

AN OVERVIEW OF TAXATION

Before moving on to Taxation Management, we must know what taxes are:

- **General Understanding of Tax:**

- Literal meanings ----- Burden, Strain
- The long journey would be too much of a tax on my father's strength.
- I found they were taxing my patience by asking irrelevant questions.
- Such a long rough journey would be very taxing for old man.

- **General Definition of Tax:**

General compulsory contributions of wealth levied upon persons by the state, to meet the expenses incurred in providing common benefits upon the residents.

- **Statutory Definition of Tax**

Tax means any tax imposed under chapter II includes a penalty, fee or other charge or any sum or amount leviable or payable under this ordinance.

- **Taxes Vs Fees:**

Taxes are compulsory levy and it is the legal obligation of the person to pay the amount of tax which is required to pay under the law, where as payment of fee is the discretion of any person and when a fee is paid, the person becomes an entitled to claim counter benefits.

- Taxes are important instrument of Fiscal Policy.

AN OVERVIEW OF TAXATION

What is Fiscal Policy?

Fiscal policy is a discipline that deals with arrangements which are adopted by government to collect the revenue and make the expenditures so that social and economic stability could be attained / maintained.

- **Objectives of Fiscal Policy**
 - Economic Development
 - Raising level of employment (Achieving full employment level)
 - Influencing consumption patterns
 - Price stability
 - Redistribution of income
 - Removal of deficit in Balance of Payments
- **Instruments of Fiscal Policy**
 - Government Expenditures
 - Taxes
 - Deficit Financing
 - Subsidies
 - Transfer Payments—like Unemployment Allowances etc.
 - **Sources for Revenue Generation for State**
 - Taxes, Tariffs
 - Internal & External Borrowing
 - Penalties & Fines
 - Aids & Grants

Canons of Taxation:

Simplicity

This principle implies that taxation system should be plain, and easily understandable by the tax payer.

Convenience

The convenience of tax payer as well as tax collector must be the bottom line of any taxation system. The time of payment of tax, mode of collection of tax, should be convenient for the tax payers.

Certainty

This canon suggest that the amount of payment should be certain and there should not be any arbitrariness or ambiguity with respect to the amount of tax to be paid by the tax payer.

Judicious

The taxation system should be based on the principles of equity, fair play, and all known principles of natural justice.

Capacity to Pay

This principle suggests that taxation system must be based keeping in view the capacity to sacrifice by the person on whom the tax is levied, those who have more income should pay taxes at high rates/ proportions, where as those who have low income, they should pay taxes at lower rates or proportion.

Benefit principle

This principle suggests that taxes should be levied according to the benefits derived by the person from the state. Since more benefits are derived by lower income groups, hence according to this principle, those who derive more income but enjoy less benefits from the state should be taxed at the lower rates and those persons who derives less income but more benefits from State should be taxed at high rates.

Business Friendly

According to this principle, the taxation policy should be such as to boost business atmosphere and not discouraging the investment environment.

AN OVERVIEW OF TAXATION**Type of Taxes:**

Different types of taxes are explained below:

- **Direct taxes**
Direct taxes are the taxes where incidence of taxation is on the person on whom levied. For example income tax
- **Indirect Taxes**
Indirect taxes are the taxes where incidence of tax can be shifted by the person on whom levied to other persons. For example sale tax
- **Proportional Taxes**
These taxes are levied with the same percentage. For example, sales tax is levied at the rate of 15%.
- **Progressive Taxes**
This is based on the “capacity to pay” principle of taxation. In this type, the rate of tax increase as the income increase.
- **Regressive taxes**
It is based on the benefits received principle
- **Value Added Taxes.**
This type of tax is levied at each stage of value addition. For example sales tax

Taxation Structure of Pakistan:

- **Federal Taxes:**
Federal taxes are the taxes which can be levied by the federal government and include among others the followings:
 - Income tax
 - Corporate tax
 - Customs duties/Tariffs
 - Sales tax
- **Provincial Taxes:**
 - Stamps Duty
 - Registration Tax
 - Motor vehicle tax

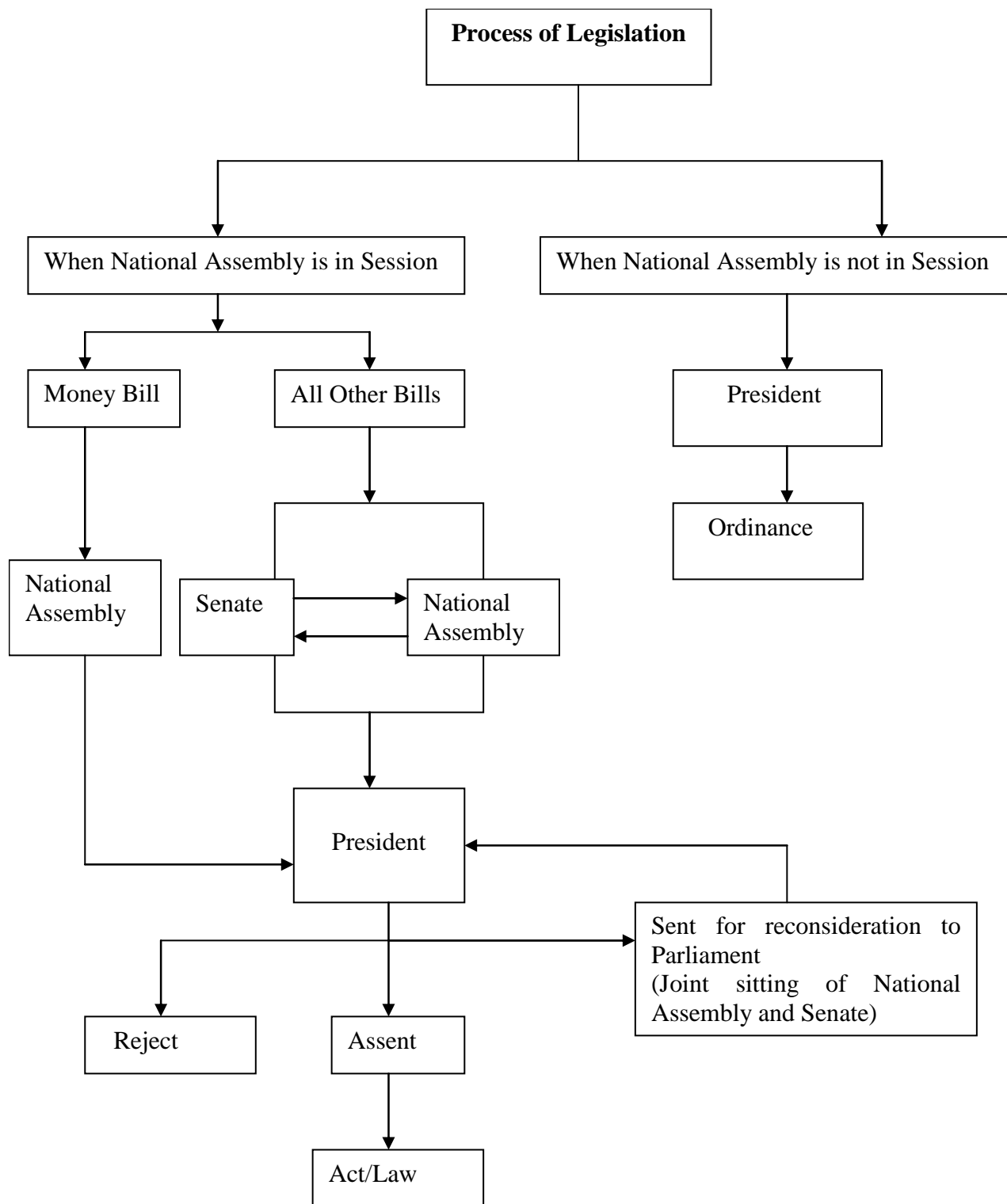
Taxation Management—Explained

Taxation management is a strategy where by a person manages its business and other transactions/ activities in such a way so as to make maximum use of tax holidays, exemption, concession, rebates, tax credits, deductible allowances available under law and as a result is able to derive the benefit of minimizing his tax liability. To achieve this objective, clear understanding of respective laws and professional expertise of their application is of at most importance. Scope of taxation management is multi-dimension, while making choices among different opportunities available to a person, the tax factor among others also plays an important role. Taxation management covers a decision regarding available choice between an employment and self- employment or available choice of a business as sole proprietorship, partnership, private company or public company. It is professional strategy to plan tax affairs of a person. It is of significant importance in business management decision.

- Person includes a living person (natural) or artificial person (corporate person).
- Scope of Taxation Management ranges from incorporation of a business to mergers, amalgamation, winding up, liquidation, dissolution etc of business

Essentials of Taxation Management

- Understanding and application of updated laws particularly tax laws, rules and procedures
- Application/use of benefits such as Tax credits, rebates, exemptions, reductions etc available under the law.
- Maintenance of Records/Books of Accounts as per requirement of law
- Disclosure of true facts (no concealment) that is i-e; there should be no concealment with regard to furnishing of information or preparation of accounts / data.



BASIC FEATURES OF INCOME TAX**Background/ History****Income Tax Act of 1922:**

At the time of independence, this Act prevalent in undivided India was adopted by the Government of Pakistan as its Income Tax Law.

Income Tax Ordinance, 1979

First law on Income Tax was promulgated in Pakistan from 1st July, 1979.

Income Tax Ordinance, 2001

To update the tax laws and bring our law in accordance with international standards, this ordinance was promulgated on 13th September, 2001, which became effective from 1st July, 2002

IT rules 2002

These were promulgated by CBR on 1st July 2002 in exercise of powers granted under section 237 of the Ordinance.

- Rules are integral part of the main enactment / Law.
- I.T Ordinance 1979 stands repealed vide section 238 of the Ordinance.
- The Ordinance overrules all other laws for the time being in force (Sec 3).
- Federal Government empowered to allow exemptions to certain types of income or specific persons during financial year but required to place the same before National Assembly at the end of that financial year Sec 53(3).
- CBR can issue administrative instructions explanations/circulars under the powers vested through Sec 206 and 213. However, CBR's instructions not binding on Tax Payers since these are administrative interpretation not judicial interpretation.

Sec 206 and sec 213 of the ordinance are reproduced below:

Section 206:

- (1) To achieve consistency in the administration of this Ordinance and to provide guidance to taxpayers and officers of the Central Board of Revenue, the Central Board of Revenue may issue Circulars setting out the Board's interpretation of this Ordinance.
- (2) A circular issued by the Central Board of Revenue shall be binding on all Income Tax Authorities and other persons employed in the execution of the Ordinance, under the control of the said Board other than Commissioners of Income Tax (Appeals).
- (3) A Circular shall not be binding on a taxpayer.

Section 213:

In the course of any proceedings under this Ordinance, the Commissioner or any taxation officer may be assisted, guided or instructed by any income tax authority to which he is subordinate or any other person authorized in this behalf by the Central Board of Revenue.

- Case Law is an important source of interpretation.
- Decisions and interpretation of Supreme Court are binding on all courts in Pakistan, according to Article 189 of constitution 1973.
- Decisions and interpretation of High courts are binding on subordinate courts/tribunals in the area of their jurisdictions.

Basic Features of Income Tax Ordinance 2001

Scheme of the Ordinance is given below:

- There are thirteen chapters
- Chapters are divided into:
 - Parts &
 - Divisions
- There are 240 Sections
- This ordinance comprises of seven Schedules
- Schedules are integral part of the Ordinance.

Rules of Interpretation or Construction of Statutes

Following aids / assistance are available that help in the interpretation of law / statute.

Internal Aids:

These are available in the Act:

- Explanation to the section
- Marginal notes
- Punctuation marks
- Preamble
- Title of a chapter
- Non-Obstinate clause
- Proviso
- Context

External Aids:

These are not available in the statute/ law but are available in the following instruments / sources.

- Dictionary
- Tax committee report
- Statement of objects appended to a finance bill
- Finance Minister's budget speech
- CBR's circulars
- Definitions in other statutes
- Departmental manuals

STATUTORY DEFINITIONS

Legal concepts and technical words are to be understood in the legal and technical perspective.

- Dictionary meanings can also be referred in the absence of statutory definition.
- In addition to words defined in Section 2, certain words are also defined in other sections.

Type of Definitions

Exclusive or Exhaustive Definition:

- It excludes ordinary dictionary meanings of the word. Exclusive definitions start with the expression ‘mean’ or ‘means’.

Examples of exclusive definitions are given below:

Sec. 2(2) Appellate Tribunal means the Appellate Tribunal established under section 130.

2(5A) “assessment year” means assessment year as defined in the repealed Ordinance;

2(6) “association of persons” means an association of persons as defined in section 80;

2(13) “Commissioner” means a person appointed as a Commissioner of Income Tax under section 208, and includes a taxation officer vested with all or any of the powers, and functions of the Commissioner;

2(15) “debt” means any amount owing, including accounts payable and the amounts owing under promissory notes, bills of exchange, debentures, securities, bonds or other financial instruments;

2(23) “fee for technical services” means any consideration, whether periodical or lump sum, for the rendering of any managerial, technical or consultancy services including the services of technical or other personnel, but does not include:

- (a) Consideration for services rendered in relation to a construction, assembly or like project undertaken by the recipient; or
- (b) Consideration which would be income of the recipient chargeable under the head “Salary”;

2(36) “non-profit organization” means any person, other than an individual, which is:

- (a) established for religious, educational, charitable, welfare or development purposes, or for the promotion of an amateur sport;
- (b) formed and registered under any law as a non-profit organization;
- (c) approved by the Commissioner for specified period, on an application made by such person in the prescribed form and manner, accompanied by the prescribed documents and, on requisition, such other documents as may be required by the Commissioner; and none of the assets of such person confers, or may confer, a private benefit to any other person;

Inclusive Definition:

Examples of inclusive definitions are given below:

It includes dictionary meanings as well as meanings conveyed by definition.

Sec. 2(9)—Business includes any trade, commerce, manufacture, profession, vocation or adventure or concern in the nature of trade, commerce, manufacture, profession, vocation, but doesn’t include employment.

(11A) “charitable purpose” includes relief of the poor, education, medical relief and the advancement of any other object of general public utility;

2(22) “employment” includes:

- a directorship or any other office involved in the management of a company;
- a position entitling the holder to a fixed or ascertainable remuneration; or
- the holding or acting in any public office;

2(19) “dividend” includes:

- (a) any distribution by a company of accumulated profits to its shareholders, whether capitalized or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets including money of the company;

- (b) any distribution by a company, to its shareholders of debentures, debenture-stock or deposit certificate in any form, whether with or without profit, to the extent to which the company possesses accumulated profits whether capitalized or not;
- (c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not;
- (d) any distribution by a company to its shareholders on the reduction of its capital, to the extent to which the company possesses accumulated profits, whether such accumulated profits have been capitalized or not; or
- (e) any payment by a private company or trust of any sum (whether as representing a part of the assets of the company or trust, or otherwise) by way of advance or loan to a shareholder or any payment by any such company or trust on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company or trust, in either case, possesses accumulated profits;

But does not include:

- (i) a distribution made in accordance with sub-clause (c) or (d) in respect of any share for full cash consideration, or redemption of debentures or debenture stock, where the holder of the share or debenture is not entitled in the event of liquidation to participate in the surplus assets;
- (ii) any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company; and
- (iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (c) to the extent to which it is so set off;

2(58) “share” in relation to a company, includes a modaraba certificate and the interest of a beneficiary in a trust (including units in a trust);

2(59) “shareholder” in relation to a company, includes a modaraba certificate holder, a unit holder of a unit trust and a beneficiary of a trust;

Exclusive as well as Inclusive Definition:

Such definitions contain both elements as enumerated above.

Examples of above type of definitions are given below:

Sec 2(7) ‘banking company means a banking company as defined in the banking companies ordinance, 1962 and includes any body corporate which transacts the business of banking in Pakistan.

2(41) “permanent establishment” in relation to a person, means a fixed place of business through which the business of the person is wholly or partly carried on, and includes:

- a) a place of management, branch, office, factory or workshop, premises for soliciting orders, warehouse, permanent sales exhibition or sales outlet, other than a liaison office except where the office engages in the negotiation of contracts (other than contracts of purchase);
- b) a mine, oil or gas well, quarry or any other place of extraction of natural resources;
- c) a building site, a construction, assembly or installation project or supervisory activities connected with such site or project but only where such site, project and its connected supervisory activities continue for a period or periods aggregating more than ninety days within any twelve-months period;
- d) the furnishing of services, including consultancy services, by any person through employees or other personnel engaged by the person for such purpose
- e) a person acting in Pakistan on behalf of the person (hereinafter referred to as the “agent”), other than an agent of independent status acting in the ordinary course of business as such, if the agent
- f) has and habitually exercises an authority to conclude contracts on behalf of the other person;
- g) has no such authority, but habitually maintains a stock-in-trade or other merchandise from which the agent regularly delivers goods or merchandise on behalf of the other person; or
- h) any substantial equipment installed, or other asset or property capable of activity giving rise to income.

Tax Year:

Sec. 2(68) read with Sec. 74---Tax year means a period of 12 months ending on June 30th which is also called Normal Tax Year.

Special Tax Year:

In case a person has a different accounting period from normal tax year or adopted such a period after seeking approval from commissioner under section 74(3) it is called special tax year.

Explanation—a tax year can be a period of less than 12 months under special circumstances for example discontinuance of business u/s 117.

Section 117 is reproduced below:

117. Notice of discontinued business

- (1) Any person discontinuing a business shall give the Commissioner a notice in writing to that effect within fifteen days of the discontinuance.
- (2) The person discontinuing a business shall, under the provisions of this Ordinance or on being required by the Commissioner by notice, in writing, furnish a return of income for the period commencing on the first day of the tax year in which the discontinuance occurred and ending on the date of discontinuance and this period shall be treated as a separate tax year for the purposes of this Ordinance.
- (3) Where no notice has been given under sub-section (1) but the Commissioner has reasonable grounds to believe that a business has discontinued or is likely to discontinue, the Commissioner may serve a notice on the person who has discontinued the business or is likely to discontinue the business to furnish to the Commissioner within the time specified in the notice a return of income for the period specified in the notice.
- (4) A return furnished under this section shall be treated for all purposes of this Ordinance as a return of income, including the application of Section 120.

Person—Sec. 2(42) read with section 80. Person includes:

- An individual
- A company or association of persons incorporated or formed in Pakistan or elsewhere; and
- The federal Government, a foreign government, a political sub division of foreign government, or public international organization

For the purpose of the above:

- “An association of persons”—includes a firm, a Hindu Undivided Family, any artificial juridical person and anybody of persons formed under a foreign law, but doesn’t include a company.
 - **“Company” means---**
 - A company as defined in companies ordinance, 1984
 - A small company as defined in sec. 2(59A)
 - A body corporate formed by or under any law in force in Pakistan;
 - A modarba
 - A body incorporated by or under the law of a country outside Pakistan, relating to incorporation of companies;
 - A trust, a cooperative society or a finance society
 - A foreign association whether incorporated or not, which the central board of revenue has, by general or special order, declared to be a company for the purpose of this ordinance;
 - A provincial govt.;
 - A local authority in Pakistan
 - c) **Firm** means the relation between persons who have agreed to share the profits of a business carried on by all or anyone of them acting for all;
 - d) **Trust** means an obligation annexed to the ownership of a property and arising out of the confidence reposed in and accepted by the owner, or declared and accepted by the owner for the benefit of another, or of another and the owner, and includes a “unit trust”; and
 - e) **“Unit trust”** means any trust under which beneficial interest are divided into units such that the entitlements of the beneficiaries to income or capital are determined by the number of units held.

IMPORTANT DEFINITIONS

Sec. 2(66) “Taxpayer” means any person who derives an amount chargeable to tax under this ordinance;

- Any representative of a person who derives an amount chargeable to tax under this ordinance
- Any person who is required to deduct or collect tax under part V of chapter X and chapter XII
- Any person required to furnish a return of income or pay tax under this ordinance.

Exercises on determination of Tax Year

Exercise 1: Determine Tax year relating to following accounting period:

A 1st July 2002 to 30th June 2003

B 1st July 2003 to 30th June 2004

C 1st July 2004 to 30th June 2005

Answers:

A— Tax year 2003

B— Tax year 2004

C— Tax year 2005

Exercise 2: Determine tax year pertaining to accounting periods given here under:

Sr	Classes of Tax Payers	Accounting Period
A	Mr. Aslam, a rice exporter	(i) 1st Jan 03 to 31st Dec 04 (ii) 1st Jan 05 to 31st Dec 05 (iii) 1st Jan 06 to 31st Dec 06
B	Mr. Kamal, a manufacturer of shawls.	(i) 1st April 02 to 31st Mar 03 (ii) 1st April 03 to 31st Mar 04 (iii) 1st April 04 to 31st Mar 05 (iv) 1st April 05 to 31st Mar 06
C	M/S XYZ, a company manufacturing sugar.	(i) 1st Oct 03 to 30th Sep 04 (ii) 1st Oct 04 to 30th Sep 05 (iii) 1st Oct 05 to 30th Sep 06
D	M/S ABC, Insurance Company.	(i) 1st Jan 02 to 31st Dec 02 (ii) 1st Jan 03 to 31st Dec 03 (iii) 1st Jan 04 to 31st Dec 04 (iv) 1st Jan 05 to 31st Dec 05

Answer E-2: The tax years in the above exercise are special tax year.

A (i) Special Tax year 2005

A (ii) Special Tax year 2006

A (iii) Special Tax year 2007

B (i) Special Tax year 2003

B (ii) Special Tax year 2004

B (iii) Special Tax year 2005

B (iv) Special Tax year 2006

C (i) Special Tax year 2005

C (ii) Special Tax year 2006

C (iii) Special Tax year 2007

D (i) Special Tax year 2003

- D (ii) Special Tax year 2004
- D (iii) Special Tax year 2005
- D (iv) Special Tax year 2006

Tax Year – Points to Remember

- Normal Tax Year starts from 1st July and ends on 30th June (a period of twelve months).
- A tax payer can adopt a special Tax year after seeking approval from Commissioner of Income Tax (CIT),
- Commissioner can withdraw the permission granted to adopt a special Tax year in respect of a tax payer, if in the opinion of CIT it is not feasible. But CIT must notify the tax payer the reasons in writing for withdrawal of permission granted to tax payer.
- A Tax Payer using special Tax year may revert to Normal Tax Year after seeking approval from Commissioner of Income Tax (CIT).

DETERMINATION OF LEGAL STATUS OF A PERSON

Exercise: Determine legal status of the following persons under the provisions of section 80 of the ordinance.

- i. ABC University, Karachi
- ii. XYZ Bank Limited
- iii. A joint family of Mr. H (a Hindu), Comprising Mr. H, his sons Mr. C & Mr. D
- iv. XYZ Modaraba
- v. XYZ Mills Ltd.
- vi. Federal Government
- vii. Government of Sind
- viii. Government of Punjab
- ix. ABC Trust
- x. KDs' an unregistered firm of K and D
- xi. Mr. A Serving as a Manager in a Textiles Company
- xii. Mr. Z, a Director in Private Company
- xiii. Mr. y, Running his Business as Sole Proprietor
- xiv. ABC Welfare Trust
- xv. Mr. A & B Joint Owners in Immovable Property
- xvi. XYZ Cooperative Housing Society

Answer to exercise on legal status:

- A (i) Company
- A (ii) Banking Company
- A (iii) Hindu Undivided Family
- A (iv) Company
- A (v) Public Company
- A (vi) person
- A (vii) Company
- A (viii) Company
- A (ix) Company
- A (x) Firm
- A (xi) Individual
- A (xii) Individual
- A (xiii) Individual
- A (xiv) Company
- A (xv) Association of persons
- A (xvi) Company

Tax on Income

- Income Tax is a tax on a person in respect of his income during a tax year
- Income of a tax year as computed under the provisions of this ordinance is Taxable Income, it is total income reduced by total of any deductible allowances. It is charged to tax in a tax year according to applicable rules.

'Income– Sec. 2 (29)

Income has been defined in section 2 (29) of the ordinance as under:

- (29) **“income”** includes any amount chargeable to tax under this Ordinance, any amount subject to collection or deduction of tax and any loss of income but does not include, in case of a shareholder of a company, the amount representing the face value of any bonus share or the amount of any bonus declared, issued or paid by the company to the shareholders with a view to increasing its paid up share capital;
- Any amount chargeable to tax under this ordinance
 - Any amount subject to deduction and collection under various sections of this ordinance.
 - Any loss of Income.

SCOPE OF INCOME/CONCEPT

- Receipt of Income may be
 - On Cash Basis as well as
 - In kind
- Deemed Income at Par with real income
- Cash Basis Vs Accrual Basis
- Illegal Income
- Lump Sum Receipts
- Tax-free income
- Income can not be taxed twice, if not expressly
- Mentioned otherwise
- Charge on Person
- Certain Incomes excluded from Taxable Income (exemptions).
- Lump Sum Receipts
- Tax-free income
- Income can not be taxed twice, if not expressly
- Mentioned otherwise
- Certain Incomes excluded from Taxable Income (exemptions)

MODULE 4**HEADS OF INCOME (Section 11)**

Following are the heads of income, ascertained in section 11

- Salary (Section 12)
- Income from Property (Section 15)
- Income from Business (Section 18)
- Capital Gains (Section 37)
- Income from other Sources (Section 39)

Total Income (Section 10)

Total income of a person for a tax year shall be the sum of the person's income under each of the heads of income.

Exempt Income

It has been laid down in Section 41 to 53, 102 & Second Schedule of the ordinance.

HEADS OF INCOME (SECTION 11)

Method of accounting (Section 32)

- Cash Basis or
- Accrual Basis
- For Companies ‘Accrual Basis’ method of accounting is compulsory [Section 32(2)]
- Change of Method of Accounting can be made under [Section 32(4)]

Rules to Prevent Double Derivation of Income and Double Deductions (Section 73)

Where:

- Any amount chargeable to tax on the basis that it is receivable, the amount shall not be charged that it is received;
- or
- Any amount is chargeable to tax on the basis that it is received the amount shall not be chargeable to tax again on the basis that it is receivable.

With regard to expenditure, where:

- Any expenditure is deductible on the basis that it is payable, the expenditure shall not be deductible again on the basis that it is paid;
- or
- Any expenditure is deductible on the basis that it is paid, the expenditure shall not be deductible again on the basis that it is payable.

Exemptions and Tax Concessions:

Section 41 to 53, section 102 and various clauses of second schedule to the ordinance deal with exemptions available to incomes or class of incomes or persons or class of persons specified therein shall be:

- a) Exempt from tax under this ordinance, subject to the conditions and to the extent specified therein;
- or
- b) Liable to tax at such rates, which are less than the rates specified in the First schedule? Or
- c) Allowed a reduction in tax liability, subject to the conditions and to the extent specified therein; or
- d) Exempt from the operation of any provisions of this Ordinance, subject to the conditions and to the extent specified therein;

Federal government has been empowered vide section 53 (2) and (3) to make amendments in the second schedule by:

- 1- Adding any clause or condition therein;
- 2 - Omitting any clause or condition therein;
- Or
- 3- Making any change in any clause or condition therein.

HEADS OF INCOME (SECTION 11)

Agricultural Income (Section 41) derived by a person shall be exempt from tax under this ordinance.

Agricultural income:

- (1) Agricultural income derived by a person shall be exempt from tax under this Ordinance.
- (2) In this section, “agricultural income” means,
 - (a) Any rent or revenue derived by a person from land which is situated in Pakistan and is used for agricultural purposes;
 - (b) Any income derived by a person from land situated in Pakistan from –
 - (i) Agriculture;
 - (ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by such person to render the produce raised or received by the person fit to be taken to market; or
 - (iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by such person, in respect of which no process has been performed other than a process of the nature described in sub-clause (ii); or
 - (c) Any income derived by a person from:
 - i) any building owned and occupied by the receiver of the rent or revenue of any land described in clause (a) or (b);
 - ii) any building occupied by the cultivator, or the receiver of rent-in-kind, of any land in respect of which, or the produce of which, any operation specified in sub clauses (ii) or (iii) of clause (b) is carried on, but only where the building is on, or in the immediate vicinity of the land and is a building which the receiver of the rent or revenue, or the cultivator, or the receiver of the rent-in-kind by reason of the person’s connection with the land, requires as a dwelling-house, a store-house, or other out-building.

Agricultural income means:

- Rent or Revenue derived by a person from land.
- Income derived from land situated in Pakistan.
- The land is used for agricultural purposes.

Following Incomes are held to be “Non-Agricultural Income”

- Income from spontaneous forest
- Income from sale of fruits and flowers growing on land naturally, spontaneously, and without the intervention of human agency
- Interest on arrears of rent payable in respect of agricultural land as it is neither “rent” nor “revenue” derived from land.
- Interest accrued on promissory notes obtained by a zamindar from defaulting tenants.
- Income from sale of wild grass and weeds of spontaneous growth
- Profit accruing from the purchase of standing crops and resale of it after harvest by a merchant having no interest in land except a mere licence to enter upon the land and gather upon the produce, land is not direct, immediate or effective source of income.
- Interest received by a money-lender in the form of agriculture produce.
- Income from sale of agricultural produce received by way of price for water supplied to land.
- Commission earned by the landlord for selling agricultural produce of his tenant.
- Dividend paid by a company out of its agriculture income.
- Income from fisheries
- Royalty income of mines
- Income received from land let out for storing crops
- Income from butter and cheese making
- Income from poultry farming
- Maintenance allowance charged on agricultural land.

Following Income are held to be “Agricultural Income”

- If denuded parts of the forest are replanted and subsequent operations in forestry is carried out the income arising from the sale of replanted trees.
- The fees collected from owners of cattle (normally used for agricultural purpose) for allowing them to graze on forest lands covered by jungle and grass grown spontaneously.
- Profit on sale of standing crops or the produce after harvest by a cultivating owner or tenant of land.
- Compensation received from an insurance company for danger caused by hailstorm or another natural calamity to crops or agricultural produce.
- Income from growing flowers and creepers.
- Share of profit of a partner from a firm engaged in agricultural operation (similarly salary received by him for services in agricultural operations as salary is only a mode of adjustment of the firm's income).
- Interest on capital received by a partner from a firm engaged in agricultural operation.

HEADS OF INCOME (SECTION 11)**Computation of Income which is partly Agricultural and Partly from Business OR where Agricultural Produce is used as raw material [rule 11]**

Where a person who is a cultivator or receiver of agricultural produce as rent-in-kind and who uses agricultural produce raised or received as raw material in a business the market value of the said produce shall be deducted as business expenditure. No further deduction is allowed in respect of any expenditure incurred by the Tax Payer as a cultivator or receiver of rent-in-kind. The word “Market Value” [sub-rule (3) of Rule 11] shall be:

- a) Where agricultural produce is ordinarily sold in the market in its raw state or after application of any process ordinarily employed by a cultivator or receiver of agricultural income as rent-in-kind to render it fit to be taken to market, the market price for the produce at the time it is used as raw material in the person’s business;
- OR
- b) In any other case, the sum of the following amounts, namely:
 - o the expenses of cultivation; and
 - o The land revenue rent paid for the area in which the produce is grown.

HEADS OF INCOME (SECTION 11)**Section 43 Foreign Government Officials**

Salary of an employee of foreign government exempt Provided:

- a. Employee citizen of foreign country and not a citizen of Pakistan.
- b. Services performed are similar to services performed by employees of the Federal Government in foreign countries and
- c. Foreign government also grants similar exemptions to employees of Federal Government.

Exemptions under International Agreements Section 44**44. Exemptions under international agreements**

- (1) Any Pakistan-source income which Pakistan is not permitted to tax under a tax treaty shall be exempt from tax under this Ordinance.
- (2) Any salary received by an individual (not being a citizen of Pakistan) shall be exempt from tax under this Ordinance to the extent provided for in an Aid Agreement between the Federal Government and a foreign government or public international organization, where:
 - (a) the individual is either not a resident individual or a resident individual solely by reason of the performance of services under the Aid Agreement;
 - (b) if the Aid Agreement is with a foreign country, the individual is a citizen of that country; and
 - (c) The salary is paid by the foreign government or public international organization out of funds or grants released as aid to Pakistan in pursuance of such Agreement.
- (3) Any income received by a person (not being a citizen of Pakistan) engaged as a contractor, consultant, or expert on a project in Pakistan shall be exempt from tax under this Ordinance to the extent provided for in a bilateral or multilateral technical assistance agreement between the Federal Government and a foreign government or public international organization, where:
 - (a) the project is financed out of grant funds in accordance with the agreement;
 - (b) the person is either a non-resident person or a resident person solely by reason of the performance of services under the agreement; and
 - (c) the income is paid out of the funds of the grant in pursuance of the agreement.

- **Exemptions under Tax Treaty**

- **Any salary received by an individual (not being a citizen of Pakistan) shall be exempt from Tax to the extent provided for in an Aid Agreement.**

Section 45 President's Honour

- (1) Any allowance attached to any Honour, Award, or Medal awarded to a person by the President of Pakistan shall be exempt from tax under this Ordinance.
- (2) Any monetary award granted to a person by the President of Pakistan shall be exempt from tax under this Ordinance.

Section 46 Profit on Debt

Any profit received by a non – resident person on a security issued by a resident person shall be exempt from tax Provided:

- Persons not associates
- Security widely issued by resident person outside Pakistan
- Profit on security was paid outside Pakistan
- Security approved by Central Board of Revenue (CBR)

Section 47 Scholarships

- Any scholarship granted to a person to meet the cost of person's education shall be exempt from tax.

Section 48 Support Payments under an Agreement to Live Apart

Any income received by a spouse as support payment under an agreement to live apart shall be exempt from tax under this Ordinance.

Section 49 Federal & Provincial Govt. and Local Authority Income

- Income of Federal Government exempt from tax
- Income of Provincial Government or a Local Authority in Pakistan shall be exempt under all heads of income other than income from Business, derived outside its jurisdictional area, that shall be taxable.
- Federal Government, a Provincial Government or a Local Authority shall not be liable to any collection or deduction of advance tax.

Section 50 Foreign-Source Income of Short-Term Resident Individuals

1. Subject to sub-section-2, the foreign-source income of an individual shall be exempt:
 - a. Who is a resident individual solely by reason of the individual's employment; and
 - b. Who is present in Pakistan for a period or periods not exceeding three years,
2. This section shall not apply to
 - a. Any income derived from a business of the person established in Pakistan; or
 - b. Any foreign-source income brought into or received in Pakistan by the person.

Section 51 Foreign-Source Income of Returning Expatriates

1. Any foreign-source income derived by a citizen of Pakistan in a tax year who was not a resident individual in any of the four tax years preceding the tax year in which the individual became a resident shall be exempt from tax under this Ordinance in the tax year in which the individual became a resident individual and in the following tax year.
2. Where a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during that tax year, any income chargeable under the head "Salary" earned by him outside Pakistan during that year shall be exempt from tax under the Ordinance.

Exemptions and tax Concessions in second Schedule Section 53

Income is exempt from income tax derived from voluntary contributions, to charitable or religious institutions. The exemption is conditional to:

- a. must be solely applied for the purposes of the objects of the institution
 - b. No benefit for private religious trust which do not ensure for public benefit.
- **Certain receipts of charitable institution [Clause (60), Part I of the Second Schedule]**
 - **Donation to certain institution [Clause (61), Part I of the Second Schedule]**
 "[Any] amount paid as donation to the following institution, foundations, societies, boards, trusts and funds, namely:
 - i) Any Sports Board or Institution recognized by the Federal Government for the purposes of promoting, controlling or regulating any sport or game;
 - ii) Fund for Promotion of Science and Technology in Pakistan
 - iii) Fund for Retarded and Handicapped Children; Proviso, Individual 30,Co.15p.c

Donation to the President's Relief Fund for Earthquake Victims 2005 [Clause (63A),]

"Any amount paid as donation to the President's Relief Fund for Earthquake Victims 2005."

Foreign Currency Accounts [Clause (80), Part I of the Second Schedule]

"Any income derived from a private foreign currency account held with an authorized bank in Pakistan, [or certificates of investment issued by Investment Banks,] in accordance with the Foreign Currency Accounts Scheme introduced by the State Bank of Pakistan, by a resident individual who is a citizen of Pakistan.

Provided that the exemption under this clause shall not be available in respect of any incremental deposits made in the said accounts on the after the 16th day of December, 1999, or in respect of any accounts opened under the said scheme on or after the said date."

HEADS OF INCOME (SECTION 11)**Exemptions and Tax Concessions**

- Foreign Currency Bearer Certificates] (81A)
- Profits on Special US Dollar Bonds, 1998 rules [Clause (82), Part I of Second Schedule].
- Income of Text-Book Boards [Clause (91), Part I of the Second Schedule]
- Income of certain educational institutions [Clause (92), Part I of the Second Schedule] “income of any university or other educational institution established solely for educational purposes and not for purposes of profit”
- Income of Sports Boards [Clause (98), Part 1 of the Second Schedule] “Any income derived by any Board or other organization established in Pakistan for the purposes of controlling, regulating or encouraging major games and sports recognized by Government.”
- Mutual Funds [Clause (99), Part 1 of the Second Schedule]
- Encashment of Special US Dollar Bond [Clause (135), Part 1 of the Second Schedule] “Any amount received on encashment of Special US Dollar Bond issued under the Special US Dollar Bonds Rules, 1998.”

Medical Expenditure by individuals, [Clause (139), Part 1 of the Second Schedule]

“(a) benefit represented by free provision to the employee of medical treatment or hospitalization or both by an employer or the reimbursement received by the employee of the medical charges or hospital charges or both paid by him, where such provision or reimbursement is in accordance with the terms of employment:

Provided that National Tax Number of the hospital or clinic, as the case may be, is given and the employer also certifies and attests the medical or hospital bills to which this clause applies;

any medical allowance received by an employee not exceeding ten per cent of the basic salary of the employee if free medical treatment or hospitalization or reimbursement of medical or hospitalization charges is not provided for in the terms of employment;

or

Provided that the receipts of such expenditure bearing name, National Tax Number and complete address of the medical practitioners are furnished along with his return of income.

Exemptions from Total Income under Second Schedule-- Part 1:

- Allowance and perquisites of Govt. employees posted abroad
- Salary of foreign employees of British Council
- Pension Clause (9):

Pension of Federal, Provincial Govt. & Armed Forces employees & Families

- Commutation of pension Clause (12)
- Perquisites to President, Governors and Chiefs of Staff-Residence (51)
- Perquisites of Governors, Chiefs of Staff and Corps Commanders-Conveyance and Entertainment (52)
- Perquisites of Federal Ministers
- Perquisites of Judges (56)
- Allowances and privileges of Judges
- Income of Sports Boards (61)

Reduction in Tax Rates under Second Schedule Part 2

- Profit on Special US Dollar Bonds or out of new account opened after December 16, 1999. At the Rate of 10 percent of amount of profit by Resident Person
- Presumptive tax for business of shipping of resident persons

Reduction in Tax Liability under Second Schedule Part 3

- Any amount received as flying allowance by pilots etc. and junior commissioned officers or other ranks shall be taxed @2.5% as separate block.
- Senior citizen-age 60 years & above where taxable income not exceeding Rs.400,000/- tax liability reduced by 50%.

RESIDENTIAL STATUS & TAXATION**Residential Status**

- Determination of residential status of a person is an important concept.
- Significance of residential status in computing total income and tax liability
- Residential status has always nexus to a tax year.

Resident Person (Section 81)

- a. Resident Individual, Resident Company, or Resident Association of Persons for the year or
- b. The Federal Government

Non-Resident Person (Section 81) (2)

- A person shall be non-resident person for a tax year if the person is not a resident person for a tax year.

Resident Individual (Section 82)

- An individual shall be a resident individual for a tax year if the individual-
- is present in Pakistan for a period of, or periods amounting in aggregate to, one hundred and [eighty-three] days or more in the tax year; or
- is an employee or official of the Federal Government or a Provincial Government posted abroad in the tax year.

Resident Association of Persons Sec. 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.

RESIDENTIAL STATUS & TAXATION**Residential Status and Taxation Rules Governing Resident Individual:**

- A day of leave including sick leave
- A day that individual's activity is stopped because of strike etc
- A holiday spent in Pakistan

Rules Governing Resident Individual

- Part of day shall be counted as a whole day, for example day of arrival or day of departure
- Following days shall be counted as whole day:
- A Public Holiday

Residential Status of “Association of Person”

Under the law a Firm, HUF, etc. are placed under the head AOP.

Control and management of affairs of AOP is situated wholly or partly in Pakistan.

Theory of Control and Management

- If Control and Management of affairs of a company lies in Pakistan, it is Resident Company, even if not incorporated in Pakistan.
- Control & Management refers to management of vital affairs/Policy Making Decisions of the company.

RESIDENTIAL STATUS & TAXATION**Scope of Total Income of a Resident Person Section 11 (5)****Resident Person Changeable to tax on:**

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.

Pakistan Source Income & Foreign Source Income Sec.11 (5) whereas, non-resident person charged only on Pakistan Source Income Sec.11 (6)

Important Points Regarding Income:

- Receipt ---- Remittance
- Cash & Kind
- Receipt & Accrual
- Actual Receipt & Constructive Receipt

Geographical Source of Income-Sec101 Pakistan-Source Income:

- 1) Salary shall be Pakistan-source income to the extent to which the salary-
 - Is received from any employment exercised in Pakistan, wherever paid; or
 - Is paid by, or on behalf of, the Federal Government, a Provincial Government, or a local authority in Pakistan, wherever the employment is exercised
- 2) Business income of a resident person shall be Pakistan-source income to the extent to which the income is derived from any business carried on in Pakistan.
- 3) Business income of a non- resident person shall be Pakistan- source income to the extent to which it is directly or indirectly attributable to-
 - A permanent establishment of the non-resident person in Pakistan;
 - Sales in Pakistan of goods or merchandise of the same or similar kind as those sold by the person through a permanent establishment in Pakistan
 - Other business activities carried on in Pakistan of the same or similar kind as those effected by the non-resident through a permanent establishment in Pakistan (or)
 - Any business connection in Pakistan
- 4) Where the business of a non-resident person comprises the rendering of independent services (including professional services and the services of entertainers and sports persons), the Pakistan-source business income of the person shall include [in addition to any amounts treated as Pakistan-source income under sub-section (3)] any remuneration derived by the person where the remuneration is paid by a resident person or borne by a permanent establishment in Pakistan of a non-resident person.
- 5) Any gain from the disposal of any asset or property used in deriving any business income referred to in sub-section (2), (3) or (4) shall be Pakistan-source income.
- 6) A dividend shall be Pakistan-source income if it is paid by a resident company.
- 7) Profit on debt shall be Pakistan-source income if it is-
 - (1) Paid by a resident person, except where the profit is payable in respect of any debt used for the purposes of a business carried on by the resident outside Pakistan through a permanent establishment; or
 - (2) Borne by a permanent establishment in Pakistan of a non-resident person.

RESIDENTIAL STATUS & TAXATION**Geographical Source of Income Sec. 101 Pakistan Source Income:**

- 8) A royalty shall be Pakistan-source income if it is:
- Paid by resident person, except where the royalty is payable in respect of any right, property, or information used, or services utilized for the purposes of a business carried on by the resident outside Pakistan through a permanent establishment; or
 - Borne by a permanent establishment in Pakistan of a non-resident person
- 9) Rental income shall be Pakistan-source income if it is derived from the lease of immovable property in Pakistan whether improved or not, or from any other interest in or over immovable property, including a right to explore for, or exploit, natural resources in Pakistan.
- 10) Any gain from the alienation of any property or right referred to in sub-section (9) or from the alienation of any share in a company the assets of which consist wholly or principally, directly or indirectly, or property or rights referred to in sub-section (9) shall be Pakistan-source income.
- 11) A pension or annuity shall be Pakistan-source income if it is paid by a resident or borne by a permanent establishment in Pakistan of a non-resident person.
- 12) A technical fee shall be Pakistan-source income if it is- Paid by a resident person, except where the fee is payable in respect services utilized in a business carried on by the resident outside Pakistan through a permanent establishment; or Borne by a permanent establishment in Pakistan of a non-resident person
- 13) Any gain arising on the disposal of shares in a resident company shall be Pakistan- source income.
- 14) Any amount not mentioned in the preceding sub-sections shall be Pakistan-source income if it is paid by a resident person or borne by a permanent establishment in Pakistan of a non-resident person.
- 15) Where an amount may be dealt with under sub-section (3) and under another sub-section (other than sub-section (14)), this section shall apply:
- By first determining whether the amount is Pakistan-source income under that other sub-section; and
 - If the amount is not Pakistan-source income under that sub-section, then determining whether it is Pakistan-source income under sub-section (3).
- 16) An amount shall be foreign-source income to the extent to which it is not Pakistan-source income.

Permanent Establishment—Defined Sec. 2(41)

Permanent establishment in relation to a person, means a fixed place of business through which the business of the person is wholly or partly carried on, and includes-

- a) a place of management, branch office, factory or workshop, premises for soliciting orders, ware house, permanent sales exhibitions or sales outlet, other than a liaison office except where the office engages in the negotiation of contracts (other than contracts of purchase);
- b) a mine, oil or gas well, quarry or any other place of extraction of natural resources;
- c) A building site, a construction, assembly or installation project or supervisory activities connected with such site or project but only where such sites, project and its concerned supervisory activates continue for period or periods aggregating more than ninety days within any twelve-months period;
- d) The furnishing of services, including consultancy services, by any person through employees or other personal engaged by the person for such purpose;
- e) a person acting in Pakistan on behalf of (hereinafter referred to as agent), other than an agent of independent status acting in the ordinary course of business as such, if the agent:
 - i. Has and habitually exercises an authority to conclude contracts on behalf of the other person.
 - ii. Has no such authority, but habitually maintains a stock in trade or other merchandise from which the agent regularly delivers good or merchandise on behalf of other person
- f) Any substantial equipment installed, or other asset and property capable of activity giving rise to income.

Royalty Defined Sec. 2 (54)

Royalty means any amount paid or payable however described or computed, whether periodical or lump sum, as a consideration for:

- a) The use of, or right to use any patent, invention, design or model, secret formula or process, trade mark or other like property or right;
- b) The use of, or right to use any copy right of a literary, artistic or scientific work, including films or video tapes for use in connection with television or tapes in connection with radio broadcasting, but shall not include consideration for the sale, distribution or exhibition of cinematograph films.
- c) the receipt of, or right to receive, any visual images or sounds or both, transmitted by satellite, cable, optic fiber or similar technology in connection with television, radio or internet broadcasting;
- d) the supply of any technical, industrial, commercial or scientific knowledge, experience or skill;
- e) the use of or right to use any industrial, commercial or scientific equipment;
- f) The supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as mentioned in sub-clause (a) through (e)
- g) The disposal of any property or right referred to in (sub-clause) (a) through (e).

RESIDENTIAL STATUS & TAXATION

Taxation of Foreign-Source Income of Residents:

Foreign Source Salary of Resident Individuals Sec. 102

- (1) Any foreign-source salary received by a resident individual shall be exempt from tax if the individual has paid foreign income tax in respect of the salary.
- (2) A resident individual shall be treated as having paid foreign income tax in respect of foreign-source salary if tax has been withheld from the salary by the individual's employer and paid to the revenue authority of the foreign country in which the employment was exercised.
 - Foreign losses Sec.104: Deductible expenditures incurred by a person in deriving foreign-source income chargeable to tax under a head of income shall be deductible only against that income.

Taxation of Non-Residents

Taxation of a permanent establishment in Pakistan of a non-resident person Sec. 105:

- (1) The following principles shall apply in determining the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head "Income from Business", namely:
 - The profit of the permanent establishment shall be computed on the basis that it is a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the non-resident person of which it is a permanent establishment;

Taxation of Non-Residents-Deductions

- Subject to this Ordinance, there shall be allowed as deductions any expenses incurred for the purposes of the business activities of the permanent establishment including executive and administrative expenses so incurred, whether in Pakistan or elsewhere;
- No deduction shall be allowed for amounts paid or payable by the permanent establishment to its head office or to another permanent establishment of the non-resident person (other than towards reimbursement of actual expenses incurred by the non-resident person to third parties) by way of:
- Royalties, fees or other similar payments for the use of any tangible or intangible asset by the permanent establishment
 - Compensation for any services including management services performed for the permanent establishment; or
 - Profit on debt on moneys lent to the permanent establishment, except in connection with a banking business; and

Taxation of Non-Residents Deductions

- Compensation for any services including management services performed by the permanent establishment; or
- Profit on debt on moneys lent by the permanent establishment, except in connection with a banking business.
- No account shall be taken in the determination of the income of a permanent establishment of amounts charged by the permanent establishment to the head office or to another permanent establishment of the non-resident person (other than towards reimbursement of actual expenses incurred by the permanent establishment to third parties) by way of:
- Royalties, fee or other similar payments for the use of any tangible or intangible asset;
- (2) No deduction shall be allowed in computing the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head "income from Business" for a tax year for head office expenditure in excess of the amount as bears to the turnover of the permanent establishment in Pakistan the same proportion as the non-resident's total head office expenditure bears to its worldwide turnover.

- (3) In this section: head office expenditure: means any executive or general administration expenditure incurred by the non-resident person outside Pakistan for the purposes of the business of the Pakistan permanent establishment of the person, including
- (4) No deduction shall be allowed in computing the income of a permanent establishment in Pakistan of a non-resident person chargeable under the head “Income from Business” for-
- Any profit paid or payable by the non-resident person on debt to finance the operations of the permanent establishment; or
 - Any insurance premium paid or payable by the non-resident person in respect of such debt.
 - Any rent, local rates and taxes excluding any foreign income tax, current repairs, or insurance against risks of damage or destruction outside Pakistan;
 - Any salary paid to an employee employed by the head office outside Pakistan;
 - Any traveling expenditures of such employee; and
 - Any other expenditure which may be prescribed.

EXERCISES ON RESIDENTIAL STATUS & TAXATION

Exercises on Determination of Income of Resident Person and Non- Resident Person

Exercise 1:

Determine Gross total income of Mr. A in the light of following particulars information pertaining to tax year 2006.

Mr. A, employed in Pakistan, received Rs. 400,000/ as Salary. His income from other sources is given under:

- a. Dividends received in Tokyo on 20th Aug 2005 from a Pakistani resident company: amounting Rs. 10,000;
- b. Share of profit received in Tokyo on 10th May, 2006 from a business situated in Kuwait but controlled through PE in Pakistan: amounting Rs. 60,000;
- c. Remittance from Tokyo on March 10, 2006 out of past profits earned and received there amounting Rs.600,000;
- d. Profit on debt received and earned in Pakistan on 1st Aug, 2006 Rs. 50,000. Calculate his gross total income, if he is
 - a. Resident
 - and
 - b. Non-Resident.

Solution to Exercise 1:

Computation of Gross total income of Mr. A for tax year 2006

Particulars	Gross total income if resident	Gross total income if non-resident
Dividend received	10,000	10,000
Share of profit received through PE of non-resident	60,000	Nil
Remittance out of past profit (Note1)	Nil	Nil
Profit on debt (Note2)	Nil	Nil
Total	70,000	10,000

Note 1:

Since remittance is not income, hence it is not included.

Note 2:

Profit on debt received on 1st Aug, 2006, the said date does not pertain to tax year 2006 hence this amount shall not be added towards taxable income for tax year 2006.

Exercise 2 Determine Gross total income of Mr. Z in the light of following particulars information pertaining to tax year 2006.

Royalty earned in Pakistan but received on April 01, 2006 in Sydney: Rs. 140,000; dividend from a foreign company received in London on May 10, 2006: Rs.150,000; share of profit of business situated in Sydney, received in Paris on Aug 14, 2005 but from PE in Pakistan: Rs. 250,000; and rent for tax year 2006 of a house property situated in Sydney and received there on 01-01-2006: Rs.1,000,000.

- a) if Z is resident
- b) if Z is non-resident

Solution to Exercise 2:

Particulars	Gross total income if resident	Gross total income if non-resident
a. Royalty	140,000	140,000
b. Dividend	150,000	Nil
c. Share of profit from PE in Pakistan	250,000	250,000
d. Rent for tax year 2006 Rs. 1,000,000 – 200,000 (Allowance for Repairs being 1/5 th of total rent subtracted)	800,000	Nil
Total	1,340,000	390,000

MODULE 5**LESSON 5.20****EXERCISES ON RESIDENTIAL STATUS & TAXATION**

Exercise 3: Determine Gross total income of Mr. A in the light of following particulars information pertaining to tax year 2006.

Interest on Australian Bonds (one-third is received in Pakistan)	24,000
Income from agriculture in Australia, received there but later on remitted to Pakistan	50,000
Income from property in London received outside Pakistan	20,000
Income earned from business in London which is controlled through a PE in Pakistan (Rs.10,000 is received in Pakistan)	30,000
Profit on sale of an asset in Pakistan but received in Sydney	5,000
Pension from Pakistan Government but received in Sydney	20,000

Find out gross total income of A, if he is: (i) resident in Pakistan and (ii) non-resident

Solution to Exercise 3:**Computation of Gross total income of Mr. A for tax year 2006**

Particulars	Gross total income if resident	Gross total income if non-resident
a. Interest on bonds...	24,000	Nil
b. Agriculture Income in Australia	50,000	Nil
c. income from property...	20,000	Nil
d. income from business...	30,000	30,000
e. Profit on sale of asset...	5000	5000
f. Pension from Government of Pakistan in Sydney..	20,000	20,000
Total	149,000	55,000

Exercise 4: Determine Gross total income of Mr. A in the light of following particulars information pertaining to tax year 2006.

a. Profit on sale of plot at Sydney (One-half received in Pakistan)	250,000
b. Profit on sale of plot at Tokyo (One-half received in London)	150,000
c. Salary from a Pakistani company received in London. (One-half is paid for rendering service in Pakistan)	350,000
d. Interest on Australian Bonds (entire amount received in London)	100,000
e. Income from property in Tokyo received there.	400,000
f. Agricultural income in USA received in London but later on remitted to Pakistan.	100,000

Solution to Exercise 4:**Computation of Gross Total Income of Mr. A for tax year 2006**

Particulars	Gross total income if resident	Gross total income if non-resident
a. Sale of plot....	250,000	Nil
b. Sale of plot....	150,000	Nil
c. Salary from Pakistani company...	350,000	175,000
d. Interest on Australian bond	140,000	Nil
e. Income from property in Tokyo Rs 400,000 – 80,000	320,000	Nil

(1/5 th Subtracted as allowance for repairs For tax year 2006)		
f. Agricultural income in USA....	100,000	Nil
Total	1,310,000	175,000

SALARY AND ITS COMPUTATION

There are followings heads of income, we start from the first head that is salary i.e. Income from Salary.

- Salary
- Income from Property
- Income from Business
- Capital Gains
- Income from other sources

Employer and Employee Relationship between Payer and Payee

- **Salary** represents amount received by an employee from an employment.
- **Employee sec 2(20)**: means any individual engaged in employment.
- **Employer sec 2(21)**: means any person who engages and remunerates an employee.

Employment Sec. 2(22)**Employment includes:**

- A directorship or any other office involved in the management of a company;
- A position entitling the holder to fixed or ascertainable remuneration; or
- Holding or acting in any public office

Significant Points:

Salary from more than one source during a tax year is taxable income.

- Salary may be from former employer, present employer or prospective employer.
- Salary may be from former employer, present employer or prospective employer.
- No deductions are allowed under the head “Income from Salary”
- In case of Tax Free Salary by the employer, the amount of tax paid by employer shall be added back to employee’s salary. It tantamount to Tax on Tax
- Voluntary Payments Taxable
- Tax year of a salaried Person shall be Normal Tax year
- In case of Tax Free Salary by the employer, the amount of tax paid by employer shall be added back to employee’s salary. It tantamount to Tax on Tax
- Voluntary Payments Taxable
- Tax year of a salaried Person shall be Normal Tax year
- Tax on salary income for Tax year 2007 (1st July 2006 to 30th July 2007) shall be computed according to amendments as made by Finance Act, 2006.
- Salary by members of AOP is not treated as Salary but treated as appropriation of profit and charged under the head “Income from Business”

Treatment of Salary by members of AOP:

Any salary drawn by a member of an AOP [as defined in section 80] is appropriation of profits and is chargeable to tax as ‘Income from Business’ being share of a member in the total income of AOP in view of provision contained in section 93(6).

Taxation of members of an associations of persons Section 93(6)

- Sec 93 (6) the share of a member in the total income of a association of persons shall be determined according to the member’s interest in the association and shall include any profit on debt, brokerage, commission, salary or other remuneration received or due from the association.
- Salary sec 12(1): any salary received by an employee in a tax year, other than salary that is exempt from tax under this Ordinance, shall be chargeable to tax in that year under the head “Salary”.

SALARY AND ITS COMPUTATION**Salary as defined in Section 12(2)**

- “Salary means any amount received by an employee from any employment, whether of a revenue or capital nature, including-
Any pay, wages or other remuneration provided to an employee, including leave pay, payment in lieu of leave, overtime payment, bonus, commission, fees, gratuity or work condition supplements (such as for unpleasant or dangerous working conditions)
- Any perquisite, whether convertible to money or not;
- The amount of any allowance provided by an employer to an employee including a cost of living, subsistence, rent, utilities, education entertainment or travel allowance, but shall not include any allowance solely expended in the performance of the employee’s duties of employment;
 - As consideration for a person’s agreement to enter into an employment relationship;
 - As consideration for an employee’s agreement to any conditions of employment or any changes to the employee’s conditions of employments;

On termination of employment, whether paid voluntarily or under an agreement, including any compensation for loss of employment and golden handshake payments;

From a provident or other fund, to the extent to which the amount is not a repayment of contributions made by the employee to the fund in respect of which the employee was not entitled to a deduction; and --as consideration for an employee’s agreement to a restrictive covenant in respect of any past, present or prospective employment;

- Any pension or annuity, or any supplement to a pension or annuity; and
- Any amount chargeable to tax as “Salary” under section 14.”— (Employee Share Schemes)

Sec. 13 Value of Perquisites:

Sub Sec (1) for the purpose of computing the income of an employee for a tax year, chargeable to tax under the head “salary”, the value of any perquisite provided by an employer to the employee in that year that is included in the employee’s salary under section 12 shall be determined in accordance with this section.

Sub Sec. (2) this section shall not apply to any amount referred to in clause (c) or (d) of sub section 12.

Sub Sec.(3) Where, in a tax year, a motor vehicle is provided by employer to an employee wholly or partly for the private use of the employee the amount chargeable to tax to the employee under the head “Salary” for that year shall include an amount computed as may be prescribed.

Sub Sec.(5) Where, in a tax year, the services of a housekeeper, driver, gardener or other domestic assistant provided by an employer to an employee, the amount chargeable to tax to the employee under the head “ salary” for that year shall include the total salary paid to [such housekeeper, driver, gardener or other domestic assistant] in that year for services rendered to the employee, as reduced by any payment made by the employee [to the employer] for such services.

Sub Sec. (6) where, in a tax year, utilities are provided by an employer to an employee, the amount chargeable to tax to the employee under the head “Salary” for that year shall include the fair market value of the utilities provided, as reduced by any payment made by the employee for the utilities.

Sub Sec. (7) Where a loan is made, on or after the 1st day of July, 2002, by an employer to an employee and either no profit on loan is payable by the employee or the rate of profit on loan is less than benchmark rate, the amount chargeable to tax to the employee under the head “Salary” for a tax year shall include an amount equal to-

Sub Sec. 7(a) the profit on loan computed at the benchmark rate, where no profit on loan is payable by the employee, or

(b) the difference between the amount of profit on loan paid by the employee in that tax year and the amount of profit on loan computed at the benchmark rate, as the case may be.

Sub Sec. (8) For the purpose of the Ordinance not including sub-section (7), where the employee uses a loan refer to in sub Sec. (7) wholly or partly for acquisition of any asset or property producing income chargeable to tax under any head of income, the employee shall be treated as having paid an amount as profit equal to the bench mark rate on the loan or that part of the loan used to acquire any asset or property

Sub Sec. (9) where, in a tax year, an obligation of an employee to pay or repay an amount owing by the employee to the employer is waived by the employer that shall be included under the head Salary.

Sub Sec. (10) where, in a tax year an obligation of an employee to repay an amount owing by the employee to an other person is paid by the employer that amount shall be included in salary income

Sub Sec. (11) where in a tax year property is transferred or services are provided by an employer to an employee the fair market value of the property or services determined at the time the property is transferred or services are provided shall be included in salary income for the year, as reduced by any payment made by the employee for the property or services.

Sub Sec. (12) where, in the tax year, accommodation or housing is provided by an employer to an employee, the amount chargeable to tax to the employee under the head “salary” for that year shall included an amount computed as may be prescribed.

Sub Sec. (13) where, in a tax year an employer has provided an employee with a perquisites which is not covered by sub section (3) through (12), the amount chargeable to tax to the employee under the head “salary” for that year shall include the fair market value of the perquisites except where the rules, if any, provide otherwise, determined at the time it is provided, as reduced by any payment made by the employee for the perquisites.

Sub Sec. (14) in this section

“Benchmark rate” means:

- For the tax year commencing on the first day of July 2002, a rate of 5% per annum; and
- For the tax year next following the tax year refer to in sub clause (i), the rate for each successive year taken as 1% above the rate applicable for the immediately preceding tax year but not exceeding such rate, if any, as the federal Govt., may , by notification, specified in respect of any tax year.
- “Services” includes the provision of any facility; and
- “Utilities” includes electricity, gas, water, and telephone.

Employee Share Schemes sec 14:

- The value of a right or option to acquire share under this scheme shall be not chargeable to tax.
- Where shares issued are subject to a restriction on transfer of the shares-
 - a) no amount shall be chargeable to tax under the head Salary until the earlier of-
 - i. the time the employee has a free right to transfer the shares; or
 - ii. the time the employee disposes of the shares &
 - b) the amount chargeable to tax to the employee shall be fair market value of shares at the time employee has free right to transfer as reduced be any amount given as consideration for the grant of a right or option to acquire the shares.
- Where in a tax year an employee disposes of a right or option to acquire shares under an employee share scheme, the amount chargeable to tax shall include the amount of any gain made on the disposal computed accordance with the following formula:

$$A-B$$
- Where A is the consideration received from the disposal of the right or option.
- B is the employee’s cost in respect of the right or option.

SALARY AND ITS COMPUTATION

Significant points regarding Salary:

Reimbursement of expenditure by the employer	Taxable
Profits in lieu of salary received as: <ul style="list-style-type: none"> • Consideration for a person’s agreement to enter into an employment relationship • On termination of employment/ Golden handshake payments 	Taxable
Provident fund payments, only Employers contribution	Taxable
Computation of value of perquisites (Sec 13)	
Motor vehicle	As prescribed in IT rules 2002
Services of house keeper, driver, gardener, other domestic servant	Amount provided by employer added back to employee’s salary.
Add FMV of utilities as reduced by any amount paid by employee	
Loan below benchmark rate for tax year 2007 is 9% PA	Add back
In case, Conessional loan as above used for construction of house or purchase of house	No Add back
Obligation of employee waived off by employer.	Add back
Any property transferred to employee.	FMV of property to be added back
Accommodation or housing provided.	As prescribed in IT rules 2002

According to sub section 14 of Section 13:

- Bench mark rate means rate of 5%PA
For tax year 2003 and increase by 1% for succeeding tax years.
- Services include any facility provided.
- Utilities include electricity, gas, water, and telephone.

Employee share schemes (sec 14)

Treatment of value of a right or option vested in an employee.

Formula:

$$A - B$$

❖ When Commissioner can tax "salary" on due basis:-

In certain cases, the Commissioner has been given powers to tax salary on due basis. Section 110 reads as under:

“Salary paid by Private Companies”:

where, in any tax year, salary is paid by a private company to an employee of the company for services rendered by the employee in an earlier tax year and the salary has not been included in the employee’s salary chargeable to tax in that earlier year, the Commissioner may, if there are reasonable grounds to believe that payment of the salary was deferred, include the amount in the employee’s income under the head “Salary” in the earlier year.

Leave Salary:

This is taxable whenever received or right to receive is exercised by the employee. Leave encashment on retirement falls in this category. The only exemption available is for the members of the Armed Forces of Pakistan, employees of the Federal Government and Provincial Governments.

Under clause (19), Part I of Second

Schedule to the Ordinance any sum representing encashment of leave preparatory to retirement in their case is exempt.

- Salary in lieu of notice: Taxable
- Fee and Commission: Taxable
- Bonus: Taxable
- Remuneration for extra duties: Taxable
- Voluntary payments to employees: Taxable

Flying Allowance

Any amount received as flying allowance by:

- a) pilots, flight engineers and navigators of Pakistan Armed forces, Pakistani Airline or Civil Aviation Authority; and
- b) Junior commissioned officers of Pakistan Armed Forces.
Shall be taxed @ 2.5% as a separate block of income

Deductible Allowance:

The person shall be entitled to a deductible allowance for any **Zakat** paid by the person in a tax year according to provisions of sec.60, for the amount of any **Workers' Welfare Fund** paid by the person in a tax year under Sec 60-A, for the amount of any **Workers' Participation Fund** paid by the person in a tax year under section 60-B.

SALARY AND ITS COMPUTATION**Tax credits on Charitable Donations (Sec 61)**

Tax credit allowed in respect of any sum paid or any property given by the person in a tax year as a donation to:

- Any board of education or any university of Pakistan established by, or under, Federal or a Provincial law;
- Any educational institution, hospital or relief fund established or run in Pakistan by federal government or a provincial government or a local authority or;
- Any non-profit organization
- ❖ The amount of tax credit shall be computed according to following formula:

$$(A/B) \times C$$

Here:

A is the amount of tax assessed to the person for the tax year before allowance of any tax credit under this part;

B is the person's taxable income for the tax year; and

C is the lesser of:

- The total amount of the person's donations referred to in sub-section (1) in the year, including the fair market value of any property given; or
- Where the person is-
 - i. an individual or association of person, thirty percent of the taxable income of the person for the year; or
 - ii. a company, fifteen percent of the taxable income of the person for the year.
- ❖ Fair market value of any property given as donation shall be determined at the time it is given.
- ❖ A cash amount paid by a person as donation shall be taken into account only if it was paid by a crossed cheque drawn on a bank.

Investment in shares: Sec 62:

- ❖ A person (other than a company) shall be entitled to a tax credit for a tax year in respect of the cost of acquiring in the year new shares offered by a public company listed on a stock exchange in Pakistan where the person is the original allottee of the shares or the shares are acquired from Privatization Commission of Pakistan.
- ❖ Formula:

It is same that is i.e. $(A/B) \times C$

A and B are the same as explained in Sec 61.

Here **C** is lesser of:

- The total cost of acquiring the shares referred to in sub-section (1) in the year;
- Ten percent of the person's (taxable) income for the year; or
- (Two hundred) thousand rupees
- ❖ If the person has availed tax credit in respect of purchase of share and has made a disposal of the said shares within 12 months of the date of acquisition. The amount of tax payable by the person for the tax year in which the share were disposed of shall be increased by the amount of credit allowed.

Profit on debt- Sec 64

A person shall be entitled to a tax credit for a tax year in respect of any profit or share in rent paid by a person in the year on a loan by a schedule bank or non-banking finance institution or advanced by government or the local authority or a statutory body or a public company listed on a registered stock exchange of Pakistan, where the person utilizes the loan for the construction of a new house or the acquisition of a house.

Formula for computation of Profit on debt:

$$(A/B) \times C$$

A and B are the same as explained in Sec 61

C is the lesser of:

- The total profit referred to in sub-section (1) paid by the person during the year;
- (Forty) percent of the person's (taxable) income for the year; or
- [Five hundred] thousand rupees

Income tax rules, 2002 regarding salary:

Effective from 01-07-2006 (Tax Year 2007)

• **Rule 3: valuation of perquisites, allowances and benefits:**

The benefits provided by the employer to the employee shall be included in the said income in accordance with rules 4 to 7.

• **Rule 4: valuation of accommodation:**

This shall be taken equal to the amount that would have been paid by the employer in case such an accommodation was not provided.

Provided that the value taken for this purpose shall, in any case, not be less than 45 percent of minimum of time scale or the basic salary where there is no time scale.

• **Rule 5: valuation of conveyance:**

- | | |
|---|--|
| (i) Partly for personal
and partly official use | 5% of:
a) the cost to the employer for
acquiring the vehicle or ,
b) the fair market value of
vehicle at commencement
of the lease, if taken on
lease. |
| (ii) Conveyance provided
for personal use only
employer for | 10% of:
a) the cost to the
acquiring the vehicle or
b) the fair market value
of vehicle at
commencement
of the lease, if taken
on lease. |

• **Rule 6**

For the purpose of this part, “employee” includes a director of a company.

• **Rule 7:**

These rules shall be applicable for the salary income received after thirtieth of June, 2006

Exemptions under the head ‘Salary’

- ❖ TA/DA exempt under clause 39 of part 1 of second schedule.
- ❖ Free furnished accommodation provided to the president of Pakistan, provincial governors, and Chiefs of Staff of Pakistan Armed Forces are exempt under clause 51.
- ❖ Free conveyance and entertainment allowances are fully exempt to the following:
 - Provincial Governors, the Chiefs of Staff of Pakistan Armed Forces, and Corps Commanders of Pakistan Armed Forces under clause 52

Exemptions:

- ❖ Amount received from workers participation fund is exempt under clause 26.
- ❖ Local traveling allowance to journalists is exempt under clause 40 of part-1 of second schedule.
- ❖ Tax rebate for teachers and the researchers.

Full time teacher or researcher employed in non profit education or research institution including government training and research institution duly recognized by HEC, a Board of education or a University recognized by HEC allowed tax rebate of **75%**.

SALARY AND ITS COMPUTATION**Investment in Shares (Sec. 62)**

Restricted to original allottee

$$A/B \times C$$

- A and B are same.
- C is lesser of:
 - Cost on acquiring shares
 - 10% of taxable income
 - Rs 200,000

Profit on Debt (Sec. 63)

Profit paid or shares in rent paid on loan for construction of new house or acquisition of a house.

If loan provided by:

- Schedule Bank
- Non-Banking Finance Institution
- Government or Local Authority
- Any Statutory Body
- Listed Public Company
 - A and B are same as above
 - C is lesser of:
 - Total amount paid during tax year
 - 40% of taxable income
 - Rs 500,000

Valuation of Perquisites**Valuation of Accommodation**

- Amount that would have been otherwise provided under terms of employment but in no case less than 45% of MTS or basic salary.

Valuation of Conveyance

Partly for personal and partly for official use.	5% of cost or 5% of FMV of Vehicle on commencement of lease.
For personal use only.	10% of cost or 10% of FMV of Vehicle.

Employee includes director of a company.**Exemptions:**

- Salary earned abroad by a Pakistani citizen in the year of leaving Pakistan- exempt vide section 51 (2)
- Exemptions available to Diplomatic personnel and their staff--- exempt vide section 42
- Salary received by foreign government officials – exempt vides section 43.
- Salary received by Foreigners working on certain projects- exempt vide section 44 (2)
- Any benevolent grant paid from the benevolent fund to the employees or members of their families- exempt under clause 24 of part 1 of 2nd schedule.
- Any special allowance or benefit (not being entertainment allowance or conveyance allowance) or other perquisites as contained in section 12 specially granted to meet expenses wholly or necessarily incurred in the performance of the duties of an office or employment of profit- exempt under clause 39 of part 1 of second schedule.

Concept of MTS (Minimum of Time Scale):

This is the starting point or minimum amount which is available to an employee under a time scale for example if time scale is:

Rs. 20,000 -- 2000 -- 30000

Here Rs 20,000 is the Minimum of time scale.

Rates of tax for salaried Individuals for tax year 2007

S #	Taxable Income	Rate of tax
-----	----------------	-------------

(1)	(2)	(3)
1.	Where the taxable income does not exceed Rs. 150,000	0%
2.	Where the taxable income exceeds Rs. 150,000 but does not exceed Rs. 200,000	0.25%
3.	Where the taxable income exceeds Rs. 200,000 but does not exceed Rs. 250,000	0.50%
4.	Where the taxable income exceeds Rs. 250,000 but does not exceed Rs. 300,000	0.75%
5.	Where the taxable income exceeds Rs. 300,000 but does not exceed Rs. 350,000	1.50%
6.	Where the taxable income exceeds Rs. 350,000 but does not exceed Rs. 400,000	2.50%
7.	Where the taxable income exceeds Rs. 400,000 but does not exceed Rs. 500,000	3.50%
8.	Where the taxable income exceeds Rs. 500,000 but does not exceed Rs. 600,000	4.50%
9.	Where the taxable income exceeds Rs. 600,000 but does not exceed Rs. 700,000	6.00%
10.	Where the taxable income exceeds Rs. 700,000 but does not exceed Rs. 850,000	7.50%
11.	Where the taxable income exceeds Rs. 850,000 but does not exceed Rs. 950,000	9.00%
12.	Where the taxable income exceeds Rs. 950,000 but does not exceed Rs. 1,050,000	10.00%
13.	Where the taxable income exceeds Rs. 1,050,000 but does not exceed Rs. 1,200,000	11.00%
14.	Where the taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,500,000	12.50%
15.	Where the taxable income exceeds Rs. 1,500,000 but does not exceed Rs. 1,700,000	14.00%
16.	Where the taxable income exceeds Rs. 1,700,000 but does not exceed Rs. 2,000,000	15.00%
17.	Where the taxable income exceeds Rs. 2,000,000 but does not exceed Rs. 3,150,000	16.00%
18.	Where the taxable income exceeds Rs. 3,150,000 but does not exceed Rs. 3,700,000	17.50%
19.	Where the taxable income exceeds Rs. 3,700,000 but does not exceed Rs. 4,450,000	18.50%
20.	Where the taxable income exceeds Rs. 4,450,000 but does not exceed Rs. 8,400,000	19.00%
21.	Where the taxable income exceeds Rs. 8,400,000	20.00%

Rate of Tax for salaried Individuals

Provided that where income of a woman tax payer is covered by this clause, no tax shall be charged if taxable income does not exceed Rs 200,000.

SALARY AND ITS COMPUTATION**Exercise 1**

Compute taxable income and tax thereon from following information/ data in respect of Mr. A an employee of XYZ Company for tax year 2007

- Basic salary from 1st Jan-06 to 31st Dec-06 Rs 30,000 per month

Solution to Exercise 1

Tax payer: Mr. A

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Basic salary	180,000	Nil	180,000
Total			180,000

Tax liability:

Tax rate of 0.25 percent shall apply as given at serial #2 for taxable income exceeding Rs150,000 up to Rs 200,000.

$$\begin{aligned} \text{Income tax payable} &= 180,000 \times 0.25\% \\ &= \text{Rs } 450 \end{aligned}$$

Note:

Income received by Mr. A during calendar year 2006 (that is 01-01-06 to 31-12-2006) is Rs 360,000 but during tax year 2007, the income of Mr. A is Rs 180,000 (since tax year 2007 covers the period from 01-07-06 to 30-06-07)

Exercise 2

Compute taxable income & tax thereon from following information/ data pertaining to tax year,2007 in respect of Mr. X an employee of a private Company.

- Salary Rs 40,000 per month
- Bonuses Rs 80,000 for tax yr.
- Utilities paid by employer Rs 40,000 for tax yr.

Solution to Exercise 2

Tax payer: Mr. X

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Basic salary	480,000	Nil	480,000
Bonuses	80,000	Nil	80,000
Utilities (Note 1)	40,000	Nil	40,000
Total			600,000

Tax liability:

Tax rate of 4.50% percent as given at serial #8 for taxable income exceeding Rs 500,000 up to Rs 600,000

Income tax payable:

$$600,000 \times 4.50\% = \text{Rs } 27,000$$

Note 1:

Utilities were exempt up to 10% of MTS or Basic salary till 30th June, 2006, vide clause 38 of part 1 of Second Schedule. This clause has been omitted by Finance Act, 2006. Hence no exemption is available for tax year 2007.

Exercise 3

Compute taxable income from following information/ data in respect of Mr. Y an employee of a private Company for tax year 2007.

- MTS of Mr. Y Rs20,000—2000—30,000
- Salary Rs 24,000 per month
- House allowance Rs 2000 per month

Solution to Exercise 3:

Tax payer: Mr. Y

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Basic salary	288,000	Nil	288,000
House Allowance	24,000	Nil	24,000
Utilities (Note 1)	36,000	Nil	36,000
Total			348,000

Tax liability:

Tax rate of 1.50% percent as given at serial #5 for taxable income exceeding Rs 300,000 up to Rs 350,000

Income tax payable:

$$348,000 \times 1.50\% = \text{Rs } 5,220$$

Note 1:

Utilities were exempt up to 10% of MTS or Basic salary till 30th June, 2006, vide clause 38 of part 1 of Second Schedule. This clause has been omitted by Finance Act, 2006. Hence no exemption is available for tax year 2007.

Exercise 4:

Compute taxable income from following information/ data in respect of Mr. A an employee of XYZ

Company for tax year 2006

- MTS of Mr. A Rs 30,000--5000--50,000
- Basic salary Rs 40,000 per month
- House Allowance Rs 120,000 p.a
- Tax Deducted at Source Rs 6,000

Solution to Exercise 4:

Tax payer: Mr. A

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

Particulars	Total income	Exempt Income	Taxable Income
Salary	480,000	Nil	480,000
House Allowance	120,000	Nil	120,000
Total			480,000

Tax liability:

Tax rate of 4.50% percent as given at serial #8 for taxable income exceeding Rs 500,000 up to Rs 600,000

Income tax payable:

$$600,000 \times 4.50\% = \text{Rs } 27,000$$

$$\text{Tax deducted at source} \quad \underline{\text{Rs } 6,000}$$

$$\text{Tax payable: } 27,000 - 6,000 = \text{Rs } 21,000$$

Exercise 5:

Compute taxable income and tax thereon in respect of Mr. Yasir (a salaried individual) for the tax year 2007 from the following information/ data:

- Basic salary Rs 20,000 pm
- House rent allowance Rs 5,000 pm
- Medical Allowance Rs 5,100 pm
- Free hospitalization services availed under terms of employment. Rs 40,000 pm
- Driver's salary paid by employer Rs 8,000 pm
- Dearness Allowance Rs 6,000 pm

Solution to Exercise 5:

Tax payer: Mr. Yasir

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Salary	240,000	Nil	240,000
House Allowance	60,000	Nil	60,000
Medical allowance	61,200	Nil	61,200 (N-1)

Hospitalization	40,000	40,000	Nil
Driver's Salary	96,000	Nil	96,000
Dearness Allowance	72,000	Nil	72,000
Total			529,200

Tax liability:

Tax rate of 4.50% percent as given at serial #8 for taxable income exceeding Rs 500,000 up to Rs 600,000

Income tax payable:

$$529,000 \times 4.50\% = \text{Rs } 23,814$$

Note:

Clause 139(a) & (b) of part 1 of second schedule:

- Free hospitalization services provided under the terms of employment are exempt.
- If (a) not available then 10% of basic salary is exempt in case medical allowance provided.

MODULE 6**LESSON 6.27****SALARY AND ITS COMPUTATION****Exercise 6:**

Computation of taxable income and tax thereon in respect of Mr. Umar (a salaried individual) for the tax year 2007 from the following information/ data:

- Basic Salary Rs 20,000 pm
- Conveyance Allowance Rs 1,000 pm
- Medical Allowance Rs 28,000 pa
- Dearness Allowance Rs 1,000 pm

Solution to Exercise 6:

Tax payer: Mr. Umar

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Basic Salary	240,000	Nil	240,000
Conveyance Allowance	12,000	Nil	12,000
Medical Allowance	28,000	24,000	4,000
Dearness Allowance	12,000	Nil	12,000
Total			268,000

Tax liability:

Tax rate of 0.75% percent as given at serial #4 for taxable income exceeding Rs.250,000 up to Rs.350,000

Income tax payable:

$$268,000 \times 0.75\% = \text{Rs.}2,010$$

Note:

Medical allowance exempt up to 10% of Basic salary, if free hospitalization services or reimbursement of medical expenses not provided by employer

Exercise 7:

Computation of taxable income and tax thereon in respect of Mr. Umar (a salaried individual) for the tax year 2007 from the following information/data:

- Minimum Time Scale Rs. 20,000-2000-30,000
- Basic Salary@ Rs. 24,000 pm
- Accommodation provided by the employer. The employee is entitled for house rent allowance@50% of MTS
- Computer Allowance Rs. 1000 pm
- Qualification pay Rs. 1000 pm

Solution to Exercise 7:

Tax payer: Mr. Umar

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Basic Salary	288,000	Nil	288,000
Accommodation Refer (note-1)	---	---	144,000
Computer Allowance	12,000	Nil	12,000
Qualification Pay	12,000	Nil	12,000
Total			456,000

Tax liability:

Tax rate of 3.50 percent as given at serial #7 for taxable income exceeding Rs.400,000 up to Rs 500,000

Income tax payable:

$$456,000 \times 3.5\% = \text{Rs.}15,960$$

Note 1:

Accommodation: Amount that would have been otherwise provided under terms of employment but in no case less than 45% of MTS or basic salary.

Exercise 8:

Computation of taxable income and tax thereon in respect of Mr. Yasir (a salaried individual) for the tax year 2007 from the following information/data:

- MTS Rs20,000-2000-30000
- Basic Salary @ 30,000pm
- Accommodation provided to Mr. Yasir by employer. He is entitled for house rent allowance @60% of Basic Salary
- Motor vehicle provided by the employer exclusively for personal use. Cost of vehicle is Rs.1 million.

Solution to Exercise 8:

Tax payer: Mr. Yasir

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Salary	360,000	Nil	360,000
Accommodation Refer (note-1)	216,000	Nil	216,000
Motor Vehicle for personal use, Refer (n-2)	---	---	100,000
Total			676,000

Tax liability:

Tax rate of 6% percent as given at serial #9 for taxable income exceeding Rs 600,000 up to Rs 700,000

Income tax payable:

$$676,000 \times 6\% = \text{Rs.}40,560$$

Note 1: Accommodation -- Amount that would have been otherwise provided under terms of employment but in no case less than 45% of MTS or basic salary.

Note 2:**Valuation of Conveyance:**

For personal use only	10% of cost or 10% of FMV of Vehicle, in case of lease
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MODULE 6**LESSON 6.28****SALARY AND ITS COMPUTATION****Exercise 9:**

Computation of taxable income and tax thereon in respect of Mr. Yasir (a salaried individual) for the tax year 2007 from the following information/data:

- MTS Rs20,000--2000--30,000
- Basic salary Rs 20,000 pm
- Accommodation provided by the employer to Mr. Yasir. He is entitled to house rent allowance@50% of basic salary.
- Motor vehicle provided partly for official and partly for personal use. Cost of vehicle to the employer was Rs 1,000,000.
- Flying allowance provided, Mr. Yasir is working for a Pakistani Airline Rs 400,000
- Concessional Loan of Rs 1 million provided by employer @ of markup of 4% per annum (bench mark rate for tax year 2007 is 9% per annum).

Solution to Exercise 9:

Tax payer: Mr. Yasir

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Salary	240,000	Nil	240,000
Accommodation Refer (note-1)	---	---	120,000
Motor Vehicle for personal use, Refer (note-2)	---	---	50,000
Flying allowance Refer (note-3)	---	---	---
Concessional loan Refer (note-4)	---	---	50,000
Total			460,000

Tax liability:

Tax rate of 3.5% percent as given at serial #7 for taxable income exceeding Rs 400,000 up to Rs 500,000

Income tax payable:

$$460,000 \times 3.5\% = \text{Rs.}16,100$$

Note 1: Accommodation -- Amount that would have been otherwise provided under terms of employment but in no case less than 45% of MTS or basic salary.

Note 2:

Valuation of Conveyance

Partly for personal and partly for official use	5% of cost or 5% of FMV of Vehicle, in case of lease
--	--

Note 3:**Flying allowance**

Flying allowance shall be taxed @ 2.5% of amount received as a separate block of income under sub clause 1 of part 3 of second schedule.

Note 4:

Bench mark rate for tax year 2007 is 9%

Loan provided at the rate of mark-up of 4%

Amount added back $1,000,000 \times 5\% = \text{Rs.}50,000$

Exercise 10:

Computation of taxable income and tax thereon in respect of Mr. Yasir (a salaried individual) for the tax year 2007 from the following information/data:

- MTS Rs 30,000-2000-50,000

- Basic Salary Rs 40,000 pm
- Accommodation provided by the employer. Mr. Yasir is entitled to house rent allowance @50% of basic salary.
- Employer provided motor vehicle to Mr. Yasir exclusively for official use. Cost of the vehicle is Rs.800,000.
- Mr. Yasir paid Zakat amounting Rs 5,000 during the tax year 2007.
- The said employee paid donations amounting Rs. 10,000 to a charitable institution duly approved by CBR.

Solution to Exercise 10:

Tax payer: Mr. Yasir

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Salary	480,000	Nil	480,000
Accommodation Refer (note-1)	---	---	240,000
Motor Vehicle Refer (note-2)	---	---	---
Sub Total			720,000
Zakat paid by Mr. Yasir (Deductible allowance)			(5,000)
Total taxable income			Rs. 715,000

Tax liability:

Tax rate of 7.50% percent as given at serial #10 for taxable income exceeding Rs.700,000 up to Rs.850,000

Income tax payable: 715,000 x 7.5%= Rs.53,625**Computation of tax credit on Donation:**

$$A/B \times C$$

$$53625/715,000 \times 10,000 = \text{Rs.}750$$

Income tax payable

$$= 53625 - 750 = \text{Rs.}52,875$$

(C 30% of taxable income shall be: 715,000 x 30%=214500. Hence C taken as Rs.10,000)

Note 1: Accommodation -- Amount that would have been otherwise provided under terms of employment but in no case less than 45% of MTS or basic salary.**Note 2: Motor vehicle**—provided for official use since motor vehicle is provided exclusively for official use, no add-back shall be made towards the salary income of the employee.**Exercise 11- Consolidated exercise.**

Compute taxable income & tax thereon for tax year 2007 in respect of Mr. Yasir, a salaried individual.

MTS Rs30,000-2,500-50,000

- a. Basic salary, Rs. 420,000pa
 - b. Salary received from former employer Rs 200,000
 - c. Salary received from prospective employer Rs 100,000
 - d. Tax liability of employee paid by the employer Rs 40,000
 - e. Voluntary payments made by employee. Rs 80,000
 - f. Mr. Yasir incurred the expenses during the tax year on account of personal car Rs. 40,000 and on renovation of his house Rs.100,000
 - g. Leave pay Rs.20,000
 - h. Medical allowance Rs.60,000
 - i. Free hospitalization services received under the term of employment. Rs.100,000
 - j. Extra duty Allowance Rs.15,000
 - k. Bonuses received Rs.40,000
 - l. Utilities provided by the employer Rs.30,000
 - m. T.A /D.A reimbursed on account of official assignments. Rs 40,000
 - n. Golden handshake payments received Rs 1,600,000
- Average rate of tax for last 3 years was 25%, 20%, 15%.

o. Donation paid by the employee to a charitable institution duly approved by CBR

Rs. 40,000

p. Deduction of tax at source

Rs. 224,000

Solution to Exercise 11:

Tax payer: Mr. Yasir

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Salary	420,000	Nil	420,000
Salary from former employer	200,000	Nil	200,000
Salary from prospective employer	100,000	Nil	100,000
Tax liability paid by employer	40,000	Nil	40,000
Voluntary payments	80,000	Nil	80,000
Expenses incurred (deductions not admissible to salaried individuals)	---	---	---
Leave pay	20,000	Nil	20,000
Medical allowance (Exemption not allowed since free hospitalization services provided)	60,000	Nil	60,000
Free hospitalization	100,000	100,000	Nil
Extra duty allowance	15,000	Nil	15,000
-Bonuses received	40,000	Nil	40,000
- Utilities	30,000	Nil	30,000
TA/DA for official purpose	40,000	40,000	Nil
Golden handshake amount of Rs 1,600,000 can be taxed @average rate of tax of last 3 years i.e.; $25+20+15/3=20\%$ --not advisable			1,600,000
Total taxable income			2,605,000

Tax liability:

Tax rate of 16% percent as given at serial #17 for taxable income exceeding Rs.2,000,000 up to Rs. 3,150,000

Income tax payable:

$$2,605,000 \times 17\% = \text{Rs. } 442,850$$

Computation of tax credit on Donation:

$$A/B \times C$$

$$442,850/2,605,000 \times 40,000 = \text{Rs. } 6,800$$

Income tax payable

$$= 442,850 - 6,800 = 436,050$$

(C is $2,605,000 \times 30\% = 781,500$. Hence C is taken as Rs.40,000)

Salary and Its Computation

- Tax Payable = Rs. 436,050
- Deduction at source = Rs. 224,000
- Tax Payable = Rs. 212,050

SALARY AND ITS COMPUTATION GRATUITY

Purpose:

- Provision of Gratuity to employees or
- Undertaking of provision (payment) of gratuity on retirement or
- On employees becoming incapacitated or
- On termination of their employment after completion of minimum period of service specified in the regulations of fund or to the widows, children or dependants of such employees on their death
- All benefits granted by the fund shall be payable only in Pakistan

Approved Gratuity Fund

- Commissioner of Income Tax may accord approval to any gratuity fund.

Condition for Approval

- Fund established under an irrevocable trust and purposes of gratuity fulfilled.

Tax treatment of Gratuity is as under:

- Gratuity pertaining to government employees/ their families:
- Any gratuity received on retirement/ death by employee of the government, a local authority or a statutory body or corporation or family is wholly exempt from tax under clause 13(i), part I of second schedule.

Clause 13, Part I of Second Schedule

- (i) In the case of an employee of the Government, a local authority, a statutory body or corporation established by any law for the time being in force, the amount receivable in accordance with the rules and conditions of the employee's services;
- (ii) Any amount receivable from any gratuity fund approved by the Commissioner in accordance with the rules in Part III of the Sixth Schedule;
- (iii) In the case of any other employee, the amount not exceeding two hundred thousand rupees receivable under any scheme applicable to all employees of the employer and approved by the Central Board of revenue for the purposes of this sub-clause; and
- (iv) In the case of any employee to whom *sub-clause (i), (ii) and (iii) do not apply, fifty per cent of the amount receivable or seventy-five thousand rupees, whichever is the less:

Provided that nothing in this sub-clause shall apply:

- (a) To any payment which is not received in Pakistan.
- (b) To any payment received from a company by a director of such company who is not a regular employee of such company.
- (c) To any payment received by an employee who is not a resident individual; and to any gratuity received by any employee who has already received any gratuity from the same or any other employer.

Exercise-1 on Gratuity:

Compute taxable income and tax thereon for tax year 2007 in respect of Mr. A, an employee of Government of the Punjab.

Relevant information/data is given below.

Salary	Rs. 800,000
Gratuity	Rs. 1,000,000
Tax deducted at source	Rs. 54,000

Solution to Exercise 1:

Tax payer: Mr. Yasir	Tax year: 2007
Residential Status: Resident	NTN: 000111

Computation of taxable income and tax thereon:

Particulars	Total income	Exempt Income	In Rs
			Taxable Income
Salary	800,000	Nil	800,000
Gratuity	1,000,000	1,000,000	Nil
Refer (Note-1)			

Taxable Income			800,000
-----------------------	--	--	----------------

Tax liability:

Tax rate of 7.50 is at serial no 10 for taxable income exceeding Rs 700,000 up to Rs 850,000 shall be applied.

$$800,000 \times 7.5\% = \text{Rs.}60,000$$

Tax payable =	Rs 60,000
Tax deducted at source =	<u>Rs 54,000</u>
Tax payable with return	Rs 6,000

N-1:

Amount received as gratuity is exempt in this case under clause 13(i), Part I, Second Schedule of the Ordinance.

**SALARY AND ITS COMPUTATION
GRATUITY RECEIVED UNDER SIXTH SCHEDULE**

In the case of employees covered by approved gratuity under Sixth Schedule:

Any gratuity received by an employee from a gratuity fund approved by the Commissioner of Income Tax in accordance with the rules contained in Part III of the Sixth Schedule, is fully exempt under clause (13)(ii), Part I of Second Schedule.

Exercise-2 on Gratuity:

Mr. A, an employee of a private Company, received Rs. 1,000,000 at the time of retirement on 01-10-2006, from a gratuity fund approved by the Commissioner of Income Tax under Sixth Schedule.

Other information/data for tax year 2007 is given here under:

- | | |
|-----------------|------------|
| 1. Basic salary | Rs.360,000 |
| 2. Bonus | Rs. 90,000 |
| 3. Gardener | Rs. 48,000 |

Compute taxable income and tax thereon for tax year 2007.

Solution of Exercise 2:

Tax payer: Mr. A

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs

Particulars	Total income	Exempt Income	Taxable Income
Basic Salary	360,000	Nil	360,000
Bonus	90,000	Nil	90,000
Gardener	48,000	Nil	48,000
Gratuity	1,000,000	1,000,000	Nil
Taxable Income			498,000

Tax Liability:

$$\text{Tax payable} = 498,000 \times 3.5\% = 17,430$$

N-1

Gratuity fund approved by the Commissioner of Income Tax is exempt under Sixth Schedule.

Treatment if Gratuity Approved by Central Board of Revenue

In Case Gratuity Approved Under clause (13)(iii), Part I, Second Schedule-CBR approval

- First gratuity received up to Rs. 200,000 is exempt.
- Amount exceeding Rs. 200,000/- will be taxable as salary.

Treatment of Gratuity not Covered under any other Clause of Part I of 2nd Schedule:

Gratuity received by an employee/family on retirement or death shall be exempt from tax to the extent of the least of the following:

- a. 50% of amount receivable
- Or
- b. Rs. 75,000

However, this exemption is not available in the following cases:

- If gratuity is received outside Pakistan
- Received by a director of a company who is not a regular employee of the company
- If received by a non resident person
- If recipient has already received any gratuity from the same or any other employer

Exercise-3

Mr. A retired on 01.01.2007, he received gratuity amounting Rs. 600,000. The gratuity fund was not approved by the authorities stipulated in the ordinance. Explain treatment of gratuity received by the said employee under the provisions of the Ordinance.

Solution:

As per clause (13)(iv), Part I of Second Schedule, exemption is available as follows:

50% of Rs. 600,000 received = Rs. 300,000 or Rs.75,000, whichever is less.

In this case Rs.75,000 is exempt and balance amount of Rs.225,000 will be taxable.

Gratuity: Points to Remember:

- Gratuity will be ignored while computing taxable income and tax liability of a deceased person.
- In case the gratuity is received by legal heirs, where employee dies before retirement the gratuity would be taxable in the hands of legal heirs of the deceased.

Pension

Pension is the amount received on account of past services/employment

- **Tax treatment of Pension**
- **Pension Totally Exempt**

If received by a citizen of Pakistan under clause (8) part I of second Schedule. Provided

- **As stated above the recipient should be citizen of Pakistan**
- The recipient must not be working for the same employer for any remuneration.
- In case a person receives pension from more than one employer, the exemption shall be available to the higher of the pensions received by him.
- **Pension Received by Ex-Government Employees and Members of Armed Forces.**
- Any pension received by employees of federal govt./Provincial govts. Members of Armed Forces of Pakistan or granted under the rules to their families is exempt from tax under clause (9), part I of second Schedule

Clauses (8),(9), (12), (16), (17) Part I of Second Schedule.

Clause (8)

Any pension received by a citizen of Pakistan from a former employer, other than where the person continues to work for the employer (or an associate of the employer).

Provided that where the person receives more than one such pension, the exemption applies only to the higher of the pensions received.

Clause (9)

Any Pension:

- (i) Received in respect of services rendered by a member of the Armed Forces of Pakistan of Federal Government or a Provincial Government;
- (ii) Granted under the relevant rules to the families and dependents of public servants or members of the Armed Forces of Pakistan who die during service.

Clause (12)

Any payment in the nature of commutation of pension received from Government or under any pension scheme approved by the Central Board of Revenue for the purpose of the clause.

Clause (16)

Any income derived by the families and dependents of the “Shaheeds” belonging to Pakistan Armed Forces from the special family pension, dependents** pension or children’s allowance.

Clause (17)

Any income derived by the families and dependents of the “Shaheeds” belonging to the Civil Armed Forces of Pakistan to whom the provisions of the Joint Services Instruction No. 5/66 would have applied had they belonged to the Pakistan Armed Forces from any like payment made to them.

Exercise on Pension

Mr. A retired on 01-01-2007 and thereafter joined a private Co.

Other information/data for tax year 2007 is given here under:

1. Salary Rs.600,000
2. Pension Rs.300,000

Compute taxable income and tax thereon for tax year 2007.

Solution:

In this case taxable income for tax year 2007 will be Rs. 600,000.

Pension from ex-employer is exempt under clause (17), Part I, Second Schedule.

Taxable income = 600,000

Tax payable = 600,000 x 6%= Rs 36,000

Pension Granted to Injured or Disabled:

Pension granted to a public servant or personnel of Armed Forces on injuries or body disability and to families and dependents of 'Shaheeds' belonging to civil or Pakistan Armed Forces; or public servant or member of Armed Forces, who dies during service is exempt as provided in part I of Second Schedule. Any payment in the nature of commutation of pension [Clause (12), Part I, 2nd Schedule] is Exempt from tax:

Any payment in the nature of commutation of pension received from the government or under any pension scheme approved by the Central Board of Revenue under clause (12), Part I, Second Schedule is exempt from tax.

Exercise on Commutation of Pension:

Mr. A, a government servant, retired on 1-12-2006 and received Rs.900,000 as commutation of pension. Compute taxable income for tax year 2007.

Solution:

Commutation of Pension is exempt under clause (12) Part I of Second Schedule.

Exercise- on lump sum payments received:

Mr. A received Rs. 1,500,000 on opting for Golden Handshake in the tax year 2007. He received total income amounting Rs. 600,000 as salary during said year. Rate of tax for preceding three tax year was 20%, 15% and 10%. Compute taxable income and tax thereon for tax year 2007.

Solution:

Tax payer can opt to seek approval from CIT to charge lump sum payments received in a tax year at average tax rate of last three years. In this case average tax rate for last three years comes to 15%. So it is advisable to opt for charging this amount as per procedure prescribed above.

Computation of Tax:

- ❖ Salary at normal rate = Rs 600,000 x 6% = 36,000
- Lump sum payments = 1,500,000 x 15% = 225,000

If lump sum payments of Rs 1,500,000 had been included in salary income, taxable income would have been 2,100,000 and that would have been charged at the rate of 25% as shown at serial number 14 for taxable income exceeding 1,300,000.

Tax liability would have been Rs 2,100,000 x 25% that is Rs 525,000. Hence it is advisable for tax payer to opt for charging the tax at average rate of last three years.

MODULE 6**LESSON 6.31****SALARY AND ITS COMPUTATION
PROVIDENT FUND****Types:**

- Statutory Provident Fund, governed by the Provident Funds Act, 1925 (GP Fund)
- Recognized Provident Fund (recognized by Commissioner of Income Tax under Part I of Sixth Schedule).
- Unrecognized Provident Fund

Recognized Provident Fund defined in clause (48) of Section 2 as under:

Means a provident fund recognized by the commissioner in accordance with Part I of Sixth Schedule.

Recognized Provident Fund under Part I of 6th Schedule

- ❖ CIT may accord recognition, if fund in compliance with requirements as laid down in rule 2.
- ❖ CIT may withdraw recognition after providing reasonable opportunity to the trustees of the fund of being heard.

Condition for Approval

- All employees shall be employed in Pakistan or
- Shall be employed by employer whose principal place of business is in Pakistan.
- Contributions by employee in a tax year shall be a definite proportion of his salary.
- Contributions by employer to the Individual account of an employee in a tax year shall not exceed the contributions made by the employee.
- Fund shall be vested in two or more trustees, or official trustee.
- The accumulated balance due to an employee shall be payable on the day, he ceases to be an employee of the employer, who is maintaining the Fund.

Tax Treatment:

The following is the tax treatment of different kinds of provident funds:

- Statutory Provident Fund [Wholly exempt] Clause 22.
- Recognized Provident Fund [Partially taxable within limits]. This is defined in section 2(48) as a provident fund which has been recognized by the Commissioner of Income Tax in accordance with the rules contained in Part I of the Sixth Schedule. Employer's contribution up to 10 per cent of salary is exempt. Employer's contribution exceeding 10% of 'salary' is taxable under rule 3, Part 1 of Sixth Schedule.

Recognized Provident Fund

The accumulated balance due and becoming payable to any employee participating in a recognized provident fund is **fully exempt** under **clause (23)** Part I of Second Schedule.

Provident Fund

Un-recognized provident fund [wholly taxable]

Exercise on Provident Fund

Mr. A received credit of Rs. 50,000 as employer's contribution to recognized provident fund, his salary during tax year 2007 is given below:

- | | |
|-----------------------|------------|
| 1. Basic salary | Rs.840,000 |
| 2. Computer allowance | Rs. 12,000 |
| 3. Medical allowance | Rs. 60,000 |

Compute taxable income and tax thereon for tax year 2007.

Solution:

Tax payer: Mr. A Tax year: 2007

Residential Status: Resident NTN: 000111

Computation of taxable income and tax thereon:

In Rs.

Particulars	Total income	Exempt Income	Taxable Income
Basic Salary	840,000	Nil	840,000
Computer allowance	12,000	Nil	12,000

Medical allowance (10% of basic exempt)	60,000	84,000	Nil
Employer's contribution to SPF Exempt (Note-1)	---	---	---
Taxable Income			852,000

N-1:

Under rule 3 of Part I of Sixth Schedule exemption is available up to 10% of salary and excess amount shall be taxable. In this case entire amount i.e.; Rs. 50,000 is exempt as it is within prescribed limit of 10% of salary.

N-2:

Taxable income shall be Rs 852,000 and tax can be computed as explained in previous exercise.

Benevolent Grant**Exercise on Benevolent Grant:**

Mr. A, a govt. servant retired on 01-05-2007. He received Rs. 600,000 from duly approved benevolent fund. He received total income amounting Rs. 480,000 under the head salary during tax year 2007.

Compute taxable income and tax thereon in respect of Mr. A for tax year 2007.

- Exemption on account of benevolent grant paid from the Benevolent Fund under clause (24) of part 1 of 2nd schedule.
- (24) any benevolent grant paid from the Benevolent Fund to the employees or members of their families in accordance with the provisions of the Central Employee Benevolent Fund and Group Insurance Act, 1969.

MODULE 7.31**INCOME FROM PROPERTY**

Taxation of rental income arising from use and exploitation of immovable property '**Income from Property**' includes Rent received or receivable by a person in a tax year other than rent exempt from tax. Sec 15 (1)

Rent means any income received or receivable by the owner of land or building as consideration for:

- Use of land or building
- Occupation of land or building
- Right to use the land or building

Rent also includes forfeited deposits paid under a contract for the sale of land or building.

Where a building leased out together with Plant & Machinery, it is not income from property' but 'income from other sources' Sec. 15(3).

Rent to be in line with Fair Market Rent. Where the rent received or receivable by a person is less than the fair market rent for the property; the person shall be treated as having derived the fair market rent for the period, the property is let on rent in the tax year.

Where utilities provided by any person are included in rent, such amount shall be chargeable to tax under the head income from other sources and not under the head income from property.

Exemptions available under property income:

Any income of a trust or welfare institution from housing property clause (58)(1) as provided in sub clause (2) and (3) of clause (58). The said clauses are reproduced below:

- (2) A trust administered under a scheme approved by the Federal Government in this behalf and established in Pakistan exclusively for the purposes of carrying out such activities as are for the benefit and welfare of-
 - i. Ex-servicemen and serving personnel, including civilian employees of the Armed Forces, and their dependents; or
 - ii. Ex- employees and serving personnel of the Federal Government or a Provincial Government and their dependents, where the said trust is administered by a committee nominated by the Federal Government or , as the case may be, a Provincial Government.
- (3) A trust or welfare institution [or non- profit organization] approved by [Regional Commissioner of Income Tax] for the purposes of this sub-clause.

Exemptions available under Clause (59) of part 1 of 2nd schedule on income from property held under trust or other legal obligations for religious or charitable purpose.

Certain deductions were allowable/ permissible under sec 17 up to tax year 2006. Section 17 stands omitted by Finance Act, 2006. Hence no deductions are permissible from 1st July 2006.

Sec 15 (7) the provisions of sub section (1) Section 15 shall not apply in respect of a Tax Payer who:

- i. is an individual or association of persons;
- ii. Derives income chargeable to tax under this section not exceeding Rs. 150,000 in a tax year; and
- iii. Does not derive taxable income under any other head.

However, Fair Market Rent not applicable when lessee chargeable to tax under the head ‘Salary Income’.

The rent received shall not be chargeable to tax in respect of a tax payer who –

- Is an individual or association of persons;
- Derives income chargeable to tax under this section not exceeding Rs. 150,000/- in a tax year; and
- Does not derive taxable income under any other head.

Treatment of Non-Adjustable Amounts Received in Relation to Buildings

These amounts shall be treated as rent and chargeable to tax under the head “income from property”. These amounts are spread over a period of 10 years, It is adjustable as Rent.

ILLUSTRATION

Say non-adjustable advance rent received Rs.120,000.

Amount adjustable shall be $120,000/10 = \text{Rs.}12,000$ Rs12,000 shall be adjustable for ten years.

Admissible Deductions before tax year 2007

- Allowance for Repair----1/5 of total Rent in a tax year. It is a statutory allowance.
- Insurance Expenses (Payment of Premium)
- Taxes, charges, property tax
- Ground rent paid or payable by the person.
- Interest (Mark-up, Profit) paid on money borrowed for the property.
- Rent sharing by House Building Finance Corporation.
- Rent collection charges, actually incurred--- (not to exceed 6% of total rent receivable for the tax year.
- Legal expenses in connection with the relevant property.
- Unpaid rent (irrecoverable rent).
- Any expenditure allowed to a person under this head as deduction, shall not be allowed as expense under any other ‘Head of income’.

Treatment of Income from Property under Sec 155:

(1) [Every] prescribed person making a payment in full or part (including a payment by way of advance) to any person on account of rent of immovable property) including rent of furniture and fixtures, and amounts for services relating to such property) shall deduct tax from the gross amount of rent paid at the rate specified in the First Schedule (5% of gross rent paid).

(2) The tax deducted under sub-section (1) shall be a final tax on the income from property.

(3) In this section, “prescribed person” means—

- i. The Federal Government;
- ii. A Provincial Government;
- iii. Local authority;
- iv. A company;
- v. A non-profit organization;
- vi. A diplomatic mission of a foreign state; or
- vii. Any other person notified by the CBR for the purpose of this section.

The Rate of Tax on Property Income under section 15, 5% of the gross amount of rent is chargeable to tax.

Exercise-1

Compute taxable income of Mr. A, an individual in the light of following data/ information, relevant to tax year 2006.

- Mr. A let out a building to M/S XYZ and received rent amounting Rs 1,600,000 during the tax year.
- M/S XYZ also paid amount of Rs 800,000 as non-adjustable advance.
- Mr. A spent Rs 60,000 on account of repairs of said building.
- Insurance premium paid by Mr. A Rs 40,000
- Property tax in lieu of said property paid Rs 50,000

- Property tax paid in lieu of house owned and occupied by Mr. A Rs 20,000
- Salary paid to employees hired for the purpose of rent collection Rs 120,000
- Fee paid to a law firm Rs 50,000
- Mr. A entered into a sale agreement with Mr. Y on account of sale of a building at a price of Rs 2 million and received Rs 200,000 as an advance. Mr. Y failed to make the balance payment, hence advance forfeited.
- Mr. A had constructed the said property after availing loan from a commercial bank and paid mark-up amounting Rs 40,000 during the tax year.

Solution of Exercise 1

Tax payer: Mr. A

Tax year: 2006

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs.

Particulars	Total income	Exempt Income	Taxable Income
Rental Income	1,600,000	Nil	1,600,000
Non adjustable advance N-1	80,000	Nil	80,000
Forfeited deposit	200,000	Nil	200,000
Gross Total			1,880,000

Particulars	Total income	Deductions	Taxable Income
Gross income B/F	1,880,000	----	----
Repairs N2	----	136,000	----
Insurance Premium	----	40,000	----
Property tax	----	50,000	----
Property tax of self-occupied House N-3	----	----	----
Rent Collection N-4	----	112,800	----
Legal charges	----	50,000	----
Mark-up paid	----	40,000	----
Total		668,800	1,211,200

Taxable income is:

Rs. 1,211,200

Tax thereon: Rs. 1,211,200 x 5% = 60560

N-1:

Non adjustable advance is spread over ten years.

N-2:

Repairs allowed as statutory allowance @ 1/5th of gross rental.

N-3:

Expenditures allowed in respect of building that is generating rental income.

N-4:

Rent Collection charges not to exceed 6% of gross rental income.

N-5:

Forfeited amount on account of cancellation of sale agreement of building shall be treated as rental income.

Exercise 2:

Compute taxable income and tax thereon in respect of Mr. A for tax year 2007. Relevant information / data is given here under:

Rental income from shop Rs 120,000

Mr. A is an employee of a federal government and received gratuity, Rs.900,000 on retirement.

Solution of Exercise 2

Tax payer: Mr. A

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs.

Particulars	Total income	Exempt Income	Taxable Income
Rental Income	120,000	120,000	Nil

Note-1			
Gratuity	900,000	900,000	Nil
Taxable Income			Nil

N-1:

Rent received under the head income from property shall be exempt, if following condition are met;
Person receiving rent under this head is an individual or AOP.

Income under this head for a tax year does not exceed Rs 150,000

The person does not derive taxable income from any other head of income.

Exercise 3:

Compute taxable income and tax thereon in respect of Mr. A for tax year 2007 from the following information / data.

Rental income from building Rs 450,000

Non- adjustable advance received Rs 200,000

Solution of Exercise 3

Tax payer: Mr. A

Tax year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs.

Particulars	Total income	Exempt Income	Taxable Income
Rental Income Note-1	450,000	Nil	450,000
Non adjustable advance (Note-1)	---	---	20,000
Taxable Income			470,000

Under the head “Income from Property” tax is payable at the rate of 5% of gross amount of rent received.

Hence tax payable = 470,000 x 5% = Rs 23,500

N-1:

Non adjustable amount received by the owner of the building from the tenant shall be treated as rent chargeable to tax under the head “Income from Property” in the tax year in which it was received and following 9 tax years in equal proportion. Sec16.

INCOME FROM BUSINESS & ITS COMPUTATION**Business Defined Section 2(9)**

“Business includes any trade, commerce, manufacture, profession, vocation but doesn’t include employment”

Following incomes (except exempt income) shall be charged to tax under the head ‘Income from Business’.

- a) Profits & Gains from any business in a tax year.
- b) Income derived from any trade, profession, sale of goods or provision of any services.
- c) Income from hire or lease of tangible movable property.
- d) FMV of Perquisites derived by a person by virtue of business relationships.
- e) Management Fee derived by a management company.

Income from Business also includes:

- Any profit on debt derived by a person. (it is only applicable to such person, whose business is to derive such income. e.g.; a banking company)
- Any amount received by schedule bank from mutual fund, as share of profit.
- Profit earned on debts in course business shall be chargeable to ‘income from business’.
- Income on leasing by lessor, being banks, leasing companies etc.

Income derived from any trade, profession, sale of goods or provision of any services.

- Income from hire or lease of tangible movable property
- FMV of Perquisites derived by a person by virtue of business relationships.
- Management Fee derived by a management company

Exemptions on Business income Under Part 1 of second schedule

Clause	Exempt Income
(91)	Income of a Text-Book Board.
(92)	University or Educational Institution established not for profit purpose.
(93)	Recognized Computer Training Institution.
(93A)	Recognized Vocational Institute.
(98)	Income of Recognized Sports Board.
(100)	Income of Modaraba Companies.

Speculation Business shall be charged under the head income from business (Separate Treatment)

Treatment of Speculation Business (Sec 19):

- To be treated as distinct and separate from other business carried on by the person.
- Expenditures/deductions incurred on account of speculation business shall be apportioned in light of section 67.
- Profit and gains arising out of speculation business shall be included in the person’s income chargeable under the head “Income from Business”.

Speculation Business Sec.19:

- Speculation means any business in which a contract for the purchase and sale of any commodity (including [stocks] and shares) is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity, but does not include a business in which:
 - A contract in respect of raw materials merchandise is entered into by a person in the course of a manufacturing or mercantile business to guard against loss through future price fluctuations for the purpose of fulfilling the person’s other contracts for the actual delivery of the goods to be manufactured or merchandise to be sold;
 - A contract in respect of stocks and shares is entered into by a dealer or investor therein to guard against loss in the person’s holding of stocks and shares through price fluctuations; or
 - A contract is entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing [arbitrage] to guard against any loss which may arise in the ordinary course of the person’s business as such members.

INCOME FROM BUSINESS & ITS COMPUTATION**Deductions Allowed under Section 20**

Deduction allowed for expenditure incurred by a person in the year wholly for the purpose of business:

- Expenditure on acquiring a depreciable asset or an intangible with useful life of more than one year.
- Expenditure in the course of amalgamation of companies incurred by an amalgamated company

Deductions not Allowed – Sec. 21

- a. Any cess, rate or tax paid or payable by a person in Pakistan or a foreign country under PTR/Final Tax Regime.
- b. Any amount of tax deducted at source.
- c. If payer/employer does not deduct tax from payments/disbursement of salary, then payments made, salaries paid by such payer/employer shall not be allowed for deduction of these expenses.
- d. Any entertainment expenditure in excess of such limits [or in violation of such conditions] as may be prescribed;
- e. Any contribution made by the person to a fund that is not a recognized provident fund* [approved pension fund] approved superannuation fund, or approved gratuity fund;
- f. Any contribution made by the person to any provident or other fund established for the benefit of employees of the person, unless the person has made effective arrangements to secure that tax is deducted under section 149 from any payments made by the fund in respect of which the recipient is chargeable to tax under the head “Salary”
- g. Any fine or penalty paid or payable by the person for the violation of any law, rule or regulation.
- h. Any personal expenditures incurred by the person;
- i. Any amount carried to a reserve fund or capitalized in any way;
- j. Any profit on debt, brokerage, commission, salary or other remuneration paid by an association of persons to a member of the association.
- k. Omitted by finance act, 2006
- l. Any expenditure for a transaction, paid or payable under a single account head which, in aggregate, exceeds fifty thousand rupees, made other than by a crossed cheque drawn on a bank or crossed bank draft or crossed pay order or any other crossed banking instrument showing transfer of amount from the business bank account of the taxpayer:

Provided that online transfer of payment from the business account of the payer to the business account of payee as well as payments through credit card shall be treated as transactions through the banking channel, subject to the condition that such transactions are verifiable from the bank statements of the respective payer and the payee.

Provided further that this clause shall not apply in the case of-

- (a) Expenditure not exceeding ten thousand rupees;
- (b) Expenditures on account of:
 - (i) Utility bills;
 - (ii) Freight charges;
 - (iii) Travel fare;
 - (iv) postage; and
 - (v) Payment of taxes, duties, fee, fines or any other statutory obligation;
- m. Any salary paid or payable exceeding [ten] thousand rupees per month other than by a crossed cheque or direct transfer of funds to the employee’s bank account; and
- n. Except as provided in Division III of this Part, any expenditure paid or payable of a capital nature.

INCOME FROM BUSINESS & ITS COMPUTATION**Deductions---Special Provisions****Depreciation (Sec. 22)**

Deduction for depreciation allowed to a person if depreciable assets used in the person's business in a tax year. Rate of depreciations shall be applied as specified in part 1 of 3rd schedule.

Written down value of a depreciable asset of a person as at the beginning of the tax year shall be ;

- a) where the asset was acquired in the tax year, the cost of the asset to the person as reduced by any initial allowance under sec 23
 - b) in any other case, the cost of the asset to the person as reduced by the total depreciation deductions (including any initial allowance under sec 23) allowed to the person in respect to the asset in previous tax years.
- No depreciation deductions allowed where in a tax year a person disposes of a depreciable asset;
 - If consideration received exceeds the value of the written down value of the asset at the time of disposal, the excess consideration shall be chargeable to tax under the head "Income from business".
 - If the consideration received is less than the written down value, the difference shall be allowed as a deduction in computing the person's income chargeable under the head "income from business" for that year.

Depreciable asset means a tangible movable or immovable property (not unimproved land) or structural improvement to immovable property owned by a person that has:

- Normal useful life of one year or more.
- Likely to lose value due to normal wear and tear.
- Used wholly in deriving income from business chargeable to tax.

Initial Allowance (Sec. 23)

A person who places an eligible depreciable asset into service in Pakistan for the first time in a tax year shall be allowed a deduction at the rate of 50% of the cost of asset provided the asset is used by the person for the purposes of business for the first time or the tax year in which commercial production is commenced, whichever is later.

"Eligible depreciable asset" means a depreciable asset other than:

- Any road transport vehicle unless the vehicle is plying for hire;
- Any furniture, including fittings;
- Any plant or machinery that has been used previously in Pakistan or
- Any plant or machinery in relation to which a deduction has been allowed under another section of this Ordinance for the entire cost of the asset in the tax year in which the asset is acquired.

Intangibles (Sec. 24):

A person shall be allowed an amortization deduction in a tax year for the cost of intangibles;

- ❖ The intangibles or wholly or partially used by the person in the tax year in deriving income from business chargeable to tax and
- ❖ The intangibles have a normal useful life exceeding one year.

Amortization deduction allowed as under

$$\frac{A}{B}$$

Where

A is the cost of intangible; and

B is normal useful life of intangible

Deductions---Special Provisions

An intangible that has

- a) Normal useful life of more than 10 years; or
- b) Does not have an ascertainable useful life, shall be treated as if it had a normal useful life of 10 years.

Pre-commencement expenditure (Sec.25)

It means any expenditure incurred before the commencement of the business wholly and exclusively to derive income chargeable to tax, including the cost of feasibility studies, trial production activities but shall

not include any expenditure which is incurred in acquiring land, or which is depreciated or amortized under section 22 (depreciation) or section 24 (intangibles)

Rate of amortization of pre-commencement expenditure shall be **20%**.

Deductions—Special Provisions

- ❖ Scientific research institutions (sec 26)
- ❖ Employee training and facilities (sec 27)
- ❖ Profit on debt, financial costs and lease payments (sec 28)
- ❖ Bad debts (sec 29)
- ❖ **Sec 29A:** Deductions on consumer loans to a banking company, non banking finance company and house building finance corporations. (Deduction shall not exceed 3 % of income for the tax year arising out of consumer loans.
- ❖ Profit on non- performing debts of a banking company or development finance institution (sec 30)

Transfer to Participatory Reserve (Sec 31)

Following Incomes are taxable under the head Income from Business even in cases where no business is carried on by taxpayer.

- Recovery against any deduction/expenses previously allowed (Add back to income).
- Gain on sale of depreciable asset.
- Recovery of bad debt/or written off loan.
- Trading liabilities not paid within expiration of three years.
- Amount received after discontinuance of business.

INCOME FROM BUSINESS & ITS COMPUTATION**Methods of Accounting**

Under section 32, a person's income is to be computed in accordance with method of accounting regularly employed by such person.

Types of Accounting Methods

- (i) Cash-Basis accounting-Sec. 33
- (ii) Accrual-Basis accounting Sec. 34

For Companies –Accrual basis mandatory.

For Others --- optional, cash or Accrual Basis

- Under **Cash-Basis Accounting**, a person shall derive income when it is received and shall incur expenditure when it is paid.
- Under **Accrual Basis Accounting** a person derives income when it is due to the person and shall incur expenditure when it is payable by the person.
- Change in the method of accounting after seeking approval from commissioner Sec. 32(4)

Valuation of Stock:

Cost of stock-in-trade disposed of (consumed) during the year shall be computed as under.

$$A+B-C$$

A: Opening stock

B: Stock acquired during the year

C: Closing stock.

Records:

Kinds of Record to Be Maintained

- Records of Money received & expended
- Sales & purchases record
- Assets & Liabilities record
- Stock register
- If computerized system ---Electronic receipts.

General Instructions

- Back up system in place.
- Security Arrangements/system.
- Record to be maintained in line with International Accounting Standards.
- To keep record at specified place.

Rates of Tax for Individuals and AOP 1st schedule.

For Tax year 2007

Serial No.	Taxable Income	Rate of Tax
1)	Where the taxable income does not exceed Rs 100,000	0%
2)	Where the taxable income exceeds Rs. 100,000 but does not exceed Rs. 110,000	0.5%
3)	Where the taxable income exceeds Rs. 110,000 but does not exceed Rs. 125,000	1.00%
4)	Where the taxable income exceeds Rs. 125,000 but does not exceed Rs. 150,000	2.00%
5)	Where the taxable income exceeds Rs. 150,000 but does not exceed Rs. 175,000	3.00%
6)	Where the taxable income exceeds Rs. 175,000 but does not exceed Rs. 200,000	4.00%
7)	Where the taxable income exceeds Rs. 200,000 but does not exceed Rs. 300,000	5.00%
8)	Where the taxable income exceeds Rs. 300,000 but does not exceed Rs. 400,000	7.50%

9)	Where the taxable income exceeds Rs. 400,000 but does not exceed Rs. 500,000	10.00%
10)	Where the taxable income exceeds Rs. 500,000 but does not exceed Rs. 600,000	12.50%
11)	Where the taxable income exceeds Rs. 600,000 but does not exceed Rs. 800,000	15.00%
12)	Where the taxable income exceeds Rs. 800,000 but does not exceed Rs. 1,000,000	17.50%
13)	Where the taxable income exceeds Rs. 1,000,000 but does not exceed	21.00%
14)	Where the taxable income exceeds Rs 1,300,000	25.00%

Rates of Tax for Companies for Tax Year 2007

Tax Year	Banking Company	Public Company other than Banking Company	Private Company other than Banking Company
2003	47%	35%	43%
2004	44%	35%	41%
2005	41%	35%	39%
2006	38%	35%	37%
2007	35%	35%	35%

- In case the taxpayer is a society or a cooperative society, the tax shall be payable at the rates applicable to a public company or an individual, whichever is beneficial to the tax payer.
- Rate of tax for a small company shall be 20% of taxable income.

Rate of Dividend tax under Section 5:

a) in case, dividend received by a public company or insurance company or any other resident company.	5% of gross amount received.
b) in any other case.	10% of gross amount of dividend received.

Rate of tax on certain payments to Non- Residents under Section 6:

Royalty or fee for technical services	15% of gross amount received
Rate of tax on shipping or Air Transport of a non-resident person	8% of gross amount of dividend received
Shipping income	8% of gross amount received
Air transport income	3% of gross amount received

Deduction of tax at source

Profit on debt under section 151	10% of profit paid
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Prizes and winnings under section 156

On a prize bond	10% of gross amount paid
On winnings from raffle, lottery, prize on winning a quiz etc	20% of gross amount paid

Depreciation (Sec.22) Third Schedule Part 1

Depreciation rates specified for the purposes of section 22 shall be:

1. Building (all types)	10%
2. Furniture (including fittings) and machinery and plant (not otherwise specified), Motor Vehicles (all types), ships, technical or professional Books.	15%
3. Computer hardware including printer, monitor and allied items [machinery and equipment used in manufacture of I.T. products], aircrafts and aero engines.	30%

4. In case of mineral oil concerns the income of which is liable to be computed in accordance with the rules of Part 1 of the fifth Schedule. a) Below ground installations b) Offshore platform and production installations.	100% 20%
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INCOME FROM BUSINESS & ITS COMPUTATION

Taxation of Resident Company

Exercise 1

M/S XYZ Ltd. filed tax return for tax year 2006, declaring taxable income as Rs.1,350,000/-; during the assessment and scrutiny of record by the tax authority it was observed that deduction of tax at source was not made by the company, while making the following payments. Compute taxable income and tax thereon for tax year 2006.

Salaries	Rs. 350,000
Payments made in execution of a contract for purchase of office appliances	Rs. 150,000
Professional fee paid to chartered accountant.	Rs. 100,000

Solution E-1

Tax payer: M/S XYZ Ltd. Tax year: 2006

Residential status Resident NTN: 000111

Following amounts are added back since deductions are not allowed under provisions of section 21.

Salaries	Rs. 350,000
Payment in execution of contract	Rs. 150,000
Professional Fee	<u>Rs. 100,000</u>
Total amount to be Added Back	Rs. 600,000

Income from Business

Solution E-1

Taxable income declared Rs. 1,350,000

Add back under section 21 Rs. 600,000

Taxable income after add back Rs. 1,950,000

Computation of Tax

Tax already paid with return

Rs. 1,350,000 x 35% = Rs. 472,500

Tax payable on account of additions of Rs. 600,000/-

Rs. 600,000 x 35% = Rs. 210,000

Taxation of Companies

Minimum Tax on Resident Companies Sec. 113

Resident Company is subjected to minimum tax @ **0.50%** of its turnover for a tax year, even in cases where the company sustains loss.

Turnover under this section means:

- the gross receipts, exclusive of sales tax and central excise duty or any trade discounts shown on invoice or bills, derived from the sale of goods;
- the gross fees for the rendering of services or giving benefits, including commissions;
- the gross receipts from the executions of contracts; and
- the company's share of the amounts stated above of any association of persons of which the company is a member

Exercise-2

M/s XYZ (Pvt) Ltd. filed return for tax year 2007, declaring taxable income of Rs. 1,300,000 and paid entire liability of tax. On scrutiny of record by tax authorities, it came to their notice that following amounts have been paid by Cash. In the light of this information/data compute tax liability of said company for tax year-2007.

Salary	Rs. 30,000
Office Rent	Rs. 120,000
Professional Fee	Rs. 80,000
Postages	Rs. 8,000
Freight paid	Rs. 9,000

Electricity bill	Rs. 7,000
Telephone	Rs. 5,000
Penalty	Rs. 9,000

Solution of E-2**Add Back Inadmissible Deductions U/S 21**

Salary paid by cash	Rs. 30,000
Rent of office paid by cash	Rs. 120,000
Professional fee paid by cash	Rs. 80,000
Total Additions	Rs. 230,000

▪ Declared income	Rs. 1,300,000
▪ Tax already paid (1,300,000 x 35%)	Rs. 455,000
▪ Additions made U/S 21	Rs. 230,000
▪ Tax payable on additions Rs. 230,000 x 35%=	Rs. 80,500

Note: Additions on account of rest of payments, although by cash not required to be added back as provided in section 21(L)

Computation of Depreciation**Exercise 3**

M/S A.K. Brothers is a partnership firm. In the books of accounts the following information/data has been provided with respect to plant and machinery. Compute normal depreciation and initial allowance in the light of the given information.

Book value of plant and machinery as on 01-07-2006	Rs. 1,800,000
Machinery disposed of during the year with book value.	Rs. 600,000
Additions of eligible depreciable asset during the year	Rs. 1,000,000

Solution of E-3

Tax Payer: A.K. Brothers
Residential Status: Resident

Tax Year: 2007
NTN: 000111

Particulars	Book value	Depreciation
Opening W.D.V	1,800,000	----
Disposals	(600,000)	----
Balance W.D.V	1,200,000(X)	----
Additions during Year	1,000,000	
Initial allowance @ 50% on 1,000,000		500,000
Balance book value	(Y) 500,000	
Total book value (X+Y)	1,700,000	

Normal Depreciation@ 15%	<u>255,000</u>
Total Depreciation	755,000

On Speculation Business**Exercise – 4**

M/s ABC Ltd. A manufacturing company has furnished the following accounting information for tax year 2007. Compute taxable income and tax thereon:

- Gross Income from normal business	Rs.2,500,000
- Expenditures on normal business	Rs. 1,000,000
- Gross income from speculation business	Rs. 600,000
- Expenditures on speculation business	Rs.300,000
- Loss carried forward on normal business	Rs. 200,000
- Loss Carried forward on speculation business	Rs. 900,000
- Advance Tax Paid	Rs. 200,000

Solution of E-4

Tax Payer: ABC Ltd. Tax Year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs.

Particulars	Speculation Operations	Normal Business	Total
Gross Income	600,000	2,500,000	3,100,000
Expenditures	(300,000)	(1,000,000)	(1,300,000)
Net Income	300,000	1,500,000	1,800,000
C/F Loss	(900,000)	(200,000)	(1,100,000)
Taxable Income	(600,000)	1,300,000	---
Note-1			

Taxable Income:

Normal business Rs.1,300,000

Tax payable= (1,300,000 x 35%) = Rs. 455,000

Note-1:

Loss of Rs. 600,000 from speculation business can not be set off against business income, it can be set off against speculation business income, and hence this loss of Rs. 600,000 shall be carried forward to next year.

INCOME FROM BUSINESS & ITS COMPUTATION

Taxation of Companies

Exercise-5

M/S XYZ is a limited company, running a chain of hospitals. The company filed tax return along with relevant accounts/ documents for tax year 2006. This return has been selected for total audit. As a taxation officer, work out taxable income and tax liability of the said company for tax year 2006.

Medicines purchased	Rs. 1,000,000
Ambulances- running expenses.	Rs. 300,000
Depreciation on ambulances	Rs. 40,000
Depreciation on other assets	Rs. 60,000
Salaries paid through bank accounts of employees	Rs. 300,000
Unsupported payment for purchase of stationery	Rs. 12,000
Depreciation on account of car owned by director and in his personal use	Rs. 40,000
Payment of legal fee by cash	Rs. 60,000
Received payments from corporations on the panel of the hospitals	Rs. 6,000,000
Other receipts	Rs. 2,000,000
Gain on sale of a vehicle	Rs. 200,000
Purchase of X-Ray machine for shown as expense in revenue account	Rs. 1,000,000
Withholding tax deductions	Rs. 525,000
Loss carried forward from tax year 2005	Rs. 1,200,000

Solution of E-5

Tax Payer: M/S XYZ Ltd.

Tax Year: 2006

Resident Company

NTN: 000111

Revenue Account as Submitted by Co.

<u>EXPENDITURES</u>		<u>RECEIPTS</u>	
<u>Particulars</u>	<u>Amount in Rs.</u>	<u>Particulars</u>	<u>Amount in Rs.</u>
Medicines	1,000,000	From Corporations	6,000,000
Ambulances	300,000	Other Receipts	2,000,000
Depreciation (Ambulances)	40,000	Gain on Sale of Vehicles	200,000
Depreciation Others	60,000		
Salaries thru bank	300,000		
Unsupported PAMT	12,000		
Depreciation on personal car	40,000		
Legal Fee by cash	60,000		
X-Ray machine	1,000,000		
Net Profit	5,388,000		
	8,200,000		8,200,000

Computation of Tax Payable:

Net Profit as computed by Co.	5,388,000
Less set off of c/f losses	(1,200,000)
Taxable Income	4,188,000
Tax Payable 4,188,000x35%	1,465,800
Less withholding Tax deductions	525,000
Balance Tax Payable	940,800
Tax Paid with Return	940,800
Tax Payable/Refundable	NIL
Additions by Taxation Officer on account of inadmissible expenses:	
Unsupported payments	12,000
Depreciation claimed on personal car of Director	40,000
Payment of legal fee by cash	60,000
Purchase of X-Ray machine (to be capitalized, balance sheet item as such	1,000,000

not to be shown in Revenue a/c)	
Total additions	1,112,000
Tax payable on account of add backs (1,112,000 x 35%= 389,200)	389,200
The company shall have to pay tax amounting Rs 389,200.	

Sole Proprietorship**Exercise-6**

Mr. A is running business as sole proprietor. From the following information/data relevant to tax year 2007, compute taxable income and tax thereon.

Opening Stock	Rs.800,000
Purchases	Rs.1,000,000
Sales	Rs.2,000,000
Carriage inwards	Rs.30,000
Closing stock	Rs.800,000
Electric bill of office paid	Rs 18,000
Telephone bill paid	Rs 20,000
Rent of office	Rs 120,000
Stationary for office	Rs 4000
Postages	Rs 3000
Salaries to staff	Rs 200,000
Advertisement expenses	Rs 10,000
Advance tax paid	Rs 60,000

Solution Exercise 6:

Tax Payer: Mr. A

Tax Year: 2007

Sole proprietorship

NTN: 000111

Trading and Profit & Loss Account**In Rs**

Opening balance	800,000	Sale	2,000,000
Purchases	1,000,000	Closing Stock	800,000
Carriage inward	30,000		
Gross profit	970,000		
Total	2,800,000		2,800,000
Electricity	18,000		
Telephone	20,000		
Office rent	120,000		
Stationary	4,000		
Postages	3,000		
Salaries	200,000		
Advertising	10,000		
Net profit	595,000		
Total	970,000		970,000

Tax payable 595,000 x 12.50%= Rs. 74,375

Advance tax paid Rs 60,000

Tax payable Rs 14,375

Tax paid with return Rs 14,375Tax payable / refundable Nil**Taxation of Association of persons****Exercise 7:**

From the following information/ data for tax year 2007 regarding M/S XYZ brothers, a partnership firm, compute taxable income and tax liability of the firm as well as individual members.

This firm comprises of three partners Mr. X, Mr. Y and Mr. Z, each partner has equal share in profits.

Net profit of M/S XYZ brothers for tax year 2007 is worked out as Rs 900,000.

Mr. Z has also earned income amounting Rs 200,000 from other sources.

Solution Exercise 7:

Tax Payer: M/S. XYZ

Tax Year: 2007

Partnership Firm	NTN: 000111
Net profit (Taxable Income) =	Rs 900,000
Tax liability of firm (900,000 x 17.50 %*) =	Rs 157,500

*Tax rate at serial # 12 for income range Rs 800,000 to 1,000,000 is applied.

Note: Tax liability is the obligation of firm and not of the partners. However, if partner has income from any other source, his share of income from partnership is added to taxable income only for rate purposes.

Share of profit of each member Mr. X, Mr. Y, Mr. Z

Rs 300,000 each

Computation of tax liability of Mr. Z:

○ Income from other sources	Rs200,000
○ Share of profit of Mr. Z from firm M/S XYZ brothers (Add for rate purposes only)	<u>Rs 300,000</u>
○ Taxable income	<u>Rs 500,000</u>
○ Tax payable (500,000 x 10%)	Rs 50,000
○ Subtract tax liability due to addition of Rs 300,000 for rate purposes (50,000/ 500,000 x 300,000=30,000)	<u>Rs 30,000</u>

Tax payable by Mr. Z

Rs 20,000

If Rs 300,000 would have not been added for rate purposes, Mr. Z would have paid tax at the rate of 4 % that is 200,000 x 4% = 8,000 instead of Rs 20,000.

CAPITAL GAINS

Capital gain subject to this ordinance, a gain arising on the disposal of a capital asset by a person in a tax year, other than a gain that is exempt from tax under this ordinance shall be chargeable to tax under the head “Capital gains”.

Computation of Capital Gain

Capital gain shall be computed in accordance with following formula:

A-B

- **A** is the consideration received by the person on disposal of the capital asset
- **B** is the cost of the asset.

If capital asset has been held by a person for more than one year, the gain shall be considered as 3/4th of total capital gain derived on disposal of capital asset.

Example:

Say capital gain is Rs 100,000, if the capital asset is disposed of after retaining for more than one year, then gain chargeable to tax would be as under:

$$100,000 \times \frac{3}{4} = \text{Rs } 75,000$$

No amount shall be included in the cost of the capital asset (B as outlined in the formula) for any expenditure incurred by a person where, a capital asset becomes the property of the person as outlined below:

- a) Under a gift or will;
- b) By succession, inheritance or devolution;
- c) A distribution of assets on dissolution of an association of persons; or
- d) On distribution of assets on liquidation of a company, the fair market value of the asset, on the date of its transfer or acquisition by the person shall be treated to be the cost of the asset.

Deductions of losses in computing the amount chargeable under the head “Capital Gains” sec 38

Deductions shall be allowed under sec 38 for any loss on the disposal of a capital asset by the person in the year.

No loss shall be recognized under this ordinance on the disposal of the following capital assets:

A painting, sculpture, drawing or other work of art

- Jewelry
- A rare manuscript, folio or book
- A postage stamp
- A coin or medallion or
- An antique

‘Capital Asset’ means property of any kind held by a tax payer, whether or not connected with business but does not include the following:

Assets Excluded From the Definition of “Capital Asset”

- Any stock-in-trade (not being stocks and shares), consumable stores or raw materials held for the purpose of business.
- Any property with respect to which the person is entitled to a depreciation deduction under section 22 or amortization deduction under section 24;
- Any immovable property; or
- Any movable property (excluding capital assets specified in sub section (5) of section 38) held for personal use by the person or any member of the person’s family dependent on the person.

“Capital Assets” Include among others the following:

- Movable assets.
- Immovable Assets (excluding Immoveable Property)
- Tangible Assets
- Intangible Assets etc
- Share of partner/member in a firm or AOP (in this ordinance even firms are treated as AOP)

- Mining rights
- Industrial licenses & import/export licenses acquired for consideration
- Tenancy right or leasehold rights
- Foreign currency
- Right to subscribe for shares
- The contractual right of a purchaser to obtain title to an immovable property
- A license to manufacture certain product or render any services (know as franchise)
- Goodwill for which payment has been made. Self-created goodwill does not come into the ambit of chargeability under this head.
- All precious metals, gems, stones, antique pieces and Jewelry which are not held by the assessee for his family members dependent on him. This includes gold and silver coins, art collections etc

Term Disposal – Defined:

(Section 2(8) read with section 75)

Some Examples of Disposal:

- i) Transfer of capital asset by a subsidiary company to a parent company or vice versa
- ii) Any transfer, in a scheme of amalgamation, or a capital asset by the amalgamating company to the amalgamated company.
- iii) Transfer of share by a share holder in a scheme of amalgamation of companies.
- iv) Any transfer of a capital asset by a wholly-owned subsidiary company to its Pakistani holding company.
- v) Any transfer of capital asset being any work of art, archaeological, scientific nature or art collection, book, manuscript, drawing, painting, photograph or paint, to the Government or a University or the National Museums, National Art Gallery, National Archives or any other such public museum or institution.

CAPITAL GAINS

Disposals Not Chargeable To Tax Under Sec.79 Non Recognition Rules

No gain or loss shall be taken to arise on the disposal of an asset:

- Between spouses under an agreement to live apart;
- By reason of the transmission of the asset to an executor or beneficiary on the death of person;
- By reason of a gift of the asset;
- By reason of the compulsory acquisition of the asset under any law where the consideration received for the disposal is reinvested by the recipient in an asset of a like kind within one year of the disposal;
- By a company to its shareholders on liquidation of the company; or
- By an association of persons to its member on dissolution of the association where the assets are distributed to members in accordance with their interests in the capital of the association

Exemptions in respect to capital gains have been outlined in various clauses of Part 1 of Second Schedule.

Exemptions as Contained in Second Schedule

Clause (110) Any income chargeable under the head “capital gains”, being income from the sale of Mudarba certificates or any instrument of redeemable capital as defined in the Companies Ordinance, 1984, listed on any stock exchange in Pakistan or shares of public company and the Pakistan telecommunication corporation vouchers issued by the Government of Pakistan derived by a tax-payer.

Clause(111) any income chargeable under the head “capital gains” being income from the sale of shares of a public company derived by any foreign institutional investor as is approved by the federal Government for the purpose of this clause

Clause (112) omitted.

Clause (113) any income chargeable under the head “capital gains” being income from the sale of shares of a public company set up in any special industrial zone referred to in clause [126] of this schedule, derived by a person for a period of five years from the date of commencement of its commercial production: provided that the exemption under this clause shall not be available to a person from the sale of shares of such companies which are not eligible for exemption from tax under clause (126).

Clause (114) any income chargeable under the head “capital gains “ derived by a person from an industrial undertaking set up in an area declared by the Federal Government to be a “Zone” within the meaning of the export processing zone Authority Ordinance 1980.

Clause(114A) any income chargeable under the head “capital gains”, derived by a person from sale of ships and all floating crafts including tugs, dredgers, survey vessels and other specialized craft up to tax year ending on the thirtieth day of June ,2011]

Exercise on Capital Gain

Exercise-1:

On 1st July 2006, the Govt. prohibited the sale of plastic bags through an Ordinance and took over the machines of M/s WW Ltd; amounting Rs. 1,000,000/-. As a compensation package the Govt. paid Rs. 2,500,000/- to the Company. The company purchased new machines of the related business on 1st April 2007 costing the company Rs. 4,000,000/-.

Calculate gain on disposal and also explain whether this gain is chargeable to tax.

Solution E 1:

Considerations received (A)	Rs. 2,500,000
Cost of Acquisition (B)	<u>Rs. 1,000,000</u>
Capital Gain = (A – B)	Rs.1,500,000

Although there is gain of Rs.1,500,000/ on disposal but it is not chargeable to tax since amount of consideration received has been invested in the like business during one year of disposal.

Exercise2: On 01/01/2004 Mr. Y purchased 10,000 shares at a price of Rs 30 per share. He sold these shares on 20/06/2006 at a price of Rs 50 per share. Calculate the gain taxable on this disposal.

Solution Ex. 2:

- Consideration received on disposal (A) (10,000 x 50) =	Rs. 500,000
- Cost of acquisition (B) (10,000 x 30) =	<u>Rs. 300,000</u>
- Capital Gain (A-B)	Rs. 200,000

Since shares held by the person for more than one year therefore under the provision of law 3/4th of the gain would be taxable. Hence:

Taxable Capital Gain = 200,000 x ¾ = **Rs 150,000**

Exercise 3:

On 01/10/2006, Mr. A had acquired mining rights at a cost of Rs 2,000,000. On 01/02/2007, he disposed of the rights to Mr. Y for consideration of Rs 5,000,000. Calculate Capital Gain.

Solution to Ex. 3:

Consideration received on disposal (A)	Rs. 5,000,000
Cost of acquisition (B)	<u>Rs. 2,000,000</u>
Capital Gain	Rs. 3,000,000

Exercise4:

On 01/01/2004, M/s XYZ Pvt. Ltd. purchased 5000 shares of a public limited company at a price of Rs 100 per share. On 10/05/2006, the company disposed of these shares at a price of Rs 150 per share.

Compute taxable gain on disposal of these shares.

Solution to E 4:

Consideration received on disposal (A)	Rs. 750,000
Cost of acquisition (B)	<u>Rs. 500,000</u>
Capital Gain	Rs. 250,000

Since Capital assets held by the person for more than one year therefore under the provisions of law 3/4th of the gain would be taxable. Hence,

Taxable Capital Gain = 250,000 x ¾ = Rs 187,500

However, in this case, gain shall not be taxable since exemption under clause 110 of part 1 of 2nd schedule has been granted on gain on account of disposal of shares of a public limited company.

INCOME FROM OTHER SOURCES (SECTION 39)

Incomes not covered by any given heads of income are covered under this head.

Some types covered under the head ‘Income from other Sources’

- Income from Dividends
- Income from Royalty
- Profit on debt
- ❖ Profit, yield, interest, premium etc. received as well as accrued.
- ❖ However, Rental income (Leasing) received by a bank shall be ‘Income from Business’ not ‘Income from other sources’.
- ❖ Any amount received by bank from Mutual Funds shall be taxed under the head ‘Income from Business’ not under ‘Income from other sources’.
- ❖ Profit derived from National Saving Scheme is covered under the head ‘Income from other sources’.

Other Miscellaneous Incomes Covered Under the Head ‘Income From Other Sources’

Income from:

- Annuities including annuities paid to a lender of trademark.
- Pension
- Income arising out of exploration rights (exploration of oil fields.
- Income on account of interest- free loans (Over Bench mark rate).
- Sum paid for vacating premises shall be treated as income of recipient.

Other Specific Items Covered Under the Head Income From Other Sources:

- ❖ Sum received not through permissible banking channels on account of loans, Advances, Gifts, and Deposits for issuance of Shares of companies offered for public subscription.

Sec. 39(3): if above sums received:

- Otherwise than through crossed bank cheque
- Otherwise than through banking channel or from a person not holding National Tax Number shall be treated as income chargeable to tax under the head ‘Income from Other Sources’ for the tax year in which it was received.

Exception to above:

- **Sub Sec. (4):** sub Section 3 of section 39 shall not apply to an advance payment for the sale of goods or supply of services. Advances received from customers in connection with sale of goods & services are not to be included /added to income.
- However, advances received against execution of contract or any other purposes shall be included to income if amount not received through crossed bank cheques or through permissible banking channels.

Unexplained Investments

Sec. 111 unexplained income or assets

Where

- A person has made an investment,
- Any amount credited to person’s books of account
- A person has incurred expenditure
- A person has made an investment,
- Any amount credited to person’s books of account
- A person has incurred expenditure.

Sec. III unexplained income or assets

But no reasonable explanation offered regarding sources of fund –the amount as (a), (b) and (c) above shall be included in person’s income chargeable to tax.

- ❖ Sub Sec. 1 of Sec. 111 does not apply to any amount of Foreign Exchange remitted from outside Pakistan through normal banking channels that is en-cashed into Pak. Rupees by a scheduled Bank and encashment certificate from such bank is produced to that effect.

- ❖ Sub Sec. 1 of Sec 111 does not also apply to any unexplained amount relating to a period beyond preceding five tax years.

Immune (Exempted) Investments/Income

- ❖ Private foreign Currency Accounts
- ❖ Three years Foreign Currency Bearer Certificates
- ❖ Rupees withdrawn or assets created out of:
 - Withdrawal from US Dollar Bearer Certificates,
 - Withdrawal from F.C. Accounts
 - Encashment of foreign exchange bearer certificates

Admissible Deductions:

- Expenditure incurred to derive income chargeable to tax.
- A person receiving any profit on debt chargeable to tax under the head Income from Other Sources' shall be allowed a deduction for any Zakat paid by the person at the time the profit is paid to the person, deducted at the time of making payment of profit.
- Depreciation allowed as deduction.

56. SET OFF OF LOSSES

- (1) Subject to sections 58 and 59, where a person sustains a loss for any tax year under any head of income specified in section 11, the person shall be entitled to have the amount of the loss set off against the person's income, if any, chargeable to tax under any other head of income for the year.
- (2) Except as provided in this Part, where a person sustains a loss under a head of income for a tax year that cannot be set off under sub-section (1), the person shall not be permitted to carry the loss forward to the next tax year.
- (3) Where, in a tax year, a person sustains a loss under the head "Income from Business" and a loss under another head of income, the loss under the head "Income from Business" shall be set off last.

57. Carry forward of Business Losses

- (1) Where a person sustains a loss for a tax year under the head "Income from Business" (other than a loss to which section 58 applies) and the loss cannot be wholly set off under section 56, so much of the loss that has not been set off shall be carried forward to the following tax year and set off against the person's income chargeable under the head "Income from Business" for that year.
- (2) If a loss sustained by a person for a tax year under the head "Income from Business" is not wholly set off under sub-section (1), then the amount of the loss not set off shall be carried forward to the following tax year and applied as specified in subsection (1) in that year, and so on, but no loss can be carried forward to more than six tax years immediately succeeding the tax year for which the loss was first computed.
- (2A) Where a loss, referred to in sub-section (2), relating to any assessment year commencing on or after 1st day of July, 1995, and ending on the 30th day of June 2001, is sustained by a banking company wholly owned by the Federal Government as on first day of June, 2002, which is approved by the State Bank of Pakistan for the purpose of this sub-section, the said loss shall be carried forward for a period of ten years.
- (3) Where a person has a loss carried forward under this section for more than one tax year, the loss of the earliest tax year shall be set off first.
- (4) Where the loss referred to in sub-section (1) includes deductions allowed under sections 22, 23 and 24 that have not been set off against income, the amount not set off shall be added to the deductions allowed under those sections in the following tax year, and so on until completely set off.
- (5) In determining whether a person's deductions under sections 22, 23 and 24 have been set off against income, the deductions allowed under those sections shall be taken into account last.

57A. Set off of business loss consequent to Amalgamation

- (1) The accumulated loss under the head "Income from Business" (not being a loss to which section 58 applies) of an amalgamating company or companies shall be set off or carried forward against the business profits and gains of the amalgamated company and vice versa up to a period of six tax years immediately succeeding the tax year in which the loss was first computed in the case of amalgamated company amalgamating company or companies.
- (2) The provisions of sub-section (4) and (5) of section 57 shall, *mutatis mutandis*, apply for the purposes of allowing unabsorbed depreciation of amalgamating company or companies in the assessment of amalgamated company and vice versa
- (3) Where any of the conditions as laid down by the State Bank of Pakistan or the Securities and Exchange Commission of Pakistan or any court, as the case may be, in the scheme of amalgamation, are not fulfilled, the set off of loss or allowance for depreciation made in any tax year of the amalgamated company or the amalgamating company or companies shall be deemed to be the income of that amalgamated company or the amalgamating company or

companies, as the case may be, for the year in which such default is discovered by the Commissioner or taxation officer, and all the provisions of this Ordinance shall apply accordingly.

59. Carry forward of Capital Losses

- (1) Where a person sustains a loss for a tax year under the head “Capital Gains” (hereinafter referred to as a “capital loss”), the loss shall not be set off against the person’s income, if any, chargeable under any other head of income for the year, but shall be carried forward to the next tax year and set off against the capital gain, if any, chargeable under the head “Capital Gains” for that year.
- (2) If a capital loss sustained by a person for a tax year under the head “Capital Gains” is not wholly set off under sub-section (1), then the amount of the loss not set off shall be carried forward to the following tax year, and so on, but no loss shall be carried forward to more than six tax years immediately succeeding the tax year for which the loss was first computed.
- (3) Where a person has a loss carried forward under this section for more than one tax year, the loss of the earliest tax year shall be set off first.

Deductible Allowances:

60. Zakat

- (1) A person shall be entitled to a deductible allowance for the amount of any Zakat paid by the person in a tax year under the Zakat and Ushr Ordinance, 1980 (XVIII of 1980).
- (2) Sub-section (1) does not apply to any Zakat taken into account under subsection (2) of section 40.
- (3) Any allowance or part of an allowance under this section for a tax year that is not able to be deducted under section 9 for the year shall not be refunded, carried forward to a subsequent tax year, or carried back to a preceding tax year.

61. Charitable donations:

- (1) A person shall be entitled to a tax credit in respect of any sum paid, or any property given by the person in the tax year as a donation to –
 - a) any board of education or any university in Pakistan established by, or under, a Federal or a Provincial law;
 - b) any educational institution, hospital or relief fund established or run in Pakistan by Federal Government or a Provincial Government or a local authority; or
 - c) any non-profit organization.

Sub-section (1) substituted by Finance Act, 2003 which previously read as follows:

A person shall be entitled to a tax credit for a tax year in respect of any amount paid, or property given by the person in the tax year as a donation to a non-profit organization."

- (2) The amount of a person’s tax credit allowed under sub-section (1) for a tax year shall be computed according to the following formula, namely:

$$(A/B) \times C$$

Where:

A is the amount of tax assessed to the person for the tax year before allowance of any tax credit under this Part;

B is the person’s taxable income for the tax year; and

C is the lesser of:

- (a) the total amount of the person’s donations referred to in subsection (1) in the year, including the fair market value of any property given; or
- (b) where the person is:
 - (i) an individual or association of persons, thirty per cent of the taxable income of the person for the year; or
 - (ii) a company, fifteen per cent of the taxable income of the person for the year.
- (3) For the purposes of clause (a) of component **C** of the formula in subsection (2), the fair market value of any property given shall be determined at the time it is given.
- (4) A cash amount paid by a person as a donation shall be taken into account under clause (a) of component **C** of sub-section (2) only if it was paid by a crossed cheque drawn on a bank.

- (5) The Central Board of Revenue may make rules regulating the procedure of the grant of approval under sub-clause (c) of clause (36) of section 2 and any other matter connected with, or incidental to, the operation of this section.

62. Investment in shares

- (1) A person other than a company shall be entitled to a tax credit for a tax year in respect of the cost of acquiring in the year new shares offered to the public by a public company listed on a stock exchange in Pakistan where the person other than a company is the original allottee of the shares or the shares are acquired from the Privatization Commission of Pakistan.
- (2) The amount of a person's tax credit allowed under sub-section (1) for a tax year shall be computed according to the following formula, namely:

$$(A/B) \times C$$

Where:

A is the amount of tax assessed to the person for the tax year before allowance of any tax credit under this Part;

B is the person's taxable income for the tax year; and

C is the lesser of:

- (a) the total cost of acquiring the shares referred to in sub-section (1) in the year;
 - (b) ten per cent of the person's taxable income for the year; or
 - (c) two hundred thousand rupees.
- (3) Where:
- a) a person has been allowed a tax credit under sub-section (1) in a tax year in respect of the purchase of a share; and
 - b) the person has made a disposal of the share within twelve months of the date of acquisition,

The amount of tax payable by the person for the tax year in which the shares were disposed of shall be increased by the amount of the credit allowed.

63. Contribution to an Approved Pension Fund

- (1) An eligible person as defined in sub-section (19A) of section 2 deriving income chargeable to tax under the head "Salary" or the head "Income from Business" shall be entitled to a tax credit for a tax year in respect of any contribution or premium paid in the year by the person in approved pension fund under the Voluntary Pension System Rules, 2005.
- (2) The amount of a person's tax credit allowed under sub-section (1) for a tax year shall be computed according to the following formula, namely:

$$(A/B) \times C$$

Where:

A is the amount of tax assessed to the person for the tax year, before allowance of any tax credit under this Part;

B is the person's taxable income for the tax year; and

C is the lesser of

- (a) the total contribution or premium referred to in sub-section (1) paid by the person in the year; or
 - (b) twenty per cent of the eligible person's taxable income for the relevant tax year; Provided that an eligible person (words "a person" substituted by Finance Bill 2006) joining the pension fund at the age of forty-one years or above, during the first ten years starting from July 1, 2006 (words "of the notification of the Voluntary Pension System Rules, 2005" substituted by Finance Bill 2006), shall be allowed additional contribution of 2% per annum for each year of age exceeding forty years. Provided further that the total contribution allowed to such person shall not exceed 50% of the total taxable income of the preceding year; or
 - (c) five hundred thousand rupees.
- (3) The transfer by the members of approved employment pension or annuity scheme or approved occupational saving scheme of their existing balance to their individual pension accounts maintained with one or more pension fund managers shall not qualify for tax credit under this section.

63. Retirement annuity scheme

- (1) Subject to subsection (3), a resident individual deriving income chargeable to tax under the head "Salary" or the head "Income from Business" shall be entitled to a tax credit for a tax year in respect of any contribution or premium paid in the year by the person under a contract of annuity scheme approved by , Securities and Exchange Commission of Pakistan of an insurance company duly registered under the Insurance Ordinance, 2000 (XXXIX of 2000), having its main object the provision to the person of an annuity in old age.
- (2) The amount of a resident individual's tax credit allowed under sub-section (1) for a tax year shall be computed according to the following formula, namely:

$$(A/B) \times C$$

Where:

A is the amount of tax assessed to the person for the tax year before allowance of any tax credit under this Part;

B is the person's taxable income for the tax year; and

C is the lesser of:

- a) the total contribution or premium referred to in sub-section (1) paid by the individual in the year;
 - b) ten (Substituted for "five" by Finance Act, 2003) per cent of the person's taxable (Substituted for "total" by Finance Act, 2003) income for the tax year; or
 - c) two (Substituted for "one" by Finance Act, 2003) hundred thousand rupees.
- (3) A person shall not be entitled to a tax credit under sub-section (1) in respect of a contract of annuity which provides:
- (a) for the payment during the life of the person of any amount besides an annuity;
 - (b) for the annuity payable to the person to commence before the person attains the age of sixty years;
 - (c) that the annuity is capable, in whole or part, of surrender, commutation, or assignment; or
 - (d) for payment of the annuity outside Pakistan.

64. Profit on debt:

- (1) A person shall be entitled to a tax credit for a tax year in respect of any profit or share in rent and share in appreciation for value of house paid by the person in the year on a loan by a scheduled bank or non-banking finance institution regulated by the Security and Exchange Commission of Pakistan or advanced by Government or the local authority or a statutory body or a public company listed on a registered stock exchange in Pakistan where the person utilizes the loan for the construction of a new house or the acquisition of a house.

Sub-Section (1) substituted by Finance Act, 2003 which previously read as follows:

"(1) A person shall be entitled to a tax credit for a tax year in respect of any profit or share in rent and share in appreciation of value of house paid by the person in the year on a loan by a scheduled bank under a house finance scheme approved by the State Bank of Pakistan or advanced by Government, the local authority or House Building Finance Corporation where the person utilizes the loan for the construction of a new house or the acquisition of a house."

- (2) The amount of a person's tax credit allowed under sub-section (1) for a tax year shall be computed according to the following formula, namely:

$$(A/B) \times C$$

Where:

A is the amount of tax assessed to the person for the tax year before allowance of any tax credit under this Part;

B is the person's taxable income for the tax year; and

C is the lesser of:

- (a) the total profit referred to in sub-section (1) paid by the person in the year;

- (b) forty (substituted “twenty five” by Finance Act, 2003) per cent of the person’s taxable (Substituted for "total" by Finance Act, 2003) income for the year; or
 - (c) five (Substituted for "one" by Finance Act, 2003) hundred thousand rupees.
- (3) A person is not entitled to tax credit under this section for any profit deductible under section 17.

Common Rules

Income of joint owners Section 66

- Where any property is own by two or more persons and there respective shares are definite and ascertainable:
 - a) the persons shall not be assessed as an AOP in respect of the property; and
 - b) the share of each person in the income from property for a tax year shall be taken into account in the computation of persons taxable income for that year.
- This section shall not apply in computing income chargeable under the head “Income from Business”

Apportionment of deductions Section 67

Where the expenditure relates to:

- The derivation of more than one head of income; or
- The derivation of income comprising of taxable income and any income under final tax regime
- The derivation of income chargeable to tax under a head of income and to some other purpose,
- The expenditure shall be apportioned on any reasonable basis taking account of the relative nature and size of the activities to which the amount relates.

Fair Market Value Section 68

- Fair market value of any property or rent, asset, service, benefit or perquisites at a particular time shall be the price which these mentioned above would ordinarily fetch on sale or supply in the open market at that time.

Receipt of Income Section 69:

- A person shall be treated as having received an amount, benefit, or perquisites if it is:
 - (a) actually received by the person
 - (b) applied on behalf of the person, at the instruction of the person or under any law; or
 - (c) made available to the person.

Recouped expenditure: Section 70

- where a person has been allowed a deduction for any expenditure or loss incurred in a tax year in the computation of persons income chargeable to tax under a head of income and, subsequently, the person has received in cash or in kind, any amount in respect of such expenditure or loss, the amount so received shall be included in the income chargeable under the head for the tax year in which it is received.

Currency Conversion: Section 71

- Every amount taken into account under this ordinance shall be in Rupees
- Where an amount is in a currency other than Rupees, the amount shall be converted to the Rupees at the State Bank of Pakistan exchange rate applicable on that date.

Cessation of Source of Income: Section 72

- Where:
 - a) any income is derived by a person in a tax year from any business, activity, investment or other source that has ceased either before the commencement of the year or during the year; and
 - b) if the income has been derived before the business, activity, investment or other source ceased, it would have been chargeable to tax under this ordinance,
- This ordinance shall apply to the income on the basis that the business, activity, investment or other source had not ceased at the time the income was derived.

Rules to prevent double Derivation and double Deductions: Section 73

Sec 73

- (1) Where:
 - (a) any amount is chargeable to tax under this ordinance on the basis that it is receivable, the amount shall not be chargeable again on the basis that it is received; or
 - (b) any amount is chargeable to tax under this ordinance on the basis that it is received, the amount shall not be chargeable again on the basis that it is receivable; or

(2) For the purposes of this Ordinance,

Where:

- (a) any expenditure is deductible under this Ordinance on the basis that it is payable, the expenditure shall not be deductible again on the basis that it is paid; or
- (b) any expenditure is deductible under this Ordinance on the basis that it is paid, the expenditure shall not be deductible again on the basis that it is payable.

**TAXATION OF INDIVIDUALS
AND
TAXATION OF ASSOCIATION OF PERSONS**

Exercise1-Sole Proprietorship

Mr. A is running business as sole proprietor. From the following information/data relevant to tax year 2007.

Opening Stock	Rs.800,000
Purchases	Rs.1,000,000
Sales	Rs.2,000,000
Carriage inwards	Rs.30,000
Closing stock	Rs.800,000
Electric bill of office paid	Rs 18,000
Telephone bill paid	Rs 20,000
Rent of office	Rs 120,000
Stationary for office	Rs 4000
Postages	Rs 3000
Salaries to staff	Rs 200,000
Advertisement expenses	Rs 10,000
Advance tax paid	Rs 60,000

Compute taxable income and tax thereon.

Solution to Ex. 1:

Tax Payer: Mr. A

Tax Year: 2007

Sole proprietorship

NTN: 000111

Trading and Profit & Loss Account

In Rs

Opening balance	800,000	Sale	2,000,000
Purchases	1,000,000	Closing Stock	800,000
Carriage inward	30,000		
Gross profit	970,000		
Total	2,800,000		2,800,000
Electricity	18,000		
Telephone	20,000		
Office rent	120,000		
Stationary	4,000		
Postages	3,000		
Salaries	200,000		
Advertising	10,000		
Net profit	595,000		
Total	970,000		970,000

Tax payable $595,000 \times 12.50\% =$ Rs. 74,375

Advance tax paid Rs 60,000

Tax payable Rs 14,375

Tax paid with return Rs 14,375

Tax payable / refundable Nil

Exercise 2: Taxation of Association of Persons

From the following information/ data for tax year 2007 regarding M/S XYZ brothers, a partnership firm, compute taxable income and tax liability of the firm as well as individual members.

- This firm comprises of three partners Mr. X, Mr. Y and Mr. Z, each partner has equal share in profits.
- Net profit of M/S XYZ brothers for tax year 2007 is worked out as Rs 900,000.
- Mr. Z has also earned income amounting Rs 200,000 from other sources.

Solution Exercise 2:

Tax Payer: M/S. XYZ

Tax Year: 2007

Partnership Firm

NTN: 000111

- Net profit (taxable income)

= Rs 900,000

- Tax liability of firm
(900,000 x 17.50 %*)

= Rs 157,500

*Tax rate at serial # 12 for income range Rs 800,000 to 1,000,000 is applied.

- **Note:**

Tax liability is the obligation of firm and not of the partners. However, if partner has income from any other source, his share of income from partnership is added to taxable income only for rate purposes. Share of profit of each member Mr. X, Mr. Y and Mr. Z Rs 300,000 each.

Computation of tax liability of Mr. Z

▪ Income from other sources	Rs200,000	
▪ Share of profit of Mr. Z from firm M/s XYZ brothers (Add for rate purposes only)	<u>Rs 300,000</u>	
▪ Taxable income	<u>Rs 500,000</u>	
▪ Tax payable (500,000 x 10%)		Rs 50,000
▪ Subtract tax liability due to addition of Rs 300,000 for rate purposes (50,000/ 500,000 x 300,000 = 30,000)		<u>Rs 30,000</u>
▪ Tax payable by Mr. Z (50,000-30,000=20,000)		<u>Rs 20,000</u>

If Rs 300,000 would have not been added for rate purposes, Mr. Z would have paid tax at the rate of 4 % that is 200,000 x 4% = 8,000 instead of Rs 20,000.

TAXATION OF COMPANIES**Minimum Tax on Resident Companies Sec 113**

- Resident Company is subjected to minimum tax @ 0.50% of its turnover for a tax year, even in cases where the company sustains loss.

Turnover under this section means:

- the gross receipts, exclusive of sales tax and central excise duty or any trade discounts shown on invoice or bills, derived from the sale of goods;
- the gross fees for the rendering of services or giving benefits, including commissions;
- the gross receipts from the executions of contracts; and
- the company's share of the amounts stated above of any association of persons of which the company is a member

Exercise-1

M/S XYZ (PVT) Ltd. filed return for tax year 2007, declaring taxable income of Rs. 1,300,000 and paid entire liability of tax. On scrutiny of record by tax authorities, it came to their notice that following amounts have been paid by Cash. In the light of this information/data compute tax liability of said company for tax year-2007.

Salary	Rs. 30,000
Office Rent	Rs. 120,000
Professional Fee	Rs. 80,000
Postages	Rs. 8,000
Freight paid	Rs. 9,000
Electricity bill	Rs. 7,000
Telephone	Rs. 5,000
Penalty	Rs. 9,000

Solution of E-1

Add Back Inadmissible Deductions Under Section 21

Salary paid by cash	Rs. 30,000
Rent of office paid by cash	Rs. 120,000
Professional fee paid by cash	<u>Rs. 80,000</u>
Total Additions	Rs. 230,000
Declared income	Rs. 1,300,000
Tax already paid (1,300,000 x 35%)	Rs. 455,000
Additions made U/S 21	Rs. 230,000
Tax payable on additions	Rs. 80,500

Note:

Additions on account of rest of payments, although by cash not required to be added back as provided in section 21(L)

Computation of Depreciation**Exercise 2**

M/S A.K. Brothers is a partnership firm. In the books of accounts the following information/data has been provided with respect to plant and machinery. Compute normal depreciation and initial allowance in the light of the given information.

Book value of plant and machinery as on 01-07-2006	Rs. 1,800,000
Machinery disposed of during the year with book value.	Rs. 600,000
Additions of eligible depreciable asset during the year	Rs. 1,000,000

Solution of E-2

Tax Payer: A.K. Brothers Tax Year: 2007

Residential Status: Resident NTN: 000111

Particulars	Book value	Depreciation
Opening W.D.V	1,800,000	---
Disposals	<u>(600,000)</u>	---

Balance W.D.V	1,200,000(X)	----
Additions during Year	1,000,000	
Initial allowance		
@ 50% on 1,000,000		500,000
Balance book value	(Y) 500,000	
Total book value (X+Y)	1,700,000	

Normal Depreciation@ 15%	<u>255,000</u>
Total Depreciation	755,000

On Speculation Business**Exercise 3**

M/s ABC Ltd. A manufacturing company has furnished the following accounting information for tax year 2007. Compute taxable income and tax thereon:

- Gross Income from normal business	Rs.2,500,000
- Expenditures on normal business	Rs. 1,000,000
- Gross income from speculation business	Rs. 600,000
- Expenditures on speculation business	Rs.300,000
- Loss carried forward on normal business	Rs. 200,000
- Loss Carried forward on speculation business	Rs. 900,000
- Advance Tax Paid	Rs. 200,000

Solution of E-4

Tax Payer: ABC Ltd.

Tax Year: 2007

Residential Status: Resident

NTN: 000111

Computation of taxable income and tax thereon:

In Rs.

Particulars	Speculation Operations	Normal Business	Total
Gross Income	600,000	2,500,000	3,100,000
Expenditures	(300,000)	(1,000,000)	(1,300,000)
Net Income	300,000	1,500,000	1,800,000
C/F Loss	(900,000)	(200,000)	(1,100,000)
Taxable Income	(600,000)	1,300,000	---
Note-1			

Taxable Income:

Normal business Rs.1,300,000

Tax payable= (1,300,000 x 35%) = Rs. 455,000

Note-1:

Loss of Rs. 600,000 from speculation business can not be set off against business income, it can be set off against speculation business income, and hence this loss of Rs. 600,000 shall be carried forward to next year.

Taxation of Companies**Exercise-4**

M/S XYZ is a limited company, running a chain of hospitals. The company filed tax return along with relevant accounts/ documents for tax year 2006. This return has been selected for total audit. As a taxation officer, work out taxable income and tax liability of the said company for tax year 2006.

Medicines purchased Rs. 1,000,000

Ambulances- running expenses. Rs. 300,000

Depreciation on ambulances Rs. 40,000

Depreciation on other assets Rs. 60,000

Salaries paid through bank accounts of employees Rs. 300,000

Unsupported payment for purchase of stationery Rs. 12,000

Depreciation on account of car owned by director and in his personal use Rs. 40,000

Payment of legal fee by cash Rs. 60,000

Received payments from corporations on the panel of the hospitals Rs. 6,000,000

Other receipts Rs. 2,000,000

Gain on sale of a vehicle Rs. 200,000

Purchase of X-Ray machine for shown as expense in revenue account Rs. 1,000,000

Withholding tax deductions Rs. 525,000

Loss carried forward from tax year 2005

Rs. 1,200,000

Solution of E-4

Tax Payer: M/S XYZ Ltd.

Tax Year: 2006

Resident Company

NTN: 000111

Revenue Account as Submitted by Co.

EXPENDITURES		RECEIPTS	
Particulars	Amount in Rs.	Particulars	Amount in Rs.
Medicines	1,000,000	From Corporations	6,000,000
Ambulances	300,000	Other Receipts	2,000,000
Depreciation (Ambulances)	40,000	Gain on Sale of Vehicles	200,000
Depreciation Others	60,000		
Salaries thru bank	300,000		
Unsupported PAMT	12,000		
Depreciation on personal car	40,000		
Legal Fee by cash	60,000		
X-Ray machine	1,000,000		
Net Profit	5,388,000		
	8,200,000		8,200,000

Computation of Tax Payable:

Net Profit as computed by Co.	5,388,000
Less set off of c/f losses	(1,200,000)
Taxable Income	4,188,000
Tax Payable 4,188,000x35%	1,465,800
Less withholding Tax deductions	525,000
Balance Tax Payable	940,800
Tax Paid with Return	940,800
Tax Payable/Refundable	NIL
Additions by Taxation Officer on account of inadmissible expenses:	
Unsupported payments	12,000
Depreciation claimed on personal car of Director	40,000
Payment of legal fee by cash	60,000
Purchase of X-Ray machine (to be capitalized, balance sheet item as such not to be shown in Revenue a/c)	1,000,000
Total additions	1,112,000
Tax payable on account of add backs (1,112,000 x 35%= 389,200)	389,200
The company shall have to pay tax amounting Rs 389,200.	

Presumptive income
Taxation of permanent establishment (pe)

Presumptive Income:

Under normal tax regime, income tax is chargeable on taxable income but under some exceptional circumstances, the income tax shall be charged on gross receipts. This is also called as presumptive tax regime. Under following situations the tax will be charged on gross receipts basis.

Tax on dividends:

- (a) Subject to this Ordinance, a tax shall be imposed, at the rate specified in Division III of Part I of the First Schedule, on every person who receives a dividend from a company.
- (b) The tax imposed under sub-section (1) on a person who receives a dividend shall be computed by applying the relevant rate of tax to the gross amount of the dividend.
- (c) This section shall not apply to a dividend that is exempt from tax under this Ordinance.

6. Tax on Certain Payments to Non-Residents:

- (1) Subject to this Ordinance, a tax shall be imposed, at the rate specified in Division IV of Part I of the First Schedule, on every non-resident person who receives any Pakistan-source royalty or fee for technical services.
- (2) The tax imposed under sub-section (1) on a non-resident person shall be computed by applying the relevant rate of tax to the gross amount of the royalty or fee for technical services.
- (3) This section shall not apply to:
 - (a) any royalty where the property or right giving rise to the royalty is effectively connected with a permanent establishment in Pakistan of the non-resident person;
 - (b) any fee for technical services where the services giving rise to the fee are rendered through a permanent establishment in Pakistan of the non-resident person; or
 - (c) any royalty or fee for technical services that is exempt from tax under this Ordinance.
- (4) Any Pakistani-source royalty or fee for technical services received by a non-resident person to whom this section does not apply by virtue of clause (a) or (b) of sub-section (3) shall be treated as income from business attributable to the permanent establishment in Pakistan of the person.

7. Tax on Shipping and Air Transport Income of a Non-Resident Person

- (1) Subject to this Ordinance, a tax shall be imposed, at the rate specified in Division V of Part I of the First Schedule, on every non-resident person carrying on the business of operating ships or aircraft as the owner or charterer thereof in respect of–
 - (a) the gross amount received or receivable (whether in or out of Pakistan) for the carriage of passengers, livestock, mail or goods embarked in Pakistan; and
 - (b) the gross amount received or receivable in Pakistan for the carriage of passengers, livestock, mail or goods embarked outside Pakistan.
- (2) The tax imposed under sub-section (1) on a non-resident person shall be computed by applying the relevant rate of tax to the gross amount referred to in subsection (1).
- (3) This section shall not apply to any amounts exempt from tax under this Ordinance.

Taxation of PE**105. Taxation of a Permanent Establishment in Pakistan of a Non-Resident Person.**

- (1) The following principles shall apply in determining the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head “Income from Business”, namely:
 - (a) The profit of the permanent establishment shall be computed on the basis that it is a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the nonresident person of which it is a permanent establishment;
 - (b) subject to this Ordinance, there shall be allowed as deductions any expenses incurred for the purposes of the business activities of the permanent establishment including executive and administrative expenses so incurred, whether in Pakistan or elsewhere;
 - (c) no deduction shall be allowed for amounts paid or payable by the permanent establishment to its head office or to another permanent establishment of the non-resident person (other

than towards reimbursement of actual expenses incurred by the non-resident person to third parties) by way of:

- (i) royalties, fees or other similar payments for the use of any tangible or intangible asset by the permanent establishment;
 - (ii) compensation for any services including management services performed for the permanent establishment; or
 - (iii) profit on debt on moneys lent to the permanent establishment, except in connection with a banking business; and
- (d) no account shall be taken in the determination of the income of a permanent establishment of amounts charged by the permanent establishment to the head office or to another permanent establishment of the non-resident person (other than towards reimbursement of actual expenses incurred by the permanent establishment to third parties) by way of:
- (i) royalties, fees or other similar payments for the use of any tangible or intangible asset;
 - (ii) compensation for any services including management services performed by the permanent establishment; or
 - (iii) profit on debt on moneys lent by the permanent establishment, except in connection with a banking business.
- (2) No deduction shall be allowed in computing the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head “Income from Business” for a tax year for head office expenditure in excess of the amount as bears to the turnover of the permanent establishment in Pakistan the same proportion as the non-resident’s total head office expenditure bears to its worldwide turnover.
- (3) In this section, “head office expenditure” means any executive or general administration expenditure incurred by the non-resident person outside Pakistan for the purposes of the business of the Pakistan permanent establishment of the person, including:
- (a) any rent, local rates and taxes excluding any foreign income tax, current repairs, or insurance against risks of damage or destruction outside Pakistan;
 - (b) any salary paid to an employee employed by the head office outside Pakistan;
 - (c) any traveling expenditures of such employee; and
 - (d) any other expenditures which may be prescribed
- (4) No deduction shall be allowed in computing the income of a permanent establishment in Pakistan of a non-resident person chargeable under the head “Income from Business” for:
- (a) any profit paid or payable by the non-resident person on debt to finance the operations of the permanent establishment; or
 - (b) any insurance premium paid or payable by the non-resident person in respect of such debt.

MODULE 15**LESSON 15.40****TAX RETURNS & ASSESSMENT OF INCOME
UNIVERSAL SELF ASSESSMENT SCHEME****Tax Return:**

Return is prescribed document for submission of taxable income by taxpayer. Specimens of Return to be submitted by different taxpayers are designed by CBR under Income Tax rules, 2002.

Persons Required to File Returns**a) Every Company:**

Every person (other than company) whose taxable income exceeds the initial threshold as provided under the ordinance (However, companies to submit return & pay minimum tax even in case of loss @ 0.50% of annual turn over)

b) Every Person:

- Charged to tax for any two preceding years
- Claims loss that is carried forward
- Owns immovable property, with a land area of 250 Sq. yards or more in municipal limits, cantonment and CDA

A return of income shall be:

- (a) Prescribed form along with required documents.
- (b) Fully state all relevant particulars or information as specified in the form of return, including a declaration of the records kept by the taxpayer; and
- (c) Shall be signed by the person, being an individual, or the person's representative where section 172 applies.

❖ A return of income can also be filed electronically. (e- Filing of return)

Returns on Notice by Commissioner

The Commissioner may, by notice in writing, require a person, or a person's representative, as the case may be, to furnish a return of income by the date specified in the notice for a period of less than 12 month, where-

- The person has died;
 - The person has become bankrupt or gone into liquidation;
 - The person is about to leave Pakistan permanently.
- The commissioner may require any person to file a return of income, if in the opinion of the commissioner, a person is required to file a return for a tax year but he failed to do so. The person on whom the notice is served shall file return within 30 days from the date of service of notice.
 - In case of any omission by a tax payer, a revised return can be filed within 5 years of the date that the original return was furnished.

Person Not Required to File Tax Return

Section 115 grants immunity to salaried person in lieu of filing a return as outlined below:

- **Salary certificate from employer sufficient in lieu of return**

Other Exceptions: Sec-115

- Widow
- Orphan below age of 25 years
- Disabled person or
- In case of ownership of immovable property, a non-resident person

Further Exceptions

All persons subject to final tax regime/PTR u/s5, 6, 7, 113A, 148, 153, 154, 156, 156A, 233 or 235(5) shall furnish to CIT a statement showing such particulars relating to person's income for tax year in such form and verified in such manner as may be prescribed.

Filing of Wealth Statement (Sec. 116)

The Commissioner may, by notice in writing, require any person to furnish, on the date specified in the notice, a statement (hereinafter referred to as the "wealth statement") in the prescribed form and verified in the prescribed manner giving particulars of:

- (a) The person's total assets and liabilities as on the date or dates specified in such notice;

- (b) The total assets and liabilities of the person's spouse, minor children and other dependents as on the date or dates specified in such notice;
 - (c) Any assets transferred by the person to any other person during the period or periods specified in such notice and the consideration for the transfer; and
 - (d) The total expenditures incurred by the person, and the person's spouse, minor children, and other dependents during the period or periods specified in the notice and the details of such expenditures.
- Every resident taxpayer filing a return of income for any tax year (whose last declared or assessed income, is five hundred thousand rupees or more) shall furnish a wealth statement for that year along with such return.
 - Where a person, who has furnished a wealth statement, discovers any omission or wrong statement therein, he may, without prejudice to any liability incurred by him under any provision of this Ordinance, furnish a revised wealth statement at any time before an assessment, for the tax year to which it relates, is made under sub sec (1).

Sec. 117—Discontinuance of Business:

Return to be filed within 15 days of discontinuance.

- Where NTN is not already registered /allotted/ issued taxpayer shall apply on prescribed form for NTN at the time of furnishing return of income.

Provision of Revised Tax Return:

A person may furnish Revised Return within five years of the date when the original return was furnished.

Extension in time for furnishing returns and other documents:

If commissioner is satisfied that applicant is unable to furnish returns and other documents by due date because of the following reasons, he can grant extension for 15 days from the due date, however, under exceptional circumstances, a longer extension of time can also be granted.

Longer extension in time can be granted in the following situations:

- Absence from Pakistan
- Sickness or other misadventure; or
- Any other reasonable cause

**TAX RETURNS & ASSESSMENT OF INCOME
UNIVERSAL SELF ASSESSMENT SCHEME**

Assessments

Process whereby claims of taxpayers are verified by tax authorities and taxable income & tax thereon is determined according to the ordinance.

Ways of Framing Assessment under Normal Tax Regime

1. **Normal Assessment/ USAS**
2. **Provisional Assessment**
3. **Best Judgment Assessment**

1. **Normal Assessment/Universal Self assessment Scheme (Sec. 120)**

Where complete return furnished by taxpayer:

(Other than revised return u/s 114(6) which can be submitted within five years of original return)

- The commissioner shall be taken to have made an assessment of taxable income for tax year and tax thereon, equal to amount as specified in the return.
- Return shall be taken as Assessment Order by the commissioner.

Return shall be taken as complete if in accordance with Sec. 114(2)

- (a) If return is incomplete, notice by CIT to rectify omissions, deficiencies by due date (However, errors pertaining to taxable income and tax payable not rectifiable under this section)
- (b) If reply not submitted by due date incomplete return submitted shall be treated as invalid Return.
- (c) Return submitted shall be treated as complete, if tax payer complied with requirements of notice under Sub. Sec. (3)
- (d) No notice u/s 120(3) after expiration of one year. (Return & Assessment attains finality after expiration of one year)

Best Judgment Assessment Sec. 121 (1) where a person:

- (a) Fails to furnish a return u/s 114(3) or 114(4)
- (b) Fails to furnish return u/s 143 or 144
- (c) (Return to be filed by non-resident Air Carriers or Shipping Companies)
- (d) Fails to furnish return u/s 116 (Wealth Statement on notice by CIT or where income is rupees 500,000/ and above.)
- (e) Fails to furnish documents u/s 174 (prescribed documents)

Assessment Order by Commissioner

Shall state the following details:

- Taxable Income
- Tax Due
- Amount of Tax Paid.
- Tax Payable
- Time, place & manner of appealing the assessment order.

Amendment of Assessments (Sec 122)

Amendments shall be made when the commissioner is satisfied on the basis of definite information that:

- Any income chargeable to tax has escaped assessment; or
- Total income has been under-assessed, or assessed at too low a rate, or has been the subject of excessive relief or refund; or
- Any amount under a head of income has been misclassified.

Revision by the Commissioner Sec 122 A

The commissioner shall not revised any order, if

- (a) an appeal against the order lies to the commissioner (Appeals) or to the appellate tribunal, the time within which such appeal may be made has not expired; or
- (b) the order is pending in appeal before the commissioner (appeals) or has been made the subject of appeal to the appellate tribunal.

Revision by the Regional Commissioner Sec 122 B

Revision can be made by RCIT at his own or on an application made by the tax payer relating to issuance of an exemption or lower rate certificate with regard to collection or deduction of tax at source.

2. Provisional Assessment (Sec. 123)

Sec. 123(1) Where, Concealed assets impounded by any department, agency of federal or provincial govt. the commissioner may issue to the person a provisional assessment order or provisional amended assessment order, as the case may be, for the last completed tax year of the person taking into account the concealed asset.

Concealed asset means any property or asset acquired from any income subject to tax, in the opinion of CIT.

Assessment giving effect to an order Sec. 124**Special Provisions with respect to Assessment Sec. 125**

In relation to disputed properties assessment within one year from the date of decision by court.

Sec. 126 Evidence of Assessment:

Production of assessment order or certified copy thereof shall be conclusive evidence.

- An assessment order may not deem void, void able for want of form, hence not to be quashed.
- An order may not be affected by reason of any mistake, defect or omission therein, if in substance & effect in conformity with the ordinance.

Sec. 124-A modification of an Order by Commissioner

- CIT shall follow a decision on a question of law by H.C or ITAT even in cases where appeal has been filed. On reversal CIT shall modify order.
- **Sec. 124:** Assessment to give effect to an order of CIT (A), ITAT, High Court, Supreme Court.

3. Self Assessment Scheme**Salient features of Universal Self Assessment Scheme****1) Scope of the scheme:****Section 120 (1) (2):**

- (1) Where a taxpayer has furnished a complete return of income (other than a revised return under sub-section (6) of section 114) for a tax year ending or after the 1st day of July, 2002
 - (a) the commissioner shall be taken to have made an assessment of taxable income for that tax year, and the tax due thereon, equal to those respective amounts specified in the return; and scheme.
 - (b) the return shall be taken for all purposes of this Ordinance to be an assessment order issued to the taxpayer by the Commissioner on the day the return was furnished.
- (2) A return of income shall be taken to be complete if it is in accordance with the provisions of sub-section (2) of section 114. (Prescribed Form, Relevant particulars & Signed)

Section 114 (2)

- (2) A return of income:
 - (a) shall be in the prescribed form and shall be accompanied by such annexure statements or documents as may be prescribed;
 - (b) Shall fully state all the relevant particulars or information as specified in the form of return, including a declaration of the records kept by the taxpayers;
 - (c) shall be signed by the person, being an individual, or the person's representatives where section 172 applies.

2) Requirements of a Return

Rule 34 sub-rule (2), (3) and (4):

- (2) a return of income as required to be furnished under section 114 shall be in the form specified in
 - (a) Part-i (for companies);
 - (b) Part-ii (for non- salaried individuals and association of persons)
 - (c) Part-iii A (for salaried individuals having other sources of income etc, as attachment to employer's certificate in lieu of return of income); of the Second Schedule to these rules
- (3) A return of income shall be verified in the manner specified in the form
- (4) A return of in come shall be accompanied by the following namely;
 - a. Applicable documents;
 - b. Statements;
 - c. Certificates; and
 - d. Annexes

3) Short Documents Notice**Section 120 (3) (4) (5) (6)**

- (3) Where the return of income furnished is not complete, the Commissioner shall issue a notice to the taxpayer informing him of the deficiencies (other than incorrect amount of tax payable on taxable income, as specified in the return, or short payment of tax payable) and directing him to provide such information, particulars, statement or documents by such date specified in the notice.
- (4) Where a taxpayer fails to fully comply by the due date, with the requirements, of the notice under sub-section (3), the return furnished shall be treated as an invalid return as if it had not been furnished.
- (5) Where, in response to a notice under sub-section (3), the taxpayer has, by the due date, fully complied with the requirements of the notice, the return furnished shall be treated to be complete on the day it was furnished and the provisions of sub-section (1) shall apply accordingly
- (6) No notice under Sub-section (3) shall be issued after the end of the financial year in which return was furnished, and the provisions of sub-section (1) shall apply accordingly.

4) Selection for Audit Section 177

- The Central Board of Revenue may lay down criteria for selection of any person for any audit of person's income tax affairs, by the Commissioner.
 - The Commissioner shall select a person for audit in accordance with the criteria laid down by the Central Board of Revenue under sub-section (1)
 - The Central Board of Revenue shall keep the criteria confidential.
- (4) In addition to the selection referred to in sub-section (2), the Commissioner may also select a person for an audit of the person's income tax affairs having regard to—
 - i. the person's history of compliance or non-compliance with this Ordinance;
 - ii. the amount of tax payable by the person;
 - iii. the class of business conducted by the person; and
 - iv. any other matter which in the opinion of Commissioner is material for determination of correct income.
 - (5) After selection of a person for audit under sub-section (2) and (4), the Commissioner shall conduct an audit of the income tax affairs (including examination of accounts and records, enquiry into expenditure, assets and liabilities) of that person.
 - (6) After completion of the audit under sub-section (5) or sub-section (8), the Commissioner may, if considered necessary, after obtaining taxpayer's explanation on all the issues raised in the audit, amend the assessment under sub-section (1) or sub-section (4) of section `122, as the case may be.
 - (7) The fact that a person has been audited in a year shall not preclude the person from being audited again in the next and following years where there are reasonable grounds for such audits, particularly having regard to the factors in sub-section (4).
 - (8) The Central Board of Revenue may appoint a firm of Chartered Accountants to conduct an audit of the income tax affairs of any person and the scope of such audit shall be as determined by the Central Board of Revenue on a case to case basis.
 - (9) Any person employed by a firm referred to in sub-section (8) may be authorized by the Commissioner, in writing, to exercise the powers in sections 175 and 176 for the purpose of conducting an audit under that sub-section. (Power to enter and search premises & Notice to obtain information or evidence respectively)

Section 120 (1A)

Notwithstanding the provisions of sub-section (1) of Section 120, the Commissioner may select a person for an Audit of his income tax affairs under Section 177 and all the provision of that section shall apply accordingly.

**ADVANCE TAX
COLLECTION & RECOVERY OF TAX
PENALTIES & PROSECUTION**

Collection and recovery of tax gorgeous**Due date for payment of taxes (Sec. 137)**

Tax shall be due:

- On due date for furnishing the return for that tax year
- Within thirty days of service of notice, in case of an assessment order passed by the commissioner.

Recovery of tax out of Property and through arrest of Tax-Payer (Sec. 138)

- Attachment and sale of any movable or immovable property of tax payer
- Appointment of receiver for the management of movable or immovable property of the taxpayer
- Arrest of taxpayer and his detention in prison not exceeding six months

Recovery of Tax by District Officer (Revenue) (Sec. 138A)

On a Certificate from Commissioner specified property of taxpayer and amount of tax due.

Collection of tax in the case of private companies and Association of Persons:

If amount of tax due cannot be recovered from the company then it can be recovered from every person who was at any time in that tax year:

- A director of the company, other than employed director
- Share holder owning at least ten percent of paid up capital of the company shall be jointly and severally responsible.
- In case of AOP, if tax due from member in respect of member's share of income of the association for any tax year cannot be recovered from the member, the association shall be liable for the tax due by the member.

Recovery of Tax from persons holding money due on behalf of a taxpayer (Sec. 140)

- For the purpose of recovering any tax due by a taxpayer, the commissioner may, by notice, in writing, require any person
- Owing or who may owe money to the taxpayer; or
- Holding or who may hold money for or on account of the taxpayer;
- Holding or who may hold money on account of some other person for payment to the taxpayer; or
- Having authority of some other person to pay money to the taxpayer

Liquidators (Sec. 141):

Following are referred to as liquidator:

- A liquidator of a company
- A receiver appointed by a Court or appointed out of court
- A trustee for a bankrupt
- A mortgagee in possession
- **Liquidators** shall, within fourteen days of being appointed or taking possession of an asset in Pakistan, whichever occurs first, give written notice thereof to the commissioner.
- **Commissioner** shall within three months of being notified to provide the information regarding tax payable by the person, whose assets are in the possession of liquidators.
- A liquidator shall not, without leave of commissioner, part with any asset held as liquidator until liquidator has been notified by the commissioner.
- **A liquidator:**
 - Shall set aside, out of the proceeds of sale of any asset by the liquidator, the amount notified by the Commissioner under sub-section 2, or such lesser amount as is subsequently agreed to by the Commissioner;
 - Shall be liable to the extent of the amount set aside for the tax of the person who owned the asset; and
 - May pay any debt that has priority over the tax referred to in this section notwithstanding any provision of this section

- Recovery of tax due by non-resident member of an Association of Persons Sec. 142
- Non resident ship owner or charterer (Sec.143)
- Non resident aircraft owner or charterer (Sec. 144)

Assessment of Person about to Leave Pakistan (Sec. 145)

Notify to CIT about probable date of departure not less than fifteen days from said date if he has to leave country with no intention to return to Pakistan.

- CIT shall give notice to furnish return of taxable income for tax year for which tax payer is required to file return. Taxable income shall be charged to tax.
- Recovery of tax from Persons assessed in AJK

Penalty

Penalty for failure to furnish a return or statement Sec. 182

Liable for penalty equal to one-tenth of one percent of the tax payable for each day of default subject to a minimum penalty of Rupees five hundred and maximum penalty of twenty five percent of tax payable in respect of that tax year.

Penalty for non-payment of tax Sec 183:

Liable for penalty equal to:

- a) In the case of **first default, five percent** of the amount of tax in default
- b) In case of the **second default**, an additional penalty of **twenty five percent** of the amount of tax in default;
- c) In the case of **third default**, an additional penalty of **twenty five percent** of the amount of tax in default
- d) In the case of a **fourth and subsequent default**, an additional penalty of up-to **fifty percent** of the amount of tax in default and determined by the commissioner, but the total penalty in respect of the amount of tax in default shall not exceed, one hundred percent of such amount of tax.

Penalty for failure to maintain records Sec. 185

- a) in case of **first failure, two thousand rupees**
- b) in the case of **second failure, five thousand rupees.**
- c) in the case of **third and subsequent failure, ten thousand rupees.**

Penalty for non-compliance with notice: Sec 186

- a) in case of **first failure, two thousand rupees**
- b) in the case of **second failure, five thousand rupees.**
- c) in the case of **third and subsequent failure, ten thousand rupees.**

Penalty for making false or misleading statements Sec 187:

- Where the statement or omission are made knowingly or recklessly, two hundred percent of the tax short fall; or
- In any other case, twenty five percent of tax short fall

Penalty for failure to give notice Sec 188

- The commissioner may impose a penalty on the person not exceeding the amount of tax payable by the person for the tax year in which business was discontinued.
- Where a person fails to give notice of the person's appointment as liquidator as required under section 141, the commissioner may impose a penalty on the person not exceeding ten thousand rupees.

Penalty for obstruction Sec 189

Commissioner may impose a penalty **not exceeding ten thousand rupees.**

Imposition of penalty Sec 190

No penalty may be imposed on any person unless the person is given a reasonable opportunity of being heard.

Offences & Prosecutions

▪Prosecution for non-compliance with certain statutory obligations (Sec. 191)

- Non-compliance of notice
- Non-payment of advance tax u/s 147
- Non-collection/deduction of tax
- A person who fails to comply with the provisions of this section shall commit an offence punishable on conviction with a fine or imprisonment for a term not exceeding one year or both.

▪ **Prosecution for false statement in verification (Sec. 192)**

The person shall commit an offence punishable on conviction with a fine or imprisonment for a term not exceeding three years, or both.

▪ **Prosecution for failure to maintain records (Sec.193)**

- Where the failure was deliberate, a fine or imprisonment for a term not exceeding two years, or both; or
- In any other case, a fine shall be imposed.

Prosecution for improper use of National Tax Number card (Sec. 194)

The person shall commit an offence punishable on conviction with a fine or imprisonment for a term not exceeding two years, or both.

Prosecution for making false or misleading statements (Sec. 195)

-The person shall commit an offence punishable on conviction:

- Where the statement or conviction was made knowingly or recklessly, with a fine or imprisonment for a term not exceeding two years, or both; or
- In any other case, with a fine

❖ **Prosecution for obstructing an income tax authority (Sec.196)**

The person shall commit an offence punishable on conviction with a fine or imprisonment for a term not exceeding one year, or both.

❖ **Prosecution for disposal of property to prevent attachment (Sec. 197)**

The person shall commit an offence punishable on conviction with a fine or imprisonment for a term not exceeding three years, or both.

❖ **Prosecution for unauthorized disclosure of information by a public servant (Sec. 198)**

The person shall commit an offence punishable on conviction with a fine or imprisonment for a term not exceeding six months, or both.

▪ **Prosecution for abetment (Sec. 199)**

- The person shall commit an offence punishable on conviction with a fine or imprisonment for a term not exceeding three years, or both.

▪ **Offences by companies and associations of persons (Sec. 200)**

In case of company, every person who at the time, offence was committed, was:

- Principal Officer, Director, General Manager, Company secretary or any other similar officer of the company; or
- Acting or purporting to act in that capacity shall be guilty of the offence
- Power to compound offences (Sec. 202)
- CIT may compound with tax payer/person and order that such person to pay the amount for which offence may be compounded.

147. Advance tax paid by the taxpayer.

- (1) Subject to sub-section (2), every taxpayer whose income was charged to tax for the latest tax year under this ordinance or latest assessment year under the repealed ordinance other than –
 - (a) Income chargeable to tax under the head “Capital Gains”;
 - (b) Income chargeable to tax under sections 5, 6 and 7;
 - (ba) Income chargeable to tax under section 15;
 - (c) Income subject to deduction of tax at source under section 149; or
 - (ca) Income chargeable to tax under section 233 and clauses (a) and (b) of sub-section (1) of section 233A.
 - (d) Income from which tax has been collected under Division II or deducted under Division III and for which no tax credit is allowed as a result of sub-section (3) of section 168, shall be liable to pay advance tax for the year in accordance with this section.
- (2) This section does not apply to an individual or association of persons where the individual’s or association of persons latest assessed taxable income excluding income referred to in clauses (a), (b), (ba), (c) and (d) of sub-section (1) is less than one hundred and fifty thousand rupees.
- (4) Where the taxpayer is a company, the amount of advance tax due for a quarter shall be computed according to the following formula, namely:

$$(A/4) - B$$

Where:

A is the tax assessed to the taxpayer for the latest tax year or latest assessment year under the repealed ordinance; 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

**APPEALS AND REFERENCES
FEDERAL TAX OMBUDSMAN**

Appeals**Appeal to the Commissioner (Appeals) (Sec.127)****Provided:**

Amount of tax due under section 137 has been paid and

Appeal shall be filed:

- i) In prescribed form
- ii) Verification
- iii) Grounds of appeal
- iv) Prescribed fee
- v) Within 30 days of the date of service of the order against which appeal is filed

Prescribed Fee--In case of appeal against assessment order / notice

- Lesser of Rs.1000 or
- 10% of tax assessed

In any other case:

- Companies to pay rupees one thousand
- Others rupees two hundred only

Procedure in appeal (Sec.128)

- CIT shall give notice of hearing to the appellant and to the commissioner.
- CIT, if satisfied may allow an appellant to file any new ground of appeal.
- CIT (Appeal) shall not admit any documentary material or evidence which was not produced before the commissioner unless the commissioner (Appeal) is satisfied that appellant was prevented by sufficient cause from producing such material or evidence before the commissioner.

Decision in Appeal (Sec.129)

Commissioner of appeal may:

- Confirm, modify or annul assessment order.
- Order to be passed within three month of date of filing appeal, otherwise the relief sought by the appellant in the appeal shall be treated as having been given.

Appointment of the Appellate Tribunal (Sec. 130)

- Appellant tribunal shall consist of a chair person, judicial members and accountant members as are appointed by the Federal Government.
- Qualification of a judicial member:
 - a) The person who has exercised the powers of a District Judge and is qualified to be a Judge of a High Court; or
 - b) Is or has been an advocate of a High Court and is qualified to be a Judge of a High Court.
- Qualification of an accountant member:
 - a) The person who is an officer of an income tax group equivalent in rank to that of a regional commissioner

Appeal to Appellate Tribunal (Sec. 131)

Appeal shall be:

- In the prescribed form;
- Verified in the prescribed manner
- Accompanied by prescribed fee
- The prescribed fee shall be in case of appeal in relation to an assessment order lesser of:
 - **Two thousand five hundred rupees or 10% of the tax accessed or**
 - **In any other case-**
 - **If appellant is an company, two thousand rupees; or**
 - **Where appellant is not a company, five hundred rupees**
- Appeal to be filed within sixty days of the order of the commissioner (Appeals)

- Maximum period for staying recovery of tax not beyond six months
- The appellate tribunal shall decide appeal within 6 months of its filing.
- The appellate tribunal shall communicate its order to the tax payer and the commissioner.

Reference to the High Court (Sec. 133) on a Question of Law

- Reference to High Court may be filed within 90 days of the communication of the order of appellate tribunal.
- The aggrieved person or the commissioner may prefer an application, in the prescribed form along with a statement of the case, to the high court, stating any question of law arising out of such order.
- Division Bench of High Court to hear reference application.
- High court to deliver the judgment and copy is sent to Tribunal for giving effect to its judgment.
- Fee of rupees one hundred shall be paid by a person other than the commissioner.

Burden of proof in appeals (sec. 136) on Tax Payers:

- In case of assessment order on the tax Payer, to the extent to which order does not correctly reflect tax payer's liability for the tax year; or
- In the case of any other decision that the decision is erroneous

Alternate Dispute Resolution

- An aggrieved person may apply to CBR for the appointment of a committee for the resolution of any hardship or dispute in connection with any matter pending before an appellate authority
- CBR shall appoint a committee for resolution of a dispute consisting of the following:
 - An officer of an income tax
 - Two persons from a panel comprising of Chartered accountants or cost accountants, Advocates, income tax practitioners, or reputable tax payers.
- The committee after conducting inquiry and
- Seeking expert opinion shall make recommendations in respect of the dispute, as it may deem fit.
- CBR may on recommendations of the committee, pass such order as it may deem appropriate.
- The order passed by CBR in the light of recommendation of the committee shall be submitted before that authority, tribunal or the court where the matter is subjudic for consideration and orders as deemed appropriate.
- If tax payer is not satisfied with the said order he may continue to pursue his remedy before the relevant Authority, Tribunal, or Court.

Federal Tax Ombudsman

This office was established by the “**Establishment of the Office of the Federal Tax Ombudsman, Ordinance, 2000**”, promulgated by the president on 11/08/2000.

Object:

“To diagnose, investigate, redress and rectify any injustice done to a person through mal-administration by functionaries administering tax laws”.

The term “mal-administration” includes:

- (i) A decision, process, recommendation, act of omission or commission which-
 - (a) is contrary to law, rules or regulations or is a departure from established practice or procedure, unless it is bona fide and for valid reasons;
 - (b) is perverse, arbitrary or unreasonable, unjust, biased, oppressive, or discriminatory;
 - (c) is based on irrelevant grounds; or
 - (d) involves the exercise of powers, or the failure or refusal to do so, for corrupt or improper motives, such as bribery, jobbery, favouritism, nepotism and administrative excesses;
- (ii) neglect, inattention, delay, incompetence, inefficiency and ineptitude, in the administration or discharge of duties and responsibilities;
- (iii) repeated notices, unnecessary attendance or prolonged hearings while deciding cases involving-
 - (a) assessment of income or wealth;
 - (b) determination of liability of tax or duty;
 - (c) classification or valuation of goods;
 - (d) settlement of claims or refund, rebate or duty drawback; or
 - (e) determination of fiscal and tax concessions or exemptions.
- (iv) wilful errors in the determination of refunds, rebates or duty drawbacks;

- (v) deliberate withholding or non-payment or refunds, rebates or drawbacks already determined by the competent authority;
- (vi) coercive methods of tax recovery in cases where default payment of tax or duty is not apparent from record; and
- (vii) avoidance of disciplinary action against an officer or official whose order of assessment or valuation is held by a competent appellate authority to be vindictive, capricious, biased or patently illegal

Characteristics:

- (i) Independent from executive
 - All executive authorities throughout Pakistan shall act in aid of the Federal Tax Ombudsman.
- (ii) Easy accessibility to the complainant
- (iii) Impartiality and fairness
- (iv) Credibility of review process
- (v) Quick disposal
- (vi) Implementation of recommendation, decision or order of Federal Tax Ombudsman mandatory duty of Central Board of Revenue

Jurisdiction

The jurisdiction of the Federal Tax Ombudsman (FTO) extends to all Federal Taxes and the Revenue Division being the administrative unit responsible for the conduct of the business of the Federal Government, its Offices and agencies.

Exercise of jurisdiction

The jurisdiction can be exercised by the FTO:

- (i) On a complaint by an aggrieved party
- (ii) On a reference by the President
- (iii) On a reference by the Senate
- (iv) On reference by the National Assembly
- (v) On a motion of the Supreme Court in a proceeding pending before it
- (vi) On a motion of the High Court in a proceeding before it
- (vii) On his own motion

The jurisdiction cannot be exercised into matters, which are

- (g) Subjudic or
- (h) relate to assessment of income, wealth, duty, tax liability, classification or valuation of goods, interpretation of law rules and regulation in respect of which remedies of appeal reviews or revision are available under the law and
- (i) Service matter of the employees or Revenue Division

Procedure for approach:

- Any aggrieved person can send his application/letter duly attested on solemn affirmation, written on a plain paper. Anonymous complaints are not entertained.
- Compliant should be filed not later than six months from the date complainant had notice of the matter. In special circumstances time can be extended by FTO.
- After scrutiny of complaint notice is issued to Central Board of Revenue (CBR) for reply. On receipt of reply hearing is fixed and mostly cases are disposed on in 60 days except those, which require recording of evidence or involve deeper investigation. Federal Tax Ombudsman makes Recommendation/Finding.

Implementation of Recommendation/Finding:

Unlike similar statutes, this Ordinance provides:

- “It shall be the duty of the Revenue Division and Tax Employees to implement the findings made under Sections 11 and 12 within thirty days of such decision being communicated to the concerned Tax Employees”.
- If the CBR fails to comply with the Recommendation/Findings within the specified time or does not give reason to the satisfaction of the Federal Tax Ombudsman it is treated as Defiance of Recommendation.

If there is a defiance of Recommendation by a Tax Employee;

- The Federal Tax Ombudsman may refer the matter to the President who may in his discretion direct the Revenue Division to implement.

- A report by the Federal Tax ombudsman shall become part of personal file or character roll of the Tax Employee, primarily responsible for defiance.
- Such Tax Employee shall be liable for contempt.
- The Federal Tax Ombudsman has the same powers as the Supreme Court has to punish any person for its contempt.

Reference

Any person aggrieved by the finding/Recommendation of the Federal Tax Ombudsman can file representation to the President.

MODULE 18

LESSON 18.43

SALES TAX

Background:

- ❖ At the time of independence of Pakistan, Sales Tax was a provincial subject and was in vogue in the provinces of Sind and Punjab.
- ❖ Sales tax was declared as federal subject in 1948 vide General Sales Tax Act, 1948.
- ❖ This levy was transferred to the domain of Central Government vide Sales Tax Act, 1951.
- ❖ Sales Tax Act, 1951 was replaced by Sales tax act, 1990 which is the sales tax law till date.

Sales Tax Act 1990:

Basic philosophy of this Act is based on “VAT” type of tax.

What is Value Added Tax (VAT)?

VAT is a specific turnover tax levied at each stage in the production and distribution process. VAT, ultimately has its incidence on the individual consuming the goods and availing the services. However, liability for VAT is on the supplier of goods and services. In this type of tax, VAT system of Tax Credit is available for all the intermediaries (suppliers of goods and services) and burden of tax lies on final consumer.

Preamble of the Act, states that it is an Act to consolidate and amend the law relating to levy of tax on:

- Sale
- Importation
- Exportation
- Production
- Manufacture or
- Consumption of goods

Features of Sales Tax

- Indirect tax
- Broad based
- Elastic/ Flexible
- Easy to collect
- Potential for revenue generation

Definitions: ‘Section 2’

"Appellate Tribunal" means the Customs, Excise and Sales Tax Appellate Tribunal constituted under section 194 of the Customs Act;

"Appropriate officer" means an officer of Sales Tax authorized by the Board by notification in the official Gazette to perform certain functions under this Act;

'arrears' includes the un-paid amounts of tax, default surcharge, extra amount of tax, fines, penalties, fees or any other sums, however described, as have been assessed, adjudged or demanded under this Act,

"associated persons" means any two or more persons who are close relatives to each other or who are interconnected with each other in the following way, namely:--

- (i) if the persons, being companies or undertakings, are under common management or control or one is the subsidiary of the other;
- (ii) if a person who is the owner or partner or director of a company or undertaking, or who, directly or indirectly, holds or controls twenty per cent shares in such company or undertaking, is also the owner, partner or director of another company or undertaking, or, directly or indirectly, holds or controls twenty per cent shares in that company or undertaking;

"Banking Company" means a banking company as defined in the Banking Companies Ordinance, 1962 (LVII of 1962) and includes any body corporate which transacts the business of banking in Pakistan.

"Board" means the Central Board of Revenue constituted under the Central Board of Revenue Act, 1924 (IV of 1924);

"Collector" means the Collector of Sales Tax appointed under section 30;

"Common taxpayer identification number" means the registration number or any other number allocated to a registered person;

"Computerized system" means any comprehensive information technology system to be used by the Board or any other office as may be notified by the Board, for carrying out the purposes of this Act;

"Customs Act" means the Customs Act 1969 (IV of 1969), and where appropriate all rules and notifications made under that Act;

(6A) 'defaulter' means a person and, in the case of company or firm, every director, or partner of the company, or as the case may be, of the firm, of which he is a director or a partner or a proprietor and includes guarantors or successors, who fail to pay the arrears;

(6B) "Default Surcharge" means the surcharge payable by a defaulter at the rate specified in section 34 of this Act;";

(7) "Distributor" means a person appointed by a manufacturer, importer or any other person for a specified area to purchase goods from him for further supply and includes a person who in addition to being a distributor is also engaged in supply of goods as a wholesaler or a retailer;

(8) "Document" includes any electronic data, computer programs, computer tapes, computer disks, micro-films or any other medium for the storage of such data;

(9) "due date", in relation to the furnishing of a return under section 26 and section 26AA means the 15th day of the month following the end of the tax period, or such other date as the Federal Government may, by notification in the official Gazette, specify;

(9A) "e-intermediary" means a person appointed as e-intermediary under section 52A for filing of electronic returns and such other documents as may be prescribed by the Board from time to time, on behalf of a person registered under section 14;

(10) "establishment" means an undertaking, firm or company, whether incorporated or not, an association of persons or an individual;

(11) "exempt supply" means a supply which is exempt from tax under section 13;

(12) "goods" include every kind of movable property other than actionable claims, money, stocks, shares and securities;

(13) "importer" means any person who lawfully imports any goods into Pakistan;

(14) "input tax", in relation to a registered person, means the tax -

- (a) levied under this Act on the supply of goods received by that person;
- (b) levied under this Act on goods imported, entered and cleared under section 79 or section 104 of the Customs Act, by that person;
- (c) levied under the Sales Tax Act, 1990 of Pakistan as adapted in the State of Azad Jammu and Kashmir, on the supply of goods received by that person; and
- (d) chargeable as duties of excise under section 3 of the Federal Excise Act, 2005, on such excisable goods as are mentioned in the Second Schedule thereto or such excisable services as the Federal Government may from time to time notify under section 7 thereof and on which such duties are charged, levied and paid as if it were a tax payable under section 3 of this Act.

(15) "Local Sales Tax Office" means the office of Superintendent of Sales Tax, or such other office as the Board may, by notification in the official Gazette, specify;

(16) "Manufacture" or "produce" includes -

- (a) any process in which an article singly or in combination with other articles, materials, components, is either converted into another distinct article or product or is so changed, transformed or reshaped that it becomes capable of being put to use differently or distinctly and includes any process incidental or ancillary to the completion of a manufactured product;
- (b) process of printing, publishing, lithography and engraving; and
- (c) process and operations of assembling, mixing, cutting, diluting, bottling, packaging, repacking or preparation of goods in any other manner;

(17) "manufacturer" or "producer" means a person who engages, whether exclusively or not, in the production or manufacture of goods whether or not the raw material of which the goods are produced or manufactured are owned by him; and shall include --

- (a) a person who by any process or operation assembles, mixes, cuts, dilutes, bottles, packages, repackages or prepares goods by any other manner;
- (b) an assignee or trustee in bankruptcy, liquidator, executor, or curator or any manufacturer or producer and any person who disposes of his assets in any fiduciary capacity; and
- (c) any person, firm or company which owns, holds, claims or uses any patent, proprietary or other right to goods being manufactured, whether in his or its name, or on his or its behalf, as the case

may be, whether or not such person, firm or company sells, distributes, consigns or otherwise disposes of the goods:

- Provided that for the purpose of refund under this Act, only such person shall be treated as manufacturer-cum-exporter who owns or has his own manufacturing facility to manufacture or produce the goods exported or to be exported;

(18) "Officer of Sales Tax" means an officer appointed under section 30,

(19) "open market price" means the consideration in money which that supply or a similar supply would generally fetch in an open market;

SALES TAX

- (20) **"output tax"** in relation to any registered person means the tax charged under this Act in respect of a supply of goods made by that person and shall include duties of excise chargeable under section 3 of the Central Excises Act, 1944 (I of 1944) on such excisable goods or services as are notified by the Federal Government under the third proviso to sub-section (1) thereof and on which such duties are charged, levied and paid as if it were a tax payable under section 3 of this Act;
- (21) **"Person"** includes a company, an association, a body of individuals whether incorporated or not, a public or local authority, a Provincial Government or the Federal Government;
- (22) **"Prescribed"** means prescribed by rules made under this Act;
- (23) **"registered office"** means the office or other place of business specified by the registered person in the application made by him for registration under this Act or through any subsequent application to the Collector;
- (24) **"registration number"** means the number allocated to the registered person for the purpose of this Act;
- (25) **"registered person"** means a person who is registered or is liable to be registered under this Act:
- Provided that a person liable to be registered but not registered under this Act and shall remain liable to further tax under sub-section (1A) of section 3 and shall not be entitled to any benefit available to a registered person under any of the provisions of this Act or the rules made there under;
- (27) **"retail price"**, with reference to the Third Schedule, means the price fixed by the manufacturer inclusive of all charges and taxes (other than sales tax) at which any particular brand or variety of any article should be sold to the general body of consumers or, if more than one such price is so fixed for the same brand or variety, the highest of such price,
- 28) **"retailer"** means a person, supplying goods to general public for the purpose of consumption:
- Provided that any person, who combines the business of import and retail or manufacture or production with retail, shall notify and advertise wholesale prices and retail prices separately, and declare the address of retail outlets, and his total turnover per annum shall be taken into account for the purposes of registration under section 14.
- (28A) **"retail tax"** means tax levied under section 3AA;
- (29) **"return"** means any return required to be furnished under Chapter V of this Act;
- (29A) **"sales tax account"** means an account representing the double entry recording of sales tax transactions in the books of account;
- (30) **"Schedule"** means a Schedule appended to this Act;
- (31) **"similar supply"**, in relation to the open market price of goods, means any other supply of goods which closely or substantially resemble the characteristics, quantity, components and materials of the aforementioned goods;
- (31A) **"special audit"** means an audit conducted under section 32A;
- (32) **"Special Judge"** means the Special Judge appointed under Section 185 of the Customs Act;
- (33) **"supply"** includes sale, lease or other disposition of goods in the course or carried out for consideration and also includes –
- (a) putting to private, business or non-business use of goods acquired, produced or manufactured in the course of business;
 - (b) auction or disposal of goods to satisfy a debt owed by a person; and
 - (c) possession of taxable goods held immediately before a person ceases to be a registered person:
- Provided that the Federal Government, may by notification in the official Gazette, specify such other transactions which shall or shall not constitute supply;
- (34) **"tax"** means the sales tax, retail tax and includes default surcharge, or any other sum payable under any of the provisions of this Act or the rules made there under;
- (35) **"taxable activity"** means any activity which is carried on by any person, whether or not for a pecuniary profit, and involves in whole or in part, the supply of goods or rendering of services on which sales tax has been levied under the respective ordinance and use of goods acquired for private purposes or for the manufacture of exempt goods without making supply to any other person, whether for any

consideration or otherwise, and includes any activity carried on in the form of a business, trade or manufacture;

(36) "tax fraction" means the amount worked out in accordance with the following formula:

$$\frac{a}{100 + a}$$

('a' is the rate of tax specified in section 3):

(37) "Tax fraud" means knowingly, dishonestly or fraudulently and without any lawful excuse (burden of proof of which excuse shall be upon the accused)

- (i) doing of any act or causing to do any act; or
 - (ii) omitting to take any action or causing the omission to take any action including the making of taxable supplies without getting registration under this Act; or
 - (iii) falsifying the sales tax invoices;
- In contravention of duties or obligations imposed under this Act, rules or instructions issued there under with the intention of understating the tax liability or underpaying the tax liability or underpaying the tax liability for two consecutive tax periods for two consecutive tax periods or overstating the entitlement to tax credit or tax refund to cause loss of tax;

(39) "taxable goods" means all goods other than those which have been exempted under section 13;

(40) "tax invoice" means a document required to be issued under section 23;

(41) "taxable supply" means a supply of taxable goods made by an importer; manufacturer, wholesaler (including dealer), distributor or retailer other than a supply of goods which is exempt under section 13 and includes a supply of goods chargeable to tax at the rate of zero per cent under section 4;

(43) "tax period" means a period of one month or such other period as the Federal Government may, by notification in the official Gazette, specify;

(44) "time of supply" means a supply shall be deemed to have taken place at the earlier of the time of delivery of goods or the time when any payment is received by the supplier in respect of that supply:

- Provided that where any part payment is received –
 - (a) for a supply in a tax period, it shall be accounted for in the return for that tax period; and
 - (b) in respect of an exempt supply, it shall be accounted for in the return for that tax period during which the exemption is withdrawn from such supply;
- Provided further that:
 - (a) where any goods are supplied by a registered person to an associated person and the goods are not to be removed, the time of supply shall be the time at which these goods are made available to the recipient; and
 - (b) where the goods are supplied under hire purchase agreement, the time of supply shall be the time at which the agreement is entered into;

(46) "Value of supply" means;

- (a) in respect of a taxable supply, the consideration in money including all Federal and Provincial duties and taxes, if any, which the supplier receives from the recipient for that supply but excluding the amount of tax:

Provided that:

- (i) in case the consideration for a supply is in kind or is partly in kind and partly in money, the value of the supply shall mean the open market price of the supply excluding the amount of tax;
 - (ii) in case the supplier and recipient are associated persons and the supply is made for no consideration or for a consideration which is lower than the open market price, the value of supply shall mean the open market price of the supply excluding the amount of tax; and
 - (iii) in case a taxable supply is made to a consumer from general public on installment basis on a price inclusive of mark up or surcharge rendering it higher than open market price, the value of supply shall mean the open market price of the supply excluding the amount of tax.
- (b) In case of trade discounts, the discounted price excluding the amount of tax, provided the tax invoice shows the discounted price and the related tax and the discount allowed is in conformity with the normal business practices;
 - (c) in case where for any special nature of transaction it is difficult to ascertain the value of a supply, the open market price;

- (d) in case of imported goods, the value determined under section 25 of the Customs Act, including the amount of customs-duties and central excise duty levied hereon;
 - (e) in case where there is sufficient reason to believe that the value of a supply has not been correctly declared in the invoice, the value determined by the Valuation Committee comprising representatives of trade and the Sales Tax Department constituted by the Collector ; and
 - (f) in case the goods other than taxable goods are Supplied to a registered person for processing, the value of supply of such processed goods shall mean the price excluding the amount of sales tax which such goods will fetch on sale in the market;
 - Provided that, where the Central Board of Revenue deems it necessary, it may, by notification in the official Gazette, fix the value of any taxable supplies or class of supplies and for that purpose fix different values for different classes or description of same type of supplies:
 - Provided further that where the value at which the supply is made is higher than the value fixed by the Central Board of Revenue, the value of goods shall, unless otherwise directed by the Board, be value at which the supply is made;
 - (g) in case of a taxable supply, with reference to retail tax, the price of taxable goods excluding the amount of retail tax, which a supplier will charge at the time of making taxable supply by him, or such other price as the Board may, by a notification in the Official Gazette, specify.
- (47) **"wholesaler"** includes a dealer and means any person who carries on, whether regularly or otherwise, the business of buying and selling goods by wholesale or of supplying or distributing goods, directly or indirectly, by wholesale for cash or deferred payment or for commission or other valuable consideration or stores such goods belonging to others as an agent for the purpose of sale; and includes a person supplying taxable goods to a person and a person who in addition to making retail supplies is engaged in wholesale business;
- (48) **"zero - rated supply"** means a taxable supply which is charged to tax at the rate of zero per cent under section 4

Scope of the Tax:

Subject to this act, sales tax shall be charged, levied and paid at the rate of 15 % of the value of:

- taxable supplies made by a registered person in the course or furtherance or any taxable activity carried on by him;
- goods imported into Pakistan
- Taxable supplies specified in third schedule shall be charge to tax at the rate of 15% of the retail price.
- Liability to pay tax shall be:
 - In the case of supply of goods, of the person making the supply and
 - In the case of goods, imported into Pakistan, of the person importing the goods
- However federal Government may by notification specify the goods in respect of which the liability to pay tax shall be of the person receiving the supply

Retail Tax

- Under section 3AA, the retailer shall pay retail tax at the rate specified in section 3.
- The retail tax shall be charged, collected and paid in such manner and at such higher or lower rate or rates as may be specified in the said notification.

Zero Rating Sec. 4

- Notwithstanding the provisions of section 3, the following goods shall be charged to tax at the rate of zero per cent:
 - (a) goods exported, or the goods specified in the 5th schedule
 - (b) supply of stores and provisions for consumption aboard a conveyance proceeding to a destination outside Pakistan as specified in section 24 of the Customs Act, 1969; and
 - (c) such other goods as the Federal Government may, by Notification specify:

Levy and collection of tax on specified goods on value addition

- (1) Notwithstanding anything contained in this Act or the rules made there under, the Federal Government may specify, by notification in the official gazette, that sales tax chargeable on the supply of goods of such description or class shall, with such limitations or restrictions as may be prescribed, be levied and collected on the difference between the value of supply for which the goods are acquired and the value of supply for which the goods, either in the same state or on further manufacture, are supplied.

- (2) Notwithstanding anything contained in this Act or the rules made there under, the Federal Government may, by notification in the official Gazette, and subject to the conditions, limitations, restrictions and procedure mentioned therein, specify the minimum value addition required to be declared by certain persons or categories of persons, for supply of goods of such description, or class as may be prescribed, and to waive the requirement of audit or scrutiny of records if such minimum value addition is declared.
- **Taxable Supplies**—defined in section 2 (41)
 - **Supply**—defined in section 2 (33)
 - **Taxable Goods**—defined in section 2 (39)
 - **Exempt Supplies**—defined in section 2 (11): means a supply which is exempt from tax under section 13
 - **Retailer**—defined in section 228
 - **Registered person**—defined in section 225

Registration Section 14:

- Persons required to get registration subject to sales tax rules
- Under this Act, registration will be required for such persons and be regulated in such manner and subject to rules as the Board may, by notification in the official Gazette, prescribe.

Requirement of registration:

- (1) The following persons engaged in making of taxable supplies in Pakistan (including zero-rated supplies) in the course or furtherance of any taxable activity carried on by them, if not already registered, are required to be registered under this Act, namely:
- (i) a manufacturer whose annual turnover from taxable supplies made in any period during the last twelve months ending any tax period exceeds two and half million rupees;
 - (ii) a retailer whose value of supplies in any period during the last twelve months ending any tax period exceeds twenty million rupees;
 - (iii) an importer; and
 - (iv) a wholesaler (including dealer) and distributor:
- Provided that buyers or importers of taxable plant and machinery who intend to make taxable supplies in due course and wish to claim any credit or refund of tax paid on the said plant and machinery shall also be required to be registered under this Act.

De-Registration, Black listing and Suspension of Registration Section 21

- (1) The Board or any officer, authorized in this behalf, may subject to the rules, de-register a registered person or such class of registered persons not required to be registered under this Act.
- (2) Notwithstanding anything contained in this Act, in cases where the Collector is satisfied that a registered person is found to have issued fake invoices, or has otherwise committed tax fraud, he may blacklist such person or suspend his registration in accordance with such procedure as the Board may, by notification in the official Gazette, prescribe.

Solution: Sales tax liability of M/S WW brothers

Particulars	Value of Supplies	Rate	Sales tax	Sales tax
Out put tax	4,500,000	15%		675,000
Input tax	1,000,000	15%	(150,000)	
Input tax on dying	300,000	15%	(45,000)	
Subtract total input tax				(195,000)
Sales Tax Payable (675,000 - 195,000)				Rs.480,000

SALES TAX RETURNS**Appointment of Officer of Sales Tax Sec 30**

- A collector of Sales Tax
- A Collector of Sales Tax (Appeals)
- An additional Collector of Sales Tax
- A Deputy Collector of Sales Tax
- An Assistant Collector of Sales Tax
- A Superintendent of Sales Tax
- An officer of sales tax with any other designation

Offences and Penalties**Offences**

❖ Any person fails to furnish a return within the due Date.

Penalties

Rs 5,000

❖ Any person who fails to issue an invoice

Rs 5,000 or 3% of the amount of tax involved, whichever is higher

❖ A person who fails to deposit the amount of tax due.

Rs 10,000 or 5% of the amount of tax involved, whichever is higher

❖ A person who fails to apply for registration before making taxable supplies.

Rs 10,000 or 5% of the amount of tax involved, whichever is higher

❖ A person who fails to maintain records

Rs 10,000 or 5% of the amount of tax involved, whichever is higher

❖ A person who submits a false or forged document to any officer of sales tax

Rs 25,000 or

100% of the amount of tax involved, whichever is higher

Appeals:

- ❖ Powers of adjudication are vested in the following officers:
 - Additional Collector Cases falling under sub-section (2) of section 11 and section 36 without any restriction as to the amount of tax involved or amount erroneously refunded.
 - **Deputy Collector**
 - (a) Cases falling under sub-section (1) of section 11
 - (b) Cases falling under sub-section (2) of section 11 and section 36 provided that the amount of tax involved or the amount erroneously refunded exceeds one million rupees, but does not exceed two and a half million rupees.
 - **Assistant Collector**
 - Cases falling under sub-section (2) of section 11 and section 36 provided that the amount of tax involved or the amount erroneously refunded exceeds ten thousand rupees, but does not exceed one million rupees.
 - **Superintendent**
 - Cases falling under sub-section (2) of section 11 and section 36 provided that the amount of tax involved or the amount erroneously refunded does not exceed ten thousand rupees.
 - An officer of sales tax with any other designation
 - Such cases as may be notified by the Board:

CBR and Collector may at its own motion call for and examine the record of any departmental proceedings.

Appeal to collector of Sales Tax (Appeals) Sec 45 b

Appeal may be filed by any person other than officer of sales tax within 30 days of the date of receipt of such decision or order against which appeals is proffered.

Appeals to Appellant Tribunal:

- (1) Any person including an officer of Sales Tax not below the rank of an Additional Collector (words " the Sales Tax Department" substituted by Finance Act 2006), aggrieved by:
 - a. any order passed by the Collector under sub-section (4) of section 45A or (words inserted by Finance Act 2005.) the Collector of Sales Tax (Appeals) under section 45B; and
 - b. Any order passed by the Board or the Collector of Sales Tax under section 45A, may, within sixty days of the receipt of such decision or order, prefer appeal to the Appellate Tribunal.
- (2) The Appellate Tribunal may admit an appeal preferred after the period of limitation specified in sub-section (1) if it is satisfied that there was sufficient cause for not presenting it within the specified period.
- (3) The appeal shall be accompanied by a fee of one thousand rupees paid in such manner as the Board may prescribe.
- (4) The Appellate Tribunal, after giving the parties to the appeal, an opportunity of being heard may pass such orders in relation to the matter before it as it thinks fit:
 - Provided that when any such order amounts to an interim order staying the recovery of tax, such order shall cease to have effect on the expiration of a period of six months following the day on which it is made unless the case is finally decided, or the interim order is withdrawn by the Tribunal earlier:
 - Provided further that such interim order or orders, as the case may be, shall cease to have effect on the expiration of a total period of six months following the day on which the first interim order is made, unless the case is finally decided, or the interim order is withdrawn by the Appellate Tribunal earlier.
 - Order under this section shall be passed within six months of the filing of appeal.

Reference to High Court

- (1) Within ninety days of the communication of the order of the Appellate Tribunal under sub-section (5) of section 46, the aggrieved person or any officer of Sales Tax not below the rank of an Additional Collector may prefer an application in the prescribed form along with a statement of the case to the High Court, stating any question of law arising out of such order.
 - A reference to the high court under this section shall be heard by a bench of not less than two judges of the high court.

**CAPITAL VALUE TAX (CVT)
PROCEDURE FOR LEVY & COLLECTION OF CAPITAL VALUE TAX
CAPITAL VALUE TAX RECOVERY & REFUND RULES**

Capital Value Tax was levied with effect from 1st July, 1989 on the capital value of assets.

This is payable by every individual, association of persons, firm or a company which acquires by purchase gift, exchange, relinquishment, surrender of rights by the owners (whether effected orally or by deed or obtained through court decree) except by inheritance an asset or a right to the use thereof for more than twenty years. An asset or a right to the use thereof for more than twenty years.

Levy of tax on Capital Value of certain assets:

- Capital value tax shall be payable by
 - **Individual**
 - **Association of persons, firm or**
 - **A company which acquires by:**
 - **Purchase**
 - **Gift**
 - **Exchange**
 - **Power of attorney**
 - **Surrender of rights**
 - **Relinquishment of rights by the owner**

Exceptions: when capital assets acquired by:

- Inheritance
- Gift from spouse, Parents, Grand parents, a brother and a sister
- An asset or a right to use thereof for more than 20 years
- Capital value tax shall be payable at the rates specified in sub section of 2 of Section 7

Explanation of certain “Expressions”

- **"association of persons"** and **"firm"** shall have the same meaning as contained in the Income Tax Ordinance, 1979 (XXXI of 1979); and **"company"** shall have the same meaning as defined in the Income Tax Ordinance, 1979 (XXXI of 1979);
- **"development authority"** means an authority formed by or under any law for the purposes of development of an area and includes any authority, society, agency, trust, association or institution declared as development authority by the Central Board of Revenue by a notification in the official Gazette; and **"registration authority"** means the person responsible for registering or attesting the transfer of the asset or of the right to use thereof for more than twenty years, and in the case of a development authority or a cooperative society, its principal officer.
- **“Urban area”** means area falling within the limits of:
 - The Islamabad Capital Territory;
 - A cantonment board; or
 - A municipal body;
 - In case of Karachi up to 40 kilometers from the outer limit of municipal or cantonment limits;
 - In case of Lahore and Faisalabad up to 30 kilometers from the outer limit of municipal or cantonment limits;
 - In other cases, up to 10 kilometers from the outer limits of municipal bodies or cantonment boards; and
 - Includes areas defined as such in the Urban Immovable Property Tax Act, 1958 and such areas as the Central Board of Revenue may, for time to time, by notification in the official Gazette specify.

Capital Value Tax— Tax Rates

Motor vehicles:

Capital Value Tax shall be payable on purchase of motor vehicles, not previously used in Pakistan, at the following rates:

Motor vehicle of an engine capacity	Tax Rates
Not exceeding 800 cubic centimeters and three wheelers.	Nil
Exceeding 800 cubic centimeters but not exceeding 1000 cubic centimeters	3.75%
Exceeding 1000 cubic centimeters but not exceeding 1300 cubic centimeters	5%
Exceeding 1300 cubic centimeters but not exceeding 1600 cubic centimeters	6.25%
Exceeding 1600 cubic centimeters	7.5%

Immovable property (other than commercial property and residential flats), situated in urban areas, measuring at list one canal or 500 square yards whichever is less.

Tax Rates

(i) Where the value of immovable Property is recorded.	2% of the recorded value
(ii) Where the value of immovable property is not recorded.	Rs. 50 per square Yard of the landed area.

Commercial immovable property of any size situated in urban area.

Tax Rates

(i) Where the value of immovable Property is recorded.	2% of the recorded value
(ii) Where the value of immovable property is not recorded.	Rs. 50 per square Yard of the landed area.

Residential flats with covered areas measuring 1500 sq. feet and above.

Tax Rates

(i) Where the value of immovable Property is recorded.	2% of the recorded value
(ii) Where the value of immovable property is not recorded.	Rs. 50 per square Yard of the landed area.

Description	Rate of Tax
Purchase of modaraba certificates or shares of a listed public company.	0.02% of the purchase value
Imported motor vehicle not plying for hire customs authorities.	Landed cost a determined by
Motor Vehicle Purchased from a manufacturer in Pakistan.	The price paid by the Purchase.
Others	As declared by the transferee.

- CVT to be collected by the person responsible for registering or attesting the transfer of the asset.
- In case of purchase of motor vehicle from a manufacturer in Pakistan, CVT shall be collected by the manufacturer before making the delivery of said vehicle.
- Collector of customs shall collect CVT in case of motor vehicle imported into Pakistan.
- Registered stock exchange in Pakistan shall collect CVT on the purchase value of Modaraba Certificates or shares of a public company from the resident persons.
- The proceeds of the tax collected shall be credited to the Federal Consolidated Funds under the head specified by the Federal Government.
- Where any person fails to collect or having collected fails to pay the capital value tax as required, he shall be personally liable to pay the tax along with additional tax at the rate of 15% per annum for the period for which such tax or part thereof remains unpaid.
- The Commissioner of Wealth Tax, on an application by the assessee, may revise any order made under this section.
- The Federal Government may, by notification in the official Gazette, exempt any person or class of persons or asset or class of assets from the Capital Value Tax.

Annexure
First & Third
Schedule
THE FIRST SCHEDULE
Rates of Tax

Part I.

- Division I:** **Rates of Tax for Individuals and Association of Persons**
Division IA: **Rate of Tax on certain persons**
Division II: **Rates of Tax for Companies**
Division III: **Rate of Dividend Tax**
Division IV: **Rate of Tax on Certain Payments to Non-residents**
Division V: **Rate of Tax on Shipping or Air Transport Income of a Non-resident Person**
Division VI: **Rate of Tax on Income From Property**

Part II.**Rates of Advance Tax****Tax on Import of Goods****Part III.****Deduction of Tax at Source**

- Division I:** **Profit on debt**
Division II: **Payments to non-residents**
Division III: **Payments for Goods or Services**
Division IV: **Exports**
Division V: **Income from Property**
Division VI: **Prizes and Winnings**
Division VIA: **Petroleum Products**
Division VII: **Petroleum Products [Omitted]**

Part IV.**Deduction or Collection of Advance Tax**

- Division I:** **Transfer of Funds [Omitted]**
Division II: **Brokerage Commission**
Division III: **Transport Business**
Division IV: **Electricity Consumption**
Division V: **Telephone users**
Division VI: **Cash Withdrawal from a bank**

PART I
RATES OF TAX
(See Chapter II)

Division I
Rates of Tax for Individuals and Association of Persons

1. Subject to clause (1A) the rates of tax imposed on the taxable income of every individual except a salaried taxpayer or association of persons to which sub-section (1) of section 92 applies shall be as set out in the following table, namely:

TABLE

S. No.	Taxable income	Rate of tax
(1)	(2)	(3)
1	Where the taxable income does not exceed Rs.100,000	0%
2	Where the taxable income exceeds Rs.100,000 but does not exceed Rs.110,000	0.50%
3	Where the taxable income exceeds Rs.110,000 but does not exceed Rs.125,000	1.00%
4	Where the taxable income exceeds Rs.125,000 but does not exceed Rs.150,000	2.00%
5	Where the taxable income exceeds Rs.150,000 but does not exceed Rs.175,000	3.00%
6	Where the taxable income exceeds Rs.175,000 but does not exceed Rs.200,000	4.00%
7	Where the taxable income exceeds Rs.200,000 but does not exceed Rs.300,000	5.00%
8	Where the taxable income exceeds Rs.300,000 but does not exceed Rs.400,000	7.50%
9	Where the taxable income exceeds Rs.400,000 but does not exceed Rs.500,000	10.00%
10	Where the taxable income exceeds Rs.500,000 but does not exceed Rs.600,000	12.50%
11	Where the taxable income exceeds Rs.600,000 but does not exceed Rs.800,000	15.00%
12	Where the taxable income exceeds Rs.800,000 but does not exceed Rs.10,00,000	17.50%
13	Where the taxable income exceeds Rs.10,00,000 but does not exceed Rs.13,00,000	21.00%
14	Where the taxable income exceeds Rs.13,00,000	25.00%

Provided that where income of a woman taxpayer is covered by this clause, no tax shall be charged if the taxable income does not exceed Rs.125,000/-.

TABLE

S. No.	Taxable income	Rate of tax
(1)	(2)	(3)
1	Where the taxable income does not exceed Rs.150,000	0%
2	Where the taxable income exceeds Rs.150,000 but does not exceed Rs.200,000	0.25%
3	Where the taxable income exceeds Rs.200,000 but does not exceed Rs.250,000	0.50%
4	. Where the taxable income exceeds Rs.250,000 but does not exceed Rs.300,000	0.75%
5	Where the taxable income exceeds Rs.300,000 but does not exceed Rs.350,000	1.50%
6	Where the taxable income exceeds Rs.350,000 but does not exceed Rs.400,000	2.50%
7	Where the taxable income exceeds Rs.400,000 but does not exceed Rs.500,000	3.50%
8	Where the taxable income exceeds Rs.500,000 but does not exceed Rs.600,000	4.50%
9	. Where the taxable income exceeds Rs.600,000 but does not exceed Rs.700,000	6.00%
10	Where the taxable income exceeds Rs.700,000 but does not exceed Rs.850,000	7.50%
11	Where the taxable income exceeds Rs.850,000 but does not exceed Rs.950,000	9.00%
12	Where the taxable income exceeds Rs.950,000 but does not exceed Rs.1,050,000	10.00%
13	Where the taxable income exceeds Rs.1,050,000 but does not exceed Rs.1,200,000	11.00%
14	Where the taxable income exceeds Rs.1,200,000 but does not exceed Rs.1,500,000	12.50%
15	Where the taxable income exceeds Rs.1,500,000 but does not exceed Rs.1,700,000	14.00%
16	Where the taxable income exceeds Rs.1,700,000 but does not exceed Rs.2,000,000	15.00%
17	Where the taxable income exceeds Rs.2,000,000 but does not exceed Rs.3,150,000	16.00%
18	Where the taxable income exceeds Rs.3,150,000 but does not exceed Rs.3,700,000,	17.50%
19	Where the taxable income exceeds Rs.3,700,000 but does not exceed Rs.4,450,000,	18.50%
20	Where the taxable income exceeds Rs.4,450,000 but does not exceed Rs.8,400,000,	19.00%
21	Where the taxable income exceeds Rs.8,400,000.	20.00%

Provided that where income of a woman taxpayer is covered by this clause, no tax shall be charged if the taxable income does not exceed Rs.200,000/-

Division IA**Rate of Tax on certain persons**

The rate of tax to be paid under sub- section (1) of section 113A shall be 0.75% of the turnover.

Division II**Rates of Tax for Companies**

- (i) The rates of tax imposed on the taxable income of a company shall be as set out in the following table, namely:

TABLE

Tax Year	Banking company	Public company other than a banking company	Private company other than a banking company
(1)	(2)	(3)	(4)
2003	47%	35%	43%
2004	44%	35%	41%
2005	41%	35%	39%
2006	38%	35%	37%
2007	35%	35%	35%

- (ii) Where the taxpayer is a society or a cooperative society, the tax shall be payable at the rates applicable to the public company or an individual, whichever is beneficial to the taxpayer.
- (iii) Where the taxpayer is a small company as defined in section 2, tax shall be payable at the rate of 20%

Division III**Rate of Dividend Tax**

The rate of tax imposed under section 5 on dividend received from a company shall be –

- (a) in the case of dividend received by a public company or an insurance company, or any other resident company 5% of the gross amount of the dividend; or
- (b) in any other case, 10% of the gross amount of the dividend.

Division IV**Rate of Tax on Certain Payments to Non-residents**

The rate of tax imposed under section 6 on payments to non-residents shall be 15% of the gross amount of the royalty or fee for technical services.

Division V**Rate of Tax on Shipping or Air Transport Income of a Non-resident Person**

The rate of tax imposed under section 7 shall be:

- (a) in the case of shipping income, 8% of the gross amount received or receivable; or
- (b) in the case of air transport income, 3% of the gross amount received or receivable.

Division VI

Income from property: the rate of tax to be paid under section 15 shall be 5% of the gross amount of rent chargeable to tax under that Section.

PART II**RATES OF ADVANCE TAX**

(See Division II of Part V of Chapter X)

The rate of advance tax to be collected by the Collector of Customs under section 148 shall be 6% of the value of the goods.

PART III**DEDUCTION OF TAX AT SOURCE**

(See Division III of Part V of Chapter X)

Division I**Profit on debt**

The rate of tax to be deducted under section 151 shall be 10% of the yield or profit paid.

Division II**Payments to non-residents**

- (1) The rate of tax to be deducted from a payment referred to in sub-section (1A) of section 152 shall be 6% of the gross amount payable.
- (2) The rate of tax to be deducted under sub-section (2) of section 152 shall be 30% of the gross amount paid.

Division II substituted by Finance Bill 2006. Before substitution it read as follows:

The rate of tax to be deducted under sub-section (2) of section 152 shall be 30% of the gross amount paid.

Division III**Payments for Goods or Services**

- (1) The rate of tax to be deducted from a payment referred to in clause (a) of sub-section (1) of section 153 shall be:
 - a. In the case of the sale of rice, cotton seed or edible oils, 1.5% of the gross amount payable; or
 - b. In the case of the sale of any other goods, 3.5% of the gross amount payable.
- (2) The rate of tax to be deducted from a payment referred to in clause (b) of sub-section (1) of section 153 shall be 6% of the gross amount payable.
- (3) the rate of tax to be deducted from a payment referred to in clause © of sub-section (1) of section 153 shall be 6% of the gross amount payable.

Division IV
Exports

- (1) The rate of tax to be deducted under sub-section (1A) of section 153 and sub-section (1), (3), (3A) or (3B) of section 154 shall be as set out in the following table, namely:

TABLE

S. No.	Nature of goods exported.	Rate of deduction of tax.
(1)	(2)	(3)
1.	Exports listed in Part I of the Seventh Schedule	0.75% of the proceeds of the export
2.	Exports listed in Part II of the Seventh Schedule	1.0% of the proceeds of the export
3.	Exports listed in Part III of the Seventh Schedule	1.25% of the proceeds of the export
4.	Exports listed in Part IV of the Seventh Schedule	1.50% of the proceeds of the export

- (2) The rate of tax to be deducted under sub-section (2) of section 154 shall be 5.

Division V
Income from Property

The rate of tax to be paid under section 15 shall be 5% of the gross amount of rent chargeable to tax under that section.

Division VI
Prizes and Winnings

- (1) The rate of tax to be deducted under section 156 on a prize on prize bond shall be 10% of the gross amount paid.
- (2) The rate of tax to be deducted under section 156 on winnings from a raffle, lottery, prize on winning a quiz, prize offered by companies for promotion of sale, or cross-word puzzle shall be 20% of the gross amount paid.

Division VIA
Petroleum Products

Rate of collection of tax under section 156 A shall be 10% of the amount of payment.

PART IV
(See Chapter XII)

DEDUCTION OR COLLECTION OF ADVANCE TAX

Division II
Brokerage and Commission

The rate of collection under sub-section (1) of section 233 shall be 10% of the amount of the payment.

Division III
Transport Business

Rates of collection of tax under section 234,

(1) In the case of goods transport vehicles with registered laden weight of:

(a)	Less than 2030 kilograms.	Rs. 1,200.
(b)	2030 kilograms or more but less than 8120 kilograms.	Rs. 7,200.
(c)	8120 kilograms or more but less than 15000 kilograms.	Rs.12,000.
(d)	15000 kilograms or more but less than 30,000 kilograms.	Rs.18,000.
(e)	30,000 kilograms or more but less than 45,000 kilograms.	Rs.24,000.
(f)	45,000 kilograms or more but less than 60,000 kilograms.	Rs.30,000.
(g)	60,000 kilograms or more.	Rs.36,000.

(1A) In the case of goods transport vehicles with laden weight of 8120 Kg or more, advance tax after a period of ten years from the date of first registration of vehicle in Pakistan shall be collected at the rate of twelve hundred rupees per annum;

(2) In the case of passenger transport vehicles plying for hire with registered seating capacity of:

(a)	Four or more persons but less than ten persons.	Rs. 25 per seat per annum
(b)	Ten or more persons but less than twenty persons.	Rs. 60 per seat per annum.
(c)	Twenty persons ore more.	Rs.100 per seat per annum

(3) Other private motor cars with engine capacity of:

(a)	1000cc to 1199 cc.	Rs. 500.
(b)	1200cc to 1299cc.	Rs. 750.

(c)	1300cc to 1599cc.	Rs. 1,500
(ca)	1600cc to 1999cc.	Rs. 2,000
(d)	2000cc and above.	Rs. 3,000.

Division IV
Electricity Consumption

Rate of collection of tax under section 235 where the amount of electricity bill,-

(a)	does not exceed Rs. 400.	Rs.	60
(b)	exceeds Rs. 400 but does not exceed Rs. 600	Rs.	80
(c)	exceeds Rs. 600 but does not exceed Rs. 800	Rs.	100
(d)	exceeds Rs. 800 but does not exceed Rs. 1000	Rs.	160
(e)	exceeds Rs. 1000 but does not exceed Rs. 1500	Rs.	300
(f)	exceeds Rs. 1500 but does not exceed Rs. 3000	Rs.	350
(g)	exceeds Rs. 3000 but does not exceed Rs. 4500	Rs.	450
(h)	exceeds Rs. 4500 but does not exceed Rs. 6000	Rs.	500
(i)	exceeds Rs. 6000 but does not exceed Rs. 10000	Rs.	650
(j)	exceeds Rs. 10000 but does not exceed Rs. 15000	Rs.	1000
(k)	exceeds Rs. 15000 but does not exceed Rs. 20000	Rs.	1500
(l)	exceeds Rs. 20000	Rs.	2000

Division V
Telephone users

(a)	In the case of prepaid telephone cards	10% of the Amount of sale Price of prepaid Telephone card
(b)	In the case of post-paid telephone bill	
	-- Where the monthly bill exceed Rs 1000	10% of the amount of bill; and

Division VI
Cash Withdrawal from a bank

The rate of tax to be deducted under section 231A of the cash amount withdrawn.

THE THIRD SCHEDULE

Part I. Depreciation

Part II. Initial Allowance

Part II. Pre-Commencement Expenditure

PART I
DEPRECIATION

(See Section 22)

Depreciation rates specified for the purposes of section 22 shall be:

I. Building (all types)	10%
II. Furniture (including fittings) and machinery and plant (not otherwise specified), Motor Vehicles (all types), ships, technical or professional Books.	15%
III. Computer hardware including printer, monitor and allied items [machinery and equipment used in manufacture of I.T. products], aircrafts and aero engines.	30%
IV. In case of mineral oil concerns the income of which is liable to be computed in accordance with the rules of Part 1 of the fifth Schedule.	
a) Below ground installations	100%
b) Offshore platform and production installations.	20%

PART II
INITIAL ALLOWANCE

(See Section 23)

The rate of initial allowance under section 23 shall be 50%.

PART III
PRE-COMMENCEMENT EXPENDITURE

(See Section 25)

The rate of amortization of pre-commencement expenditure under section 25 shall be 20%.