FUNDAMENTALS OF INCOME TAX LAW IN PAKISTAN

August 31, 2023

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I N D E X

Constitutional framework of taxation in Pakistan

Introduction

- Tax is a **compulsory extraction** of money from the subjects by **the State** in exercise of its **sovereign power.**
- Owing to the constitutional evolution in England, the taxation powers **shifted from King to the Parliament.**
- The **Constitution of Pakistan** as well as legal framework has its **roots in English system** to a larger extent.
- A **tax can be levied only by the legislature** (Article 77 of the Constitution). The constitutional principle is that the executive makes a demand of money usually through an **annual budget proposal** and **money is supplied by parliament** by levying taxes and its appropriation.
- As tax is a **common burden**, it is levied by the House (**National Assembly**) that represents popular will and not by a House (**Senate)** that is indirectly elected. For taxation and appropriation, usually a special legislative procedure is provided than an ordinary law.
- The above principles have their root in English legal system and hence it's called 'money bill' for which the procedure is laid down in **Article 73.**

Concept of legislative lists in the Constitution

- The taxing power in a **federal state** is **shared between parliament and the provincial/state** assemblies. To make things simple, legislative powers, including taxing fields, are elaborately provided in the **legislative lists** given in the constitution or appended therewith.

- These legislative lists can be as **numerous** as three, like **India**, Union List, State List and a Concurrent List or like **America**, which has clearly defined legislative powers of the Congress and all other powers not enumerated therein are vested in the states.

- **Pakistan** was destined to be a **federation**. It had five provinces and many acceding states in 1947. The **first constitution** came into effect on March 23, 1956. It was drafted on the Indian model. It had **three clearly devised legislative lists**. Both constitutions were mainly based on the **Government of India Act, 1935**. It clearly laid down taxing powers in the federal list as well as in the provincial list.

- The **Constitution of 1962** had a **single legislative list**. Over and above the legislative list, special powers were vested in the central legislature to legislate upon matters of national importance. The taxation power of the federation was clearly provided under that List. All residuary powers were vested in the provinces.

Concept of legislative lists in the Constitution

- The third **constitution of 1973** took its effect on April 12, 1973. Under this constitution, the taxation power of the federation has been given in the **Fourth Schedule** made pursuant to Article 142(1).

- **Originally**, there were **two legislative lists** in the Fourth Schedule, the **federal** and **concurrent lists** – but after 37 years, the concurrent list was abolished through 18^{th} amendment. **There were no taxing powers in the concurrent list.**

- The constitution of Pakistan envisages **unitary taxing power**. All taxation power has been given to **parliament**. The tax collected is then **divided amongst the provinces** and the federal government in accordance with the provisions of **Article 160**, which envisages a **National Finance Commission** entrusted with the duty to give an Award for the division of taxes according to the Award.

- The **taxation power of the federation** has **two basic foundations**. The tax power in respect of **all matters in the Federal Legislative List** is **vested in parliament**. **Provinces have no taxation power in respect of those matters unless expressly given by the constitution.**

Relevant entries in the legislative list and division of tax powers

- **Article 142** of the Constitution of Pakistan provides that Parliament shall have **exclusive power** to make laws with respect to **any matter specified in Federal Legislative List**.
- The said Article also provides that **any matter not enumerated** in the Federal Legislative List falls **exclusively in the provincial domain**.
- **Entry nos. 47 and 48** of the Federal Legislative List as contained in Part I of the Fourth Schedule to the Constitution of Pakistan, empowers Parliament to make laws with respect to **taxes on income (other than agriculture income)** and **corporations** (i.e. Federal Government is empowered to impose tax on income and corporations.)
- **Entry no. 49** of the said list also empowers **Federal Government** to levy **taxes on sales and purchases of goods imported, exported, produced, manufactured or consumed.** Entry no. 49 was amended by the **18th Amendment** in 2010 and the words **"except sales tax on services" were included** in the said Entry.
- **Entry no. 44** of the said list also empowers Federal Government to levy **duties of excise.**

Relevant entries in the legislative list and division of tax powers

- Subject to what is stated below, **the 18th Amendment shifted and transferred** the power to impose a levy on the providing or rendering of services exclusively to the Provinces.
- **Clause 7 of the Article 270AA** (as substituted by the 18th Amendment) allowed the relevant provisions of the **Federal Law** (e.g. Federal Excise Act, 2005 to remain in field till such time as the Provinces enacted their respective laws.
- **For example**, in Sindh the **Sindh Sales Tax on Services, 2011** was enacted with effect from July 1, 2011 and, therefore, from that date onwards, the relevant provisions of the Federal Excise Act, 2005 became ultra vires the Constitution with respect to Sindh.
- Similarly, under **entry 50** which deals with **Taxes on the capital value of the assets**, earlier the exclusion was stated as 'not including taxes on capital gains on immovable property', however, through **18th amendment** this exclusion was amended to state '**not including taxes on immovable property**' thus being interpreted that all such powers now vest in Provincial Government.
- **Taxing powers are thus either vested in Parliament or expressly given to the Provinces in the manner indicated above.**

Territorial jurisdiction of tax laws

- The Federal tax laws **extends to whole of Pakistan.**

- As per Constitution of Pakistan, the territories of Pakistan shall comprise:
  - The provinces of Balochistan, Khyber Pakhtunkhwa, Punjab and Sindh
  - The Islamabad Capital Territory; and
  - Such states and territories as are or may be included in Pakistan, whether by accession or otherwise.

- Prior to **25th Amendment**, any Federal law, including tax laws, did 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.

- After 25th amendment, **FATA and PATA have been included in the respective Provinces .**

Relevant Judgements on Constitutional division of taxation powers

- Judgement of **High Court of Sindh** in **Pakistan Freight forwarders.**
  - FED after July 1, 2011 in respect of Sindh held as ultra vires.
  - Sindh Sales tax on Services Act 2011 held as intra vires except in relation to certain shipping agents related services which were held to be covered by Entry 53 of Federal legislative list.

- Judgement of Islamabad High Court with respect to W.P. No. 1618/2015 (**Telenor & others**)
  - Issue under consideration: Duplicate levy of FED on telecommunication services as well as Provincial sales tax after 18th amendment.
  - Judgement: Excise Duty and Sales tax are two distinct taxes and hence even after 18th amendment, Federal Government is empowered to charge Excise Duty on same services which are subject to Provincial Sales Tax on services.
    Current status: Itra Court appeal pending

- Supreme Court judgement in **Civil Aviation** case on taxation of Federal Government entity.

Principles of interpretation of fiscal / taxing statutes

Introduction

- The Three organs of State – **Executive**, **Parliament** & **Judiciary**
- Legal system of Pakistan having **roots in English System**
- **Article 77** of the Constitution of Pakistan – Tax to be levied by law only
- Complexities of taxation laws (**composite knowledge** required for comprehension)
- Interpretation or construction of Statute – meaning as per **Salmond's jurisprudence**

> ***"the process by which the courts seek to ascertain the <u>meaning of the legislature</u> through the medium of authoritative forms in which it is expressed."***

Basic Principles / Rules of interpretation

Basic Principles / rules of interpretation

- Legislative intent
- Literal interpretation
- Strict interpretation
- Contextual interpretation
- Harmonious interpretation
- Mischief Rule
- The golden rule – purposive interpretation
- Ejusdem generis & noscitur a sociis

Aids to construction of statute

Aids to construction of statute

INTERNAL / INTRINSIC AIDS

EXTERNAL / EXTRINSIC AIDS

Internal / intrinsic aids to construction

- The Long Title
- Headings
- Punctuation
- Non obstante clauses
- Definition clauses & undefined words

External aids to construction

- Legislative history & background
- Circulars & FBR's interpretations
- Speech of a Minister & Parliamentary debates

Subsidiary Rules

Subsidiary rules of interpretation

- Special Overrides General
- Charging Vs. Procedural Provisions
- Retrospective
- Creative interpretation
- Proviso
- Explanation
- Conjunction Disjunction
- Audi Alteram Partem
- Mandatory Vs. Directory

Law of Precedents

Law of precedents

- **Stare Decisis** - a legal doctrine that obligates courts to follow historical cases when making a ruling on a similar case. Ensures that cases with similar scenarios and facts are approached in the same way. Simply put, it binds courts to follow legal precedents set by previous decisions.

- **Authoritative** Vs. **Persuasive** precedents

- Precedents in Pakistan – taxation context
  - Judgements of **Supreme Court** of Pakistan
  - Judgements of **High Court** of **same Province**
  - Judgements of **High Court** of **other Provinces**
  - Orders of the **Appellate Tribunals** (Single, Double & Larger Bench)

- Judgements of **Indian Courts** and **other foreign jurisdictions** - Persuasive

Law of precedents

Rules for reading the precedents

- ***Ratio Decidendi - a Latin phrase meaning "the reason" or "the rationale for the decision". ... It is a legal phrase which refers to the legal, moral, political and social principles used by a court to compose the rationale of a particular judgment.***

- ***Obiter Dicta - Latin phrase meaning "that which is said in passing," an incidental statement. Specifically, in law, it refers to a passage in a judicial opinion which is not necessary for the decision of the case before the court.***

Circumstances that weaken the binding force of Precedents

- **Reversed** by Higher Courts
- **Change in law** to nullify the effect of judgement
- **Subsequent decision** being **inconsistent** with earlier decision of same rank or higher court
- Rendered ***Per Incuriam***

Law of precedents – observations of Indian Supreme Court

Supreme Court of India in Commissioner of Income Tax Vs. Sun Engineering Works (1992) 198 ITR 297

"It is neither desirable nor permissible to pick out a word or a sentence from the judgment of this Court, divorced from the context of the question under consideration and treat it to be the complete 'law' declared by this Court. The judgment must be read as a whole and the observations from the judgment have to be considered in the light of the questions which were before this Court. A decision of this Court takes its colour from the questions involved in the case in which it is rendered and while applying the decision to a later case, the courts must carefully try to ascertain the true principle laid down by the decision of this Court and not to pick out words or sentences from the judgment, divorced from the context of the questions under consideration by this Court, to support their reasonings. In Madhav Rao Jiwaji Rao Scindia Bahadur and Ors. v. Union of India this Court cautioned: It is not proper to regard a word, a clause or a sentence occurring in a judgment of the Supreme Court, divorced from its context, as containing a full exposition of the law on a question when the question did not even fall to be answered in that judgment."

Income tax legislative history

Income tax legislative history relevant for Pakistan Before partition

- **Income Tax Act, 1860**: In the undivided India, Income Tax was for the first time in the history introduced in 1860 by the British Government through Income Tax Act 1860 **to overcome the financial difficulties after 1857 war of independence**. In the This Act, exactly the same pattern was followed as that was prevailing in those days in the United Kingdom. The Act was enforced effective from July 1, 1860 and was continued **for a period of five years** up to 1st August 1865. Then it was withdrawn in 1865.

- **License Tax Act, 1867, Certificate Act 1868, General Income Tax Act – II 1869, Income Tax Act 1886, Income Tax Act, 1918** (heads of income were introduced whereas no tax on capital gains), **Super Tax Act, 1920**

- **Income Tax Act, 1922:** The Income Act no XI of 1922 was promulgated on recommendation of All India Income Tax committee appointed in 1921. **The Income Tax Act 1918 and Super Tax Act 1920 was consolidated into Income Tax Act 1922.**

Income tax legislative history relevant for Pakistan Before partition (Contd.)

- In the Income Tax Act 1922, **Administration of Income Tax was shifted from the hands of provincial Governments to the Central Government of India**. Another remarkable feature of this Act was that the rates were to be enunciated by **annual finance Acts** instead of Basic enactments.

- This Act like Act of 1918 was applicable to all Incomes except Capital Gain, Casual income and income in kind not convertible into money except rent free accommodation. Tax was levied in the year of assessment on the basis of earning of previous year.

- In Income Act 1922 set of loss again profit or gain under one head of income against the other one was permitted provided that the loss was relating to the same assessment year. **This Act was amended as many as twenty times between 1922 and 1939.**

- **Income Tax (Amendment) Act, 1939:** Basic tax structure was carried from 1922 Act, however, residential status was introduced for the first time, slab rates were introduced and pay as you earn scheme was also introduced.

Income tax legislative history relevant for Pakistan After partition

- After Independence both the Governments of India and Pakistan in 1947, **adopted the Income Tax Act, 1922** as its official income tax laws. The provisions of the Act were **extended to the whole of Pakistan except the special areas.**

- In **June 1958** a special taxation inquiry committee was formed to review the existing income tax system and submit recommendation to the CBR for amendments in current tax laws. The Committee consists of officials and representatives of trade and commerce. The recommendations of the committee were accepted and **income Tax Act, 1922, was amended accordingly.**

- In **1959**, **Super Tax was abolished** on income of all persons except registered firms and companies. The rates of each slab were expressed as a percentage of income.

- In **1960** financial year was changed to commence on **1st July** and end on 30 June. Previously, it used to start on **1st April and end on 31st March**.

Income tax legislative history relevant for Pakistan
After partition

- In **1961** the Central Board of Revenue (CBR) Introduction Income Tax Committee for simplification of Income Tax laws 1922 and procedures.

- In **1965** "Self-Assessment scheme" was introduced. Before 1965, an assessment officer was to assess the income and determine the tax liability of the person.

- **Promulgation of the Income Tax Ordinance, 1979:** Between 1922 and 1979 as many as 71 amendment acts were passed by the legislature. As a result of these amendments the Act become a complicated law and difficulties arose in its working. Keeping these difficulties in view, the government promulgated a new tax law namely **"Income Tax Ordinance, 1979" through finance ordinance June 28, 1979** and included all the basic concepts of the repealed Act, so that the benefits of the whole case laws built over the last 57 years is not rendered useless. **The Ordinance replaced the Income Tax Act 1922 and was enforced effective from 1st July 1979.**

Income tax legislative history relevant for Pakistan After partition

- **Promulgation of income tax ordinance, 2001:** After 22 years of the promulgation of the Income Tax Ordinance, 2001, there was continuous criticism from the major foreign donors IMF and world Bank that the existing Income Tax laws of the country is **not aligned with the international standards** the Government of Pakistan on the dictation of IMF introduced a new income tax law namely, "The Income Tax Ordinance, 2001" as a precondition of the loan program with IMF. The Ordinance was promulgated on September 13, 2001 by the Government of General Pervez Musharraf.

- The Federal Government, vide its notification No. S.R.O. 381 (1)/ 2002, dated 15th June, 2002, announced that the Income Tax Ordinance, 2001 shall came into force on the **first day of July, 2002**. The new Income Tax Ordinance was written by an Australian Law practitioner and Assistant Professor **Mr. Lee Burns**.

- Income Tax Rules 2002 were subsequently issued.

- Both 2001 Ordinance and 2002 Rules have been amended from time to time

Structure of Income Tax Ordinance, 2001

Three stages of tax imposition

Witney Vs. IR Commissioners **(1926) 10 TC 88** (Lord Dunedin on behalf of House of Lords), as also quoted by the Hon'ble Supreme Court of Pakistan (Justice Munib Akhtar (in the case of H.M. Extraction Ghee & Oil Industries (**2019 PTD 1479**)

> *"Now, there are **three stages** in the imposition of tax; there is the **declaration of liability**, that is the part of the statute which determines what persons in respect of what properties are liable. Next, there is the **assessment**. Liability does not depend upon assessment. That, ex hypothesi, has already been fixed. But assessment particularizes the exact sum which a person liable has to pay. Lastly, come the methods of **recovery**, if the person taxed does not voluntarily pay."*

Structure of Income Tax Ordinance, 2001
Sections

- Chapter I – Preliminary (Sections 1 to 3)
- Chapter II – Charge of Tax (Sections 4 to 8)
- Chapter III – Tax on Taxable Income (10 parts – sections 9 to 65H)
- Chapter IV – Common Rules (3 parts – sections 66 to 79)
- Chapter V – Provisions governing persons (6 parts – sections 80 to 100F)
- Chapter VII – International (4 parts – sections 101 to 107)
- Chapter VIII – Anti-avoidance (Sections 108 to 112)
- Chapter IX – Minimum Tax (Sections 113 to 113C)
- Chapter X – Procedure (13 parts – Sections 114 to 206A)
- Chapter XI – Administration (3 parts – Sections 207 to 231)
- Chapter XII – Transitional Advance Tax (231A to 236Z)
- Chapter XIII – Miscellaneous (Sections 237 to 242)

Structure of Income Tax Ordinance, 2001
Schedules

- First Schedule – Rates of Tax (Parts I to IV subdivided into divisions)
- Second Schedule – Exemptions (Part I to IV)
- Third Schedule – Depreciation
- Fourth Schedule – Insurance business (Parts I & 2)
- Fifth Schedule – Exploration business (Parts 1 & 2)
- Sixth Schedule – Retirement funds (3 parts)
- Seventh Schedule – Banking companies
- Eighth Schedule – CGT on listed securities
- Ninth Schedule – Traders
- Tenth Schedule – Inactive taxpayers
- Eleventh Schedule – Taxation of Builders & developers
- Twelfth Schedule – Rate of tax on imports
- Thirteenth Schedule – Non profit organizations
- Fourteenth Schedule – SMEs

Charging Provisions

Charging provisions – Charge of tax

• Section 4	Tax on Taxable income
• Section 4B	Super tax on rehabilitation of temporary displaced persons
• Section 4C	Super tax on high earning persons
• Section 5	Tax on dividends
• Section 5A	Tax on undistributed reserves
• Section 5AA	Tax on return on investment in sukuks
• Section 6	Tax on certain payments to non-residents
• Section 7	Tax on shipping and air transport income of non residents
• Section 7A	Tax on shipping income of residents
• Section 7B	Tax on profit on debt
• Section 7C	Tax on builders
• Section 7D	Tax on developers
• Section 7E	Tax on deemed income
• Section 8	General provisions relating to taxes imposed under sections 5 - 7

Section 4 – Tax on Taxable income

Sub-section (1) – Normal Tax Regime / Net Income basis

- Subject to the provisions of the Ordinance
- Income tax is imposed for each **tax year**
- at the rates specified in Division I or II of Part I the First Schedule
- On every **person**
- Who has **taxable income** for the year

Sub-sections (2) & (3)

- Income tax liability computation by reference to **the rate applicable** on taxable income
- Reduction by **tax credits** in a **sequential order** (foreign tax credit, other tax credits and then advance tax / adjustable WHT)

Section 4 – Tax on Taxable income

Sub-section (4) & (5) – Separate block & final tax regime

- Certain **classes of income** / including income of certain **classes of persons**
- May be subject to **separate taxation** as provided in the respective provisions or
- Collection or deduction of tax as a **final tax on the income of the person**
- Income subject to final tax **not includible in taxable income**

Sub-section (6)

- Enabling provision for payment of tax collected or deducted at source

Concept of 'income' – Section 2(29)

Inclusive definition

a) Any amount **chargeable to tax** under the Ordinance;

b) Any amount subject to **collection or deduction of tax** under section 148, 150, 152(1), 153, 154, 156, 156A, 233, section 234(5), section 236Z;

c) Any amount **treated as income** under any provision of the Ordinance; and

d) Any **loss of income**

Concept of 'income' – judicial observations

- The object of income tax law is to tax 'income', a term of **formidably wide and vague import.**

- The word 'income' is an **expression of elastic ambit** and the Court while interpreting the same always qualified their description by saying that **it is not exhaustive.**

- Income connotes **monetary return** coming in with some sort of **regularity** or **expected regularity** from definite sources.

- Income has been likened pictorially to the **fruit of a tree**, or the **crop of a field**. It is essentially the **produce of something** which is often loosely spoken of as **'capital'**.

- **Anything which can properly be described as income, is taxable unless expressly exempted.**

- The **multiplicity of forms** which income may assume is **beyond enumeration.**

Capital & income

- Whilst all **revenue receipts** are assessable under the Income Tax Law unless specifically exempted, **a capital receipt may not be so chargeable to tax unless it falls within the purview of 'capital gains'.**

- The problem of **discriminating** between capital receipts and income receipts has very **frequently engaged the attention of the Courts.**

- As the Law itself does not define income except by way of adding artificial categories, one has to make a **reference to the decided cases** and as such, each case is found to turn upon its own facts and **no infallible criterion emerges.**

Examples of certain cases dealt by Pakistani Courts

- Non compete fee / compensation for restraint of trade (**2019 PTD 1278 - LHC)**

- Compensation for loss of sole earning apparatus (**39 TAX 21 – SHC) & 2006 PTD 2291 (ATIR)**

Concept of 'person' – Section 2(42) / 80

Sub-section (1)

Following are **treated as persons** for the purpose of this Ordinance:-

a) An **individual**;

b) A **company**;

c) Association of Persons (**AOP**);

d) The Federal **Government**, a foreign government, a political sub-division of a foreign government or public international organization.

A company and AOP incorporated, formed, organized or established **in Pakistan or elsewhere** is to be treated as person.

Concept of 'person' – Section 2(42) / 80

Sub-section (2)(a)

AOP **includes:-**

1. a **firm** (further defined in 80(2)(c) as relationship of persons who have agreed to share profits of a business carried on by all or any of them acting for all)

2. a **Hindu Undivided Family**

3. any **artificial juridical person**

4. Any **body of persons** formed under a foreign law

But **does not include a company**

Concept of 'person' – Section 2(42) / 80

Sub-section (2)(b)

Company **means:-**

1. a company as defined in the **Companies Act, 2017**;
2. a **body corporate** formed by or under any law in force in Pakistan;
3. a **modaraba**;
4. a body incorporated by or under any law of a **country outside Pakistan** relating to incorporation of companies;
5. a **co-operative society, finance society** or any **other society**;
6. a **non-profit organization** - defined in section 2(36);
7. a **trust** (defined in clause d to include unit trust), an entity or a body of persons established or constituted by or under any law for the time being in force;
8. a **foreign association**, whether incorporated or not, which the Board has, by general or special order, declared to be a company for the purposes of this Ordinance;
9. a **provincial government**;
10. a **local government** in Pakistan; or
11. a **small company** as defined in section 2(59AB)

Concept of 'tax year' – Section 74

- **Normal Tax Year:** A period of 12 months **ending on June 30th** – to be denoted by the **calendar year** in which such date falls (e.g. year ending on June 30, 2023 denoted as tax year 2023).

- **Special Tax Year:** A taxpayer allowed **under the repealed Ordinance** to use a 12 months period different from normal tax year **OR** where a person is allowed under the 2001 Ordinance to **use different period**. Such year is **denoted by the calendar year relevant to normal tax year in which such closing date falls** (e.g. year ended on December 31, 2022 since corresponds to normal tax year of June 30, 2023 will be denoted as Tax year 2023).

- FBR also empowered to specify special tax years for class of persons.

- **Examples:** Insurance Companies, Sugar companies, Textile companies, etc.

- Process of seeking special tax year or vice versa: **subject to the Commissioner's approval.**

Concept of 'tax year' – Section 74

Transitional Tax year

Where the tax year of a person **changes due to special permission of the Commissioner**, **the intervening period** between the end of the last tax year prior to change and the date on which the changed tax year commences shall be treated as a separate tax year, to be known as the **"transitional tax year"**.

Example: A person is allowed to use December 31 as its year end with effect from January 1, 2024, since his last normal tax year ended on June 30, 2023, the intervening period between July 1, 2023 to December 31, 2023 shall be treated as a transitional tax year.

Test of residence – sections 81 to 84

- A person is a resident person for a tax year if he is a **resident individual**, **resident AOP**, a **resident company** or the **Federal Government** (section 81)

- **Resident individual – section 82**

  An individual is a resident individual for a tax year if the individual-

  a) is present in Pakistan for a period or periods amounting in aggregate to **183 days or more** in a tax year;

  b) is an **employee or official of the Federal Government** or a **Provincial government posted abroad** in the tax year;

  c) being a **citizen of Pakistan** is **not present in any other country for more than 182 days** during the tax year **OR** who is **not a resident taxpayer** of any other country.

Test of residence – sections 81 to 84

Computing the number of days is made in accordance with **Rule 14**

- A **part of a day** that an individual is present in Pakistan (including the day of arrival in, and the day of departure from, Pakistan) **counts as a whole day** of such presence.

- A day or part of a day where an individual is in Pakistan **solely by reason of being in transit** between two different places outside Pakistan **does not count** as a day present in Pakistan.

- The **following days** in which an individual is wholly or partly present in Pakistan **count as a whole day** of such presence, namely:-
  a) a **public holiday**;
  b) a day or **leave** including sick leave;
  c) a day that the individual's activity in Pakistan is **interrupted** because of a strike, lock-out or delay in receipt of supplies;
  d) a **holiday** spent by the individual in Pakistan before, during or after any activity in Pakistan

Test of residence – sections 81 to 84

- **Resident Company – section 83**

  A company is a resident company for a tax year if -

  a) It is **incorporated or formed** by or under any law in force **in Pakistan**;

  b) The **control and management of the affairs** of the company is situated **wholly in Pakistan** at any time in the tax year; or

  c) It is a **provincial** or **local government** in Pakistan.

- **Resident AOP – section 84**

  An association of persons shall be a resident association of persons for a tax year if the **control and management of the affairs** of the association is situated **wholly or partly** in Pakistan at any time in the year.

Test of management and control

- The test of control and management has been in use **since Income Tax Act, 1922** and thus interpreted judicially by the **House of Lords** and Courts of both Pakistan and India.

- The expression 'control and management' means ***de facto*** control and management and **not** merely the right or power to control and manage i.e. ***de jure***.

- The central management and control has sometimes been stated in the form **"head, seat and directing power"**. The question depends on the fact of the management and not on the physical situation of the thing that is managed. A company is managed by the **board of directors** and if the meetings of the board of directors are **held within Pakistan**, it may be said that the central control and management is situated here irrespective of whether such directors are otherwise resident or non-resident in Pakistan.

- The direction, management and control "the head and seat and directing power" of a company's affairs is, therefore, **situated at the place where the directors' meetings are held.**

Test of management and control

- Consequently, a non-Pakistani company would be a resident in Pakistan if the meetings of the directors who manage and control the business are held here.

- The word **"affairs"** means affairs which are **relevant for the purpose of the Income Tax Ordinance** and which have some relation to the income sought to be taxed.

- It is not the **bare possession of powers by the directors**, but their taking part in or controlling the affairs relating to the business, that is of importance in determining the question of the place where the control is exercised.

- They **must exercise their power of control** in relation to business or activity wherefrom the profit is derived.

Taxable Income & Total Income

Taxable income (section 9)

- The taxable income of a person for a tax year shall be the **'total income under section 10(a)'** of the person for the year
- Reduced (**but not below zero**) by the total of any **deductible allowances** under Part IX Chapter III of the person for the year

Total income (section 10)

The total income of a person for a tax year shall be the **sum of the-**

a) Person's **income under all heads of income** for the year; and

b) Person's income **exempt from tax** under any of the provisions of the Ordinance

Heads of income – Section 11

- For the purposes of the imposition of tax and the computation of total income, all income shall be **classified under the following heads:-**

  a) Salary

  b) Income from property

  c) Income from business

  d) Capital Gains; and

  e) Income from other sources

- The income of a person under a head of income for a tax year shall be the **total of the amounts derived by the person in that year that are chargeable to tax** under the head **as reduced by the total deductions**, if any, allowed under this Ordinance to the person for the year under that head.

- In case of total deductions exceeding the revenue and there is hence a loss, separate provisions apply.

Difference in taxability of residents & non-residents

- The income of a **resident person** under a head of income shall be computed by taking into account amounts that are **Pakistan-source income** and amounts that are **foreign-source income.** (Sub-section 4)

- The income of a **non-resident person** under a head of income shall be computed by taking into account only amounts that are **Pakistan-source income.** (Sub-section 5)

- Pakistan source income means Pakistan source income **as defined in section 101**

- **Foreign source income** means foreign source income as defined in **section 101(16)**

Final / presumptive tax regime

- Concept was part of tax statutes but only for certain specific incomes of non-residents, such as royalties, Fees for Technical services, etc.
- The scope was extended to residents' transactions in **1991** under the **repealed 1979 Ordinance** for contractors, suppliers, interest income, etc.
- Judicially reviewed and upheld by the Supreme Court of Pakistan in the case of **Elahi Cotton Mills**, reported as **1997 PTD 1555 / 76 TAX 5**
- Under the repealed 1979 Ordinance, such tax was labelled as **presumptive tax** which was subsequently named as **Final Tax** under the 2001 Ordinance.
- The concept of final tax is **embedded in the charging provisions** of section 4, however, the detailed impact of any item being taxed under Final Tax Regime is given in **sections 8 & 169 of the Ordinance**.
- From **July 1, 2019,** the scope of FTR on various items has been converted into Minimum Tax Regime.

Final / presumptive tax regime – currently governed by section 8

• Section 5	Tax on **dividends** of both residents and non-residents
• Section 5AA	Tax on return on investment in **Sukuks** (residents & non-residents)
• Section 6	**Royalty**, **FTS**, fees for **offshore digital services** & fee for money transfer operations, card payment networks, etc. (Non-residents)
• Section 7	**Shipping & Air transport** income of **non-residents**
• Section 7A	**Shipping income** of **resident persons**
• Section 7B	**Profit on debt** of **resident non-corporate persons**
• Section 7E	Tax on **deemed rental income** of resident persons

Final / presumptive tax regime – governed by section 8
Salient features

- Tax imposed under the specific provisions is a **final tax** on the amount in respect of which the tax is imposed
- The amount is **not chargeable to tax** under any **head of income** in computing the taxable income of the person who derives it for any tax year
- **No deduction** is to be allowed under the Ordinance for any expenditure incurred in deriving the amount
- The amount shall **not** be **reduced** by any **deductible allowance or loss**
- **No tax credit** allowed against the tax liability
- Liability stands discharged **to the extent of withholding taxes** suffered at source

Final / presumptive tax regime – governed by section 169

• Section 152(1E)	Certain **payments to non-residents**
• Section 154	**Export** of **goods**
• Section 154A	**Export** of **services**
• Section 156	**Prizes** & **winnings**
• Section 156A	**Petroleum** product **commission** agents
• Section 236Z	**Bonus** shares issued by Companies

The language of **section 169** is **similar to section 8** except for the following additions:-

- No refund for tax deducted or collected except where such tax is in excess of actual tax due

- For tax not deducted, recovery provisions of section 162 apply

Final / presumptive tax regime – other provisions

- **Clause 5A of Part II of the Second Schedule**
  Tax deducted on profit on debt from debt instruments, Government securities, including treasury bills and PIBs for non-resident persons having no Permanent Establishment in Pakistan, where the investments are exclusively made through SCRAs

- **Clause 5AA of Part II of the Second Schedule**
  Payments to non-residents for profit on debt earned from a debt instrument, issued by the Federal Government and purchased exclusively through a bank account maintained abroad, a non-resident Rupee Account repatriable or a foreign currency account maintained with a banking company in Pakistan

- **Clause 5AB of Part II of the Second Schedule**
  Payments to residents for profit on debt earned from a debt instrument, issued by the Federal Government or its wholly owned Special Purpose Company and purchased by a resident citizen of Pakistan who has already declared foreign assets to FBR through a Foreign Currency Value Account maintained with Authorised banks in Pakistan

Final / presumptive tax regime – other provisions

- **Clause 17 of Part III of the Second Schedule**

  Tax payable on cotton ginners' turnover from cotton lint, cotton seed oil and cotton seed cake

- **100D read with Eleventh Schedule**

  Special area based taxation for certain builders and developers

- **Fourteenth Schedule**

  SMEs allowed an option to pay tax on the basis of their turnover

Separate block of incomes

- **Section 37(1A)**

  Capital Gains on disposal of immoveable properties

- **Section 37A**

  Capital gains on disposal of securities

- **Clause 27 of Part II of the Second Schedule**

  Tax on payments under the Compulsory Monetization of Transport Facility for certain civil servants

Minimum tax provisions

- **Section 113**

  Minimum tax on the basis of turnover

- **Section 113C**

  Alternative corporate tax for companies

- **Withholding taxes**

  Various withholding taxes are considered to be minimum tax, such as those relating to certain importers (section 148), profit on debt (section 151) sale of goods by non-manufacturers (section 153), contractors (section 152 and 153), service providers (section 153), commission agents (section 233), etc.

Exemptions, tax concessions & tax neutral provisions

Exemptions & tax concessions

• Section 41	Agricultural income
• Section 42	Diplomatic and UN exemptions
• Section 43	Foreign Government officials
• Section 44	Exemptions under International Agreements
• Section 44A	Exemption under Foreign Investment Protection Act 2022
• Section 45	President honors
• Section 46	Profit on debt of certain non-residents
• Section 47	Scholarships
• Section 48	Support payments under agreement to live apart
• Section 49	Federal Government, Provincial government, local governments
• Section 50	Foreign Source income of short term residents
• Section 51	Income of returning expatriates
• Section 53	Exemptions and tax concessions in Second Schedule
• Section 54	Exemptions & concessions in other laws
• Section 55	Limitations of exemption to the original recipient

Tax neutral provisions

- Section 79 — Non-recognition rules for assets transferred between spouses under an agreement to live apart, transmission of asset to executor or beneficiary on the death of a person, gifts to certain relatives, compulsory acquisition of assets under any law, liquidation of a company, dissolution of AOP
- Section 95 — Disposal of business by an individual to a wholly owned company
- Section 96 — Disposal of business by AOP to a wholly owned company
- Section 97 — Disposal of assets between 100% resident group companies
- Section 97A — Disposal of assets under Scheme of Arrangements, etc

Deductible Allowances & Tax Credits

Deductible Allowances

- Section 60 Zakat
- Section 60A Workers Welfare Fund
- Section 60B Workers Profit Participation Fund
- Section 60D Education expenses

Tax credits

Section 61	Charitable Donations
Section 63	Contributions to an Approved Pension fund
Section 64B	Employment generation by manufacturers
Section 64D	Point of Sale machines
Section 65B	Tax credit for BMR investments
Section 65E	Tax credit for equity based investments for certain industries
Section 65F	Tax credits for coal mining projects & start ups
Section 65G	Tax credits for greenfield investments, shipbuilding, renewable energy projects
Section 103A	Foreign Tax credits

Relevant books and reference materials

Relevant books & reference material

- Interpretation of Statutes by Maxwell, Crawford, Craie’s, Bindra, Justice Katju (fiscal statutes), Antonin Scalia, S.M.Zafar
- Black’s law dictionary, Legal terms & phrases by Ilyas Khan
- Kanga & Palkhiwala’s – The law & practice of Income Tax
- Sampath Iyengar’s law of Income tax
- Chaturvedi & Pithisaria
- Raza Naqvi – The law & practice of Income tax in Pakistan
- Rehmatullah Malik software, Ladhani Associates, Pakistan law site
- Monthly Journals of PTD, Taxation, PLD & Income Tax Reports
- ITAT online of India & Indiankanoon website
- Klaus Vogel, D.P.Mittal, Philip Baker on Double tax treaties, OECD & IBFD

Questions ??

&

Answers