

Income Tax

Significant amendments

Dividend Taxation

Remittance of profit by branches

Sections 2(19), 5 and section 150

The Finance Act, 2008 extended the definition of term 'dividend' to include 'after tax profit of a branch of a foreign company operating in Pakistan'. This amendment is intended to impose tax on after tax profits of branch of a foreign company operating in Pakistan. However, the corresponding provisions relating to charging tax on dividend and geographical source of income were not amended to enable this levy. The Finance Bill now proposes to amend the definition of dividend contained in section 2(19)(f) to specify that the after tax profit shall be treated as dividend at the time of remittance and also proposes to amend section 5 for the purpose of imposing tax on such after tax profits of a branch. Further, the amendment has been proposed in section 150 to provide a person (instead of a resident company) paying dividend shall deduct tax.

After these amendments, remittance of after tax profits by a branch of a foreign company shall be subject to withholding tax at the rate of 10 percent.

We have highlighted in Budget Brief 2008 that after tax profits of a branch, which has the status of non-resident person for Pakistan tax purposes, cannot be charged to tax unless the provisions relating to

geographical source of income contained in section 101(6) are amended appropriately. The Finance Bill does not propose to make any amendment in section 101(6) as aforesaid, therefore, in our opinion, still a controversy can arise that whether without amending section 101(6) tax on remittance of after tax profit can be imposed.

The Finance Bill also proposes to exclude remittance of after tax profits by a branch of Petroleum Exploration and Production (E&P) foreign company from the ambit of 'dividend' for the purpose of levy.

Internally Displaced Persons Tax (IDPT)

Division I of Part I of First Schedule

To raise funds for the rehabilitation of internally displaced persons, the Finance Bill proposes one time levy of 5 percent of tax payable for tax year 2009 by individuals (salaried and non-salaried) and association of persons, where taxable income exceeds Rs. 1,000,000.

It appears that IDPT will largely be applicable to salaried individuals, as income of non-salaried individuals and association of persons are generally covered under Final Tax Regime where IDPT has not been proposed.

Salary Taxation

Section 12(2), Paragraph (1A) & (2) of Division of First Schedule

The Finance Bill proposes to amend provisions relating to salary taxation in the following manner:

- The threshold of non-taxable salary income is proposed to be enhanced from Rs. 180,000 to Rs. 200,000. This limit in the case of woman salaried taxpayer is proposed to be enhanced from Rs. 240,000 to Rs.260,000. Accordingly, the slabs rates for salary taxation have been adjusted and thresholds for marginal relief have also been aligned with slab rates.
- One time levy at the rate of 30 percent for tax year 2009 is proposed to be imposed on bonus paid or payable to corporate employees receiving salary income of Rs. 1,000,000 or more excluding such bonus. It has been explained that this one time levy has been imposed to support rehabilitation of internally displaced persons. It may be noted that tax on bonus in such cases shall be imposed as a separate block of income and will not be subject to tax again as part of salary income (i.e. the impact will be of differential in tax rate).

Taxation of Senior Citizens

Clause (1A) of Part III of Second Schedule

Presently, taxpayers aged 60 years or more on the first day of tax year

having taxable income of Rs. 500,000 or less are entitled to 50 percent reduction in tax liability.

The Finance Bill proposes to enhance the threshold to Rs. 750,000.

Taxation of Full Time Teachers / Researchers

Clauses (2) of Part III of Second Schedule

This clause provides for reduction of tax liability by 75 percent of a full time teacher / researcher employed in a non-profit education or research institution duly recognized by the Higher Education Commission, a Board of Education or a University recognized by the Higher Education Commission, including government training and research institution.

The Finance Bill now proposes to reduce the benefit to 50 percent of tax liability.

Income from property

Sections 15 (1) (6) and (7)

Division VI of Part I of First Schedule and Division V of Part III of First Schedule

Clause (27A) and clause (28) in Part II of First Schedule

The amendments proposed in the relevant provisions pertaining to income from

property are only of editorial nature. The amendments in the rates etc. were earlier made by inserting clause (27A) and clause (28) in Part II of First Schedule. These clauses are now proposed to be deleted and the relevant amendments have been made in Division VI of Part I of First Schedule and Division V of Part III of First Schedule.

Dairy Farming / Livestock

Section 20(1A)

The Finance Bill proposes to provide for deduction for the difference between the actual cost of the animals and the amount, if any, realized in respect of the carcasses or animals where such animals have been used for the purposes of the business or profession, other than as stock-in-trade, and that have died or become permanently useless for the purpose of business.

The cost of animals used for carrying of business should generally be entitled to depreciation / initial depreciation to equate with matching principle of accounting, whereas, the proposed amendment seeks to allow such deduction when the animal is dead or useless. We suggest the amendment should be reviewed to allow depreciation.

Depreciation on Motor Vehicles not plying for hire

Section 22(13)(a)

Historically, the cost of motor vehicles not plying for hire was restricted for depreciation purposes. Through the Finance Act, 2005, such restriction was withdrawn and the motor vehicles were entitled for depreciation on actual cost basis without any threshold.

The Finance Bill now seeks to re-introduce the limitation of cost of such motor vehicles for depreciation purposes at Rs. 1,500,000 where actual cost exceeds this amount.

Alternate Energy Projects

Section 23B, Part II of Third Schedule

To encourage investment in alternate energy projects the Finance Bill proposes to provide for accelerated depreciation for alternate energy projects in the following manner:

- Any plant, machinery and equipment installed for generation of alternate energy shall be entitled for first year allowance at 90 percent of the cost, provided that such assets fall within the purview of eligible depreciable asset as provided in section 23

- The assets should have been placed into use after 01 July 2009 (i.e. on or after 02 July 2009)
- Other provisions of section 23 shall remain applicable to such assets

It is noted that Alternate Energy Projects involved in electric power generation would be entitled for exemption from income tax in terms of clause (132) of Part I of Second Schedule, subject to specified conditions, where the proposal may not have any impact.

Tax Credit on Donations and Profit on Debt

Tax credit on donations

Sections 61, clause (61) of Part I of Second Schedule

A company is entitled to a tax credit in respect of charitable donations including property to specified institutions equal to the amount lower of:

- 15 percent of taxable income for the year; or
- the amount of donation

The Finance Bill seeks to enhance the limit to 20 percent of taxable income for the year or the actual amount of donation, whichever is less. Similarly, for donations made to institutions specified in clause (61) of Part I of Second Schedule, where instead of tax credit

deduction is allowed, for determination of allowable deduction similar amendment is proposed.

Tax credit on profit on debt

Sections 61

Tax credit in respect of profit on debt paid on loan for purchase or construction of house property is allowed on lower of the following amounts:

- Actual of profit on debt paid;
- 40 percent of taxable income for the year; or
- Rs. 500,000

The Finance Bill now seeks to enhance the above limits of 40 percent to 50 percent of taxable income for the year and Rs. 500,000 to Rs. 750,000.

Tax Credit to Sales Tax Registered Manufacturers

Section 65A

The Finance Bill seeks to incentivise the manufactures registered under the Sales Tax Act, 1990 by allowing a tax credit at 2.5 percent of the tax payable for a tax year. The salient features of the scheme are as follows:

- 90 percent of sales of the manufacturer are required to be made to the sales tax registered persons;

- Complete details of persons to whom sales were made are required to be provided
- Income covered under final tax or minimum tax schemes are not entitled to this tax credit
- Carry forward of this tax credit will not be allowed

Cost of Assets acquired through Foreign Currency Loans

Section 76(5)

The Finance Bill seeks to insert an explanation to clarify that the value of asset acquired with a foreign currency loan shall be adjusted in the year of occurrence of foreign currency fluctuation.

Minimum Tax

Section 113, clauses (11A),(16) & (57) of Part IV of Second Schedule, Rule 7A of Seventh Schedule

The levy of minimum tax has a long history in the Pakistan tax laws, originally levied in 1991 and undergone changes at different times, was finally abolished in 2008.

The Finance Bill seeks to re-introduce this levy by clarifying certain aspects which have raised controversies in the past. The salient features of the proposed levy are as follows:

- This levy shall apply to a resident company where for any reason whatsoever (e.g. loss for the year, setting-off of loss of an earlier period, exemption from tax, tax credits or rebates, or allowances or deductions etc.) no tax is payable or paid or is less than 0.5 percent of turnover from all sources.

- Minimum tax shall be levied at the rate of 0.5 percent of the turnover from all sources.

- This levy shall not apply to a company who has declared gross loss before set off of depreciation and other inadmissible expenses.

The Commissioner shall have powers to ignore any loss arising due to change in accounting pattern.

The term 'accounting pattern' is ambiguous as the change could arise either due to a change in accounting policy, accounting standard or method of accounting. This needs further clarification.

- Minimum tax paid in excess of actual tax payable shall be carried forward for adjustment against succeeding three tax years' tax liability.
- The term turnover used for the purpose of this levy has been defined in the section which is not reproduced for sake of brevity.

The Finance Bill also proposes to extend levy of minimum tax on banking companies covered in Seventh Schedule.

Exemption from minimum tax

The Finance Bill also seeks to provide exemption from proposed levy of minimum tax to the following:

- National Investment (Unit) Trust
- Collective Investment Scheme authorized or registered under Non-banking Finance Companies (Establishment and Regulations) Rules, 2003
- Real Estate Investment Trust approved and authorized under the Real Estate Investment Trust Rules, 2006
- Any company in respect of turnover representing transaction in shares or securities listed on a stock exchange
- Petroleum dealers as specified
- Hub Power Company Limited (to the extent of receipts from sale of electricity)
- Kot Addu Power Company Limited subject to specified condition
- Companies engaged in electric power generation projects and qualifying for exemption under clause (132) of Part I of Second Schedule in respect of

income from export of computer software or IT services or IT enables services

- Provincial Government and Local Government entitled for exemption under section 49
- Pakistan Red Crescent Society
- Special purpose non-profit companies engaged in securitization of receivables of Provincial Governments
- Non-profit organizations approved under section 2(36)(c) or clause (58) of Part I of Second Schedule
- Taxpayers qualifying for exemption under clause (133) of Part I of Second Schedule
- Resident persons engaged in shipping business and qualify for tax on tonnage basis as final tax under clause (21) of Part II of Second Schedule
- Modaraba registered under the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980
- Corporate and Industrial Restructuring Corporation
- Corporate entities of WAPDA (to the extent of receipts from sale of electricity from the date of their creation upto the date of completion of corporatization process)

- Morabaha bank or financial institution, subject to required approvals, in respect of turnover from morabaha arrangement
- WAPDA First Sukuk Company Limited
- Institutions of Agha Khan Development Network (Pakistan)
- Companies Operating Trading House, meeting criteria specified in clause (57), upto ten years starting from the tax year in which the business commenced

Taxation of Income of Retailers

Section 113B

The Finance Act, 2005 introduced fixed tax scheme for retailers. The scheme prohibits claim of any withholding tax which causes double taxation of same turnover once by way of withholding tax and then taxation under this provision.

The Finance Bill now seeks to remove this double taxation by excluding the turnover subjected to withholding tax from the purview of this provision.

Return of Income, Statement of Final Taxation, Wealth Statement

Sections 114, 115 & 116

The proposed amendments relating to filing of return of income, statement of final taxation and wealth statement are explained below:

■ Return filing requirement

The Finance Bill seeks to extend the requirement of filing of return of income for the following persons, who:

- (a) own immovable property with a land area of 500 square yards or more located in rating area;
- (b) own a flat having covered area of 2,000 feet or more located in a rating area
- (c) own a motor vehicle of above 1000CC
- (d) has obtained National Tax Number

The mandatory requirement of obtaining NTN is also proposed to be extended for purchase of property, obtaining commercial / industrial gas / electricity connections and opening of bank accounts. As such all these would be required to file return of income.

■ Revision of return and statement of final taxation

A return filed can be revised within five years from the date of filing without any condition precedent. The Finance Bill now seeks to amend the provisions to provide for that revision of return can be made subject to the following conditions:

- (a) Return can be revised within five years from the end of financial year in which the original return was filed;
- (b) The revised return is accompanied by the revised accounts or revised audited accounts, as the case may be;
- (c) Reason for revision should be made in writing and duly signed
- (d) The revised return should be filed before issuance of notice for amendment of assessment

Certain omissions / misstatement necessitating revision of return may not require revised accounts or audited accounts, therefore, requirement of revised accounts or audited accounts be restricted to the situations where such accounts have any relevance to the revision of return.

Further, issuance of notice for amendment of assessment on

a particular issue should not impair the right of the taxpayer to revise a return on a point not subject matter of notice.

The Finance Bill also seeks to provide revision of statement of final taxation, however, no condition is proposed to be precedent for such revision unlike revision of return of income.

■ **Filing of return and wealth statement electronically by salaried person**

Presently, a salaried person is not required to file return of income if the employer has submitted annual statement of withholding tax. The Finance Bill now seeks to require salaried person having taxable income of Rs. 500,000 or more to file return of income electronically along with proof of deduction or payment of tax and wealth statement.

Since all salaried taxpayers may not be able to file return and other documents electronically, it is suggested that electronic filing should be optional in the case of salaried taxpayers.

■ **Filing of wealth statement by persons filing statement of final taxation**

The Finance Bill seeks to require filing of wealth statement by persons, other than company, filing statement of final taxation where the tax

under final tax regime is Rs. 20,000 or more for the tax year.

■ **Reconciliation of wealth**

The Finance Bill proposes that wherever a person is required to file wealth statement, it will be accompanied by a reconciliation of wealth.

Assessment, Appeals and Dispute Resolution

Sections 121, 122, 127, 129, 130, 131 and 134A

The Finance Bill proposes to make following amendments in provisions relating to assessment and appeals:

■ **Best judgment assessment**

The Commissioner is proposed to be empowered to make best judgment assessments in cases where a person has failed to furnish a statement of final taxation.

■ **Amendment of assessment**

Presently, an amendment of assessment can be made within five years from the date of original assessment (i.e. date of filing of complete return of income) or one year from the last amendment of assessment, whichever is later.

The Finance Bill proposes to extend this statute of limitation in the following manner:

- (a) five years from the end of financial year in which the original assessment has been made; or
- (b) one year from the end of the financial year in which the Commissioner has issued the amended assessment order, whichever is later.

■ **Appeal to the Commissioner (Appeals)**

Presently, in specified situations / orders, a taxpayer can file an appeal before the Commissioner (Appeals). The Finance Bill now seeks to further entitle the taxpayer to file an appeal against following orders:

- (a) orders levying additional tax
- (b) orders passed consequent to appellate orders

■ **Time limitation for disposal of appeals by the Commissioner (Appeals)**

Presently, the Commissioner (Appeals) is required to decide an appeal within four months from the end of the month in which the appeal was filed, subject to the condition that the appellant have served a notice personally to the

Commissioner (Appeals) before 30 days of expiry of such limit.

The Finance Bill now seeks to prescribe time limit of 120 days from the date of filing of appeal for decision by the Commissioner (Appeals). This period however can be extended for further 60 days by recording reasons by the Commissioner (Appeals). The period of adjournment sought by the appellant or period in which hearing is postponed for any reason including stay order, remand etc. shall however be excluded in computation of limitation for decision in appeal.

■ **Constitution of single member bench at Tribunal**

The Finance Bill seeks to empower the Chairman of the Income Tax Appellate Tribunal to constitute single member benches for cases or classes of cases to be specified by the Federal Government or cases where the amount of tax or penalty involved does not exceed Rs. 5,000,000.

■ **Fee for filing of appeal before the Commissioner (Appeals) and the Tribunal**

The Finance Bill proposes to prescribe fixed fee of Rs. 1,000 and Rs. 2,500 for filing of appeal before the Commissioner (Appeals) and the Tribunal, respectively.

■ **Scope and time limits for Alternative Dispute Resolution**

The Alternative Dispute Resolution mechanism was introduced in 2004, however, it could not yield the desired results for variety of reasons including delay in actions by the Alternative Dispute Resolution Committees. The Finance Bill now proposes following time limitations:

- (a) For constitution of Committee – within 60 days of receipt of application
- (b) For recommendations by the Committee – within 180 days of constitution
- (c) For order by the Board on recommendation of the Committee – within 45 days of receipt of recommendations

If a Committee does not make recommendation within proposed time limit the Board may dissolve the Committee and constitute a new Committee.

The Bill also proposes to exclude the matters from the purview of this mechanism where prosecution proceedings have been initiated or where interpretation of question of law having effect on identical cases is involved.

Advance Tax

Section 147 (1)(ca)(d), (2), (4), (4AAA), (6A)

Advance tax provisions have been subject to change from time to time. Presently, advance tax is required to be paid on the basis of tax assessed for latest tax year, with an exception that an individual or an association of person having latest assessed taxable income below than Rs. 200,000 are not required to pay advance tax.

The Finance Bill now proposes following amendments relating to computation and payment of advance tax:

- Association of Persons are now required to pay advance tax even if assessed taxable income is below Rs. 200,000
- Presently, advance tax liability is required to be computed as per following formula:

$(A / 4) - B$ where:

A is the tax assessed to the taxpayer for the latest tax year; and

B is the tax paid in the quarter for which a tax credit is allowed under section 168, other than tax deducted under section 149 or 155

The Finance Bill seeks to change the basis of computing advance tax liability as follows:

(A x B / C) – D where:

A is the taxpayers' turnover for the quarter;

B is the tax assessed for the latest tax year;

C is the taxpayer's turnover for latest tax year; and

D is the tax paid in the quarter for which a tax credit is allowed under section 168, other than tax deducted under section 155.

- As minimum tax is also being proposed to be re-introduced, the same is to be taken into account for computation of advance tax liability in case of resident company.
- Advance tax obligation will also arise for companies and Association of Persons even if there is no last assessed income or declared turnover. In that case the taxpayer will be required to estimate the amount of advance tax payable on the basis of quarterly turnover and pay such tax, after taking into account minimum tax if any, and adjustment of tax already paid.

Collection / Deduction of Tax and Final Tax Regime

Sections 148, 153, 154, 115, 164, 165, 168, 231B, 234, 235,

236A, and 169, Part II and Division IV of Part III and Divisions III, V, VII & VIII of Part IV of First Schedule, clauses (5), (17), (13C) and (24A) of Part II of Second Schedule, clauses (57) & (66A) of Part IV of Second Schedule

Withdrawal of Final Tax Regime

Presently, the following taxes collected or deducted are treated as final tax:

- Tax collected under section 148 at import stage for the commercial importer including importer of edible oil
- Tax deducted under section 154 on realization of export proceeds and indenting commission
- Tax deduction from payment for rendering or providing of services by individuals and Association of Persons under section 153(1)(b)

The Finance Bill now seeks to withdraw final tax regime in respect of the above collection or deduction of taxes and to treat such collection or deduction of taxes as minimum tax. Consequently, income arising from the transactions so stated above will be taxable on net income basis and in case the final tax liability is less than the tax so collected or deducted, the tax so collected or deducted will be treated as minimum tax liability, otherwise, the same will be available for adjustment against

tax liability computed on net income basis.

Corresponding amendments have also been proposed in sections 115(4), 168(3) and 169 of the Ordinance.

For Large Import Houses, the tax collected at import stage was not treated as final tax and was taxed under normal tax regime where such import houses:

- Had paid up capital exceeding Rs. 100 million
- Had imports exceeding Rs. 500 million during the tax year
- Owned total assets exceeding Rs. 100 million at the close of the tax year.

In view of the proposed amendments, for such Large Import Houses, the tax collected at import stage will not be treated as minimum tax and will be taxed under normal tax regime where such import houses:

- Have paid up capital exceeding Rs.250 million
- Have imports exceeding Rs. 500 million during the tax year
- Own total assets exceeding Rs.350 million at the close of the tax year.

Extension of Final Tax Regime

Under the provisions of section 153, a company being a

manufacturer of goods is excluded from the ambit of final tax regime. The Finance Bill seeks to exclude persons engaged in packing and repacking from the inclusive definition of the word “manufacturer” for the purposes of section 153.

It appears that companies engaged in packing and repacking may now fall under the final tax regime.

Changes in rates for collection or deduction of tax

The Finance Bill proposes changes in rates for collection or deduction of tax in respect of the following:

- Import of goods – from 2 to 4 percent
- Supply of cigarette and pharmaceutical products by distributors – from 3.5 to 1 percent
- Indenting commission in respect of export of goods – from 1 to 5 percent
- Dividend paid by privatized projects of WAPDA – from 7.5 to 10 percent
- News print media services – from 6 to 2 percent

Local purchase of imported Edible Oil

Tax collected on the import of edible oil for a tax year was treated as final tax. The Finance Bill seeks to treat the tax collected on the import of edible oil and packing

material as minimum tax instead of final tax.

For manufacturers of cooking oil or vegetable ghee or both, a concessional rate of income tax on purchase of locally produced edible oil was provided at 2 percent of purchase price. The Finance Bill seeks to provide the same concessional rate for local purchase of imported edible oil.

Collection of tax on imports by Trading Houses

The provisions relating to collection of tax on imports are not applicable to Trading Houses which meets the prescribed criteria. The Finance Bill seeks to withdraw this exemption.

Non-profit organizations as withholding agent

The Finance Bill seeks to include a non-profit organization in the definition of “prescribed person” for the purposes of section 153. Accordingly, non-profit organizations will be required to withhold tax from payments made on account of supply of goods, rendering of or providing of services and execution of contracts.

Collection of tax on export of goods through land routes

A new sub-section (3C) is proposed to be inserted in section 154 to provide for collection of tax at 1 percent by Collector of Customs at the time of clearing of goods exported. The rationale for this change appears to be that on

export of goods made through land route, in absence of banking transactions, tax could not be collected as the export proceeds are received in cash. Presently, such exports are mainly allowed to Afghanistan through land routes.

Evidence of tax collected or deducted to be provided

The Finance Bill seeks to make the withholding tax agent liable to furnish, to the person from whom tax has been collected or deducted, copies of challan of payment or any other equivalent document alongwith the prescribed certificate.

Similarly, the person to whom such challans or other documents are furnished will now be required to attach such documents alongwith the prescribed certificate with the return of income.

Due date for furnishing annual statements under section 165 for taxpayers having special tax year

Due date for furnishing of annual statements under section 165 of the Ordinance in all cases is within two months after the end of the financial year.

The Finance Bill seeks to amend the due date in the case of a taxpayer to two months after the end of the tax year of such taxpayer and in all other cases within two months after the end of the financial year.

Withholding of services charges by withholding agents not permitted

Reportedly, certain government organisations, acting as collecting agent for withholding tax purposes, retained certain part of the tax so collected as service charges. To address such situation, the Finance Bill seeks to insert two new sub-sections (6) and (7) in section 168 to provide that withholding tax collected by a withholding agent is fully deposited in the government treasury without withholding any services charges from the amount of tax withheld.

Advance Tax on private motor vehicles

The Finance Bill seeks to amend the relevant provisions for collection of advance tax on private motor vehicles as follows:

- Every motor vehicle registering authority of Excise and Taxation Department has been made responsible to collect this tax
- In place of “new motor car and jeep” the words “new locally manufactured motor vehicle” have been substituted.
- Apart from the Federal Government, Provincial Government, a foreign diplomat and a diplomatic mission in Pakistan, the Local Government has also been exempted from the application of this provision.

Advance Tax on electricity consumption

Advance tax collected on the amount of electricity bill of a commercial or industrial consumer upto bill amount of Rs. 20,000 per month is treated as minimum tax on the income of a person, other than a company. The Finance Bill seeks to enhance the threshold of bill amount to Rs. 30,000 and to provide that the tax collected on monthly bills exceeding Rs. 30,000 would be adjustable whereas in case of company any amount of tax collected would be adjustable.

Cotton ginners and suppliers of lint are proposed to be exempted from withholding tax provisions on electricity consumption through insertion of new clause (66A) in Part IV of Second Schedule.

Advance Tax at the time of sale by auction

Provision for collection of advance tax at the time of sale by auction existed in the Repealed Income Tax Ordinance, 1979 from 1981 to 2000.

A new section 236A has been inserted to re-introduce collection of such advance tax and the salient features are as follows:

- Any person making sale by public auction of any property or goods confiscated or attached is responsible for collection of this tax
- The said property or goods may or may not belong to the

Government, local government, any authority, a company, a foreign association, a foreign contractor or a consultant or a consortium, Collector of Customs, Commissioner of Income Tax or any other authority

- The advance tax shall be computed at the rate of five percent of the gross sale price
- The credit for the tax so collected shall be given to the person purchasing the property in the relevant tax year or in the case of a taxpayer whose business is dissolved or who is about to leave Pakistan, the tax year in which the date for dissolution or leaving Pakistan falls.
- Sale of property for the purpose of this section includes awarding of any lease to any person including a lease of the right to collect tolls, fees or other levies, by whatever name called.

Telephone users

Withholding tax at the rate of ten percent is proposed to be levied on sale of units of mobile telephone and prepaid telephone through CD and other forms in addition to sale of such unit through pre-paid cards through an amendment proposed in paragraph (b), of Division V of Part IV of First Schedule.

Summary of significant changes in withholding tax regime

Nature of transactions	Existing		Proposed	
	Rate	Status	Rate	Status
Imports by commercial importers and import of edible oil	2%	F	4%	A / M
Service providers other than companies	6%	F	6%	A / M
Exports	1%	F	1%	A / M
Indenting commission on export of goods	1%	F	5%	A / M
Sale by auction	Nil	-	5%	A
Newsprint media services by companies	6%	A	2%	A
Newsprint media services by others	6%	F	2%	A
Supply of cigarettes and pharmaceutical products by distributors being listed companies	3.5%	A	1%	A
Supply of cigarettes and pharmaceutical products by other distributors	3.5%	F	1%	A

F Final tax
A Adjustable tax
M Minimum tax

Refund

Section 170

The Commissioner is presently required to pass refund order on a refund application within 45 days of its filing.

The Finance Bill seeks to extend this time limit of 45 days to 90 days.

Power to withhold refund

Section 170A

The Finance Bill seeks to empower the Commissioner to withhold tax refund due to a taxpayer where the order giving rise to refund is subject matter of appeal or further proceedings under the Ordinance.

However, before withholding refund, the Commissioner will be required to provide a reasonable opportunity of being heard to the tax payer by communicating reasons for withholding of refund.

This power may give rise to frivolous appeals by the department just to withhold such refunds.

Additional payment for delayed refunds

Sections 2(30AA) & 171

Presently, a taxpayer is entitled to compensation at 6 percent per annum on the amount of tax refund not paid within three months from the date of such refund becoming due.

The Finance Bill seeks to change the rate of compensation from the present rate of 6 percent to KIBOR. Further, the compensation will not be made where a refund claim is subject to post-refund

investigations until such time the investigation is concluded.

For this purpose, definition of KIBOR has been provided which means Karachi Interbank Offered Rate applicable on the first day of each quarter of the financial year.

Records, Information and Audit

Sections 174, 176, 177 & 210

Presently, a taxpayer is required to maintain prescribed documents and records for five years from the end of relevant tax year. The Finance Bill now proposes to require the taxpayer to maintain documents and records till final decision in any proceedings for assessment, appeal, revision, reference, petition and any proceedings before Alternative Dispute Resolution Committee.

As reported, the Board is considering outsourcing of tax audits to Chartered Accountant Firms. To enable the Chartered Accountant Firms to conduct such tax audits, the Finance Bill seeks to empower Chartered Accountant Firms, with the prior approval of the Commissioner, to obtain and retain information, record or computers for such time as necessary. Similarly, it is proposed to empower the Commissioner to delegate the powers to conduct the audit of persons selected for audit to a Firm appointed by the Board.

Presently, the Board or the Commissioner may select any person for audit under specified provisions. The Finance Bill proposes to empower the Board and the Commissioner to select 'classes of persons' for tax audit as well.

Recovery of tax

Section 138

Presently, the Commissioner is empowered to recover tax due from a taxpayer through attachment and sale of taxpayer's property or by appointing a receiver to manage such property. Further, the Commissioner is also empowered to arrest a tax payer and order his detention in prison for up to six months.

The Finance Bill seeks to further enhance the Commissioner's powers for tax recovery by authorising him to serve a notice on the tax payer or any other person to stop removal of any goods manufactured or stored on behalf of the taxpayer. However, this power is to be exercisable only when tax demand has been confirmed or modified by the Income Tax Appellate Tribunal.

Prosecution for non compliance with certain statutory obligations

Section 191

The Ordinance provides for conviction with a fine or imprisonment for up to one year for certain offences which include *amongst others*, non-filing of return of income or wealth statement where required to be filed by the Commissioner, non-payment of advance tax, non-compliance with the provisions for deduction or collection of tax and deposit of tax and non-compliance with notice for providing information etc.

The Finance Bill now seeks to enhance the scope of this provision by making the following as offences punishable with prosecution or fine or both:

- non-compliance with notice of the Commissioner to stop removal of manufactured goods for recovery of tax
- Non-filing of annual tax return or statement of final taxation and wealth statement voluntarily by due date

Further, the Finance Bill proposes that a fine of up to Rs. 50,000 may be imposed for these offences.

Prosecution for concealment of income

Section 192A

The Finance Bill proposes to insert a new section with reference to concealment of income during proceedings or furnishing inaccurate particulars of such income and where related tax is Rs. 500,000 or more. It is proposed that these offences be punishable with imprisonment for up to two years or fine or with both.

For the purpose, concealment of income and filing of inaccurate particulars of income shall include suppression of any income or amount chargeable to tax; claiming of any deduction for any expenditure not actually incurred; or where the person offers no explanation about the nature and source of the amount credited or the investment, money, valuable, article or fund from which the expenditure was made or the explanation offered is not satisfactory.

Fines for certain specified offences

Sections 193, 194, 195, 196, 197 and 198

The Finance Bill proposes that fines as follows be charged for the following offences:

Sec.	Offence	Fine Amount (Rs.)
192	False statement in verification	Upto 50,000
193	Failure to maintain records	Upto 50,000
194	Improper use of National Tax Number	Upto 50,000
195	Filing of false statement	Upto 50,000
196	Obstructing an income tax authority	Upto 50,000
197	Prevention of disposal of property	Upto 100,000
198	Unauthorised disclosure of information by a public servant.	25,000

Power to compound offences

Section 202

Presently, the power to compound an offence (punishable with imprisonment or fine) rests with the Commissioner. The Finance Bill seeks to transfer the power of compounding offence to the Director General subject to prior approval of the Board and payment

of tax, additional tax and penalty by the taxpayer.

Jurisdiction of Income Tax Authorities

Section 209

Presently, the Commissioner shall have jurisdiction within the area assigned in respect of the following:

- (a) person carrying on business and having place of business within such area, or if business is carried on in more than one place, if the principal place of business is within such area
- (b) any other person if resides in such area

The term place of business is however not defined. The Finance Bill now seeks to define the same in the following manner:

- In the case of listed or unlisted public limited company, the place where the registered office is situated
- In the case of other companies:
 - (i) if it is primarily engaged in manufacture or processing, the place where the factory is located

- (ii) if it is primarily engaged in business other than manufacturing or processing, the place where main business activities are actually carried on.

Powers of the Board

Condonation of Time Limit

Section 214A

The Ordinance specifies time limit under various situations e.g. for amendment of assessment, maintenance of record, payment of tax etc. Similarly, the Finance Bill also proposes to specify time limitation for certain acts e.g. constitution, recommendations and decision by the Board under Alternative Dispute Resolution mechanism.

The Finance Bill now proposes to empower the Board to condone such time limitations and permit that an application to be made, or an act or thing to be done can be made or done within such time or period as the Board considers appropriate. It is also proposed that the Board, by notification in the official gazette, can delegate such powers to the Director General or the Commissioner subject to limitations or conditions specified in such notification.

It is suggested that the condonation in case is prejudicial to the interest of taxpayer, then such taxpayer should be provided with an

opportunity of being heard before any such condonation is granted. Further, such powers should not be available in appeal matters pending with appellate authorities.

Call for records

Section 214B

The Finance Bill also proposes to empower the Board to call for and examine the record of any departmental proceedings, at own motion to satisfy itself about the decision made therein and pass such order as it may think fit. The salient features of the proposed provisions are as follows:

- The Board will not make an order imposing or enhancing any tax or penalty than the originally levied unless the person affected by such order has been given an opportunity of showing cause and of being heard.
- No proceedings shall be undertaken where an appeal is pending

An order shall be made within 3 years from the date of original decision or order.

Director General (Intelligence and Investigation of Income Tax)

Section 229A

The Finance Bill seeks to introduce Directorate General for intelligence

and investigation of income tax. The Board shall be empowered to appoint Director General, Directors, Additional Directors, Deputy Directors, Assistant Directors and other officers for the purpose. The Directorate shall exercise such powers as may be assigned by the Board.

Rate of tax for small companies

Section 236A

Division II para (iii) of Part I of First Schedule

The corporate rate of tax for small companies is 20 percent. In order to fall within the definition of small company, the turnover has to be upto two hundred and fifty million rupees.

Finance Act 2008 inserted a proviso in para (iii) of Part I of First Schedule to provide rates ranging from 25 percent to 35 percent on three slabs, where turnover exceeded the threshold of Rs.250 million in order to enable the company to still qualify as a small company and avail the reduced rate.

The Finance Bill seeks to omit the said proviso to bring a small company at par with a normal company, when the turnover threshold is exceeded.

Second Schedule

Part I

Withdrawal from Voluntary Pension Scheme

Clause (23A)

Presently, 25 percent of the accumulated balance received from a voluntary pension scheme under the Voluntary Pension System Rules, 2005 is exempt from tax.

The Finance Bill proposes to enhance the tax exempt threshold to 50 percent.

Exemption to Educational Institutions

Clause (92)

Income of universities and educational institutions established on non-profits basis is presently tax exempt.

The Finance Bill seeks to insert a proviso to this clause whereby new universities or educational institutions established after 30 June 2009 will be required to obtain prior approval from the Director General in order to claim tax exemption.

It is also proposed that existing universities or educational institutions exempt from tax ought to take approval from the Director General within six months from the date of notification of the Finance Act, 2009 in order to claim tax exemption.

Taxation of banking companies

Section 29A, Rules 1(c) & (ca) and 7A of Seventh Schedule

Prior to the Finance Act, 2007, income of banking companies was computed by and large under general provisions of the Ordinance with a very few provisions specific to banking companies. Through the Finance Act, 2007, section 100A and the Seventh Schedule were promulgated to provide exclusively for taxation of banking companies.

The Seventh Schedule contained a set of Rules to be applicable effective Tax Year 2009 (income year ended 31 December 2008). These rules were further modified through Finance Act, 2008. By and large, the Seventh Schedule provides that income, profits and gains of a banking company are to be taken as income from all sources before tax, as disclosed in the annual accounts furnished to the State Bank of Pakistan subject to certain specified adjustments to such income.

These specified adjustments mainly include inadmissible deductions listed in section 21, and other adjustments in relation to accounting and tax depreciation, amortization and expense representing bad debts or provision against bad debts.

With specific reference to tax deduction for expense on account

of bad debts (or provisions), the Finance Act 2007 provided for such deduction on account of classified advances and off balance sheet items subject to filing of external auditors' certificate to the effect that such provisions were made in line with requirements of the Prudential Regulations of the State Bank of Pakistan. Further, the expense was not admissible for debts classified as 'substandard' under the said Prudential Regulations and was admissible only if such debt was re-classified later as 'doubtful' or 'loss'.

The above mentioned rule was modified through the Finance Act, 2008 thereby allowing for recoverability of bad debts in line with the legal provisions as existed before Finance Act, 2007 that is in accordance with section 29 and 29A of the Ordinance

The Finance Bill now seeks further amendment of this Rule by deleting application of section 29 and 29A to banking companies and to allow deduction for bad debts in the following manner:

- Rule 1 (c) - to provide allowability of provisions for classified advances and off balance sheet items at the rate of one percent of such classified advances; subject to filing of external auditors' certificate to the effect that such provisions have been made in line with the requirements of Prudential Regulations.

However, in case actual bad debts are less than the amount computed as above, the deduction shall be limited to actual bad debts. Further, in case the actual bad debts exceed the amount computed above, the excess shall not be carried forward.

- Rule 1(ca)- to provide inadmissibility of amount claimed as expense on account of bad debts classified as 'sub-standard' under Prudential Regulations.
- Rule 1(cb)- to provide for deduction in accordance with Rule 1(c) in case any addition made under Rule 1(ca) is reclassified as doubtful or loss under the Prudential Regulations.
- Rule 1(cc)- to provide for deduction in case any addition made under Rule 1(ca) is re-classified as 'recoverable'

Further, it is also proposed to charge minimum tax at one-half percent of turnover.

Introduction of the Seventh Schedule in 2007 was initially perceived to mitigate litigation between the tax authorities and the banking sector, especially on account of allowability of bad debts. However, after going through the amendments made one after the other specifically those relating to provision for bad debts, it appears that it would be difficult to achieve this objective.

The industry was rather pursuing for introduction of transitory provisions relating to deduction of bad debts already disallowed in prior years and deducibility of unabsorbed depreciation of leased assets.

The proposed amendments on the contrary have worsened the position for banks in respect of deduction of bad debts by restricting the same to 1 percent of classified advances.

We believe the provisions of the Seventh Schedule relating to allowability of bad and doubtful debts should be brought in line with the realities of banking business and approach followed for other specialized industries (insurance, oil and gas exploration). A balanced approach would be to restore original position of Seventh Schedule when introduced and introduction of transitional provisions to allow bad debts already disallowed over a defined period.