

**GENERAL**

Heads of income (Section 11)	Amount
Salary	xxxx
Income from Property	xxxx
Income from Business	xxxx
Capital Gains	Xxxx
Income from Other Sources	Xxxx
Total Income (Section 10)	Xxxx
<b>Less Deductible allowances:</b>	
Zakat (Section 60)	xxxx
Workers' Welfare Fund (Section 60A)	xxxx
Workers' Participation Fund (Section 60B)	xxxx
Taxable Income (Section 9)	xxxx

For the purpose of imposition of tax and the computation of total income, all incomes chargeable to tax shall be classified under the above mentioned heads of income.

Furthermore, for the computation of income of a resident person, the considerations shall be given to the amounts that are Pakistan source income and the amounts that are foreign source income. And for the determination of income of a non resident person, only the amounts that are Pakistan source income are taken into account for the computation of taxable income.

**Workers' Welfare Fund (Section 60A):**

It is payable @ 2% of the taxable income. It should be added back to accounting profit and deducted from total income to arrive at taxable income.

For the purpose of above, 'taxable income' means:

- Where return of income is required to be filed, accounting profit before tax or declared income as per return of income, whichever is higher
- Where return of income is not required to be filed, accounting profit before tax or 4% of the receipts as per statement of FTR u/s 115, whichever is higher

**Residential Status of Persons:**

For the purpose of determining the residential status of a person, the following rules mentioned in the section 81-84 are considered along with Rule 14 of the Income Tax Rules, 2002. The principles for determination of residential status are as under:

**Individual:** if he is present in Pakistan for 183 days or more in a tax year or he is an employee of federal or provincial government posted abroad for performing his duties (**Section 82**)

**Rule 14 of the Income Tax Rules, 2002:** Rules for determination of physical stay in Pakistan of an individual:

A part of a day that an individual is present in Pakistan counts as a whole day of such presence except where the person is present in Pakistan solely by the reason of being in transit i.e. in a journey between two different places in Pakistan does not count as a day present in Pakistan.

The following days count as a whole day of such presence, namely:

A day of arrival in/departure from Pakistan	A day that an individual's activity in Pakistan is interrupted because of a strike, lock-out or delay in receipt of supplies
Public holiday	
Day of leave	A holiday spent by the individual

Tax Rates:	Mr. A	Mr. B
Taxable salary	500,000	420,000
Capital gain	450,000	470,000
<b>Taxable income</b>	<b>950,000</b>	<b>890,000</b>

<u>Taxable Salary</u>	$\frac{500,000}{950,000} = 52\%$	$\frac{420,000}{890,000} = 47\%$
Taxable Income	950,000	890,000
	↓	↓
	Salaried Case	Non-Salaried Case

Tax rates for individuals have been prescribed in the 1<sup>st</sup> schedule with respect to salaried and non salaried case:

- Where taxable salary exceed 50% of the taxable income = **Salaried Case**
- Where taxable salary is less than 50% of the taxable income = **Non Salaried Case**

The basic exemption limit for the taxable income is enhanced from Rs. 300,000 to Rs. 350,000. However individual taxpayers', whose normal income is between Rs. 300,000 to Rs. 350,000, shall be required to file return of income and statement for the purposes of documentation.

**Marginal Relief:** provided that where the total income of a tax payer marginally exceeds the maximum slab limit, the income tax payable shall be the tax payable on the maximum of that slab plus the amount equal to the following as the case may be: **(benefit not available to non-salaried case)**

Rate shall be applied to the excess of the maximum in the slab	Where total income:
20%	Does not exceed 500,000
30%	Does not exceed 1,050,000
40%	Does not exceed 2,000,000
50%	Does not exceed 4,450,000
60%	Exceeds 4,450,000

Tax shall be calculated as per the slab rates or marginal relief formula, whichever is lower **(Circular 6 of 2008)**

**Company:** if it is incorporated under any law in force in Pakistan, the control and management of affairs of the company is situated wholly in Pakistan at any time in a year or it is a Provincial or Local government (**Section 83**). Company (other than small company which shall pay tax @ 25%) is taxable at 35% on its taxable income for the tax year 2007 and onwards. (**1<sup>st</sup> schedule**)

**AOP (includes partnership and joint venture):** if the control and management of the affairs is situated wholly or partly in Pakistan at any time in the year (**Section 84**). AOP is taxable at 25% on its taxable income for the tax year 2010 and onwards. (**1<sup>st</sup> schedule**)

**Scope of Taxable Income:**

1. **Foreign Source Income of a short-term resident individual: (Section 50)**

Foreign source income of a resident individual who is a resident solely by reason of employment and is present in Pakistan for a period not exceeding 3 years shall be exempt provided that any foreign source income is not brought or received into Pakistan.

Such exemption shall not apply to an income derived by the person through his business established in Pakistan.

2. **Foreign source income of returning expatriates: (Section 51)**

Foreign source income of a resident individual who is resident in current tax year but was non-resident in the preceding 4 tax years shall be exempt in the current tax year and in the following tax year.

**Tax Year: (Section 74)**

Normal: July 01 - June 30

Special: Year ending other than June 30

Transitional: Period between the ends of last tax year till the date of commencement of changed tax year.

A person using a normal or special tax year may apply to the Commissioner to allow him to use a twelve months' period other than special or normal tax year and the Commissioner shall grant permission only if the person has shown a compelling need to use a special or normal tax year as the case may be.

## SALARY

Salary is taxable on receipt basis (see Miscellaneous section for definition of receipt) i.e. any salary received by an employee in a tax year shall be chargeable to tax. However, salary paid by a private company to its employee in arrears may be taxable on accrual basis if the commissioner is of the view that the payment of salary was deferred. **(Section 110)**

Salary means any amount received by an employee from any employment, whether of a revenue or capital nature, and includes:

1. Pay, wages or other remuneration provided to an employee
2. Perquisite **(Section 13) (Rule 3-6 of Income Tax Rules, 2002)**
3. Allowances including cost of living, rent, utilities, education, entertainment or travel allowance excluding any amount expended in the performance of duties of employment
4. Reimbursement of any expenditure incurred by the employee, other than expenditure incurred solely in the performance of duties of employment
5. Profits in lieu of salary or wages including:
  - a. Consideration for an employee agreement to enter into an employment relationship, to any conditions of employment or to a restrictive covenant to any past, present or future employment
  - b. Amount received from a Provident Fund
  - c. Amount paid on termination of employment whether on voluntary basis or under any agreement **[Section 12 (6) + (8)]**
6. Pension or annuity
7. Employee share Scheme **(Section 14)**
8. Tax paid by the employer on employee's salary **(Tax on Tax)**

An amount or perquisite shall be treated as received by an employee from any employment regardless of whether the amount or perquisite is paid or provided:

- By the employee's employer, an associate of the employer, or by a third party under an arrangement with the employer or an associate of the employer;
- By a past employer or a prospective employer; or
- To the employee or to an associate of the employee or to a third party under an agreement with the employee or an associate of the employee.

Where salary is paid to an employee in arrears and as a result his income is chargeable to higher rate of tax than that would have been applicable if the amount had been paid in the tax year in which he was entitled to receive, he may by a notice in writing to the commissioner by the due date for furnishing employees return of income or employer certificate, elect for the amount to be taxed at the rates that would have been applicable if the amount had been paid in the tax year in which he was entitled to receive.

Tax shall be deducted by the employer at the time of payment of salary, at the average rate of tax after making adjustments of tax withheld from employee under other heads and admissible tax credits during the year. **(Section 149)**

Salary shall be Pakistan source income where the salary is: **(Section 101)**

- Received from any employment exercised in Pakistan, wherever paid; or
- Paid by or on behalf of FG, PG or LG in Pakistan, wherever the employment is exercised.

Taxability of the above mentioned items is as under:

**2. Perquisite: (Section 13)**

- a. Motor Vehicle provided by an employer wholly or partly for private use, the amount chargeable to tax under the head salary shall include: **(Rule 5 of Income Tax Rules, 2002)**

i.

Partly for personal and official use	5% of the cost of vehicle to the employer or FMV of motor vehicle at the commencement of lease
For personal use only	10% of the cost of vehicle to the employer or FMV of motor vehicle at the commencement of lease

- b. Services of housekeeper, gardener driver, or other domestic assistant, the amount chargeable to tax under the head salary shall include the amount of total salary paid to the domestic assistants as reduced by any payment made to the employer for such services
- c. Utilities, the amount chargeable to tax under the head salary shall include the FMV of utilities as reduced by any payment made to the employer for such utilities
- d. Interest free loan or a loan made at lower than benchmark rate by the employer on or after 1.7.2002, the amount chargeable to tax under the head salary shall include the profit on loan computed at benchmark rate or the difference between the amount of profit paid and the amount of profit on loan computed at benchmark rate (for tax year 2003 is 5% and increased by 1% for each successive year)
- i. Provided that this shall not apply where such benefit is extended by the employer due to waiver of interest by such employee on his accounts maintained with the employer
- e. For the purpose of clause 'd' above, where the employee uses the loan referred in that clause, wholly or partly for the 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 benchmark rate on the loan or that part of the loan used to acquire the asset or property. **(Indirectly by contributing to the national economy in the form of tax on taxable income).**
- f. Any obligation waived of an employee owed to the employer
- g. Any obligation paid by the employer of an employee owed to another person

- h. Difference between the FMV of any property transferred or service provided to the employee by the employer and the amount of any payment made by the employee in this respect
  - i. Accommodation or housing, the amount chargeable to tax under the head salary shall include: **(Rule 4 of the Income Tax Rules, 2002)**
    - i. Higher of the following:
      - 1. Amount that would have been paid in case such accommodation was not provided; and
      - 2. 45% (30% in case of persons serving in stations in Mufasal areas) of the MTS of the basic salary or the basic salary where there is no MTS.
5. **Profits in Lieu of Salary or Wages: [Section 12 (6) + (8) ]**
- a. An employee who has received amount on termination of employment whether on voluntary basis or under any agreement including compensation for redundancy or loss of employment and golden hand shake payments, may elect for the amount to be taxed at the last 3 year's average rate of tax computed as follows, provided that such election shall be made by the due date for furnishing employees return of income or employer certificate by a notice in writing to the commissioner:
    - i. Last 3 year's tax liability / Last 3 year's taxable income
7. **Employee Share Schemes: (Section 14)**
- a. *Right or option to acquire shares:* Taxable under the head salary when the same are disposed off as the difference between consideration received less cost of option or right
  - b. *Issue of Shares:* Taxable under the head salary at the time of issue when shares are issued without restriction as the difference between the FMV of shares issued at the date of issue less any amount paid by the employee for shares and for the grant of right or option to acquire shares.
    - i. Where shares are issued with restriction on transfers, no amount shall be chargeable to tax until the employee has a free right to transfer the shares or the time the employee disposes of the shares, whichever is earlier
    - ii. Where share are issued with restriction on transfers, the amount chargeable to tax under the head salary includes the difference between the FMV of shares issued at the date mentioned above less any amount paid by the employee for shares and for the grant of right or option to acquire shares.
  - c. Gain on shares subsequently disposed off falls under the head capital gain and for this purpose, cost of shares shall be the total of consideration given by the employee for shares, option/right and the amount taxed under the head salary in this respect.

**Difference between bonus shares and shares issued under employee stock option scheme:**

- Bonus shares are issued to shareholders in lieu of cash dividend and are not taxable at the time of issue, as the same are excluded from the definition of income.
- Shares issued under employee stock option scheme are issued to employees as an employment benefit and are taxable under the head salary.
- Option under employee stock option scheme is a capital asset as per the definition of capital asset u/s 37(5). However, this is specially taxed under the head salary as per section 145 only when it is disposed off.

**8. Tax on Tax:***Important points to note:*

- Tax rate may change due to tax borne by the employer. In this case, apply new slab rate from the beginning if it appears that slab rate may change after adding tax borne by the employer.
- In case where the employer agrees to pay specified amount of tax and the excess is to be paid by the employee, no grossing up formula is required. Specified amount of tax borne by the employer is taxable in the normal manner.
- Where employee is required to pay specified amount of tax and any excess is to be paid by the employer, only the amount in excess of the specified amount shall be grossed up.
- Employer may also agree to pay a certain percentage (%) of tax liability of the employee.

**Example:**

Basic salary	318,000
HRA	127,200
Company maintained car for both purposes costing 900,000	
Medical allowance	31,800

Tax of 11,000 is to be deducted from salary and the balance is to be borne by the company.

**Solution:**

Basic salary	318,000
HRA	127,200
Company maintained car	45,000
Medical allowance	31,800
Less: 10% of basic salary	(31,800)
<b>Taxable income</b>	<b>490,200</b>

Tax liability @ 3.5%                      17,157

Tax liability under marginal relief:

$450,000 * 2.5\% = 11,250$

$40,200 * 20\% = 8,040$

Tax liability **19,290**

Tax liability whichever is lower 17,157

Tax to be borne by the employer  $(17,157 - 11,000) = 6,157 / 96.5\% = 6,380$

Taxable income	490,200		
Tax borne by the employer	6,380	}	Always the same, it testifies the correctness of the solution.
<b>Total taxable income</b>	<b>469,580</b>		
Tax liability @ 3.5%	17,380	}	
Tax paid by the employee	11,000		
Tax borne by the employer	<b>6,380</b>		

**Example:**

Basic salary 300,000  
 HRA 120,000  
 Entertainment allowance 20,000  
 Company maintained car for both purposes costing 900,000  
 Medical allowance 30,000  
 70% of the tax is to be borne by the company.

Solution:

Basic salary	300,000
HRA	120,000
Entertainment allowance	20,000
Company maintained car	45,000
Medical allowance	30,000
Less: 10% of basic salary	(30,000)
<b>Taxable income</b>	<b>485,000</b>

Tax liability @ 3.5% 16,975  
 Tax liability under marginal relief:  
 $485,000 * 2.5\% = 11,250$   
 $35,000 * 20\% = 7,000$   
 Tax liability **18,250**

Tax liability whichever is lower 16,975  
 Tax to be borne by the employer  $(16,975/97.55\%) * 70\% = 12,181$

Taxable income	485,000		
Tax borne by the employer	12,181	}	Always the same, it testifies the correctness of the solution.
<b>Total taxable income</b>	<b>497,181</b>		
Tax liability @ 3.5%	17,401	}	
Tax borne by the employer (70%)	<b>(12,181)</b>		
Tax paid by the employee (30%)	5,220		

Grossing up formulae:  $(16,975/97.55\%) * 70\% = 12,181$   
 $100\% (3.5\%) - 3.5\% * 70\% (70\%) = 97.55\%$



**Exemptions from salary income: (2<sup>nd</sup> Schedule)**

- a) Pension received by the citizen of Pakistan from the former employee except where the person continues to work for the same employer or an associate of the employer. Where a person receives more than one pension, the exemption shall apply to higher of such pensions. **(Clause 8)**
- i. For a person over 60 years of age, all such pensions are exempt irrespective of the above mentioned conditions **(Circular 28 of 1991)**

- b) Commutation of pension received from government or any pension scheme approved by the tax authorities **(Clause 12)**

- c) Gratuity received from approved gratuity fund is fully exempt. Gratuity received from approved scheme and unapproved fund or scheme is exempt up to the following limits: **(Clause 13)**

i.

Approved gratuity scheme	Exempt up to 200,000
Unapproved gratuity scheme/fund	Exempt up to 75,000 or 50% of the amount receivable whichever is lower
Unapproved commutation of pension	

ii. Exemption in respect of unapproved gratuity/commutation of pension shall not apply in the following cases:

- a) Any payment not received in Pakistan
- b) Any payment received by a director of a company who is not a regular employee of such company
- c) Any payment received by a non-resident
- d) Any gratuity received by an employee who has already received any gratuity from the same or other employer.
- d) Accumulated balance received from a recognized provident fund **(Clause 23)**
- However, there are limits, in excess of which the employer's annual contribution and interest credited on the balance of the employee shall be deemed to be income received by the employee: **(Clause 3, Sixth Schedule)**
  - **Limit of employer's contribution:** 100,000 or 1/10<sup>th</sup> of the basic salary whichever is lower
  - **Limit on interest credited to employee balance:** 1/3<sup>rd</sup> of basic salary or 16% on the accumulated balance, whichever is lower.
- e) Amount received from WPPF **(Clause 26)**
- f) Any special allowance provided to meet the expenses incurred in performing of office duties **(Clause 39)**
- g) Perquisites: **(Clause 53A)**
- Free or concessional passage provided by transporters to its employee including airlines
  - Free or subsidized food provided by hotels and restaurants to its employees during duty hours

- Free or subsidized education provided by an educational institution to the children of employees
  - Free or subsidized medical treatment provided by a hospital or clinic to its employees
  - Any other perquisite for which the employer does not have to bear any marginal cost
- h) Medical facility or the reimbursement received by an employee where such provision or reimbursement is in accordance with the terms of employment provided that the NTN of the hospital or clinic is provided and employer also certifies and attests the medical bills.
- i) Medical allowance up to 10% of basic salary (**The same is fully taxable if it is provided in addition to the exempt medical facility provided by the employer**)
- j) Salary earned outside Pakistan by the citizen of Pakistan during the tax year in which he leaves Pakistan shall be exempt if he leaves Pakistan during the tax year and remains abroad during that tax year. [**Section 51 (2)**]
- k) Foreign source salary received by a resident shall be exempt if the individual has paid foreign income tax in respect of that salary or the employer has withheld income tax in respect of foreign source salary and paid to the revenue authority of that foreign country in which the employment was exercised. (**Section 102**)

**Example: Provident Fund**

Name	Contribution by		Interest Income
	Employee	Employer	
A	10,000	10,000	4,000
B	20,000	20,000	8,000
C	30,000	30,000	12,000

Balance of the fund = 120,000

Interest income 24,000 @ 20%

Dr: Cash           24,000

Cr:    Mr. A           4,000

Cr:    Mr. B           8,000

Cr:    Mr. C           12,000

**Situation relates to Unrecognized Provident Fund:**

In 2011, Mr. A received Rs. 24,000 from PF. Taxability of the amount received is as under:

Employee contribution 10,000 (Already Taxed)

Employer contribution 10,000 (Taxable)

Interest income           4,000 [Taxable under the head salary u/s 12(2)(e)(iv)]

**Situation relates to recognized Provident Fund:**

In 2011, Mr. A received Rs. 24,000 from PF. Taxability of the amount received is as under:

Employee contribution 10,000 (Already Taxed)

Employer contribution 10,000 (Exempt)

Interest income           4,000 (Exempt)

**Example:**

Basic salary	1,200,000
Dearness allowance	120,000
Employer's contribution to RPF:	120,000
Less: Rs. 100,000 or 10% of basic + DA Whichever is lower:	<u>(100,000)</u>
	1,340,000
Interest credited @ 17%	476,000
Less: Interest @ 16% or 1/3 <sup>rd</sup> of salary Whichever is lower:	<u>(440,000)</u>
<b>Taxable salary</b>	<b>1,176,000</b>

Temporary withdrawal: No tax treatment

Permanent withdrawal: Tax treatment is the same as in the case of amount received from PF on termination of employment.

## INCOME FROM PROPERTY

Chargeable Rent includes:

- \* Normal Rent (higher of actual or fair market rent)
- \* Non adjustable amount in respect of building
- \* Forfeited deposit
- \* Signing amount

Actual rent or Fair Market Rent, whichever is higher is taxable on accrual basis

Exclusions from section 15 (**Chargeable to tax under the head income from Other Sources**):

- Rent in respect of lease of building together with plant and machinery
- Amount received for the provision of amenities, utilities and any other service connected with renting of the building

**Taxability of property income is as under:**

**For individual and AOP:**

Gross amount of Rent	Rate of Tax
Does not exceed 150,000	0%
Exceeds 150,000 but less than 400,000	5 % of the amount exceeding 150,000
Exceeds 400,000 but less than 1,000,000	12,500 + 7.5% of the amount exceeding 400,000
Exceeds 1,000,000	57,500 + 10% of the amount exceeding 1,000,000

**For Company:**

Gross amount of Rent	Rate of Tax
Does not exceed 400,000	5 % of the gross amount
Exceeds 400,000 but less than 1,000,000	20,000 + 7.5% of the amount exceeding 400,000
Exceeds 1,000,000	65,000 + 10% of the amount exceeding 1,000,000

This section shall not apply in respect of a tax payer who is an individual or an AOP, derives income chargeable to tax under this section not exceeding 150,000 and does not derive taxable income under any other head.

Where any property is owned by two or more persons and their respective shares are defined and ascertainable, such persons shall not be treated as an AOP in respect of that property, and the share of each person is taxable in the hands of each co-owner separately. (**Section 66**)

Non adjustable amounts against the rent of a building received from a tenant in respect of rent payable by him shall be chargeable to tax under the head income from property in the tax year in which it was received and in the following nine tax years in equal proportion. Where the same is refunded to the tenant on or before the expiry of 10 years, no amount therefore shall be chargeable to tax in the year in which it is refunded subject to the following requirement: (**Section 16**)

- If the same property is lent out to the succeeding tenant, then any succeeding non adjustable amount received from the succeeding tenant as reduced by such portion of the earlier amount as was charged to tax shall be charged to tax in the year in which it was received and in the following nine tax years in equal proportion.

**Tax Deduction at Source: (Section 155)**

Following prescribed persons shall deduct tax at source when making payment on account of rent of immovable property:

- Federal, provincial or local government
- Company
- Nonprofit organization
- Diplomatic mission of a foreign state

Income from property is not taxable under FTR and no related expenses can be claimed against such income.

## INCOME FROM BUSINESS

The following incomes of a person for a tax year shall be chargeable to tax under the head income from business:

- Profits and gains of any business carried on by a person
- Income from the sale of goods or provision of services
- Income from hire or lease of tangible moveable property
- Management fee derived by a management company (including a modaraba management company)
- FMV of any benefit derived by a person in the course of or by virtue of past, present or prospective business relationship
- **Profit on debt** where the person's business is to derive such income (e.g. banks and financial institutions)
- **Lease Rentals** earned by a scheduled bank, investment bank, DFI, modaraba or a leasing company

Business income of a resident person shall be Pakistan source income if it is derived from any business carried on in Pakistan. **[Section 101 (2)]**

Where any expenditure relates to the derivation of income chargeable to tax under the head income from business (Normal) and Other business (Speculation), the expenditure shall be apportioned on any reasonable basis taking account of the relative nature and size of activities to which the amount relates **[Section 19 (1) (c) + Section 67 + Rule 13 of Income Tax Rules, 2002]**

Where a person has been allowed a tax deduction in respect of any expenditure and subsequently the person receives the amount of such expenditure as a reimbursement in cash or in kind, the amount so received shall be included in the person's income chargeable to tax in the year in which it is received. **(Section 70)**

### Carry forward of losses:

Loss for a tax year under this head (other than loss from a speculation business) shall be set off against any other head of income but can be carried forward only against future **business income** up to 6 tax years immediately succeeding the tax year in which the loss occurred. The loss of the earlier tax year shall be set off first. **(Section 57)**

Speculation business loss can be set off against any gain arising from speculation business in the tax year in which the loss arises and can be carried forward only against future **speculation gains** up to 6 tax years immediately succeeding the tax year in which the loss occurred. The loss of the earlier tax year shall be set off first. **(Section 58)**

Part of the tax depreciation (including initial allowance, first year allowance or accelerated depreciation) which has not been set off against income shall be carried forward in the normal manner in the following tax year and so on until it has been completely set off. These deductions shall be taken into account last. **(Section 57)**

**Deductions permissible in arriving at the income chargeable to tax under the head Income from business: (Section 20)**

1. A deduction shall be allowed for expenditure incurred by the person exclusively for the purpose of business.
2. Deduction equal to the amount of Cost of animals used for the purpose of business (otherwise than as stock in trade) and the Amount realized in respect of carcasses or animals shall be allowed where the animals have died or become permanently useless for such purposes
3. Amortization or depreciation of intangible or tangible assets where they have a useful life of more than 1 year **(Section 22, 23, 24), (Third Schedule)**
4. Pre-commencement expenditure at the rate of 20% on straight line basis **(Section 25), (Third Schedule)**
5. Scientific research expenditure **(Section 26)**
6. Employee training facilities expenditure **(Section 27)**
7. Profit on debt if related to Taxable Business Income **(Section 28)**
8. Entertainment expenditure in the limits as prescribed **(Rule 10 of Income Tax Rules, 2002)**
9. Bad Debts **(Section 29)**

**Explanation for the above mentioned items is as under:****3. Depreciation & Amortization:****a. Depreciation: (Section 22, 23)**

- i. Depreciation shall be allowed in relation to depreciable assets used in relation to the person's business
- ii. Depreciation rates are specified below: **(Third Schedule)**

Description of Asset	Rate of Depreciation
Building	10%
Furniture, plant and machinery, motor vehicles, ships, technical or professional books	15%
Computer hardware and aircrafts and aero engines	30%
Ramp built to provide access to disabled persons not exceeding 250,000 each	100%

- iii. Depreciation shall be allowed on proportional basis if the asset was also used for the purpose other than deriving business income in a tax year.
- iv. WDV of the asset in the above case shall be computed on the basis that the asset has been solely used to derive business income. It means that depreciation allowed as well as disallowed shall be deducted from the cost of the asset in arriving at the WDV. In that case, the WDV of the asset shall be increased by the amount of depreciation disallowed on account of non business use at the time of disposal.
- v. Depreciation shall not be allowed in the year of disposal

- vi. For computing gain on disposal of immovable property, the consideration received shall be treated as the cost of the property if the consideration exceeds its cost (**Gain on disposal shall be equal to the depreciation allowed**)
- vii. For computing gain on disposal of a depreciable asset by way of export that has been previously used in Pakistan, the consideration received shall be treated as the cost of the asset (**Gain on disposal shall be equal to the depreciation allowed**)
- viii. **Initial Allowance** equal to **50%** of the cost of the asset shall be allowed on eligible assets as defined below:
  - a. Road transport vehicle plying for hire
  - b. Building
  - c. Plant and machinery not previously used in Pakistan
  - d. Computer hardware
  - e. Technical and professional books
- ix. **First Year allowance** in lieu of initial allowance equal to **90%** of the cost of the asset shall be allowed in respect of plant & machinery installed by any industrial undertaking set up in specified rural areas and owned and managed by a company
- x. **Accelerated Depreciation** in lieu of initial allowance equal to **90%** of the cost of the asset shall be allowed in respect of plant & machinery installed for generation of alternate energy by an industrial undertaking set up anywhere in Pakistan and owned and managed by a company.

**b. Amortization: (Section 24)**

- i. Amortization shall be allowed for the cost of intangible assets that have been used for the purpose of deriving business income and that have a normal useful life of more than 1 year
- ii. An intangible with a normal useful life of more than 10 years or having an unascertainable useful life, it shall be treated as having a normal useful life of 10 years
- iii. Where intangible asset have been used partly for deriving business income, amortization deduction shall be allowed proportionately based on the number of days the intangible is used in deriving business income
- iv. No amortization shall be allowed in the year in which the person disposes off an intangible.

**7. Profit on Debt: (Section 28)**

- If the debt is utilized for business purpose
- Lease rentals of an asset to a financial institution, approved modaraba or leasing company or Special Purpose Vehicle (SPV) on behalf of an originator



- Financial cost of securitization of receivables by an originator in respect of SPV
- Share of profit under musharika scheme to a bank
- Share of profit to a certificate holder under a musharika scheme approved by SECP and Religious Board under Modaraba Ordinance
- On funds borrowed from a modaraba or participation term certificate holders
- By a bank to a person maintaining PLS account or a deposit with the bank
- SBP's share of profit by HBFC, National Development Leasing Corporation or Small and Medium Enterprises Bank on any investment or credit line provided by the SBP.

#### 8. Entertainment Expenditures: (Rule 10 of Income Tax Rules, 2002)

- a. A deduction for entertainment expenditures shall be limited to the following expenditures directly related to the person's business:
  - i. incurred outside Pakistan on entertainment in connection with business transactions
  - ii. incurred in Pakistan for foreign customers and suppliers
  - iii. incurred for customers and clients at the business premises
  - iv. incurred on entertainment at meetings of shareholders, agents, directors or employees
  - v. incurred at the opening of branches

#### 9. Bad Debts : (Section 29)

- a. Allowable subject to the following conditions:
  - i. The amount of debt was previously included in the person's income chargeable to tax or in respect of money lent by a financial institution deriving business income chargeable to tax
  - ii. The debt is written off in the accounts
  - iii. There are reasonable grounds to believe that the debt is irrecoverable
- b. Where the person receives the amount in cash or in kind, in respect of the debt which has been allowed as a deduction in prior years, the following rules shall apply:
  - i. Where the recovery is in excess of the bad debts disallowed, the excess shall be taxable in the tax year in which it is received
  - ii. Where the recovery is less than the amount of bad debts disallowed, the shortfall shall be allowed as deduction from income from business in the year in which it is received.
  - iii. **Partial Recovery of Bad Debts: (Illustration)**

	<i>Accounting</i>	<i>Taxation</i>	<i>Taxation</i>
<b>2010</b>	Bad debt expense	Admissible (No effect)	In admissible (Add)
<b>2011</b>	Bad debt recovery (Other income)	Taxable (No effect)	Not taxable (Less)

**Deductions inadmissible in arriving at the income chargeable to tax under the head Income from business: (Section 21)**

<u>Particulars</u>	<u>Accounting treatment</u>	<u>Tax treatment</u>	<u>Effect</u>
Expenditure	Admissible	Admissible	No effect
Expenditure	Admissible	In admissible	Add
Expenditure	In admissible	Admissible	Less
Income	Taxable	Taxable	No effect
Income	Taxable	Exempt	Less
Income	Exempt	Taxable	Add

- Any cess, rate, or tax paid or payable in Pakistan or foreign country on the profits of the business as a % or otherwise on the basis of such profits (Income tax charge, WWF, WPPF)
- Any amount of tax deducted at source
- Any payment of salary, rent, commission/brokerage, profit on debt, services and payments to non-residents made without tax deduction where a person is required to deduct tax.
  - Below is the table which shows necessary tax deduction requirements:

<i>Tax deducting agency</i>	<i>Salary</i>	<i>Rent</i>	<i>Brokerage/ Commission</i>	<i>Profit on debt</i>	<i>Payment to Non- resident</i>	<i>Services</i>
<b>Section</b>	<b>149</b>	<b>155(3)</b>	<b>233</b>	<b>151</b>	<b>152</b>	<b>153(7)</b>
Company	✓	✓	✓	✓	✓	✓
AOP Reg. firm	✓	×	✓	×	✓	✓
AOP URF turnover of 50m or more	✓	×	×	×	✓	✓
AOP URF turnover < 50m	✓	×	×	×	✓	×
Individual having turnover 50m or more	✓	×	×	×	✓	✓
Individual having turnover < 50m	✓	×	×	×	✓	×

- Entertainment expenditures in excess of limits provided in Rule 10 of Income Tax Rules, 2002
- Any fine or penalty for the violation of any law, rule or regulation
- Personal expenses of the tax payer
- Amount carried to reserve fund or capitalized in any way
- Any profit on debt, brokerage, commission, salary or other remuneration paid by an AOP to a member of the association

**Illustration:**

<b>Accounting Profit</b>	<b>5,000,000</b>
<b>Add:</b>	
Accounting Depreciation	150,000
Tax gain on disposal	20,000
Salary to Partners	1,250,000
Commission to Partners	500,000
<b>Less:</b>	
Tax Depreciation	200,000
Accounting gain on disposal	10,000
<b>Taxable Income</b>	<b>6,710,000</b>
Tax @ 25%	1,677,500
<b>Divisible Income</b>	<b>5,032,500</b>

	<u>Partner</u>
<b>Salary</b>	1,250,000
<b>Commission</b>	500,000
<b>Balance</b>	3,282,500
	<b>5,032,500</b>

- Payments of business expenditure required to be paid through banking channel other than the following:
  - Where salary of an employee does not exceed 15,000 per month
  - Where aggregate of a single account head does not exceed 50,000 for the year
  - Single payment up to 10,000
  - Payment on account of freight, travel fare, postage, utility and other government dues
- Payments to establish a business entity (e.g. company incorporation expenses)
- Contribution to unrecognized provident fund, unapproved pension fund, unapproved superannuation fund or unapproved gratuity fund unless the person has made effective arrangements to secure that tax is deducted from any payments made by the fund.
  - When gratuity is actually paid to an employee from any gratuity scheme or unapproved fund, the amount paid constitutes an admissible deduction for the income year in which it is paid (**Circular 11 of 1980**)

**Business Assets: (Section 75-79)**

Disposal of an asset also includes the disposal of part of an asset. A person shall be treated to have disposed off the asset when the assets is sold, destroyed, exchanged, transferred, cancelled, lost, expired etc. Application of business asset to personal use shall also be treated as disposal. (**Section 75**)

Cost of an asset purchased by a person shall include: (**Section 76**)

- Consideration paid including FMV of consideration given in kind
- Expenditure in acquiring and disposing off the asset
- Expenditure to alter or improve the asset

- Currency exchange differences arising on a loan from which the asset is purchased shall also be added to or deducted from the cost of the asset **in the year of occurrence**, including the effect of any hedging agreement relating to the loan
- Amount chargeable to tax or amount exempt from tax charged in addition to amount paid at the time of acquisition (**amount charged to sales whether taxable or exempt from tax**)
- As **reduced by** any grant subsidy, rebate, commission or any other assistance received or receivable in respect of acquisition of the asset.

No gain or loss shall arise on disposal of the asset by reason of 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.

- In such case, the cost of replacement asset shall be cost of asset disposed off + (consideration given for replacement asset in excess of consideration received for the asset disposed off)

## CAPITAL GAINS

1. **Capital Asset** has been defined as property of any kind connected with business or not, but does not include:
  - a. Stocks, consumables or raw materials held for business
  - b. Depreciable asset or amortizable asset
  - c. Immoveable property
  - d. Moveable property held for personal use of the person or any dependent family member [excluding capital assets mentioned u/s 38(5)]
2. **Specified Capital Assets (Securities u/s 37A)** includes:
  - a. Shares of a public company
  - b. Vouchers of PTCL
  - c. Modaraba Certificate
  - d. Redeemable capital
  - e. Derivative product
3. **Public Company** means:
  - Company listed in Pakistan at the year end
  - A company in which 50% or more shares are held by:
    - FG or PG; or
    - Foreign government; or
    - Foreign company wholly owned by foreign government
4. **Other Capital Assets (Section 37)** which may include shares of a private company, membership card of a stock exchange, share in partnership firm or other personal assets other than as stock in trade, depreciable or amortizable assets, immoveable property, moveable property held for personal use of a person excluding other than those mentioned in section 38 (5). [Those assets include painting, sculpture, drawing, jewelry, rare manuscript, postage stamps, first day cover, coin, or an antique on which loss shall not be recognized on their disposal]
5. Where the capital asset is held for more than 1 year, other than those mentioned in section 37A, gain if any on their disposal shall be restricted to 75% (25% is exempt)
6. Where a person sustains loss on disposal of any of the capital asset mentioned u/s 37A, it shall be set off only against gain arising from any other security mentioned u/s 37A, and any unadjusted loss shall not be carried forward.
7. Capital gain on disposal of the shares of a company in Export Processing Zone (EPZ) is exempt (Clause 114 2<sup>nd</sup> Schedule Part I)

8. Taxability of capital gain on disposal of securities mentioned u/s 37A is as under: (1<sup>st</sup> Schedule)

Holding Period	Tax Year	Rate of Tax
Less than 6 months	2011	10%
	2012	10%
	2013	12.5%
	2014	15%
	2015	17.5%

Holding Period	Tax Year	Rate of Tax
More than 6 months but less than 12 months	2011	7.5%
	2012	8%
	2013	8.5%
	2014	9%
	2015	9.5%
	2016	10%
More than 12 months	-	0%

9. Where the capital asset is transferred by way of:
- Gift, bequest or a will
  - Succession, inheritance or devolution
  - Distribution of assets on dissolution of an AOP
  - Distribution of assets on liquidation of a company

No gain or loss shall arise where the recipient is a **resident** in Pakistan in the relevant tax year. The recipient shall be treated to have acquired the capital asset at the FMV at the time of such transfer.

10. Capital gain on bonus shares subsequently disposed off representing the difference between consideration received and the dividend in specie (face value of bonus shares) is taxable in accordance with section 37 or 37A. (**Clause 103B, Part I, 2<sup>nd</sup> Schedule**)

**Illustration:**

Consideration received for all shares	xxxx
<b>Less:</b>	
Cost of shares other than bonus shares	xxxx
Face value of bonus shares	xxxx
<b>Capital gain/loss</b>	<b>xxxx</b>

11. Any gain from the alienation of any share in a company, the assets of which comprise wholly or principally, directly or indirectly, of immoveable property or rights to explore natural resources in Pakistan shall be Pakistan source income. (**Section 101**)

- It means that if a non-resident company is involved in exploration of natural resources in Pakistan wholly or substantially or where a non-resident company derives income from lease of immoveable property in Pakistan, then capital gain on shares of such a company is a Pakistan source income and a non-resident shareholder is taxable in Pakistan subject to tax treaty.

11. Any gain arising on the disposal of shares in a resident company shall be Pakistan source income.

12. **Consideration in calculation of capital gain:**

- Capital loss, if any, shall not be restricted to 75% and therefore, the full amount of loss shall be adjusted or carried forward.
- Shares held will be considered as capital asset even if they are held as stock in trade, and the gain on disposal will be taxed as capital gain (Circular 2-IT/1972 dated 01/07/1972)

**Carry forward of losses:**

Net Capital loss can be carried forward against future capital gains up to 6 tax years immediately succeeding the tax year in which the loss occurred. The loss of the earlier tax year shall be set off first. (Section 59)

## INCOME FROM OTHER SOURCES

- a. Income of every kind received by a person (taxable on receipt basis) in a tax year, if it is not included in any other head, other than income exempt from tax under the ordinance, shall be chargeable to tax in that year under the head Income from Other Sources including the following:
1. Dividend (including face value of bonus shares i.e. dividend in specie at the time of disposal of bonus shares)
  2. Royalty (foreign source royalty received by a company registered under Companies Ordinance, 1984 and having its registered office in Pakistan is exempt: Clause 131 Part I 2<sup>nd</sup> Schedule)
  3. Profit on debt
  4. Ground rent
  5. Rent in respect of lease of building together with plant and machinery
  6. Amount received for the provision of amenities, utilities and any other service connected with renting of the building
  7. Prize bond, winnings from a raffle, lottery, prize on winning a quiz, prize offered by companies for promotion of sale or cross word puzzle (**Prize bond & Cross-word puzzle is taxable @ 10% of gross amount; Raffle, lottery, prize on quiz and offered by companies for promotion is taxable @ 20% of gross amount**) [1<sup>st</sup> Schedule]
  8. Amount received as a loan, advance, deposit for issuance of shares, gift by a person otherwise than by banking channel other than advance payment for sale of goods or supply of services.
    - **Cash Loan:** (Circular 12, 1992)  
It is only the peak credit of the lender which is to be taken as deemed income of the tax payer and not the aggregate of all sums of loan received during the relevant year.
  9. Where a person fails to provide a reasonable explanation:
    - (1) For any amount credited in a person's books,
    - (2) For source of funds where a person has made an investment or is the owner of any money or valuable article,
    - (3) For any expenditure incurred or
    - (4) **Where a person has concealed income or furnished inaccurate particulars of income including:**
      - The suppression(concealment) of any production, sales or any amount chargeable to tax; or
      - The suppression(concealment) of any item of receipt liable to tax in whole or in part



- The unexplained amount shall be included in the person's income chargeable to tax under the head income from other source to the extent it is not adequately explained. **(Section 111)**
- a. Foreign exchange remitted from abroad through normal banking channels and got en-cashed in Pakistan rupee from a scheduled bank is immune and no question shall be asked
  - b. Section 111 shall not apply on encashment of Foreign Exchange Bearer Certificates (FEBC), US \$ Certificates and Foreign currency bearer certificates.
10. Where the declared cost of an asset is less than the reasonable cost of that asset, the commissioner may having regard to all the circumstances include the difference in the person's income chargeable to tax under the head income from other source. **(Section 111)**
- b. Where any profit on debt derived from National Savings Deposit Certificate including DSCs' is paid to a person in arrears and as a result his income is chargeable to higher rate of tax than would have been applicable if the amount had been paid in the tax year to which it relates, he may by a notice in writing to the commissioner by the due date for furnishing employees return of income, elect for the amount to be taxed at the rates that would have been applicable if the amount had been paid in the tax year to which it relates.
  - c. A deduction shall be allowed for any expenditure incurred in deriving income chargeable to tax under the head income from other source, such as the following:
    - i. Zakat deducted in accordance with Zakat & Ushr Ordinance, 1980 from profit on debt
    - ii. Depreciation (including initial allowance) of plant and machinery against Rent in respect of lease of building together with plant and machinery.

## LOSSES

Loss under any head of income can be set off against any other head of income specified in section 11, other than speculation loss and capital loss

Loss under the head 'Income from Business' shall be set off last in priority of loss under another head of income. **(Section 56)**

Loss incurred by an **AOP** shall not be available for its members and the AOP shall carry forward its losses in the subsequent tax years in the normal manner **(Section 59A)**

### **Foreign Losses: (Section 104)**

Foreign losses shall be carried forward only against foreign source income up to 6 years immediately succeeding the tax year for which the loss was computed. This is based on the premise that foreign source income chargeable under a head of income shall be treated as a separate head of income.

### **Business loss with reference to amalgamation: (Section 57A)**

Assessed loss (excluding capital loss) **for the tax year** of the amalgamating company(s) shall be set off against business profits or gains of the amalgamated company in the year of amalgamation subject to the condition that the amalgamated company carries on the business of amalgamating company for a minimum period of 5 years from the date of amalgamation. Any unadjusted loss can be carried forward up to a period of 6 years succeeding the year of amalgamation.

Unabsorbed depreciation can be carried forward in the normal manner with no time limits.

However in case of amalgamation of banking company, non banking finance company, modaraba or insurance company, the **accumulated business loss** (other than speculation loss) can be adjusted & carried forward in the manner mentioned above.

Non compliance with any of the conditions laid down by SBP, SECP or any court shall render the allowed adjusted loss be treated as the income of the amalgamated company in the year which the non compliance occurred.

### **Group Taxation: (Section 59AA)**

Holding companies and 100% owned subsidiaries locally incorporated under the Companies Ordinance, 1984 may opt to be taxed as a single fiscal unit for which consolidated group accounts shall be required for the computation of income and tax liability. Such option exercised by the group companies shall be irrevocable. Such relief shall not be available to losses prior to the formation of group.

Inter-corporate dividend income within the group companies shall be exempt.

**Group relief: (Section 59B)**

A subsidiary company may surrender its tax loss (**excluding b/f loss and capital loss**) in favor of its holding company or in favor of any subsidiary of its holding company. The holding company shall directly hold share capital of the subsidiary company as under:

One of the company in group is public listed	55% or more
None of the company in group is public listed	75% or more

The loss surrendered by the subsidiary company may be claimed by the holding or any subsidiary company in the tax year in which the loss has been surrendered and in the following 2 tax years subject to the following conditions:

1. There is a continued ownership for 5 years of the share capital of the subsidiary company as mentioned above (**reversal of availed relief shall take place if the equity interest falls below the minimum required in such 5 years**)
2. A trading company within the group shall not be entitled to avail group relief
3. If a holding company is a private company, it shall get itself listed within 3 years from the year in which the loss is claimed
4. Approval of BOD of both the companies (loss surrendering & loss claiming) is necessary
5. Subsidiary company shall continue the same business during the specified period of 3 years
6. All the companies in the group comply with corporate governance requirements.

The subsidiary company cannot surrender its assessed losses for more than 3 tax years. Any unadjusted loss of subsidiary company after the specified period shall be carried forward by the subsidiary in the normal manner. (**3 consecutive tax years according to Circular 1 of 2007**)

Inter-corporate dividend income within the group companies shall be exempt.

Loss claiming company may with the approval of BOD, transfer cash equal to the savings of tax in this respect. Such amount shall not be allowable tax expense nor be taxable income for both the companies.

Transfer of shares between companies and shareholders in one direction, would not be taxable capital gain provided the transfer is to acquire share capital for the formation of a group and approval of SECP or SBP has been obtained in this respect.

## TAX CREDITS

Tax credits shall be applied in the following manner:

- Foreign tax credit u/s 103
  - Tax credit/rebate on donations, investment, enlistment, etc,
  - Advance tax & tax deducted/collected at source
1. **Senior Citizen Allowance** to a person who is of 60 years of age or more on the 1<sup>st</sup> day of a tax year and his taxable income does not exceed Rs. 1 million, shall be allowed a reduction equal to 50% of his tax liability (**Clause 1A, 2<sup>nd</sup> Schedule, Part III**)
  2. **A full time teacher or researcher** of a recognized nonprofit educational or research institution including government training and research institutions shall be allowed a reduction of 75% of tax liability on taxable salary only (**Clause 2, 2<sup>nd</sup> Schedule, Part III**)
  3. Where a resident person derives foreign source income which is taxable in Pakistan, the tax payer shall be allowed a tax credit in respect of **foreign income tax** paid by him as lower of the following: (**Section 103**)
    - a. Foreign income tax paid
    - b. Pakistan tax payable in respect of foreign source income at the average rate of tax

Foreign income tax is to be paid within 2 years after the end of tax year to which it relates. If not paid within 2 years, tax credit allowed earlier shall be treated as tax payable by the person.
  4. **Charitable Donations** in the form of any sum paid or property given by the person as a donation to the following: (**Section 61**)
    - a. Board of education or university established under federal or provincial law
    - b. Educational institution, hospital or relief fund established or run by the federal, provincial or local government
    - c. Approved Non-profit organization

Rebate on donations made in cash shall only be allowed if paid by a crossed cheque drawn on a bank.

Tax credit shall be allowed at the average rate of tax on lower of the following:

- Actual amount of donation or FMV of the property given
- 30% of taxable income of individual or AOP (20% in case of a company)

Amount paid as donation to the institutions mentioned in **clause 61, 2<sup>nd</sup> schedule** are straight deduction from the total income of the donor (**treated like deductible allowances**). Provided that the maximum limits of 30% or 20% shall apply in the normal manner. The condition of payment through banking channel is not applicable for donations to be permissible deductions.

5. An eligible person (an individual Pakistani holding valid NTN, CNIC or NICOP) deriving income chargeable to tax under the head salary or income from business shall be entitled to a tax credit on the average rate of tax in respect of **contribution or premium paid to an approved pension fund**. Tax credit shall be allowed on lower of the following: **(Section 63)**

- a. Actual amount of contribution or premium; or
- b. 20% of taxable income of the relevant tax year. Provided that an eligible person joining the pension fund at the age of 41 years or above shall be entitled to additional 2% for every year of age exceeding 40 years subject to the maximum of 50% of the taxable income of the preceding year.

6. A resident person other than a company shall be entitled to a tax credit at the average rate of tax in respect of **purchase of the following shares: (Section 62)**

- a. Shares of a public listed company as an original allottee
- b. Shares acquired from the privatization commission of Pakistan

Amount eligible for tax credit shall be lower of the following:

- Actual cost of the shares
- Rs. 500,000
- 15% of the taxable income for the year

Shares are required to be held for at least 36 months otherwise tax credit allowed earlier shall be reversed.

7. A resident person other than a company shall be entitled to a tax credit at the average rate of tax in respect of any **life insurance premium paid on a policy to a life insurance company** registered by the SECP under the Insurance Ordinance, 2000, provided the resident person is deriving income chargeable to tax under the head “salary” or “income from business”. **(Section 62)**

Amount eligible for tax credit shall be lower of the following:

- Total contribution of premium paid by the person
- Rs. 500,000
- 15% of the taxable income for the year

8. A person shall be allowed a tax credit in respect of **profit on debt** (including share in appreciation in value of house) on a loan from a scheduled bank or a non banking finance institution regulated by SECP or by government or a statutory body or a listed company for the acquisition of house or construction of a new house. Tax credit shall be allowed at the average rate of tax on the lower of: **(section 64)**

- a. Actual amount paid
- b. 50% of taxable income
- c. Rs. 750,000

9. A **manufacturer registered under the Sale tax act, 1990** shall be allowed a tax credit equal to 2.5% of his tax liability if 90% of his sales are to the persons registered under sales tax act, 1990. Such credit is in respect of income other than FTR and for this purpose he shall provide complete details of the persons to whom the sales were made. **(Section 65A)**

10. For Enlistment in any registered stock exchange in Pakistan in the year in which it is listed (Tax credit equal to 15% of tax payable) [Section 65C]
11. If a company invests in purchase of plant & machinery for the purpose of BMR (Balancing, Modernization & Replacement) of plant & machinery already installed, credit @ 10% of the amount of such investment is allowed against the tax payable in the year in which such plant & machinery is installed. This tax credit is allowed if the plant & machinery is purchased and installed between 1.7.2010 and 30.6.2015. (Section 65B)
- a. If the amount of tax credit is more than the tax payable, then excess shall be carried forward for 2 subsequent tax years.
12. If a taxpayer being a company: (Section 65D)
- a. Establishes a new industrial undertaking for manufacturing in Pakistan, or
- b. Invests in purchase and installation of plant & machinery for the purpose of BMR (Balancing, Modernization & Replacement) of plant & machinery already installed, in an industrial undertaking set up in Pakistan and owned by it, with 100% equity owned by it

Tax credit @ 100% of the amount of the tax payable shall be allowed to such company on or after July 01, 2011, for a period of 5 years or commencement of commercial production, whichever is later.

If the amount of *tax credits is more than the tax liability*, then no refund shall be allowed nor the same is allowed to be carried forward or carried back (except in case of tax credit on BMR).

**Example (Senior citizen and full time teacher allowance):**

Mr. A aged 120 years

Tax year 2011

Taxable salary as full time teacher Rs. 220,000

Taxable capital gain Rs. 240,000

**Solution:**

Taxable salary	220,000
Taxable capital gain	240,000
<b>Total Taxable income</b>	<b>460,000 (Non Salaried Case)</b>

Tax liability @ 7.5%	34,500
Senior citizen allowance @ 50%	(17,250)
	17,250
Full time teacher allowance @ 75%	(6,188)
<b>Tax liability</b>	<b>11,062</b>

**Working:**

Full time teacher allowance in respect of tax liability on taxable salary:

$$(220,000/460,000) * 17,250 = 6,188$$

**Example (Donations and Shares):**

Mr. C aged 68 years

Taxable salary Rs. 300,000

Taxable capital gain Rs. 90,000

**Solution:**

Taxable salary	300,000
Taxable capital gain	<u>90,000</u>
Total income	390,000
Zakat (u/s 60)	<u>(5,000)</u>
Total Taxable income	385,000 (Salaried Case)

Tax liability @ 1.5% 5,775

Tax liability under marginal relief

350,000 \* 0.75%      2,625

35,000 \* 20%        7,000

Tax liability            9,625

Tax liability whichever is lower:            5,775

Senior citizen allowance @ 50%            (2,888)

2,887

Rebate on donation of Rs. 20,000        (150)

Rebate on investment in shares of Rs. 30,000    (337)

Tax liability            2,400

**Working:**

Rebate on donation = (A/B) \* C

$$= (2,887/385,000) * 20,000 = 150$$

Rebate on investment in shares = (A/B) \* C

$$= (2,887/385,000) * 45,000 = 337$$

### ASSOCIATION OF PERSONS

An AOP shall be liable to tax separately from its members, and where AOP has paid the tax, the amount of share of profit received by a member out of income of AOP shall be exempt in the hands of the members. But the same shall be included in the taxable income for rate purpose only. **(Section 88, 92)**

FBR has clarified that it is the divisible income (profit after tax) of AOP that will be included in the taxable income of its members for rate purpose.

Share of loss from AOP is not adjustable against income of its members nor is it considered for rate purpose.

**The amount of tax payable by the individual shall be calculated as:**

$$\frac{\text{Tax liability on an individual's taxable income including share of profit from AOP} \times \text{Actual taxable income excluding share of profit from AOP}}{\text{Taxable income including share of profit from AOP}}$$

**Tax credit to a company receiving share of profit from AOP:**

Share of profit from AOP shall be included in the taxable income of a company and taxable in the normal manner. However, the company shall be entitled to a tax credit calculated in the following manner: **(Section 88A)**

$$\frac{\text{Share of profit from AOP} \times \text{Tax assessed on AOP}}{\text{Taxable income of AOP}}$$



## DISPOSAL OF BUSINESS

### ***By an Individual to a wholly owned Company: (Section 95)***

Where a **resident individual** disposes off all the assets of a business to a **resident company**, no gain or loss on disposal is to be accounted for when following conditions are satisfied:

- Consideration received for disposal is in the form of shares (other than redeemable shares) of the company
- The transferor must beneficially own all of the issued share capital of the transferee company immediately after disposal
- Company must undertake to discharge all the liabilities in respect of assets acquired by the company
- Liabilities shall not exceed the transferor's cost of the asset at the time of disposal
- FMV of the shares received in the consideration must be substantially the same as the FMV of the assets transferred less any liabilities in respect of assets disposed off
- Company must not be exempt from tax in the tax year in which the disposal takes place.

For the purpose of above conditions:

**Cost of acquisition** shall be:

- Tax WDV in case of depreciable/amortizable assets
- Lower of cost or NRV of stock in trade
- Transferor's cost, in any other case

**Transferor's cost in respect of shares received as consideration** shall be:

- Cost of acquisition for a company
- Less: amount of liability that the company has undertaken to discharge in respect of that assets
- Divided by: number of shares received

Unabsorbed depreciation/amortization in respect of transferor's assets shall be allowed as a deduction to the company in the tax year in which the transfer is made.

### ***By an AOP to a wholly owned Company: (Section 96)***

Where a **resident AOP** disposes off all the assets of a business to a **resident company**, no gain or loss on disposal is to be accounted for when following conditions are satisfied:

- Consideration received for disposal is in the form of shares (other than redeemable shares) of the company
- The AOP must beneficially own all of the issued share capital of the transferee company immediately after disposal
- Members' of an AOP must have an interest in the shares of the company in the same proportion as in the business assets immediately before disposal
- Company must undertake to discharge all the liabilities in respect of assets acquired by the company
- Liabilities shall not exceed the AOP's cost of the asset at the time of disposal
- FMV of the shares received in the consideration must be substantially the same as the FMV of the assets transferred less any liabilities in respect of assets disposed off
- Company must not be exempt from tax in the tax year in which the disposal takes place.

For the purpose of above conditions:

**Cost of acquisition shall be:**

- Tax WDV in case of depreciable/amortizable assets
- Lower of cost or NRV of stock in trade
- Transferor's cost, in any other case

**AOP's cost in respect of shares received as consideration shall be:**

- Cost of acquisition for a company
- Less: amount of liability that the company has undertaken to discharge in respect of that assets
- Divided by: number of shares received

Unabsorbed depreciation/amortization in respect of AOP's assets shall be allowed as a deduction to the company in the tax year in which the transfer is made.

***By a wholly owned Company to a wholly owned Company: (Section 97)***

Where a resident company disposes off all the assets of a business to another resident company, no gain or loss on disposal is to be accounted for when following conditions are satisfied:

- Both companies belong to a wholly owned group of resident companies at the time of disposal
- Transferee must undertake to discharge all the liabilities in respect of assets acquired by the transferor
- Liabilities shall not exceed the transferor's cost of the asset at the time of disposal
- Transferee must not be exempt from tax in the tax year in which the disposal takes place.

For the purpose of above conditions:

**Wholly owned group companies means:**

- One of the company beneficially holds all the issued share capital of the other company, or
- A third party beneficially holds all the issued share capital in both companies.

**Cost of acquisition shall be:**

- Tax WDV in case of depreciable/amortizable assets
- Lower of cost or NRV of stock in trade
- Transferor's cost, in any other case

**Transferor's cost in respect of shares received as consideration shall be:**

- Cost of acquisition for a transferee
- Less: amount of liability that the company has undertaken to discharge in respect of that assets

Unabsorbed depreciation/amortization in respect of transferor's assets shall be allowed as a deduction to the company in the tax year in which the transfer is made.

**Under a Scheme of Arrangement or Reconstruction: (Section 97A)**

No gain or loss shall arise on the disposal of asset from one company to another, by virtue of operation of a Scheme of Arrangement and Reconstruction under the provisions of Companies Ordinance, 1984 if the following conditions are satisfied:

- Transferee must undertake to discharge all the liabilities in respect of assets acquired by the transferor
- Liabilities shall not exceed the transferor's cost of the asset at the time of disposal
- Transferee must not be exempt from tax in the tax year in which the disposal takes place
- The scheme is approved by HC, SBP or SECP as the case may be.

For the purpose of above conditions:

**Cost of acquisition** shall be:

- Tax WDV in case of depreciable/amortizable assets
- Lower of cost or NRV of stock in trade
- Transferor's cost, in any other case

Unabsorbed depreciation/amortization in respect of transferor's assets shall be allowed as a deduction to the company in the tax year in which the transfer is made.

## ASSOCIATES

**Definition:** Section 85

All transactions between associates are required to be made at an arm's length basis. However, where the transactions is not at arm's length basis, the commissioner may in respect of such transactions, distribute, allocate or apportion income, deductions or tax credits so as to reflect the income that would be realized by the associates in an arm's length transaction. **(Section 108)**

**Transfer Pricing: (Rule 20-27 on Income Tax Rules, 2002)**

**Transfer pricing** refers to the setting, analysis, documentation, and adjustment of charges made between related parties for goods, services, or use of property (including intangible property). Transfer prices among components of an enterprise may be used to reflect allocation of resources among such components, or for other purposes. [OECD Transfer Pricing Guidelines](#) state, "Transfer prices are significant for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions.

These rules are made in account of powers of the commissioner u/s 108. When exercising powers under that section, the Commissioner may give regard to the following methods for determining the arm's length result between the associated parties, based on the arm's length standard. The selection is based on the judgment of the Commissioner as to the suitability of the method:

- Comparable uncontrolled price method
- Resale price method
- Cost plus method
- Profit split method (used only where none of the above methods is applicable)

A controlled transaction is said to have meet the arm's length standard if the results of the arm's length standard is such that would have resulted if the associated parties have entered in the same transaction under the same conditions.

**Comparable Uncontrolled Price Method:**

The price charged or paid in a controlled transaction must be the same as those in a comparable uncontrolled transaction.

**Resale Price Method:**

Whether the price charged to an associated party realizes the same gross margin as would have been realized in the same transaction under the same terms with the unrelated party or transaction between uncontrolled persons.

Following steps shall apply in determining arm's length result:

1. Determine the resale price of the goods acquired from the associate
2. Deduct resale gross margin from the resale price (amount that covers the person's selling and other operating expenses)
3. Deduct other costs associated with the purchase of a product (such as custom duty)

The amount remaining as the result of the above is the arm's length result and this must also be the transfer price of the goods between associates.

**Cost plus Method:**

Following steps shall apply in determining arm's length result:

1. Determine the total cost incurred in controlled transaction
2. To this, add an appropriate cost plus markup to reflect an appropriate profit under such market conditions

The amount remaining as the result of the above is the arm's length result and this must also be the transfer price of the goods between associates.

**Profit Split Method:**

This method may be adopted when the transactions are interrelated so that the arm's length result cannot be determined on a separate basis.

Profit from such transaction is divided amongst the associates in the same manner as if amongst independent person entering into such transaction on an arm's length basis.

Profit can be split amongst associates using any of the following methods:

- a) **Contribution analysis:** based on the functions performed by each associate
- b) **Residual Analysis:** total profit from controlled transactions are divided as follows:
  - a. Each associates is allocated a basic return appropriate for the type of transaction
  - b. Residual profit is allocated on a reasonable basis as would in an independent arrangement

**Thin Capitalization: (Section 106)**

- Any profit on foreign debt incurred by a FCRC or a branch of a foreign company operating in Pakistan in excess of 3:1 foreign debts to foreign equity ratio at any time during the year shall not be allowed as tax expense.
- This section shall apply in the following cases:
  - In case of a FCRC other than a banking company or a financial institution; or
  - Where interest income of a non-resident is exempt in Pakistan or taxable at a rate lower than normal corporate tax rate.
- **Foreign Controlled Resident Company (FCRC)** means a resident company in which 50% or more of the underlying ownership is held by a non-resident person either alone or together with any associates
- **Foreign Debt** in relation to FCRC means the highest amount at any time in a tax year of the sum of the following:
  - Foreign Debt o/s to Foreign Controller
  - Foreign Debt o/s to any non-associate where that non-associate has a balance o/s of a similar amount of debt owed to FC.
- **Foreign Equity** means the aggregate at the beginning of the tax year of the following:
  - Paid-up value of shares held by FC
  - Proportionate share of acc. Profits, share premium, and revaluation surplus as it would be entitled to FC in the event of the company being wound up
  - As reduced by any debt obligation owed by FC to FCRC and proportionate share of accumulated losses if any.

## PROCEDURE

Refer sections (114-146B) for administrative procedures relating to filing of returns, assessments, appeals and collection & recovery of tax.

### Wealth Statement: (Section 116)

Wealth statement along with the wealth reconciliation statement shall be filed by every resident person **being an individual** with the return of income where taxable income for the year or last assessed income is **Rs. 1,000,000** or more. Wealth statement shall show the following:

- Total assets and liabilities of the person, spouse, minor children and other dependents
- Any asset transferred to any other person during the tax year and the consideration for the transfer
- Total expenditure incurred by the person, spouse, minor children and other dependents and details of such expenditure.

Wealth statement along with the wealth reconciliation statement shall also be filed by a person filing statement under FTR and has paid tax amounting to 35,000 or more.

**Provided that every member of an AOP whose share from the income of such AOP, before tax, for the year is Rs. 1,000,000 or more, shall also furnish wealth statement and wealth reconciliation statement for the year along with the return of income of the Association.**

A person may file a revised statement before the amendment of assessment if he finds any mistake or omission.

## MINIMUM TAX

Where in a tax year, the tax payable is less than 1% of the turnover or no tax is otherwise payable for any reason whatsoever including the following: (Section 113)

- Loss for the year
- Exemption from tax
- Application of credits/rebates
- Claiming of allowances or deductions
- Set off of a loss of an earlier year; or
- Adjustment of minimum turnover tax paid in earlier years

By the following persons:

- Resident company
- Individual having turnover of 50 million or above
- AOP having turnover of 50 million or above

Their turnover for the tax year shall be treated as the income of the person chargeable to tax and such persons shall pay tax @ 1% of their turnover instead of actual tax liability.

Provided that, the amount paid in excess of actual tax liability shall be carried forward for adjustment against tax liability for 5 tax years immediately succeeding the tax year for which the amount was paid.

**Not applicable:**

- Where a company has declared gross loss before set off of depreciation and other inadmissible expenses
- In case of Modaraba and Non-profit organization
- Special purpose, nonprofit company engaged in securitization of receivables of PG

**Turnover means:**

- **Gross sales** or gross receipts, exclusive of:
  - Sales tax
  - Excise duty
  - Trade discount shown on invoices
  - Sales/receipts taxable under FTR
- Gross fee for services, commission and gross receipts from contracts excluding covered under FTR
- Share of profit from AOP received by a company out of the above income excluding those covered under FTR

**Tax collected at import stage: [Section 148(8)]**

Tax collected @ 5% on import of edible oil and packing material for a tax year shall be minimum tax.

**Electricity consumption: (Section 235)**

Advance tax is payable on commercial and industrial electric bills as per slabs defined in Part IV of 1<sup>st</sup> schedule.

Tax collected up to bill amount of 30,000 per month shall be treated as minimum tax for person other than a company and no refund or adjustment shall be allowed to this extent. However, tax collected with electric bills shall be adjustable or refundable in the following cases:

- For a person other than a company, tax collected on bills exceeding 30,000 per month
- In case of a company, without any threshold.

**Services: [Section 153(3)(b)]**

Tax deduction at source @ 6% from gross amount of service income shall be considered as minimum tax. It means that no refund or adjustment shall be allowed from the said deduction.

The provision of minimum tax @ 6% shall not apply for a company listed on a registered stock exchange in Pakistan receiving income from services.



**FINAL TAX****Retailers having turnover up to Rs. 5 million: (Section 113A)**

May opt to pay tax @ 0.5% of their turnover as final tax

All persons selling goods to general public for consumption including manufacturers, dealers, and such like persons having turnover up to Rs. 5 million are entitled to avail benefit u/s 113A. **(Circular 19 of 2004)**

**Retailers having turnover exceeding Rs. 5 million: (Section 113B)**

Shall pay final tax on his turnover as follows:

Annual Turnover	Rate of tax
Exceeds 5 million but does not exceed 10 million	25,000 + 0.5% of the turnover exceeding 5 million
Exceeds 10 million	50,000 + 0.75% of the turnover exceeding 10 million

Turnover on which tax has been deducted at source @ 3.5% at the time of supply shall not be considered for the purpose of turnover under this section.

- Retailer means a person (being an individual or AOP) selling goods to general public for the purpose of consumption.
- Retailers would not be entitled to claim any adjustment of withholding tax collected or deducted under any head during the year.

**Advance Tax on Imports: (Section 148)**

Collector of customs shall collect income tax from every importer @ 5% on value as increased by custom duty, sales tax, and federal excise duty. However, the FBR has prescribed reduced rates for some of the items mentioned below:

- 1% on import of fiber, yarns, fabrics and goods covered by the Zero Rating Regime of sales tax notified by the Board
- 3% on the import of raw materials imported by an industrial undertaking for its own use
- 1% on import of gold, silver and mobile telephone sets.

Except in the following cases, tax collected at import stage shall become full and final tax on the income of the importer arising from the imports.

- Import of fertilizer by manufacturer of fertilizer
- Import of vehicles in Completely Built Unit (CBU) condition by manufacturer of vehicles
- Import by a large import house
- Industrial undertaking importing goods as raw material, plant & machinery and equipment for its own use.

Circular 1, 2008: 2% additional sales tax charged to commercial importer at import stage is in lieu of value addition at local supply stage. Hence it should be included in the value for the purpose of section 148. (Sales tax general order 3/2007)

Circular 14, 1997: Tax at import stage shall not be collected on re-import of those goods which were exported but rejected by foreign buyer or unsold consignment sent abroad for display/sale were brought back.

Tax at import stage shall not be paid on goods temporarily imported into Pakistan for subsequent exportation and goods imported by direct and indirect exporters if they are covered under various notifications (**Clause 56, Part IV, 2<sup>nd</sup> Schedule**)

**Commercial Importer:**

(Circular 05 of 2002) the supplier may give a written declaration to the effect that conditions for establishing commercial imports have been fulfilled and no tax @ 3.5% should be deducted while making payment of supplies. The payer may require furnishing of import documents such as original bill of entry, etc.

Toll Manufacturing Activities: The courts have held that an importer importing goods for toll manufacturing cannot be considered as a commercial importer. Toll manufacturing contracts are as good as self manufacturing / self consumption.

**Tax on Dividends: (Section 5 + 150 + Clause 17 2<sup>nd</sup> Schedules, Part II)**

Tax shall be deducted at source from the gross amount of the dividend paid by the company at the following rates specified:

Shareholder of a power project privatized by WAPDA or a company set up for power generation	7.5% of the gross amount of dividend
Other corporate and non-corporate shareholder	10% of the gross amount of dividend

Such tax is full and final tax for a non-corporate shareholder, where as dividend income of a corporate share holder is taxable @ 10% in the normal manner. It means that a corporate shareholder can deduct direct expenses, if any, from dividend income and then tax @ 10% shall be calculated as a separate block of income (**Section 8**)

**Dividend includes** any distribution by a company to its shareholder:

- Of all or part of its assets including money to the extent of accumulated profits
- Of debentures or deposit certificates to the extent of accumulated profits
- On liquidation to the extent of accumulated profits immediately before its liquidation
- On reduction of capital to the extent of accumulated profits
- Advance or loan by a private company to a shareholder where the company is substantially involved in money lending business
- Remittance of after tax profit of a branch of a foreign company operating in Pakistan, other than a branch of Petroleum Exploration and Production foreign company operating in Pakistan.

**Profit on Debt: (Section 151)**

Tax shall be deducted @ 10% on the amount of profit on debt after deducting zakat paid to a resident person on the following (other than interest income which is exempt under the Ordinance):

- Profit on certificates under NSS including DSC and Post Office Saving Account.
- Bank profit including profit and loss (PLS) sharing account
- Profit on securities including bonds, certificate, debentures etc. issued by a company or financial institution
- Profit of government securities other than issued by National Savings Centre.

Tax shall not be deducted on profit on debt on loan through a loan agreement.

**Payment for goods and services: (Section 153)**

Following are the prescribed persons for the purpose of this section:

- Federal government
- Company
- AOP constituted under the law
- Nonprofit organization
- Foreign contractor or consultant
- Consortium or joint venture
- Exporter or an export house (for the purpose of s/s 2)
- AOP & Individual having turnover of 50 million or more

Every prescribed person shall deduct tax while making payment for goods and services at the gross amount of the following:

Sale of goods	3.5% (1.5% in case of rice, cotton seed or edible oil)
Rendering of services	6% (2% in case of transportation services)
Execution of contracts	6%

Income from services rendered or construction contract outside Pakistan shall be taxable @ 1% of gross amount if such receipts are brought into Pakistan through normal banking channel (**Clause 3 & 3A, Part II, 2<sup>nd</sup> Schedule**)

Tax shall not be deducted if payment in a financial year does not exceed Rs. 25,000 in case of supply of goods and Rs. 10,000 in case of services and execution of contracts.

Important **exemptions** from tax deduction are:

- Lease payments or purchase of an asset under lease and buy-back agreement
- **Sale of goods by a large import house**
- Payments to government including local government
- Payment to an indirect exporter in respect of inland back to back LC
- **Sale made by the commercial importer who has paid tax u/s 148 at the import stage**
- **Purchase by a manufacturer - cum - exporter** (tax shall be paid in respect of goods sold in Pakistan if local sales are in excess of 5% of export sales)
- **Companies operating Trading Houses**

- Payments made to traders of yarn specified in zero-rated regime of sale tax
- On refund of security deposit
- Payment for securitization of receivables by SPV to the Originator

Tax deducted under this section on the income of a resident person or permanent establishment of a non-resident person shall be:

- Final tax on the sale of goods, except on:
  - Payments received by the manufacturer of goods in respect of supply of those goods; or
  - Payments received by a public company listed on registered stock exchange in Pakistan
- Minimum tax for the rendering or providing of services
- Final tax on the execution of contracts, except on:
  - Payments received by a public company listed on registered stock exchange in Pakistan on account of execution of contracts

Non tax deducting agencies comprise of Individuals and AOP having turnover of less than Rs. 50 million.

**Status of Tax Deducted on Supply of Goods:**

Supplier	Supply to tax deducting agency	FTR / Normal
Individuals/AOP-manufacturing	Yes	FTR
Individuals/AOP-manufacturing	No	Normal
Individuals/AOP-local trading	Yes	FTR
Individuals/AOP-local trading	No	Normal
Listed company-manufacturing/local trading	Yes	Normal
Listed company-manufacturing/local trading	No	Normal

Supplier	Supply to tax deducting agency	FTR / Normal
Unlisted company-manufacturing	Yes	Normal
Unlisted company-manufacturing	No	Normal
Unlisted company-local trading	Yes	FTR
Unlisted company-local trading	No	Normal

**Payment to non-resident media persons: (Section 153A)**

- Every person making payment for advertisement services to a non-resident media person relaying from outside Pakistan shall deduct tax from the gross amount @ 10%.
- Insurance premium or re-insurance premium paid to a non-resident is subject to tax deduction @ 5% of the gross amount which shall be final tax liability of the recipient [Section 152 (1AA)]

**Exports: (Section 154)**

Every authorized dealer in foreign exchange or a banking company shall at the time of realization of foreign exchange proceeds on account of export of goods by an exporter (direct & indirect export i.e. inland back to back LC) deduct tax @ 1% from the export proceeds.

Every authorized dealer in foreign exchange shall at the time of realization of foreign exchange proceeds on account of commission due to an indenting commission agent deduct tax @ 5% from the proceeds.

Every export house making payment on account of stitching, dying, printing, embroidery, washing, sizing and weaving shall deduct tax @ 0.5% of the gross amount payable which shall constitute a final tax on such transaction. **[Section 153 (2)]**

**Circular 3 of 2009:**

Section 154(3C) along with this circular is relevant for the export to any country including Afghanistan and received in cash without tax deduction by the authorized dealers. It provides that in respect of goods exported without Form 'E', the collector of customs shall collect tax @ 1% at the time of clearing of such goods for export

**Other references:**

- Supply of goods against international tenders are considered as export and therefore taxable under FTR **(Circular letter dated 04/04/1992)**
- Local sales of goods (manufactured for export) as well as waste material not constituting more than 20% of such production may be treated as export sales at the option of the tax payer **(Circular 20 of 1992)**
- Duty drawbacks in respect of exports already covered under FTR shall not be considered as additional receipts. The amount of such drawbacks etc. shall be deemed to have been covered for tax purpose under FTR **(Circular 14 of 1993)**
- Income from export of computer software, IT services or IT enable services is exempt up to 30.6.2016 **(Clause 133 2<sup>nd</sup> Schedule Part I)**
- Advance payment received against future exports shall be deemed to be "Export Proceed Realized" and shall be subject to tax deduction u/s 154 under FTR. **(Circular 14 of 1993)**
- Tax shall be deducted at the time of discounting of export bills, if any, by the banks. **(Circular letter dated 09.07.1992)**
- The provision of WHT and FTR will not apply in respect of exports made by those manufacturers whose income is already exempt from tax.  
In view of above explanation, we can form an opinion that if an agriculturist exports directly then his exports would be exempt and should not fall within the ambit of FTR. **(Circular 20 of 1992)**

**Prizes and Winnings: (Section 156)**

Person paying prize on a bond, winnings from a raffle, lottery, prize on winning a quiz, prize offered by companies for promotion of sales or cross-word puzzle shall deduct tax from the gross amount paid.

Where such prize is not in cash, the person shall collect tax on the FMV of such prize.

Prize and winnings	Rate of Tax
Prize bond, cross-word puzzle	10%
Winnings from raffle, lottery, prize on winning a quiz, prize offered by companies for promotion of sales	20%

**Petroleum products: (Section 156A)**

Every person selling petroleum products to a petrol pump operators shall deduct tax from the amount of commission or discount allowed to the operator @ 10% of the gross amount.

The commissioner may issue a WHT (Withholding Tax Exemption) certificate @ 3.5% where a petrol pump operator supplies goods to a tax deducting agency. **(Circular 11 of 2004)**

**Brokerage and Commission: (Section 233)**

Tax shall be deducted @ 10% of the commission or brokerage paid by government including local government, company or AOP constituted under the law which shall be considered as full and final tax liability.

Tax rate shall be 5% in case of advertising agents **(Clause 26, 2<sup>nd</sup> Schedule Part II)**

**CNG Stations: (Section 234A)**

Full and final tax @ 4% is applicable on the amount of gas consumption charges. CNG stations shall not be entitled to claim any withholding tax.

**Royalty and Fee for Technical Services earned by a non-resident: (Section 6)**

Pakistan source Royalty income and Fee for technical services earned by a non-resident is subject to withholding tax @ 15% of the gross amount which is full and final tax liability.

## MISCELLANEOUS PROVISIONS

### Tax Accounting: (Section 33-36)

- A company shall apply accrual basis of accounting for the purpose of determining income chargeable to tax under the head income from business.
- The board may prescribe for any class of persons to account for income chargeable to tax based on accrual or cash basis accounting.
- Person accounting for income chargeable to tax on cash basis accounting under the head income from business shall record income when it is received and expense when it is paid. Person accounting for income chargeable to tax on accrual basis accounting under the head income from business shall record vice versa to cash basis.
- Person accounting for income chargeable to tax on accrual basis accounting, when allowed a deduction of expense, shall pay off such liability within 3 years of the end of tax year in which it was allowed as a deduction. If not paid within such specified time, tax deduction allowed earlier shall be reversed in the first year following the end of 3 years.
- Subsequent payment of such liability as mentioned above shall be allowed as a deduction for in the year of payment.
- The closing value for a person's stock in trade shall be lower of cost and NRV.
- Income on long term contracts accounted for on the basis of accrual accounting system shall be recorded based on the percentage of completion method. Computation is as follows:

$$\frac{\text{Cost incurred before the end of a tax year}}{\text{Total estimated cost at the commencement of the contract}}$$

### Exemptions and Tax Concessions: (Section 41-55)

- Agricultural income shall be exempt
- Salary received by an employee of foreign government as remuneration for services rendered to such government shall be exempt provided that:
  - Employee is the citizen of foreign country and not a Pakistani citizen
  - Services are similar to those provided by employee of the FG in foreign countries; and
  - Similar exemption is granted by the foreign country to the employees of FG providing services in foreign country.
- Allowance/monetary reward provided by the president of Pakistan shall be exempt
- Profit on debt received by a non-resident on securities issued by a resident person shall be exempt if:
  - Persons are not associates
  - Profit was paid outside Pakistan
  - Security is widely issued outside Pakistan for the purpose of raising loan outside Pakistan for use in a business carried on in Pakistan
  - Security is approved by Board for this purpose.

- Scholarships granted to meet educational expenses shall be exempt (otherwise than where the scholarship is paid by the associate)
- Income received by spouse under agreement to live apart shall be exempt
- Income of FG, PG, or LG shall be exempt other than income from business derived by FG or PG carried on outside its jurisdictional area.
- Income of a Special Purpose Vehicle
- Foreign source Royalty and fee for technical service derived by a company registered under Companies Ordinance, 1984 **AND** Foreign source fee for technical service derived by any other tax payer subject to the following conditions: **(Clause 131, Part I, 2<sup>nd</sup> Schedule)**
  - Such income is received in Pakistan by or on behalf of the said company or other tax payer; and
  - Where such income is not brought into Pakistan in the year in which it is earned and the tax is paid thereon, an amount equal to the tax paid shall be deducted from the tax payable in the year in which such income is brought into Pakistan.

**Losses: (Section 56A)**

- Company registered in Pakistan or AJK, operating hotels in Pakistan or AJK, sustains a loss in Pakistan or AJK under the head income from business, shall be entitled to set off the amount of loss against the company's income in Pakistan or AJK.

**General:**

- **Small Company:**

A company registered under the Companies Ordinance on or after 01-07-2005 and which:

  - Has paid-up capital plus undistributed reserves not exceeding Rs. 25 million;
  - Has employees not exceeding 250 at any time during the year;
  - Has annual turnover not exceeding Rs. 250 million; and
  - Is not formed by the splitting up or the reconstitution of company already under existence
- **Special Purpose Vehicle (SPV)**
  - A public company having the prescribed amount of paid up capital, a trust or a body corporate may be registered as SPV with SECP for the purpose of Securitization under the Companies (Asset Backed Securitization) Rules.
  - An originator including a leasing company and modaraba may transfer its receivables to SPV in consideration of a mutually agreed payment by SPV who is entitled to collect the receivables.
  - Lease rentals of an asset, used by a lessee for his taxable income, to SPV on behalf of an originator is allowable tax expense for the lessee **(Section 28)**
  - Financial cost of securitization of receivables by an Originator in respect of SPV is an allowable tax expense



- Payment by SPV to an Originator in respect of securitization of receivables shall not be subject to tax deduction [**Section 153(5)(d)**]
- Income of SPV is exempt (**Clause 136, Part I, 2<sup>nd</sup> Schedule**)
- If any income arises in the accounts of SPV after the completion of securitization process, the same shall be returned to the Originator in the next income year and such income shall be taxable in the hands of Originator
- Minimum tax is not payable by a special purpose, nonprofit company engaged in securitizing the receivables of PG
- If a person deducts tax from payment to SPV on behalf of an Originator, the Originator is entitled to get credit of such tax [**Section 153(8)**]
- A person shall be treated to have received the amount or benefit if it is: (**Section 69**)
  - Actually received by the person
  - Made available to the person; or
  - Applied on behalf of a person, at the instruction of such person or under any law
- If any activity has ceased and subsequently any benefit is derived in cash or in kind from this activity that is taxable, then it shall be taxable in the normal manner had the activity not ceased and all the provisions of this ordinance shall apply accordingly. (**Section 72**)
- Any amount that is chargeable to tax is taxable on the basis of receivable, that amount shall not be chargeable again on the basis that it is received and vice versa. (**Section 73**)
- An author may elect to treat the amount received as royalty in respect of the literary or artistic work which continued for a period exceeding 24 months, as having been received in that tax year and the preceding two tax years in equal proportion. (**Section 89**)

#### Income Splitting:

- Income from an asset transferred by way of revocable transfer is taxable in the hands of the transferor. Revocable transfer means a transfer: (**Section 90**)
  - It gives the power to the transferor for the re-transfer of the asset during the life of the transferee; or
  - It gives a right to the transferor to resume power over the asset
- Income from any asset transferred by a person shall be taxable in the hands of the transferor if the asset is transferred to his spouse or minor child or to any other person for the benefit of his spouse or minor child (other than a married daughter). However, the following shall not attract the application of this provision where the asset is transferred by way of registration or mutation and the asset is transferred: (**Section 90**)
  - For an adequate consideration (direct or indirect funds not provided by the transferor); or
  - In connection with an agreement to live apart

- Income of a minor child chargeable under the head Income from Business (other than business acquired through inheritance) shall be chargeable to tax as the income of the parent with the highest taxable income for the year. **(Section 91)**

**Anti-Avoidance:**

- To determine the tax liability the commissioner may: **(Section 109)**
  - Recharacterise a transaction or an element of a transaction that was entered into as part of a tax avoidance scheme
  - Disregard a transaction that does not have substantial economic effect
  - Recharacterise a transaction where the form of the transaction does not reflect the substance.
- Where the owner of a security (bonds, certificates, debentures, stocks and shares) disposes off the security and afterward reacquires the security and as the result of the transaction, any income of the security is receivable by a person other than the owner, such income shall be treated to be of the owner's and not of the other person. **(Section 112)**

**Authorized Representative: (Section 223)**

- An authorized representative may be:
  - Principle Officer in case of an company or AOP
  - A partner in case of a partnership firm
  - Trustee
  - Relative or current full time employee
  - Bank officer
  - Legal practitioner
  - An accountant (ACA, ACMA, ACCA, member of ICAEW)
  - Income tax practitioner having experience of 10 years or more in the capacity of Income tax officer or a higher post
  - Person responsible for accounting receipts and payments in case of government or public international organization, etc.
  - In case of a non-resident tax payer: an employee, person having business connection or holds receipts belonging to the non-resident
- Following persons are not authorized to represent a tax payer:
  - An insolvent during the period of insolvency
  - An employee dismissed from the income tax department
  - An employee resigned from the income tax department (for a period of 2 years after resignation)
  - An employee retired from the income tax department who was involved in the tax payer's income tax proceedings within one year before his retirement (for a period of 1 year after his retirement)
  - Person convicted of an offence or found guilty of misconduct in relation to income tax proceedings
  - A legal practitioner or an accountant found guilty of misconduct in a professional capacity

## ADVANCE TAX AND DEDUCTION OF TAX AT SOURCE

### Quarterly Advance Tax: (Section 147)

Tax payer with the latest assessed income of 500,000 or more is required to pay advance tax on quarterly basis as under:

#### **Company and AOP: [Section 147(4)]**

(AxB/C)-D

**A** is the turnover for the quarter

**B** is the tax assessed for the latest tax year

**C** is the turnover for the latest tax year

**D** is the tax paid in the quarter

- A company or an AOP shall pay quarterly advance tax on 25<sup>th</sup> of September, December, March and June.
- A company or an AOP shall also be liable to pay quarterly advance tax in the absence of latest assessed income or declared turnover. They shall pay advance tax on the basis of quarterly estimated turnover including the effect of minimum tax.
- A person other than an individual investor shall pay quarterly adjustable advance tax on capital gains made from disposal of securities **within 21 days** of the end of the quarter as under:

Holding Period	Rate of advance tax
Less than 6 months	2% of the capital gains derived during the quarter
More than 6 months but less than 12 months	1.5% of the capital gains derived during the quarter

#### **Individual: [Section 147(4B)]**

(A/4)-B

**A** is the tax assessed for the latest tax year

**B** is the tax deduction or paid at source in the quarter

An individual shall pay quarterly advance tax on 15<sup>th</sup> of September, December, March and June.

The following shall not be considered for the purpose of this section:

- Income under FTR
- Income from property; and
- Salary Income

*If the taxpayer who is required to pay advance income tax under this section, is of the view that his income for the current tax year would be likely to be **less than** his latest assessed income, he may file an estimate of income to the Commissioner and can pay the advance tax for the current tax year accordingly.*

*If a company or an AOP is required to pay advance income tax under this section, is of the view that its income for the current tax year would be likely to be **more than** its latest assessed income, he may file an estimate of income to the Commissioner and can pay the advance tax for the current tax year accordingly.*

If a tax payer files an estimate and his advance tax paid is less than 90% of tax liability for the relevant tax year, he shall be liable to pay default surcharge [Section 205 (1B)].

#### **Cash withdrawal from a bank: (Section 231A)**

Every bank shall deduct tax @ 0.2% of the cash amount if the payment for cash withdrawal or the sum total of the payments for cash withdrawal in a day exceeds Rs. 25,000.

Such tax shall not be collected in the case of withdrawal made by:

- Federal or provincial government
- Foreign diplomat or diplomatic mission in Pakistan
- Person who produces the certificate of exemption of income.

#### **Private motor vehicles: (Section 231B)**

Every motor vehicle registration authority of Excise and Taxation Department shall collect advance tax at the time of registration of a new locally manufactured motor vehicle at following rates:

Engine Capacity	Amount of Tax
Up to 850cc	7,500
851cc to 1000cc	10,500
1001cc to 1300cc	16,875
1301cc to 1600cc	16,875
1601cc to 1800cc	22,500
1801cc to 2000cc	16,875
Above 2000cc	50,000

This section shall not be applicable in the following cases:

- Federal, provincial or local government
- Foreign diplomat or diplomatic mission in Pakistan

#### **Members of stock exchange: (Section 233A)**

A stock exchange registered in Pakistan shall collect advance tax from its members on the following:

Transaction Type	Tax Rate
Purchase of shares	0.01% of purchase value
Sale of shares	0.01% of sale value
Trading of shares	0.01% of traded value
Financing of carry over trades (Badla)	10% of the carry over charge

**Telephone users: (Section 236)**

Advance tax shall be collected on the amount of telephone bill of a subscriber, prepaid cards for telephones and sale of units through any electronic medium or whatever form (such as easy load) at the following rates:

In the case of telephone subscriber (other than mobile phone subscriber) where the amount of monthly bill exceeds 1,000	10% of the amount exceeding 1,000
In the case of subscriber of mobile phone and prepaid cards	10% of the amount of bill or sales price of prepaid card or sale of unit through any electronic medium or whatever form.

**Purchase of air ticket: (Section 236B)**

Advance tax shall be deducted @ 5% on the purchase of gross amount of domestic air ticket.

Tax collected under this section shall be adjustable. This advance tax shall not be collected in the case of:

- FG or a PG;
- A person who produces a certificate from the Commissioner Inland Revenue that income of such person during the tax year is exempt.

## INCOME OF A NON-RESIDENT PERSON

**Permanent Establishment:** For definition, see section 2(41)

A nonresident is liable to tax in Pakistan only in respect of its Pakistan source income. Section 101 clearly defines the situations where the income of a nonresident shall be treated to be Pakistan source income. **(Section 11)**

Business income of a nonresident person shall be treated to be Pakistan source income to the extent to which it is directly or indirectly attributable to: **[Section 101 (3)]**

- Permanent establishment of the non-resident person in Pakistan **(Example: business profits earned by the Permanent Establishment of a non-resident company)**
- Sales in Pakistan of goods merchandise of the same or similar kind as those sold by the person through a permanent establishment in Pakistan **(Direct sale by non-resident company of the goods similar to that dealt in by its Permanent Establishment)**
- Other business activities carried on in Pakistan of the same or similar kind as those affected by the non-resident through a permanent establishment in Pakistan; or
- Any business connection in Pakistan **(Real and intimate relationship between business activities carried on by a non-resident which yields profits or gains, and some activities carried on in Pakistan which contributes directly or indirectly to the earning of such profits or gains)**

The taxability of business profits in Pakistan of a non-resident primarily depends upon the existence of permanent establishment in Pakistan, whether such profits are directly or indirectly attributable to the non-resident person.

The following principles shall apply in determining income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head Income from Business: **(Section 105)**

- Permanent Establishment of a non-resident person shall be treated as a distinct and separate person, engaged in same or similar activities, under the same or similar conditions and dealing wholly independently as against the principle that a non-resident and its Permanent Establishment is one and the same person.
- All expenses including executive and administrative expenses whether incurred in Pakistan or elsewhere for the purpose of business activities of the Permanent Establishment are allowed as deductions in computing income chargeable to tax under the head Income from Business.
- There are disallowances of certain expenses paid or payable by the Permanent Establishment to its head office or to another permanent establishment of the non-resident person (other than that towards reimbursement of actual expenses incurred by the non-resident person to third parties). Those expenses are:
  - Royalty, fee or other similar payments for the use of any tangible & intangible assets by the Permanent Establishment
  - Compensation for any services including management service performed for the Permanent Establishment

- Profit on debt on moneys lent to the Permanent Establishment except in connection with a banking business
- There are disallowances of certain items of income in the hands of Permanent Establishment charged to the head office or to another permanent establishment of the non-resident person (other than that towards reimbursement of actual expenses incurred by the Permanent Establishment to third parties). Those items are:
  - Royalty, fee or other similar payments for the use of any tangible & intangible assets
  - Compensation for any services including management service performed by the Permanent Establishment
  - Profit on debt on moneys lent by the Permanent Establishment except in connection with a banking business
- Allocation of head office expenditures to the Permanent Establishment incurred for and on behalf of Permanent Establishment are allowable as to the lower of the following amounts:
  - Actual expenses as allocated by the head office; and
  - Allowable head office expense calculated in the manner prescribed below:

Turnover of Permanent Establishment in Pakistan	X	Total Head Office expenditure
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Worldwide turnover

- Following expenses incurred by the head office / nonresident person for the purpose of Permanent Establishment shall not be allowed as a deduction in computing income chargeable to tax under the head Income from Business:
  - Profit on debt incurred by the nonresident person on debt to finance the operations of the Permanent Establishment
  - Insurance premium paid or payable by the nonresident person in respect of such debt.

#### Service Income of a Non-Resident: [Section 101 (4)]

Where the **business** of a nonresident comprises of providing **independent services** (including professional services and the services of entertainers and sports person), the Pakistan source income of the person shall include any remuneration derived by the person in respect of such services where the remuneration is:

- Paid by a resident person; or
- Borne by a permanent establishment of a non-resident person.

It is essential to note that the nonresident must be in the business of rendering independent services, such as stock/share brokers and marketing agents operating outside Pakistan and working independently for the residents/PE in Pakistan.

It needs to be borne in mind that the said sub section does not require the presence of a PE in Pakistan.

Remuneration derived by professionals in their personal capacity, such as sports men, artists, entertainers, doctors, lawyers, etc. is also considered as Pakistan source if such receipts are received from a resident person or PE of a non resident person in Pakistan, with the effect that rendering of such services whether in Pakistan or abroad is immaterial.

**Example:** Mr. A, a resident of Pakistan, instructs ABC plc, a brokerage house in UK, to purchase shares of a company listed in the UK Stock Exchange. Any commission paid by Mr. A to ABC plc would be considered as its Pakistan source.

**Royalty: [Section 101 (8)]**

**Definition:** Section 2(54)

Royalty shall be Pakistan source if it is:

- Paid by a resident person (except where royalty is payable in respect of any right, property or information used, or services utilized for the purpose of a business carried on by the resident outside Pakistan through a Permanent establishment); or
- Borne by a Permanent Establishment in Pakistan of a nonresident person.

**Example:** A US based company, licenses its software to a Pakistani company. Payment of such licensing fee by the Pakistani company would be regarded as Pakistan source royalty income for US based company, since the payer of such royalty is a Pakistani resident.

**Example:** In the above example, the Pakistani company uses that software to operate its Dubai branch. The payment of royalty is not regarded as Pakistan source, because the royalty is payable for the purpose of a business carried on by the resident outside Pakistan.

**Example:** Suppose that Pakistani company is a branch of a UK based company. Royalty payment would be regarded as Pakistan source for the recipient (US based company) because it is borne by the Permanent Establishment of a non-resident person.

**Taxability:**

Pakistan source royalty shall be charged to tax @ of 15% of the gross amount of payment. Such tax shall be final tax on the amount of royalty. (Section 6, 8, & Part I 1<sup>st</sup> Schedule). Following are the exception where tax deducted shall not become full and final tax liability of the recipient: [Section 6(3) + Rule 18 of Income Tax Rules, 2002]

1. Where royalty is exempt from tax
2. Where payment of royalty is made in pursuance of an agreement made before 08.03.1980 in which case royalty received by the nonresident person shall be treated as income from other source against which deductions u/s 40 will be allowed
3. Where a payment is made
  - a. In pursuance of an agreement made on or after 08.03.1980
  - b. The non-resident has a PE in Pakistan
  - c. The property or right giving rise to royalty is effectively connected with the Permanent Establishment of a non-resident in Pakistan.

In that case, royalty shall be treated as “Income from Business” of the Permanent Establishment against which following expenses will be allowed:

- Expenses incurred in Pakistan to earn such income; and



- Expenses incurred outside Pakistan in pursuance of such agreement, not exceeding 10% of the gross amount of royalty.
4. In any other case, where the royalty is not subject to FTR scheme, the amount of royalty would be subject to tax after allowing for the following expenses:
- a. Expenses incurred in Pakistan to earn such income
  - b. Expenses incurred in Pakistan in respect of any work done in pursuance of such agreement; and
  - c. Expenses incurred outside Pakistan in pursuance of such agreement, not exceeding 10% of the gross amount of royalty.

**Deduction of tax at source:**

- Every person making payment on account of royalty shall deduct tax @ 15% from the gross amount chargeable to tax as Pakistan source royalty [**Section 152(1)**]
- Where the royalty is not governed under FTR, the general withholding tax of 20% would apply. [**Part I, 1<sup>st</sup> Schedule**]
- The nonresident may obtain a certificate from the concerned Commissioner to avoid deduction of tax at such a higher rate, in such case the payer would deduct tax @ 6% u/s 153(1)(c)
- Where royalty income does not fall under FTR, the tax so deducted shall be adjustable against the final tax liability of the tax payer
- Tax so withheld shall be deposited into the government treasury w/in 7 days from the end of the week in which the payment is made (**Rule 43 of Income Tax Rules, 2002**)

**Exempt royalty:**

- The recipient (nonresident) shall file return of income u/s114 in order to claim such exemption
- He must also obtain an exemption certificate from taxation authorities, to avoid deduction of tax at the time of receipt of payment.
- If tax is deducted by the payer, then such tax is required to be claimed as a refund.
- Pakistan source Royalty income may be exempt say, by virtue of Double Taxation Treaty that exists between Pakistan and the country of residence of such nonresident person.

**Fee for Technical Services:**

**Definition:** 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:

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

**Example:** A construction company has been hired to construct a building in Karachi. As part of the agreement, the company is also required to supervise the construction and electrical work over the building. Such service fee in respect of supervision of the work derived by the company would not be considered as fee for technical service, but as normal income applicable to tax payer.

**Illustration:** Where technical services are rendered as ancillary and subsidiary to allow the use of a property or right giving rise to royalty income, then receipt in respect of such technical fee is treated as “royalty income” and not as fee for technical service.

**Example:** A company incorporated in Pakistan acquired software from Microsoft US for which it pays an amount of Royalty for the right to use the software. Under the terms of the agreement, Microsoft US is also required to provide trouble-shooting services to the Pakistani company in case there are any problems with the software. Although, by default the providing of such ancillary service may be regarded as technical and hence taxable as Fee for Technical Service, however since the same is directly related to the use of the software against which royalty is being derived, the said service fee would continue to be regarded as Royalty and not a Fee for Technical Service.

**Illustration:** Transfer of technology constitutes Royalty income of the service provider of such facility, since it allows the use of technology to the user. However where there is no actual transfer of technology, but the provider merely renders such technical services to the user, then payment in respect of such service is termed as a Fee for Technical Service.

Fee for technical services shall be Pakistan source if it is:

- Paid by a resident person (except where the services are utilized for a business carried on outside Pakistan through a Permanent Establishment); or
- Borne by a Permanent Establishment in Pakistan of a nonresident.

**Taxability:**

Pakistan source fee for technical service income shall be charged to tax @ of 15% of the gross amount of payment. Such tax shall be final tax on the amount so paid. **(Section 6, 8, & Part I 1<sup>st</sup> Schedule)**. Following are the exception where tax deducted shall not become full and final tax liability of the recipient: **[Section 6(3) + Rule 18 of Income Tax Rules, 2002]**

1. Where fee for technical services is exempt from tax
2. Where payment for services is made in pursuance of an agreement made before 08.03.1980, in which case the amount received by the nonresident person shall be treated as Income from Other Source against which deductions u/s 40 will be allowed
3. Where payment for services is made in pursuance of an agreement made on or after 08.03.1980 but before 04.05.1981 in which case amount received by the nonresident person shall be treated as income from other source against which deductions u/s 40 will be allowed subject the maximum of 20% of the amount of such fee
4. Where a payment is made
  - a. In pursuance of an agreement made on or after 04.05.1981
  - b. The non-resident has a PE in Pakistan
  - c. The technical services are rendered through Permanent Establishment of a non-resident in Pakistan.

In that case, such income shall be treated as “Income from Business” of the Permanent Establishment against which following expenses will be allowed:

- Expenses incurred in Pakistan to earn such income; and
- Expenses incurred outside Pakistan in pursuance of such agreement, not exceeding 10% of the gross amount of fee.

However, the non-resident has an option to have such income charged to tax under FTR by filing a written declaration to the commissioner w/in 15 days of the commencement of the contract, which declaration shall remain valid till the completion of the contract.

**Deduction of tax at source:**

- Every person making payment on account of fee for technical service shall deduct tax @ 15% from the gross amount chargeable to tax as Pakistan source income [**Section 152(1)**]
- Where the fee for technical service is not governed under FTR, the general withholding tax of 20% would apply. [**Part I, 1<sup>st</sup> Schedule**]
- The nonresident may obtain a certificate from the concerned Commissioner to avoid deduction of tax at such a higher rate, in such case the payer would deduct tax @ 6% u/s 153(1)(c)
- Where royalty income does not fall under FTR, the tax so deducted shall be adjustable against the final tax liability of the tax payer
- Tax so withheld shall be deposited into the government treasury w/in 7 days from the end of the week in which the payment is made (**Rule 43 of Income Tax Rules, 2002**)

**Exempt fee for technical service:**

- The recipient (nonresident) shall file return of income u/s114 in order to claim such exemption
- He must also obtain an exemption certificate from taxation authorities, to avoid deduction of tax at the time of receipt of payment
- If tax is deducted by the payer, then such tax is required to be claimed as a refund
- Pakistan source Fee for Technical Service may be exempt say, by virtue of Double Taxation Treaty that exists between Pakistan and the country of residence of such nonresident person.

**Shipping and Air Transport Income: (Section 7 & 143)**

Tax shall be imposed at the rates specified below on every non-resident person carrying on the business of operating ships or aircraft as the owner or charter thereof in respect of gross amount received or receivable:

- For the carriage of passengers, livestock, mail or goods embarked (on board) in Pakistan; and
- For the carriage of passengers, livestock, mail or goods embarked (on board) outside Pakistan

Shipping	8%
Air transport	3%

Tax imposed at the above mentioned rates shall be the full and final tax liability.