of a tax credit shall not be refunded, carried back to the preceding tax year, or carried forward to the following tax year
- A foreign tax credit only available if the foreign income tax is paid within two years after the end of the tax year in which the foreign income to which the tax relates was derived by the resident taxpayer.

Double Tax Treaty Provisions vis-a-vis Foreign Source Income

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Treaty Provisions to Prevail

Where Pakistan has signed a tax treaty with another country the provisions of the treaty will prevail over the provisions of the Ordinance if the treaty provides for at least one of the following–

- relief from the tax payable under the Ordinance;
- the determination of the Pakistan-source income of non-resident persons;
- where all the operations of a business are not carried on within Pakistan, the determination of the income attributable to operations carried on within and outside Pakistan, or the income chargeable to tax in Pakistan in the hands of non-resident persons, including their agents, branches, and permanent establishments in Pakistan;
- the determination of the income to be attributed to any resident person having a special relationship with a non-resident person; and
- the exchange of information for the prevention of fiscal evasion or avoidance of taxes on income chargeable under the Ordinance and under the corresponding laws in force in that other country.

Treaty Withholding Tax Rates

- Subject to fulfillment of specified conditions, the following rates of tax may apply in the following jurisdiction in respect of Foreign source Income derived by a Pakistani resident.

Countries	Dividends %	Interest %	Royalties %
Austria	**10/15**	**15**	20
Azerbaijan	10	10	10
Bahrain	**10**	10 (b)	10
Bangladesh	**15**	15 (b)	15
Belarus	10/15 (d)	10 (b)	15
Belgium	10/15 (d)	15 (b)	20 (m)

Treaty withholding tax rates

Countries	Dividends %	Interest %	Royalties %
Denmark	**15**	15 (b)(f)	12
Egypt	15/30 (q)	15 (t)	15
Finland	12/15/**20** (s)	15 (i)	10
France	10/15 (o)	10 (t)	10
Germany	10/15 (v)	**10/20 (b)(i)**	10
HongKong	10	10 (b)	10
Hungary	15/20 (p)	15 (b)	15
Indonesia	10/15 (p)	15	15
Iran	**05**	10	10
Ireland	**05/10**	**10**	**10**
Italy	15/25 (r)	30 (t)	30
Japan	5/7.5/10 (a)	10 (b)	10

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Treaty withholding tax rates

Countries	Dividends %	Interest %	Royalties %
Jordan	**10**	10 (b)	10
Kazakhstan	12.5/15 (o)	12.5 (t)	15
Korea (South)	10/12.5 (d)	12.5 (b)	10
Kuwait	**10**	10 (t)	10
Kyrgyzstan	**10**	10	10
Lebanon	**10**	10 (b)	7.5
Libya	**0**	**0**	**0**
Malaysia	15/20 (d)	15 (b)(f)	15
Malta	**15**	10 (b)	10
Mauritius	**10**	10 (b)	12.5
Morocco	**10**	10 (b)	10
Nepal	10/15	**10/15**	15

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Treaty withholding tax rates

Countries	Dividends %	Interest %	Royalties %
Netherlands	10/20 (p)	20 (b)(l)	**10/15/10**
Nigeria	12.5/15 (o)	15	15
Norway	**15**	10 (b)	12
Oman	10/12.5 (o)	10 (t)	12.5
Philippines	15/25 (p)	15 (b)	25 (k)
Poland	**15**	**0**	**20/15**
Portugal	10/15 (a)	10 (f)	10
Qatar	05/10 (o)	10 (t)	10
Romania	10	10 (f)	12.5
Saudi Arabia	05/10 (a)	10 (f)	10
Serbia	10	10 (b)	10
Singapore	10/12.5/15 (u)	12.5	10

Treaty withholding tax rates

Countries	Dividends %	Interest %	Royalties %
South Africa	10/15 (o)	10 (t)	10
Spain	5/7.5/10 (a)	10	7.5
Sri Lanka	15	10 (b)	20
Sweden	15	15 (b)	10
Switzerland	10/20 (a)	10 (f)	10
Syria	10	10	**18/15/10** (w)
Tajikistan	05/10 (p)	10 (x)(y)	10 (x)
Thailand	15/25 (d)	**10/**25 (i)	**10/20** (j)
Tunisia	10	13	10
Turkey	10/15 (d)	10	10
Turkmenistan	10	10	10
Ukraine	10/15 (a)	10	10

Treaty withholding tax rates

Countries	Dividends %	Interest %	Royalties %
United Arab Emirates	10/15 (v)	10 (b)	12
United Kingdom	**15/20**	15 (b)	12.5
United States	8.75%	– (g)	– (e)
Uzbekistan	10	10 (b)	15
Vietnam	15	15 (y)	15
Yemen	10	10 (y)	10
Non-treaty jurisdictions (z)	7.5/12.5/15/20/25	10/17.5/20	15/20
Bosnia and Herzegovina	**10**	20	15
Brunei Darussalam	**10**	15 (b)	15
Canada	15/20 (d)	25	20 (c)
China (mainland)	01/10	10	12.5
Czech Republic	5/15 (p)	10 (b)	10

Treaty withholding tax rates

- (a) Treaty-determined percentage holding required.
- (b) Interest paid to the government or, in certain circumstances, to a financial institution owned or controlled by the government is exempt.
- (c) Fifteen percent for industrial, commercial or scientific know-how.
- (d) Treaty-determined percentage holding required, and payer must be engaged in an industrial undertaking; otherwise, higher rate or normal rate applies.
- (e) Royalties are exempt from withholding tax to the extent they represent a fair and reasonable consideration.
- (f) Certain approved loans are exempt.
- (g) Normal rates apply.
- (h) Treaty-determined percentage holding by a public company required and the profits out of which the dividends are paid must be derived from an -industrial undertaking; otherwise, normal rates apply.
- (i) Ten percent if the recipient is a financial institution.
- (j) Lower amount for literary, artistic or scientific royalties.
- (k) Fifteen percent if payer is an enterprise engaged in preferred activities.
- (l) Rate reduced to 10% if recipient is a bank or financial institution or if certain types of contracts apply. Rate reduced to 15% if recipient holds 25% of the capital of the paying company.
- (m) Copyright royalties and other similar payments for literary, dramatic, musical or artistic work are exempt.
- (n) Fifteen percent if the recipient is a company. Further reduced to 10% if the treaty-determined percentage is held by the recipient and the industrial undertaking is set up in Pakistan after 8 December 1987. Twenty percent in other cases.
- (o) Lower rate applies if the recipient is a company that controls, directly or indirectly, 10% of the voting power in the company paying the dividend.
- (p) Lower rate applies if recipient is a company that owns directly at least 25% of the capital of the paying company.
- (q) The 15% rate applies to dividends paid to companies. The 30% rate applies to other dividends.
- (r) The 15% rate applies if the recipient is a company that owns directly at least 25% of the capital of the payer and is engaged in an industrial undertaking.

Treaty withholding tax rates

- (s) The 12% rate applies if the recipient is a company that owns directly at least 25% of the capital of the payer; the 15% rate applies to dividends paid to other companies; and the 20% rate applies to other dividends.
- (t) Interest paid to the government or to an agency of or an instrumentality owned by the government is exempt from tax.
- (u) The 10% rate applies if the payer is engaged in an industrial undertaking and if the recipient is a company; the 12.5% rate applies if the recipient is a company; the 15% rate applies in all other cases.
- (v) The lower rate applies if the beneficial owner of the dividends is a company that owns at least 20% of the shares of the payer.
- (w) The 10% rate applies to royalties for cinematographic films and to tapes for television or radio broadcasting. The 15% rate applies to royalties for literary, artistic or scientific works.
- (x) The treaty rate applies to the extent the amount represents a fair and reasonable consideration.
- (y) Interest paid to the government or to the central bank is exempt.
- (z) For details regarding these rates, please see the relevant footnotes in Section A.

Thank You

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