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Exemption and concessions withdrawn in Finance Act, 2022

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What is tax exemption?

A tax exemption is the right to exclude all or some income from taxation by the governments.

Most taxpayers are entitled to various exemptions to reduce their taxable income, and certain taxpayers incomes are completely exempt from tax.

Taxation principles

These are:

1. the belief that taxes should be based on the individual's ability to pay, known as the ability-to-pay principle, and

2. the benefit principle, the idea that there should be some equivalence between what the individual pays and the benefits he subsequently receives from governmental activities.

Exemptions/ Concessions withdrawn in Finance Act 2022

Background

- The Finance Act 2022 has withdrawn various tax credits including deductible allowances, disallowance of expenses. Certain exemptions are also withdrawn in second schedule. Apart from these, certain other exemptions, concessions have been modified to reduce the available tax benefit.

- These measures taken to satisfy the International Monetary Fund (IMF) to demonstrate budget target as achievable in the next fiscal year with the expectation that withdrawal of these exemptions/ concession will pave the way for striking an agreement with the IMF for revival of the stalled program.

Exemptions/ Concessions withdrawn in Finance Act 2022

Finance Act, 2022 has withdrawn following exemptions:

1. Contribution to Approved Gratuity Fund, Pension Fund or Superannuation Fund restricted;
2. Restriction on claim of expenditure by non-POS integrated businesses;
3. Tax credit on IT and IT enabled services
4. Tax credit for industrial promotion
5. Taxation of capital gains
6. Various deductible allowances and tax credits restricted/ reduced
7. Certain clauses from Second Schedule to the Income Tax Ordinance, 2001 deleted which provided exemption from total income, reduction in tax rates and liability and exemption from specific provisions of the Ordinance

Contribution to Approved Gratuity Fund, Pension Fund or Superannuation Fund Section 21,

- ✓ Contribution by an employer to approved gratuity, pension or superannuation fund is admissible as deductible expense.
- ✓ Through Finance Act 2022, a new Clause (ea) has been inserted in Section 21 whereby such contribution has been restricted to 50% of the total contribution made by the employer to such funds.
- ✓ As a result of this restriction 50% amount of contribution will not be an allowable expense any more.
- ✓ This amendment abruptly defeats the long established concept.

Restriction on Claim of Expenditure by Non POS Integrated Businesses

- ✓ The Finance Act has inserted a new Clause (r) in Section 21 to disallow any expenditure attributable to sales claimed by the person who is required to integrate his business with FBR through approved electronic device and software but fails to do so.

- ✓ Such disallowance however cannot exceed 8% the allowable deductions.

- ✓ This is a to enforce integration of business with FBR as required under the Sales Tax Act 1990.

Tax credit on IT and IT enabled services

- Export of computer software or IT services or IT enabled services were exempted before Finance Act, 2021 in order to promote this sector in line with other countries of this region.

- Finance Act 2021 introduced WHT @1% but simultaneously granted 100% tax credit u/s 65F on fulfilment of prescribed conditions if 80% remitted to Pakistan through nomal banking channel.

- The Finance Act 2022 has now deleted 100% tax credit on income from export of computer software or IT services or IT enabled services introduced through Finance Act 2021 however reduced the WHT rate.

- Receipts from export of computer software or IT services or IT enabled services are now subject to deduction of tax at source under section 154A at reduced rate of 0.25 percent *subject to the condition that exporter is registered with and duly certified by the Pakistan Software Export Board (PSEB)*. This if final tax on income if, (i) return filed; (ii) WHT statements filed; (iii) applicable sales tax returns with federal/ provincial authorities filed; (iv) no tax credit of foreign taxes allowed
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Tax credit for industrial promotion

- Tax credit for foreign investment for industrial promotion under section 65H was introduced through Income Tax Amendment Ordinance, 2022 (one time 100% tax credit of amount remitted) but now omitted from the date of its inspection as it was never available.

  This was provided to resident (having foreign assets declared u/s 116/ 116A) as well as non-resident Pakistani citizens (having non-resident status for more than 5 years) for investment in a company to set up an industrial undertaking in Pakistan subject to the fulfillment of prescribed conditions and procedures prescribed by the SBP by 31 December 2022. This had required equity investment of not less than PKR 50 million.

Investment for industrial promotion

- The Finance Act 2022 has also deleted Special provisions relating to investment for industrial promotion under section 100F as was introduced vide Income Tax Amendment Ordinance, 2022 from the date of its introduction i.e. 02 March 2022.

This benefit was provided as a kind of amnesty scheme if prescribed statement filed by 30 September 2022 declaring funds for investment in new company for industrial undertaking and provisions of section 111 for providing explanation on source of funds were made not applicable if 5% tax is paid.

Carry forward of business losses of sick industrial units

- Section 59C introduced availability of Carry forward of business losses (latest tax year and brought forward losses) of sick industrial units on acquisition under scheme of acquisition of sick units (having (i) accumulated losses of 3 years, (ii) loan defaulted for 3 years, or (iii) Federal Government declared as sick). This was also introduced through Income Tax Amendment Ordinance 2022.

- Conditions were (i) continued ownership of 5 year effective from 30 June 2023; (ii) assets acquired not to be sold upto 30 June 2026; and (iii) company continues same business til 30 June 2026). This was introduced to promote foreign investment to set up industries in Pakistan.

- This is also now omitted from the date of its inspection as it was never available.

Taxation of Capital gains

❑ <u>Immovable property</u>

- Capital gain on disposal of immovable property was reduced based on holding period and such capital gain was subject to progressive tax rates as provided under Division VIII of the Part I of the First Schedule.

- The Act has taken away such reduction in amount of capital gain on disposal of immovable property as provided under section 37(3A) and has taxed the entire amount of capital gain arising on disposal of immovable property on the basis of holding period at different rates for open plots, constructed property and flats ranging from 15% to zero % in 6, 4 and 2 years time period.

Taxation of Capital gains

❑ Other Capital Assets

- Gain on capital assets, other than shares of public companies including the vouchers of Pakistan Telecommunication Corporation, modaraba certificates or any instrument of redeemable capital as defined in the Companies Act, 2017, held for more than 1 year was reduced by 25%.
- The Act has removed this relief of reduction in gain.
- The Act has also omitted sub-section (4A) thereby recognizing the fair market value as cost of capital asset for the person acquiring asset under the transactions:
  - under a gift,
  - by succession/ inheritance/ devolution,
  - distribution of assets on dissolution of an AOP or on liquidation of a company,
- This now aligns with section 79 for retaining same character and cost as was in the hands of the person disposing off the said asset.

Deductible allowances and tax credits

- ❑ **Deductible allowance under section 60C**

  - ➢ The Act has omitted deductible allowance for profit on debt provided under section 60C of the Ordinance.
  - ➢ Before deletion every individual was entitled to a deductible allowance for the amount of any profit or share in rent and share in appreciation for value of house paid by the individual in a tax year on a loan, subject to the conditions specified therein, to the extent of cost upto 50% of taxable income or rupees 2 million, whichever less.

- ❑ **Tax credit under section 62**

  - ➢ The Act has omitted tax credit for investment in shares and insurance provided under section 62 of the Ordinance.
  - ➢ Before deletion this tax credit was available to individuals and AOPs to the extent of cost upto 20% of taxable income or rupees 2 million, whichever less.

Deductible allowances and tax credits

❑ Tax credit under section 62A

- The Act has omitted tax credit for investment in health insurance provided under section 62A of the Ordinance.
- Before deletion this tax credit was available to resident person other than Company on contribution to the extent of 5% of taxable income or rupees 150k, whichever less.

Withdrawal of exemptions from Second Schedule to the Income Tax Ordinance, 2001

❑ <u>Exemptions on amounts received from an income payment plan</u>

- ➢ The Act has omitted clause (23B) of Part I of the Second Schedule to the Ordinance.
- ➢ This clause provided exemption to amounts received as monthly installments from an income payment plan invested out of accumulated balance of an individual pension accounts with a pension fund manager or an approved annuity plan or another individual pension account of eligible person or survivors pension account maintained with any other pension fund manager as specified in VPS Rules if accumulated balance is invested for 10 years.

❑ <u>Exemptions on allowance or perquisites</u>

- ➢ The Act has omitted clause (5) of Part I of the Second Schedule to the Ordinance.
- ➢ This clause provided exemption to any allowance / perquisite paid or allowed outside Pakistan by Government to a Pakistani citizen for rendering services outside Pakistan.

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Withdrawal of exemptions from Second Schedule to the Income Tax Ordinance, 2001

- **Withdrawal of reduced rate benefit on investment in Federal Government Securities for certain persons**
  - The Act has omitted clause (20) of Part III of the Second Schedule to the Ordinance.
  - Such clause had provided that tax payable by a person other than a banking or an insurance company in respect of profit on debt from investment in Federal Government securities @15 percent which was considered as final tax.

- **Withdrawal of reduced rate provided to certain individuals**
  - The Act has omitted clause (1) of Part III of the Second Schedule to the Ordinance
  - This clause provided reduced tax rate of 2.5% in respect of any amount received as flying allowance by flight engineers, navigators of Pakistan Armed Forces, Pakistani Airlines or Civil Aviation Authority, Junior Commissioned Officers or other ranks of Pakistan Armed Forces and submarine allowance by the officers of the Pakistan Navy.

Withdrawal of exemptions from Second Schedule to the Income Tax Ordinance, 2001

- **Exemptions on amounts received by pilots:**
  - The Act has omitted clause (1AA) of Part III of the Second Schedule to the Ordinance.
  - This clause provided exemption to amounts related to total allowances received by pilots of any Pakistani airlines which provided reduced tax rate of 7.5%.

- **Exemptions in respect of unexplained income or assets**
  - The Act has omitted clause (86) of Part IV of the Second Schedule to the Ordinance being redundant as was applicable on investment from 01 January 2014 and start of commercial production by 30 June 2019.
  - The clause provided exemption from applicability of provisions of section 111 to certain persons i.e. individuals in greenfield industrial undertaking, and AOPs / Company in industrial undertaking.

Withdrawal of exemptions from Second Schedule to the Income Tax Ordinance, 2001

- **<u>Exemptions from minimum tax u/s 113 on Special Economic Zones</u>**
  - The Act has omitted sub-clause (xlii) of clause (11A) of Part IV of the Second Schedule to the Ordinance which provided exemption from applicability of provisions of section 113 to Zone Enterprise as defined in the Special Economic Zones Act, 2012.

Thank you