Basic Concepts and Common Rules

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Objective

- The objective of this presentation is to discuss and develop some of the fundamental principles of taxation as applicable both under the direct and indirect taxes as applicable in Pakistan

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Some Basic Concepts

Power to tax

- Entry No. 47 and 48 of the Federal Legislature List as contained in Part I of the Fourth Schedule to the Constitution of Pakistan, 1973, empowers the Federal Government to impose tax on income and corporations respectively

- Entry No. 19 of the said List also empowers the Federal Government to levy taxes on the sales and purchases of goods imported exported, produced, manufactured or consumed in Pakistan

Territorial jurisdiction of tax laws

- The tax laws extends to whole of Pakistan. The territories of Pakistan under the Constitution means:
  - the four provinces;
  - the federal capital;
  - the Federally Administered Tribal Areas; and
  - such states or territories as are or may be included in the territories of Pakistan, by accession or otherwise
- However, any Federal law, including tax laws, do not automatically apply to FATA and PATA unless the president or the governor with the approval of the president respectively direct that a particular legislature is in force to the respective Federally or Provincially administered tribal area

Special provisions of law to prevail over general provisions

- Where a law provides for a specific treatment in respect of a particular category of, say, income, person, or class of persons, the same would prevail over the general provisions of the law

Principle of 'Agency'

- Law of 'Agency' provides that all the rules and the principles that apply to the Principal would apply as much to the Agent of such Principal

- Where an Agent executes a transaction on behalf of the Principal, all the provisions of the law would apply as much to the transaction as they would have applied if the transaction was carried out by the Principal itself

Income Tax

Ordinance to override other laws on income tax matters

- Per section 3 read with section 54, the Income Tax Ordinance, 2001 has supremacy over all other laws in relation to tax matters

Income – general meaning

- All receipts by a person does not necessarily constitute 'income'
- Generally, income connotes a periodical monetary return, 'coming in' with certain regularity from a definite source [Commissioner Income Tax, Bengal v. Shaw Wallace, (*AIR 1932 PC 138*)]
- Generally, capital receipts are not taxable unless they are specifically provided in the tax law to be taxable
- Revenue receipts are generally almost always taxable (being income) unless they are explicitly provided as not to be taxable

Income – general meaning (Cont'd.)

- Following may be the distinguishing criteria between capital and revenue receipts:
  - Receipt from circulating capital versus receipt from fixed capital
  - Receipt from source of income versus receipt in lieu of source of income
  - Payer's motive ignored – receipt in the hands of the recipient is relevant
  - Lump sum payment is not the determining factor between capital and revenue receipt

Income – general meaning (Cont'd.)

- Certain capital receipts deemed as "income" for tax purposes include:
  - Golden handshake payments on termination of services
  - Gain on disposal of capital assets, including jewellery, painting, manuscripts etc.
- Certain revenue receipts which should otherwise be taxed but not taxed include:
  - Agricultural income
  - Profit and gains derived by electric power generating projects

Income under the Ordinance

- As per Section 2(29) of the Ordinance, income has the following scope:
  - income as understood in normal parlance
  - any amount chargeable to tax under the Ordinance
  - any amount subject to collection or deduction of tax under the Ordinance as a final discharge of tax liability
  - any amount “treated” as income under the Ordinance
  - loss of income is also income

‘Non income’ versus ‘exempt income’ versus ‘income taxable at 0%’

- As discussed above, certain income may not be income and therefore are not taxable
- Other category of receipt may be income but provided to be exempt from tax, as in the case of Second Schedule to the Ordinance
- There may be some other receipts which are taxable at 0%

Classes of income versus Heads of income

- There are different classes of income, including:
  - salary (arising out of employment)
  - income from property (being rental income from immovable property)
  - royalty (on account of use of or right to use intellectual property)
  - profit on debt / interest (on funds landed to others)
  - dividend (from shares held by the investor)

Classes of income v/s Heads of Income (Cont'd)

- There are only five heads of income in which each of such class of income is to be classified. These heads are :
  - Salary
  - Income from Property
  - Income from Business
  - Capital gains
  - Income from Other Sources
- Categorization of a particular class of income into a particular head of income is dependent on the person who is deriving such income and therefore may differ from one person to another

Expenditure – general meaning of

- The term ‘expenditure’ means ‘spending’ or ‘paying out or away’, i.e., something that goes out of the coffers of the taxpayer. It means something which is gone irretrievably - B.K. Khanna & Co. (P.) Ltd. v. CIT [2000] 113 Taxman 164 (Delhi)

- Expenditure is allowed only against income taxable either under the head Income from Business and Income from Other Sources

- Expenditure, not being capital or personal expenditure, is an allowable deduction to the taxpayer in the tax year

- Capital expenditure, in the form of depreciable assets and intangibles, is allowed in the form of depreciation and amortization

Schemes of taxation

- Broadly, there are two schemes of taxation:
  - **Final Tax Regime** – whereby tax id levied on the gross amount, without allowability of any expense
  - **Normal Tax Regime** – whereby bottom line income, after allowing for all admissible deductions, are taxed at applicable rates

Persons liable to tax

- The Ordinance tends to tax the income derived by a person
- Following are the main categories of persons
  - Federal government
  - Foreign government
  - Political sub division of a foreign government
  - International organization
  - Individuals
  - Association of Persons
  - Companies

Tax year

- Income derived by a person in tax year is taxable
- Normal tax year is from 01 July to 30 June
- Adopting any other 12 month period may be allowed which is called as the special tax year
- Special tax year has been allowed to different categories of persons, including -
  - Insurance companies
  - Companies manufacturing sugar
  - Companies manufacturing jute goods
  - All persons manufacturing rice
- Interim period between the normal tax year and the special tax year is called the transitional tax year

Sales Tax
and
Federal Excise Duty

Power to levy Sales Tax (ST) and Federal Excise Duty (FED)

- ST on goods is a Federal levy
- ST on services is a Provincial levy
- FED on specified goods and services is a Federal levy

Basis of levying ST and FED

- Income tax is charged on the “income” derived by a person
- ST and FED are charged on the “transaction” executed by the person
- FED is levied on import, manufacturing and supply of excisable goods and excisable services
- ST is charged on:
  - Import of taxable goods; and
  - Supply of taxable goods

Rate of sales tax

- The general rate of sales tax is 16%
- **The rate of FED varies depending on the category of goods and services**

Input and Output Tax

- When a person supplies goods, sales tax is charged. This is called the “output tax”
- Generally, ST paid at import stage or purchase of goods is an “input tax”
- The “output tax” is adjusted against the “input tax” to arrive at the balance tax payable or refundable
- Generally, the tax period in ST and FED is one month

Thank You