

**PAKISTAN TAX BAR ASSOCIATION
KARACHI TAX BAR ASSOCIATION**

**PRE-BUDGET WEBINAR ON
RECOMMENDATIONS FOR THE
FINANCE BILL, 2021**

**DIRECT TAX CONSIDERATIONS
PRESENTED BY
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FORMER PRESIDENT KTBA**



COMPARISON OF DIFFERENT AVENUES OF INVESTMENT

Description	Manufacturer	Commercial importer	Owner of immovable property
Income tax withholding at import stage	Yes	Yes	N/A
Sales Tax at import stage	Yes	Yes	N/A
Sales Tax on value additions [Like services acquired, labor and manpower services, Plant and machinery, Utilities]	Yes	Commercial importers do not carry out value additions therefore, not paying sales tax on value additions	N/A

COMPARISON OF DIFFERENT AVENUES OF INVESTMENT

Description	Manufacturer	Commercial importer	Owner of immovable property
10% additional value addition sales tax over and above all input tax 8B	Yes [manufacturing sector should be exempted from section 8b]	No	N/A
Income Tax withholding at supply stage u/s 153	Yes, unless exemption is issued by the CIR [very cumbersome exercise] after payment of advance income tax	General exemption from income tax withholding at supply stage	N/A
Income tax collection on other value additions [Like electricity bills] 5%	Yes, under section 235. Impact is major as electricity is used for Plant operations	Yes, but impact is very insignificant as value addition is not carried out by commercial importers	N/A

COMPARISON OF DIFFERENT AVENUES OF INVESTMENT

Description	Manufacturer	Commercial importer	Owner of immovable property
Income Tax on dividend 15%	Yes as majority of the activities are being carried out by Companies, therefore, tax is levied on multi stage basis	Majority of the business is being carried out by Individuals / AOPs, therefore, only a single stage tax is required to be paid.	N/A
Taxability in case of disposal of shares / ownership	Yes, even if shares of a Company are sold after 20/50 years, the same are subject to the levy of income tax on gain without appreciating the fact that value of the Company is increased via profits on which tax has already been paid	Yes, unless business of commercial imports is being carried by individual.	Exempt just after holding period of 4 years without realizing the fact that land has neither contributed towards any tax / foreign exchange during all these 4 or more years nor provided any employment opportunities.

DOCUMENTING THE ECONOMY

Increasing Tax Base

- ▶ Mining of FBR's Database to identify new taxpayers & those not fully discharging their liabilities
- ▶ FBR should extract information from withholding statements, details of government supplies and maintain a database of above third party information
- ▶ Relevant organizations, departments, institutions including utility companies, banks, NADRA and information obtained related to offshore transactions should submit prescribed information on quarterly basis to the FBR
- ▶ Effective enforcement should be ensured for compliance of filing of Return of Income under section 114 of the Ordinance, 2001

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Tax Rate

- ▶ In Pakistan the corporate tax rate in FY2021 is 29% which due to multiplicity of taxes (2% Workers' Welfare Fund + 5% Workers' Participation Fund) goes up to 36%. The average tax rate in Asia was 21.32% in 2020. The high rate of tax is encouraging tax evasion and is discouraging documentation of economy and corporatization. It is also a disincentive for foreign and local investment.
- ▶ We therefore propose that the maximum rate of income tax @ 29% on Companies be brought down to 25% by reducing 1% every year similarly on single member/small companies to compete with other regional and global countries their rate of tax be reduced gradually to 22%.

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Tax Credits / Exemptions

- ▶ New local / foreign investors need to be attracted to invest in the manufacturing sector of Pakistan by providing incentives on investment and decreasing cost of doing business and removing administrative hassles
- ▶ For this purpose, tax credits may be provided for making investment in fresh/ existing industrial undertakings, such as tax credit under 65B of the Ordinance which may be restored. Simultaneously, time limit under sections 65D and 65E may be further extended up to 30th June 2025
- ▶ Exemption from income tax to Greenfield Industries should be restored. Alternatively, considering the fact that a Company usually incurs losses in its initial years of operations, tax credit should at least be extended till 5 years
- ▶ SRO 250 of 2019 requires companies to pay for the electronic monitoring and tracking of their output. SRO needs to be amended to ensure that manufacturers do not have to pay the cost of monitoring and that this will not lead to harassment

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Withholding Taxes

- ▶ Tax deduction on import of Raw material for own use u/s 148 (Imports) should be explicitly expressed as withholding advance tax across the board in the Income Tax Ordinance, which will save the companies from exposure resulting from possible delays in acceptance of application by the Commissioner/ Board or non-acceptance at all. It will remove operational and administrative hassle also.
- ▶ For entities which are exempt tax under Second Schedule such as income of Zone Enterprises, there should not be any withholding of income tax at source at any stage under any of provisions of the Ordinance till such time exemption is available to the Company
- ▶ The withholding tax regime should be simplified by reducing the number of rates significantly

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Withholding Taxes

- ▶ Section 156 requires a Company to collect 20% tax on “prize offered by companies for promotion of sale”. An explanation needs to be added to this Section to clarify that it is applicable to prizes given to end consumers only since the income of the supply chain i.e., dealers, distributors is subject to withholding tax in the shape of withholding taxes imposed under separate withholding regimes
- ▶ The withholding agent should be facilitated through robust IRIS; wherein the visibility of tax deduction should be provided to the taxpayer instead of relying on the withholding agents’ certificates
- ▶ The withholding tax challans should be made available on the IRIS to every registered person, instead of collecting the same from registered person(s) deducting and depositing the tax.

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Reduced withholding rate for Distributors

- ▶ First Schedule to the Ordinance provides for minimum tax under section 113 at 0.25% for Distributors of pharmaceutical products, fast moving consumer goods and cigarettes as well as dealers or distributors of fertilizers
- ▶ Accordingly, to synchronize the minimum tax levy under section 113 with the withholding tax rate, a clause 24C has been inserted in Part II of the Second Schedule which provides for concessionary rate of withholding to achieve the intension of not to burden the ultimate consumer with an extra tax/levy which the seller ultimately covers. However, the Clause (24C) has not specifically provided for distributors of the above sectors
- ▶ To streamline the minimum tax regime of overall supply chain of the above sectors, it is requested that distributors may specifically be included in the ambit of the above Clause. Alternately if the Board understand that the term 'dealer' provided in the Clause covers distributors as well, then it may clarify the same

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Contracts and services rendered out of Pakistan - Clause (131), Part I and Clause (3), Part II, Second Schedule

- ▶ Technical services rendered or royalty of fee received by a company or any other taxpayer and contracts executed for services rendered outside Pakistan (subject to the conditions that the income/receipts are brought into Pakistan through proper banking channel) were previously exempt / taxable at flat rate of 4%/5% [50% of the rate applicable under section 153(1)(b)].
- ▶ Through the Second Amendment Ordinance, 2021 Clause (131), Part I and Clause (3), Part II, Second Schedule have been omitted
- ▶ It is proposed that instead of providing exemption or reduced rate under Second Schedule **a uniform rate of tax equal to the rate of tax applicable to export of goods may be extended to export of services abroad** where foreign remittance is brought into Pakistan.

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Removal / Reduction of Minimum Tax Under Section 113

- ▶ In order to promote industrialization, minimum tax should be abolished for all Listed companies as these companies are subject to stringent regulations and audit. For other companies, it should be announced that the rate of minimum tax will be reduced gradually by 0.2% on an annual basis so that by Tax Year 2025 the rate is 0.5%
- ▶ After the changes made via the Finance Act, 2016, the threshold of turnover for Individual and AOP for levy of minimum tax @ 1.25% was decreased from 50(M) to 10(M). This adversely affected the true declaration of turnover and has created hardship for the taxpayers.
- ▶ Moreover, in order to streamline the mechanism of carry forward and adjustment of Minimum tax, minimum tax should also be allowed to be carried forward for adjustment in subsequent years even in case of losses.

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Capital Gains

- ▶ Gain on disposal of land after a holding period of 4 years is exempt from tax. However, gain on disposal of shares of public / private / unlisted company is taxable irrespective of any holding period without appreciation of the fact that value of the Company increases via profits on which tax is being paid
- ▶ In order to divert investment from non-revenue generating asset [land] to revenue / employment / export generating assets [industries], disposal of shares of public / private / unlisted company by sponsors / owners be allowed tax exemption on capital gain subject to the condition that the holding period should be more than 10 years in line with exemption on disposal of land. If this is not acceptable, rate of tax on disposal of shares of private company be taxed @ 15% as applicable to dividend as the breakup value of the Company would have been increased from retained profits, which could otherwise have been declared as dividend and taxed as such.

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Alternative Corporate Tax – 113C

- ▶ Whilst there is already a minimum tax regime which imposes tax on the gross turnover u/s 113, alongside minimum tax regime for supplies, services, under various section of the Ordinance, and an ACT, which actually operates as alternative minimum tax regime, for the corporate sector (with exceptions), has rendered the computation of income and tax liability very complex for the corporate sector
- ▶ In addition to the above, an important thing to note is that an exception provided in sub-section (8) of section 113C states that it would not be applicable on any receipts subject to minimum tax under any of the provisions of the Ordinance. This effectively makes ACT redundant and only results in taxing anomalies created due to various accounting treatments under IFRS which otherwise would not have been taxable
- ▶ Considering the above, it is proposed that the ACT should be withdrawn.

REDUCING THE COST OF DOING BUSINESS IN PAKISTAN

Estimate of Advance Tax – 147

- ▶ An association of persons (AOP) and company were required to estimate their income before payment of last installment of advance tax. If such estimate results into tax payable higher than on the basis of last completed assessment (base year), there was a requirement to pay the difference along with the 4th installment
- ▶ Sub-section (6) further provides that before the last instalment is due where the taxpayer estimates that his tax liability will be lower than the amount due under sub-section (4), he is required to submit the actual turnover of completed quarters of the tax year with estimate of the turnover of remaining quarters along with reasons for any decline in the estimate along with documentary evidences of expenses and estimated computation of income.
- ▶ The requirement of producing documentary evidence of expenses or deductions and the computation of estimated taxable income is highly stringent and prone to a high risk of rejection by the Commissioner. This change in law and the power given to the Commissioner to reject such estimate is highly unreasonable and unwarranted

RELIEFS FOR SALARIED INDIVIDUALS

Tax Rate / Loan From Employer

- ▶ Income under the head “salary” is currently taxed on the gross amount. This policy was introduced by bringing down the corresponding rates of tax for each income slab. However, gradually the income slabs as well as rates of tax were enhanced without restoring the deductible allowances when income from salary was taxed at higher rates.
- ▶ It is proposed to either rationalize the rates of tax or restore the deductible allowances on account of house rent, utilities, conveyance, etc. to minimize the tax burden of salaried individuals.
- ▶ Similarly, the limit of Rs.1,000,000/- for loan to employees below benchmark rate provided under section 13(7) of the Ordinance be increased to Rs.3,000,000/-

RELIEFS FOR SALARIED INDIVIDUALS

Limit On Employer's Contribution in Provident Fund

- ▶ Under Clause (3), Part I, Sixth Schedule, the employer's contribution in the recognized provident fund in excess of Rs.150,000 (increased from Rs.100,000 by Finance Act, 2016) is deemed to be income of the employee.
- ▶ This provision is invalid as the accumulated balance (it includes employer's contribution) due and becoming payable to an employee participating in a recognized provident fund is totally exempt from tax under Clause (23), Part I, Second Schedule
- ▶ Without prejudice to foregoing, since employer's contribution does not constitute an actual receipt as the same is not at the disposal of an employee and therefore tax incidence should not be levied at the time of contribution
- ▶ Alternatively, the threshold of Rs.150,000 should be increased to Rs.350,000

REMOVING ANAMOLIES

Minimum Tax Regimes – 148 and 153

- ▶ Provisions relating to issuance of exemption certificate on import of raw materials by manufacturers should be restored. Otherwise, it would not be possible for manufacturers to get their prior years' refunds adjusted against future tax liability. Moreover, withdrawal of facility of issuance of exemption certificate for import of raw material by manufacturers has created hurdles for persons starting new business, going into expansion or launch of a new product etc. These restrictions are hindering industrial growth in the country
- ▶ Various capital goods and raw materials have not been covered under Tables I and II respectively of the Twelfth Schedule, therefore, the same will fall under Table III, which is subject to 5.5% tax deduction [minimum tax]. Industrial undertakings should not be subject to minimum tax under section 148 for the goods classified in Part III of 12th Schedule unless goods imported are sold without any value addition

REMOVING ANAMOLIES

Minimum Tax Regimes – 148 and 153

- ▶ In cases where the taxpayers wish to obtain approval from the Commissioner to classify raw materials and plant & machinery to be imported by them under Part -II, such an approval should be an ongoing approval until revoked by the Commissioner. Moreover, for raw materials, maximum limit of 125% of imports made during the preceding year should be removed. This would create an ambiguous situation where imports of raw materials up to a maximum of 125% would subject to withholding of tax @ 2% and would be adjustable and imports beyond such limit would be subject to minimum tax @ 5.5%
- ▶ Commercial importers are exempt from tax withholding on supply stage whereas corporate manufacturers are subject to additional 4% income tax withholding (section 153) on supply of goods under section 153. This is an apparent anomaly specifically considering the fact that transactions undertaken by commercial importers are more prone to under invoicing, therefore, it would not be possible for manufacturers to compete with commercial importers. Consequently, corporate manufacturers should also be exempted unconditionally from supply stage withholding tax i.e. under section 153

REMOVING ANAMOLIES

Minimum Tax Regimes – Closing Stock of Commercial Imports

- ▶ For the tax year 2020, the issue of opening stocks of commercial importers already subjected to Final Tax in earlier years stands resolved by way of clarification issued by the Board (addressed to Lahore Chamber of Commerce and Industry).
- ▶ The applicability of Minimum Tax is with reference to tax payable on the income for the year from such imports. However, in almost all cases of commercial importers the corresponding income relating to closing stocks of imported goods does not form part of the current year (the year of import of goods). The law is silent as to its treatment and no uniform method to offset the effects of closing stock of imported goods by commercial importers exists

REMOVING ANAMOLIES

Minimum Tax Regimes – Attributable Income for the purposes of Minimum Tax

- ▶ IRIS calculates attributable Income on transactions subject to Minimum Tax by apportioning the entire cost of sales, Administrative expenses, Selling expense and Financial expenses considering the same as common cost/expenses for different segments of the business in total disregard to the provisions of section 67 of the Income Tax Ordinance, 2001 read with Rule 13 of the Income Tax Rules, 2002, which provides for apportionment of only common expenditures and not the directly attributable expenses;
- ▶ A solution to remove these absurdity is to allow the taxpayer to calculate the minimum tax liability and this auto function should be disabled

REMOVING ANAMOLIES

Minimum Tax Regimes – Determination of Taxable Income

- ▶ Taxable income for the year is determined irrespective of the fact whether revenue and expenses are received or paid. On the other hand all provisions of withholding tax apply at the time of making the payment or clearance of goods (commercial imports).
- ▶ There is every possibility that:
 - ▶ Taxable income declared for the year is inclusive of income in respect of unrealized revenue (under mercantile system) on which withholding provisions will apply in the following year(s);
 - ▶ Taxable income declared for the year is exclusive of income in respect of realized revenue relating to preceding year(s) on which withholding provisions will apply in the current year;

REMOVING ANAMOLIES

Minimum Tax Regimes – Determination of Taxable Income

- ▶ Taxable income declared for the year is exclusive of income in respect of stock-in-hand of un-sold commercial imports on which withholding provisions will apply in current year;
- ▶ Taxable income declared for the year is inclusive of income in respect of brought forward stock-in-hand from the previous year of commercial imports on which withholding provisions had applied in preceding year
- ▶ In these situations, the comparison of normal tax liability with minimum tax liability for a particular tax year is not appropriate / correct, hence these anomalies should be removed

REMOVING ANAMOLIES

Depreciable Cost of Vehicle – Section 22 (13)

Non-recognition Rule – Section 79

- ▶ As per sub-section (13) of Section 22 of the Ordinance, presently the admissible cost for calculating depreciation on vehicle not plying for hire is Rs.2.5 Million that was substituted through Finance Act, 2012.
- ▶ Keeping in view the devaluation of currency and multifold increase in the value of vehicle, it is proposed that cost of value under this section for calculating the depreciation may be raised to Rs.7.5 Million from Rs.2.5 Million
- ▶ The restriction under section 79(2) for non-recognition of gain or loss should be relaxed in case of non-resident being relative to whom assets are transferred by way of gift.

REMOVING ANAMOLIES

Filing of Withholding Tax Statements

- ▶ At present following difficulties are being faced by the taxpayer while filing withholding statement through IRIS:
 - ▶ The taxpayer has to determine finality or adjustability of taxes withheld before filing the statement through IRIS. This is a very difficult task for every taxpayer and as such this condition was not a part of the previous system
 - ▶ Earlier the withholding statements were available in two formats one for deduction of tax on salaries and other for remaining sections. In that situation statement relating to salary was filled in by HR Department of all medium and large organization. Due to the merger of two separate portions in one statement it is now required to file the entire withholding data through one module
 - ▶ If a person has deducted and deposited the tax in the government treasury, collected from a taxpayer who has subsequently been granted, exemption certificate, the IRIS, does not allow the withholding agent to report the tax deducted or collected through the system

REMOVING ANAMOLIES

Filing of Withholding Tax Statements

- ▶ Moreover, it is not the duty of the withholding agent to determine adjustability or finality of tax deducted by him; because it is to be determined by the payee, therefore this condition may be removed from system
- ▶ In view of the above, withholding agents may be allowed to file separate statements for salary and other than salary cases
- ▶ Withholding agents should also be allowed to report tax deducted or collected in those cases, where subsequently exemption certificates are issued
- ▶ Taxpayers should have access to details of income tax withholding made against their NTN and also the details of withholding agents within 24 hours of generation of CPRs. This will assist the taxpayer: (a) in knowing the amount of taxes paid to the Government Exchequer against their names; (b) at the time of working out the estimates of advance tax liability and also while filing the return of income (c) in following up for the CPRs from the withholding agents; (d) in compliance to the tax notices specially section 161; and (e) to avoid undue negotiations at the time of obtaining exemption certificates

PROMOTING COMPETITIVENESS

Intercompany Dividend

- ▶ Recently through the Income Tax Laws (Second Amendment) Ordinance, 2021, exemption on intercompany dividend between companies eligible for group taxation under section 59B (Group Relief) has been revoked
- ▶ Group Taxation laws should be restored in its initial form as introduced via Finance Act 2007 and Finance Act 2008
- ▶ Clause 103C, Part I, Second Schedule, providing exemption from Intercompany Dividends to group companies eligible under section 59B should be reinstated
- ▶ Amendments made in Clause 11B, Part IV, Second Schedule via Finance Act 2015 and Finance Act 2016, should be revoked to ensure exemption from withholding tax is provided on intercompany dividends exempt under clause 103A and clause 103C, Part I, Second Schedule

PROMOTING COMPETITIVENESS

Buy Back of Shares

- ▶ Clause (d) of the definition of the term 'dividend' as defined in section 2(19) includes that the distribution made by a company to its shareholders on reduction of capital shall be deemed dividend. This situation is generally referred to as Buy-back of shares.
- ▶ On the other hand, under Rule 13P of the Income Tax Rules, 2002, the shares buy-back transaction is treated as Capital Gains. Thus, there exists a contradiction among the provisions of Ordinance and Rules.
- ▶ It is proposed that following exclusion after clause (f) in sub-section (19) of section 2 be inserted:
 - ▶ any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 88 of the Companies Act, 2017 (XIX of 2017)

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