

# **BUDGET PROPOSALS**

## **BY Karachi Tax Bar Association**

### **BROADENING THE TAX BASE**

#### **102. Foreign source salary of resident individuals.**

(1) Any foreign source salary received by a resident individual shall be exempt from tax if the individual has paid income tax in respect of the salary.

(2) A resident individual shall be treated as having paid foreign income tax in respect of foreign source salary if tax has been withheld from the salary by the individual employer and paid to the revenue authority of the foreign country in which the employment was exercised.

#### **103. Foreign Tax Credit**

(1) Where a resident taxpayer derives foreign source income chargeable to tax under this ordinance in respect of which the taxpayer has paid foreign income tax the taxpayer shall be allowed a tax credit of an amount equal to the lesser of -

- a) the foreign income tax paid or  
b) the Pakistan tax payable in respect of income

(2) For the purpose of clause (b) of sub-section (1) the Pakistan tax payable in respect of foreign source income derived by a taxpayer in a tax year shall be computed by applying an average rate of Pakistan income tax applicable to the taxpayer for the year against the tax payers net foreign source income for the year.

(3) Where in a tax year, a tax payer has foreign income under more than one head of income this section shall apply separately to each head of income.

(4) For the purposes of sub-section (3) the income derived by the taxpayer from carrying on a business shall be treated as separate head of income.

(5) The tax credit allowed under this section shall be applied in accordance with sub-section 3 of section 4.

(6) Any tax credit or part of tax credit allowed under this section for a tax year i.e. not credited under sub-section 3 of section 4 shall not be refunded, carried back to the preceding tax year or carried forward to the following tax year.

(7) A credit shall be allowed under this section only if the foreign income tax is paid within two years after the end of tax year in which the foreign income to which the tax relates was derived by the resident taxpayer.

(8) In this section,-

"average rate of Pakistan income tax" in relation to a taxpayer for a tax year, means the percentage that the Pakistani income tax (before allowing of the tax credit under this section) is of the taxable income of the taxpayer for the year;

"foreign income tax" includes a foreign withholding tax; and

"net foreign source income" in relation to a taxpayer for a tax year, means the total foreign source

income of the taxpayer charged to the tax in the year, as reduced by any deductions allowed to the taxpayer under this Ordinance for the year that-

- a) related exclusively to the derivation of the foreign source income ;and
- b) are reasonably related to the derivation of foreign source income in accordance with sub-section (1) of section 67 and any rules made for the purposes of that section.

#### **104. Foreign losses:**

(1) 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.

(2) If the total deductible expenditures referred to in sub-section (1) exceed the total foreign source income for a tax year chargeable to tax under a head of income (hereinafter referred to as a "foreign losses"), 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.

(3) Where a taxpayer has a foreign loss carried forward for more than one year, the loss for the earliest year shall be set off first.

(4) Section 67 shall apply for the purposes of this section on the basis that-

- a) income from carrying on a speculation business is a separate head of income ; and
- b) foreign source income chargeable under a head of income (including the head specified in clause (a) ) shall be a separate head of income.

#### **105. Taxation of a permanent establishment in Pakistan of a non-resident person:**

1) The following principles shall apply to in determining the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head "Income from Business", namely:-

- a) The profit of the permanent establishment shall be computed on the basis that it is distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the non-resident person of which it is a permanent establishment;
- b) Subject to this Ordinance, there shall be allowed as deductions any expenses incurred for the purposes of the business activities of the permanent establishment including executive and administrative expenses so incurred, whether in Pakistan or elsewhere;
- c) No deduction shall be for amount paid or payable by the permanent establishment to its head office or to another permanent establishment of the non-resident person (other than towards reimbursement of actual expenses incurred by the non-resident person to third parties) by way of;
  - (i) royalties, fees or other similar payments for the use of any tangible or intangible asset by the permanent establishment;
  - (ii) compensation for any services including management services performed for the permanent establishment; or
  - (iii) profit on debt on moneys lent to the permanent establishment, except in connection with a banking

business; and

d) no account shall be taken in the determination of the income of a permanent establishment of amounts charged by the permanent establishment to the head office or to another permanent establishment of the non-resident person (other than towards reimbursement of actual expenses incurred by the permanent establishment to third parties) by way of;

(i) royalties, fees or other similar payments for the use of any tangible or intangible asset;

(ii) compensation for any services including management services performed by the permanent establishment; or

(iii) profit on debt on moneys lent by the permanent establishment, except in connection with a banking business.

**2)** No deduction shall be allowed in computing the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head "Income from Business" for a tax year for head office expenditure in excess of the amount as bears to the turnover of the permanent establishment in Pakistan the same proportion as the non-resident's total head office expenditure bears to its worldwide turnover.

**3)** In this section, "head office expenditure" means any executive or general administration expenditure incurred by the non-resident person outside Pakistan for the purposes of the business of the Pakistan permanent establishment of the person, including-

a) any rent, local rates and taxes excluding any foreign income tax, current repairs, or insurance against risks of damage or destruction outside Pakistan.

b) Any salary paid to an employee employed by the head office outside Pakistan.

c) Any traveling expenditures of such employees; and

d) Any other expenditure which may be prescribed.

**4)** No deduction shall be allowed in computing the income of a permanent establishment in Pakistan of a non-resident person chargeable under the head "Income from Business" for

a) any profit paid or payable by the non-resident person on debt to finance the operations of the permanent establishment; or

b) any insurance premium paid or payable by the non-resident person in respect of such debt.

Unlike, the repealed Ordinance a very exhaustive definition of Permanent Establishment has been provided in sub-section 41 of definition section 2 of the Ordinance. This section is also reproduced below: