CORPORATE TAXATION

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Lets discuss …

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Classification of Companies

- One way of classification of Companies is by its corporate status i.e.

- Public Company
- Private Company &
- Small Company

Classification of Companies – Cont.

Public company means a company;

- in which not less than fifty per cent of the shares are held by the Federal or Provincial Government; or
- in which not less than fifty per cent of the shares are held by a foreign Government, or a foreign company owned by a foreign Government; or
- whose shares were traded on a registered stock exchange in Pakistan at any time in the tax year and which remained listed on that exchange at the end of that year; or
- a unit trust whose units are widely available to the public and any other trust as defined in the Trusts Act, 1882

Classification of Companies – Cont.

Private Company means a company that is not a public company.

Small Company mean a company registered under the Companies Ordinance on or after 1 July, 2005 which satisfies the following conditions:

► Equity of such company comprising its paid-up capital and undistributed reserves should not exceed Rs.25 million;

► Number of employees should not exceed 250 at any time during the year;

► Annual turnover of such company should not exceed Rs.250 million; and

► It must be all together a new company and business which should not have been formed as a result of any restructuring caused by splitting up or reconstitution of an already existing business.

Rate of Tax

- The rate of tax for companies is 35%.
- For Small companies, the rate of tax is 25%.

Heads of income

The following heads of income are subject to taxation in the hands of a Company;

- ►Business income
- ►Income from property
- ►Capital gains
- ►Income from other sources

Basis of computation

- The starting point of the tax computation of a Company is its profit before tax.
- Adjustments for admissible / inadmissible allowances are made to profit before tax to arrive at the taxable income.

General principle of allowability

- Expenses incurred during the tax year wholly and exclusively for the purpose of business are allowed as deductions to arrive at taxable income.
- Capital expenditure (other than in respect of depreciable and intangibles) and personal expenditures are inadmissible.

Depreciation

- Depreciation is allowed only in respect of ‘depreciable assets’.
- Depreciable assets include buildings, plant and machinery, computer hardware, furniture, vehicles, ships and technical and professional books owned by the person with a useful life of more than one year; looses value due to wear and tear and is used in deriving income from business.
- Depreciation is calculated using the declining balance method.
- Tax depreciation is allowed at the specified rates against the ‘written down value’ (WDV) of the asset. In year 1, WDV means the cost of the asset as reduced by initial / first year allowance (if any).
- Full year depreciation is allowed in the year of acquisition while no depreciation is allowed in the year of disposal.

Depreciation rates

- Depreciation rates are as follows:

Building	10%
Computers and allied items	30%
Furniture fixtures, plant and machinery, vehicles, professional books and ships	15%

Initial allowance

- Initial allowance is an allowable deduction on eligible depreciable assets placed into service in Pakistan for the first time in a tax year.
- Initial allowance is allowed in the year of use or commencement of commercial production whichever is later.
- Initial allowance is allowed at the rate of 50% against the cost of the eligible asset.
- Eligible depreciable assets include –
- Vehicles plying for hire;
- Plant and machinery that has not been used previously in Pakistan.

First year allowance

- Plant, machinery and equipment installed in an industrial undertaking set up in specified rural and under developed areas, are eligible for first year allowance in lieu of initial allowance.

- First year allowance is allowable at the rate of 90% against the cost of the eligible asset put to use after 01 July 2008.

Amortization of intangibles

- Amortization of intangibles is an allowable deduction.
- It is allowed over the useful life of the intangible on the basis of number of days the intangible is used in deriving income chargeable to tax.
- Where the useful life of intangible is not ascertainable or is more than 10 years, the normal life for calculation of amortization should be taken as 10 years.

Gain / loss on disposal of depreciable assets or intangibles

- Accounting gain / loss on disposal of fixed assets as provided in the financial statements is not part of taxable income of the taxpayer.
- Tax gain / loss on disposal of fixed assets is taxable as part of income under the head 'Income from Business'.
- Tax gain/loss is calculated as the difference between the consideration received and the tax written down value of the asset at the beginning of the year in which the asset is disposed off.

Pre-commencement expenditure

- Pre-commencement expenditure includes any expenditure incurred before commencement of business including cost of feasibility study, construction of prototypes and trial production activities.
- Pre-commencement expenditure is not an allowable expenditure in the year of incurrence.
- Amortization in respect of pre-commencement expenditure is allowable on a straight-line basis @ 20%.
- Pre-commencement expenditure should not include any expenditure incurred for acquiring land, or which is depreciated or amortized under as depreciable assets or intangibles.

Bad debts

- Bad debt is allowed as a deduction when each of the following three conditions are satisfied:
- the amount of bad debts was previously included in the person's income from business chargeable to tax;
- the debt or part of the debt is written off in the accounts of the person in the tax year; and
- there are reasonable grounds for believing that the debt is irrecoverable.
- Where a deduction has been claimed in a tax year and subsequently the entire amount or a part is recovered, it should be included in the income of the Company and taxed accordingly in the tax year in which it is received.

Certain inadmissible expenditures

- Any cess, rate or tax that is levied on profit / gains of the business.
- Any amount of tax withheld.
- Payment for any expenditure without deduction of tax , which was subject to tax deduction.
- Contribution to un-approved / un-recognized Provident Fund, Pension Fund, Superannuation Fund or Gratuity Fund.
- Any fine or penalty for violation of any law / rule / regulation.

Inadmissible expenditures - Cont.

- Any personal expenditures.
- Any amount carried to a reserve fund or capitalized in any way.
- Any salary exceeding Rs.15,000 per month paid other than through banking channel.
- Any capital nature expenditure .
- Any expenditure for a transaction paid under a single account head, which in aggregate exceeds Rs.50,000, made other than through banking channel.

Inadmissible expenditures - Cont.

- The above clause would not apply on:
- expenditures not exceeding Rs.10,000
- expenditures on account of:
- Utility bills
- Freight charges
- Travel fare
- Postage
- Payment of taxes, duties, fee, fines or other statutory obligations

Computation

		AMOUNT (Rs.)	AMOUNT (Rs.)
Profit before tax (PBT)			5,000,000
Add:	Accounting depreciation	2,00,000	
	Accounting amortization	100,000	
	Provision for doubtful debts	150,000	
	Amount of tax deducted	50,000	
	Cess, rate or tax levied on profit	250,000	
	Accounting loss on sale of fixed assets	600,000	
	Pre commencement expenditures	20,000,000	
	Tax gain on sale of fixed assets	500,000	
	Workers' Welfare Fund as per accounts	150,000	
	Contribution to unrecognized PF/GF/pension/superannuation fund	800,000	

Computation – Cont.

	AMOUNT (Rs.)	AMOUNT (Rs.)
Payments without deduction of tax	500,000	
Payments in excess of specified limits other than banking channel	1,000,000	
Donation	250,000	
Trading liability outstanding for 3 years	700,000	
Benefit in respect of trading liability allowed in previous years	200,000	
Financial charges on leased assets	350,000	
Fine /penalty for violation of any law	100,000	
Expenditure not attributable to deriving taxable business income	500,000	
Personal expenditure	1,000,000	
Transfer to reserves	2,000,000	
Capital expenditure adjusted against PBT	10,000,000	39,400,000

Computation – Cont.

		AMOUNT (Rs.)	AMOUNT (Rs.)
Less:	Tax depreciation	180,000	
	Gratuity paid	500,000	
	Lease rentals paid	700,000	
	Accounting gain on sale of fixed assets	400,000	
	Tax loss on sale of fixed assets	300,000	
	Provision for doubtful debts written off (already taxed in prior years)	1,000,000	
	Provision for slow moving/ obsolete stock written off (already taxed in prior years)	500,000	
	Tax amortization of intangibles	600,000	
	Amortization of pre commencement expenditure	4,000,000	
	Liabilities no longer payable written back (already taxed in prior years)	400,000	8,580,000
Taxable Income			35,820,000

Workers' Welfare Fund

- Workers' Welfare Fund is payable by every industrial establishment, whose total income is not less than Rs.500,000 in any year of account, at the rate of 2% of its total income.
- Total income means,

i. Where return of income is required to be filed under the Ordinance, the profit (before taxation or provision for taxation) as per accounts or the declared income as per the return of income whichever is higher; and

ii. Where return of income is not required to be filed, the profit (before taxation or provision for taxation) as per accounts or 4% of the receipts as per the statement filed under section 115 of the Ordinance, whichever is higher.

- Industrial establishment also includes any establishment to which the West Pakistan Shops and Establishment Ordinance, 1969 applies. Under the said Ordinance, a commercial establishment has been defined to include an establishment which carries on any business, trade or profession or work in connection with or incidental or ancillary to any business, trade or profession.

Workers' Profit Participation Fund

- Workers Profit Participation Fund is computed @ 5% of accounting profit of the Company.

Capital Gains

- The taxability of capital gain is dependent on the category of capital asset being disposed off i.e.

- Capital gain on securities - Section 37A

- Capital gain on other capital assets - Section 37

- Securities means shares of public company vouchers of Pakistan Telecommunication Corporation, Modaraba Certificates, an instrument of redeemable capital and derivative products.

- Capital assets means property of any kind held by a person but does not include:

- Stock in trade, consumables stores or raw material held for business purposes;
- Any property on which the person is entitled for a depreciation under section 22 or amortization under section 24 of the Ordinance;
- Any immovable property;
- Any movable property (other than painting, sculpture or work of art, jewellery, a rare manuscript, folio or book, postage stamp or first day cover; coin or medallian or an antique) used personally by the taxpayer or his/her dependents.

Taxability of capital gain on securities

- In tax year 2011, capital gain arising from sale of securities held for period of less than a year is chargeable to tax at the following rates:

- Holding period less than 6 months 10%
- Holding period more than 6 months but less than 12 months 7.5%
- Holding period more than a year 0%

- Gain under section 37A shall be treated as separate block of income.

Taxability of capital assets other than Securities

- Gain on capital assets other than securities is chargeable to tax at the corporate rate of tax.
- Capital gain is the difference of consideration received on disposal of capital asset and cost of the asset.
- Where capital asset (other than securities) is held for a period of more than a year, only 75% of the capital gain is taxable.
- Where capital asset is held for a period of less than a year, the entire amount of capital gain would be taxable.

Income from other sources

- Income of every kind which is not included in any other head is chargeable to tax under the head ‘Income from Other Sources. e.g.

- Examples of Income taxable under the head Income from Other Sources include;

  - Dividend income
  - Profit on debt
  - Royalty

Dividend income

- Dividend income is chargeable to tax at the rate of 10% of the gross amount.
- Dividend includes –
- any distribution of assets by a company to it's shareholders out of its accumulated profits;
- Any distribution by a company to it's shareholders in the form of debentures, debenture-stock or deposit certificates in any form, to the extent of accumulated profits;
- any distribution to shareholders to the extent of accumulated profit on liquidation of the Company or on reduction of its capital;
- remittance of after tax profit of a branch of a foreign company (other than E&P Company) operating in Pakistan;

Dividend income - Cont.

- Advancement of any loan by a private company under the Companies Ordinance, 1984 to its shareholders to the extent of its accumulated profit, but does not include the following:
- any advance or loan to a shareholder under ordinary course of business;
- any dividend paid by a company which is set off by an amount previously treated as dividend (repayment of loan to private company by shareholder);

Profit on debt

- Profit on debt is chargeable to tax at the corporate rate of tax.
- Tax deducted @ 10% from the gross amount at the time of payment is adjustable against the eventual tax liability.

Minimum tax under Section 113

- All companies are subject to minimum tax @ 1% of its turnover if the actual tax liability is less than the amount of minimum tax.
- The excess of minimum tax over the actual tax liability may be carried forward and used to set off the actual tax liability of the following 5 tax years.
- Turnover means the gross receipts from sale of goods, services rendered and the execution of contracts, other than income governed under the final tax regime.

Dividends

- Dividend payout is the distribution of after tax profit of a company to its shareholders.

- Companies are required to withhold tax at the rate of 10% of the gross amount while making payment of dividends.

Thank You