

# INCOME TAX

&

SALES TAX

THEORY NOTES

Tax Year 2018-19

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### **QUESTION # 1**

Define and explain the following terms with reference to Income Tax Law / Ordinance 2001.

### **ANSWER**

#### **1. TAX**

According to Income Tax Ordinance the term tax includes:

##### **(i) Income Tax**

It is an annual tax charged on the income of people.

##### **(ii) Default surcharge / Additional Tax**

If a company fails to pay advance tax, required under the ordinance, they shall be liable for additional tax of @ 18% p.a. along with actual tax.

##### **(iii) Penalty**

It is a monetary punishment to a person (taxpayer) who conceals his income or presents wrong statements and books of accounts etc.

##### **(iv) Fee and Others**

Any fee paid or payable according to ordinance.

#### **2. PERSON**

Under the Income Tax ordinance, 2001, the term person includes the followings:

- (a) An individual
- (b) An association of person
- (c) A company
- (d) The Federal Government
- (e) A Foreign government
- (f) A political sub-division of a foreign government
- (g) A public international organization (WWF and WHO etc.)

#### **3. ASSOCIATION OF PERSONS**

Association of person includes a

- (a) Firm
- (b) Hindu undivided family
- (c) Any artificial judicial person (Punjab University & WAPDA)
- (d) Anybody of persons formed under a foreign law

However it does not include a company

#### **4. FIRM**

Under the income Tax Ordinance 2001, "Firm" means the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

## **5. COMPANY**

According to Income Tax Ordinance 2001, Company means and includes

- (a) A Company as defined in company's Ordinance 1984.
- (b) A body corporate formed by or under any law for the time being in force in Pakistan.
- (c) A Modaraba
- (d) A body incorporated by or under the law of a country outside Pakistan relating to incorporation of companies
- (e) A trust or a co-operative society or a finance society or any other society established under any law
- (f) A foreign association whether incorporated or not, declared by FBR as company
- (g) The Provincial Government
- (h) A local authority in Pakistan
- (i) A small company

### ***Explanation***

In our country there are three popular forms of business organization, sole proprietorship, partnership and company. The company is created by law and so has a distinct legal entity. Company pays the tax in discharge of its own liability and not on behalf of its shareholders.

## **6. ACCUMULATED PROFITS / RESERVE**

The accumulated profit means:

- 1. Any reserve maintained by a business out of its profits
- 2. All profits of the company up to the date these are distributed
- 3. These profits kept in whatever shape, whether capitalized or not will be treated as accumulated profits until their distribution to shareholders

### ***Explanation***

Many businesses prefer to set aside a portion of the earned profits for future use. It may be used for a specific purpose in future or may ultimately be distributed amongst the owners. Whenever such an amount is present in any business it will be known and treated as accumulated profit for tax purposes.

## **7. DEPRECIABLE ASSETS:**

Depreciable asset means any tangible movable property (plant, ship, aircraft etc.), immovable property (any building), or structural improvement to immovable property (road, railway, car park etc.) owned by a person that

- (a) has a normal life exceeding one year
- (b) is likely to lose value as a result of normal wear and tear or obsolescence and
- (c) is used wholly or partly by the person in deriving income from business chargeable to tax

### **8. APPROVED SUPERANNUATION FUND**

These are the funds which are maintained by organizations to provide benefit to their employees after retirement.

According to income Tax ordinance 2001, superannuation fund means a fund:

1. In which the amount is continuously contributed by the employer
2. The amount of fund is paid to employee on annuity basis.
3. The amount is paid to the employee at the time of retirement or in case of disability.
4. In case of death of an employee, the amount of fund is paid to his family.

#### **Approval**

Approval of superannuation fund is necessary for getting certain benefits. In order to getting approval

- (i) The application should be submitted to the Commissioner.
- (ii) 90% or more employees of the organization should be working in Pakistan

### **9. APPROVED GRATUITY FUND**

Approved gratuity fund means a fund in which:

1. Amount is continuously contributed by the employer only
2. Amount is paid at the time of retirement
3. Amount is paid in lump sum
4. In case of death amount is paid to his family

Both private and government organization maintain such fund for the benefit of their employees. It enables the employer to retain his employees and increase their efficiency.

#### **Approval**

Approval of gratuity fund is necessary for getting certain benefits. In order to getting approval

- (iii)The application should be submitted to the Commissioner.
- (iv)90% or more employees of the organization should be working in Pakistan

### **10. TAX YEAR / INCOME YEAR**

The Income Tax Ordinance 2001 recognizes the following different types of tax year

1. Normal Tax year
2. Special Tax year
3. Transitional Tax year

#### **1. Normal Tax Year**

Normal Tax Year is a period of 12 months which ends on the 30<sup>th</sup> June.

#### **Example of Normal Tax Year**

<b>Starting Date</b>	<b>Ending Date</b>
1 <sup>st</sup> July 2010	30 <sup>th</sup> June 2011
1 <sup>st</sup> July 2011	30 <sup>th</sup> June 2012

## **2. Special Tax Year**

A period of 12 months which ends other than 30<sup>th</sup> June is called special tax year. It is necessary to receive approval for the use of special tax year. Following are some examples of special tax years specified by the Board through notification in the official Gazette.

<b>Classes of Taxpayers</b>	<b>Starting Date</b>	<b>Ending Date</b>
Companies manufacturing sugar or cotton textile	1 <sup>st</sup> October	30 <sup>th</sup> September
All persons exporting rice	1 <sup>st</sup> January	31 <sup>st</sup> December

## **3. Transitional Tax Year**

When tax year of a person is changed from normal tax year to special tax year or vice versa, it results in the emergence of a changing period which is known as "Transitional Tax Year" and is treated to be a separate tax year.

For example a person uses a normal tax year starting on July 1, 2010 and ends on June 30, 2011. He applies for the use of special tax year starting from January 1 and ends on December 31. There is a gap of 6 months (June 30 to Jan 1) to change from normal tax year to special tax year. This gap of 6 month is called transitional tax year.

## **11. PRINCIPAL OFFICER**

Principal Officer means and includes

1. Managing Director
2. Secretary
3. Treasurer
4. Manager
5. Agent
6. Accountant
7. Official Liquidator
8. Any person connected with the management and received a notice from the Commissioner to act as principal officer.

### **Explanation**

In large organization it is very difficult for income tax department to contact every employee or owner for collection of information for assessment. For its convenient tax department specified some persons for contact. These persons are known as "Principal Officer"

## **12. CAPITAL ASSET**

Property of any kind held by a person is called capital assets. It is immaterial whether the property is connected with his business or not.

Following items are not included in capital assets

- (a) Any stock in trade, consumable stores or raw material held for the purpose of business.

### **Explanation**

1. The medicines available in medical store for the purpose of sale is stock in trade
2. Spare parts owned by a manufacturing concern for use in the machinery are consumable store.
3. Yarn possessed by a cotton mill is their raw material.

- (b) Any depreciable asset
- (c) Any intangible asset on which amortization is allowed
- (d) Any movable property (wearing apparel, jewellery, furniture) held for personal use by the person or any member of his family dependent upon him.

#### **Examples of Capital Assets**

1. Shares of companies
2. Musharika Certificate
3. Modaraba Certificate
4. PTCL Vouchers
5. Painting or Work of art
6. Collection of coins as hobby
7. A rare manuscript
8. Share in partnership business

#### **13. INCOME**

Income includes

- (a) Any amount chargeable to tax under the Income Tax Ordinance, 2001;
- (b) Any amount subject to collection or deduction of tax at the time of import of goods.

#### **Explanation**

It is necessary for Collector Customs at the time of import of goods to collect the tax from importers. The value of the import has been treated as income in the hands of importer under this clause.

- (c) Any amount received by a resident for the supply of goods and services
- (d) Any amount received as export proceeds.
- (e) Amount received on prizes and winnings
- (f) Any amount collected from a person being the owner of goods transport vehicle by the Excise Department.

#### **Explanation**

Owner of vehicles have to pay advance tax under the law. The amount so charged is included in the definition of income.

- (g) Any other amount deducted or collected by any person at source is included in the definition of income.
- (h) Any loss of income.

#### **14. PAKISTAN SOURCE INCOME**

Pakistan source income includes the income which a person earns in Pakistan, irrespective of the fact where it is actually received. Some examples of this income are as follows:

#### **Salary Income**

- (1) Salary received by virtue of employment in Pakistan, wherever paid.
- (2) Salary paid anywhere in the world by or on behalf of the federal government or provincial government or local authority in Pakistan.

**Property Income**

Rental income from the lease of immovable property in Pakistan

**Business Income**

- (1) Income derived from any business carried on in Pakistan
- (2) Business income of a non-resident person from a permanent establishment in Pakistan

**Capital Gain**

Any gain from the disposal of shares of resident company

**Dividend Income**

Any dividend paid by a resident company

**Profit on Debt**

Profit on debt paid by a resident person, if the profit is from a business carried on in Pakistan

**Pension or Annuity**

Any pension or annuity paid by a resident

**Technical Fee**

Any technical fee paid by a resident person from the business carried on in Pakistan

**15. Foreign Source Income**

According to section 101 (16) Foreign source income means.

“An amount shall be foreign source income to the extent to which it is not Pakistan source income.”

***Explanation***

To understand the concept of foreign source income, Pakistan Source income should be understood first. It means that Salary received and earned in Pakistan given by Government or private employer, income earned in Pakistan from business, any dividend any profit on debt, any royalty, any rental income, any income from letting out any right, any pension etc are called Pakistan Source Income. And the income other than these income is called Foreign Source Income. e.g/ salary received from Job in America, remittances of overseas Pakistanis in Pakistan to their relatives.

**16. TAX PAYER**

Tax payer means

- (i) A person whose income is chargeable to tax
- (ii) Representative of such person
- (iii) A person responsible to deduct or collect tax and deposit it with the government under the provision of the income tax law
- (iv) Any person required to furnish a return or pay tax under Income Tax Ordinance 2001

***Explanation***

It is necessary for following persons to furnish the return of income

- (a) Every person whose total income during the tax year exceeds the taxable limit
- (b) Every company irrespective of its income
- (c) A non-profit organization
- (d) Any approved welfare institution

Following persons are not required to file the return

- (a) A Widow
- (b) An orphan below the age of 25 years
- (c) A non-resident
- (d) A disable person

## **17. BUSINESS**

“Business” includes any trade, commerce, manufacture, profession or vocation, adventure or concern in the nature of trade, commerce, manufacture, profession or vocation but does not include employment.

### ***Explanation***

The definition of business includes the following terms

#### **(a) Trade**

Buying and selling of goods and services between two or more person for profit is called trade.

#### **(b) Commerce**

All those activities which help to bring the goods from place of production to final consumer are included in commerce.

#### **(c) Manufacture**

All those activities which are done to convert raw material into finished goods are included in manufacturing.

#### **(d) Profession or Vocation**

It is the occupation that requires some specialized education and training. Examples are architecture, law medicine, teaching, accounting etc.

## **18. SPECULATION BUSINESS**

“A speculation business means any business in which a contract for the purchase and sale of any commodity (including stock and shares) is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or merchandise, but does not include a business in which:

- (a) a contract in respect of raw material or merchandise is entered into by a person in the course of a manufacturing or mercantile business to guard against loss through future price fluctuation for the purposes of fulfilling the person’s other contract for the actual delivery of the goods to be manufactured or merchandise to be sold.
- (b) A contract in respect of stocks and shares is entered into by a dealer or investor therein to guard against loss in the person’s holding of stocks and shares through price fluctuations.

### **19. DIVIDEND**

Any payment or distribution by the company to the shareholders or Modarba certificates holders as a reward or return on their investment out of earned profit is called dividend.

According to income tax ordinance 2001, the following distributions made by the company are considered as dividend.

- (i) Distribution to shareholders out of current year profit.
- (ii) Distribution to the shareholders out of accumulated profit.
- (iii) Distribution to the shareholders out of share premium.
- (iv) Distribution to the shareholders in form of debentures or debenture stock out of accumulated profit.
- (v) Distribution to the shareholders at the time of liquidation to the extent accumulated profit.
- (vi) Distribution to the shareholders by a private company or trust in form of loan and advance out of accumulated profit

#### ***Explanation***

The profit which is distributed to the shareholders is called dividend, and the profit which is retained by a company in its business is known as accumulated profit or retained earning. Dividend may be distributed out of current year profit or out of accumulated profits. Dividend may be distributed in form of cash or shares. Dividend is distributed in proportion of shares held by shareholders.

### **20. ASSOCIATES**

Two persons will be associates where the relationship between the two is such that one may reasonably be expected to act in accordance with the instructions of other or both persons may reasonably be expected to act in accordance with the instruction of a third person, e.g.

1. an individual and his close relative
2. members of an association of persons
3. a trust and any person who benefits from the trust
4. a company and its shareholders who control 50% or more voting power, rights to dividend or rights to capital.

#### ***Explanation:***

Relative in relation to an individual means an ancestor, a descendent of the grandparents, an adopted child or a spouse of individual.

### **21. CO-OPERATIVE SOCIETY**

“Co-operative society” means a society registered under the Co-operative Societies Act, 1925 or under any law for the time being in force in Pakistan for the registration of co-operative societies.

#### ***Explanation***

According to Cooperative Society Act, 1925 “Cooperative society is formed for the promotion of thrift (saving), self-help and mutual aid among agricultural and other persons with common economic needs so as to bring about better living, better business and better methods of production and for that purpose to consolidated sources.

## **22. FINANCIAL INSTITUTION**

“Financial institution means an institution defined under the Companies ordinance 1984:

1. A Company or an institution which transacts the business of banking or any associated or ancillary (related) business, through its branches
2. A Modaraba
3. A leasing company
4. An investment bank
5. A Financing company
6. A housing finance company and
7. Such other institution or company authorized by the law to undertake any similar business.

### ***Explanation***

Finance means money or monetary support. Business needs finance to run its affairs smoothly. These institutions which provide finance to those businesses at profitable rates of interest are called financial institutions. Government financial institutions are exempt from tax and usually profits making financial institutions are taxed under the income tax law.

## **23. ROYALTIES**

“Royalties means any amount paid or payable as consideration for

- (a) the use any patent, invention, design or model, secret formula or process, copyrights a literary or videotapes, trademark or any other property or right of this type or use of any industrial, commercial or scientific equipment
- (b) the receipt of, or right to receive, any visual images or sounds, optic fiber or similar technology through television, radio or internet broadcasting
- (c) the supply of any technical, industrial, commercial or scientific knowledge, experience or skill

### ***Explanation***

A person write a book and given to a company for printing and company pay him a fixed amount after a specific time regularly it will be royalty for that writer.

## **24. Non-Profit Organization**

“Not profit organizations “Means any person othe than an individual which is

- (a) established for religious, educational, charitable, welfare or development purposes or for the promotion of an amateur sport.
- (b) It should be registered under any law as a non-profit organization and (CIR) has certified it to be a non profit organization for a specific period, under the income tax ordinance.
- (c) Any asset of the organization should not be used for the private benefit of any other person.

### ***Explanation***

ILM trust is an example of non-profit making organization.

### **25. Industrial Undertaking**

Industrial undertaking means an organization which fulfills the following conditions.

- (1) It is set up in Pakistan
- (2) It employs
  - (i) Then or more persons in Pakistan and uses electrical energy or any other form of energy which is mechanically transmitted
  - (ii) Twenty or more person in Pakistan and does not use electrical energy or any other form of energy which is mechanically transmitted and
- (3) It is engaged in
  - (i) Manufacturing or in any process which substantially change the original condition of material
  - (ii) Ship-building
  - (iii) Generation, conversion, transmission or the distribution of electrical energy, or the supply of hydraulic power or
  - (iv) Working of any mine, oil well or any other source of mineral deposits

The Board can declare any other organization as industrial undertaking even it does not fulfill the above mentioned requirements.

### **26. Intangible**

Intangible means asset or expenditure of following types which provides an advantage or benefit for a period of more than one year.

1. Patents
2. Invention
3. Trade mark
4. Computer software
5. Franchise
6. Design or model
7. Secret formula or process
8. Copyright

## QUESTION # 2

What are the different types of perquisites and allowances enjoyed by the salaried individuals, discuss.

## ANSWER

### **PERQUISITES AND ALLOWANCES**

Perquisites means non-monetary benefits and allowances means monetary benefits provided by employer to employee during course of employment for carrying out job responsibilities in an efficient manner. Different types of perquisites and allowances enjoyed by the salaried class are given below.

#### **1. ACCOMMODATION**

Accommodation is one of the benefits provided by the employer to his employee. The accommodation can be provided in the following manners.

- (a) House Rent Allowance
- (b) Accommodation facility

##### **(a) House Rent Allowance**

If the employer does not provide residence to employee but pays house rent in cash, it is called house rent allowance.

**Tax Treatment:** It is fully taxable.

##### **(b) Accommodation Facility**

If the employer provides residence to employee free of cost it is called accommodation facility. Accommodation may be furnished or unfurnished.

##### **(i) Unfurnished Accommodation**

Unfurnished accommodation includes building, electric fans, built in cupboard (wooden lockers), cooking range and water heater.

##### **(ii) Furnished Accommodation**

Furnished accommodation includes basic furniture, refrigerator, heating and cooling apparatus (equipment) besides unfurnished accommodation.

**Tax Treatment:**

- (i) Entitlement of rent
  - (ii) 45% or 30% of MTS or Basic Salary
- (i) Or (ii) whichever is higher will be taxable

#### **2. CONVEYANCE**

##### **(a) Conveyance Allowance**

The allowance provided by employer to employee for traveling purpose is called conveyance allowance.

**Tax Treatment:** Fully Taxable

**(b) Conveyance Facility**

If the employer provides a vehicle to employee for traveling purpose, it is called conveyance facility. Conveyance may be provided for personal use only or for both official and personal use.

**Tax Treatment:**

- (i) If Conveyance is provided for personal use only then 10% of Cost or FMV will be taxable
- (ii) If Conveyance is provided partly for official and partly for personal use then 5% of Cost or FMV will be taxable.
- (iii) If Conveyance is provided only for official use then it will be totally exempt.

**3. MEDICAL**

**(a) Medical Allowance**

Cash given by employer to employee for medical purpose is called medical allowance.

**Tax Treatment:** 10% of Basic Salary exempt

**(b) Medical Facility**

Medical facility includes medical treatment, hospitalization, medical expenses Re-imbursement etc.

**Tax Treatment:** Fully exempt if provided under term of employment otherwise taxable.

**4. ENTERTAINMENT**

**(a) Entertainment Allowance**

Allowance given for entertainment purpose such as for tea, coffee etc is called entertainment allowance.

**Tax Treatment:** Fully Taxable

**(b) Entertainment Facility**

Entertainment facility includes Tea, Coffee to employee at office, Entertainment bill reimbursed, Subsidized food provided to employee of hotel or restaurant during duty hours.

**Tax Treatment:** Fully exempt.

**5. LOAN TO EMPLOYEE**

The employer can provide another benefit to his employee in the form of loan. The employee can take interest free loan or at a concessional rate from employer.

**Tax Treatment:**

- (i) Interest free loan (10% of amount will be taxable if loan is above 10,00,000)
- (ii) If loan is obtain at or above 10% then nothing will be taxable
- (iii) If loan is obtain at a concessional rate then difference between bench mark rate and concessional rate will be taken.

## **6. SPECIAL ALLOWANCE**

Allowances granted to meet expenses which are incurred in the performance of official duties are called special allowance for example T/A, D/A, Uniform Allowance etc.

**Tax Treatment:** Fully exempt even actual expenses are less than allowance.

## **7. UTILITIES**

### **(a) Utilities Allowance**

If an employer provides some amount to his employee for meeting the charges of telephone, gas, water and electricity, it is called utilities allowance.

**Tax Treatment:** Fully Taxable

### **(b) Utilities facility**

Utilities may be provided by employer from his own resources which is included in utilities facility.

**Tax Treatment:** Fully exempt

## **8. PROVIDENT FUND**

It is a fund which is maintained by employer for the benefit of employee. In this fund both employer and employee contribute equal amount which is invested in a profitable business or Bank. A fix rate of interest is credited to fund. The accumulated balance is withdrawn at the time of retirement and given to employee. In case of death of employee the fund is withdrawn and given to employee's heir.

**Tax Treatment:** Recognized Provident Fund

- (i) Employee's contribution – Already included in taxable income
- (ii) Employer's contribution – 10% of (Basic salary + Dearness Allowance)
- (iii) Interest Credited – 16% or 1/3 of salary whichever is less will be exempt
- (iv) Accumulated Balance - Not included in taxable income

## **9. Salary of Domestic Servants:**

The salaries of the domestic servants i.e. housekeeper, cook, sweeper, gardener, driver or other servants etc. of an employee may be provided by employer.

**Tax Treatment:** Fully Taxable

## **10. Transfer of Property to Employee**

Another benefit may be provided by employer to employee in the form of property.

**Tax Treatment:**

- (i) Total amount of property will be taxable if nothing is paid by employee
- (ii) If some amount is paid by employee then that amount will be deducted from total value of property and remaining will be taxable.

### QUESTION # 3

Discuss the various types of reliefs and allowances which can be claimed as tax credit by an individual.

### ANSWER

Government allows tax concession on some expenditures and investments. For tax year 2014, relief in tax will be provided if the person makes any of the following payments.

- A. Donation for charitable purpose
- B. Investment in shares or Sukuks or Life insurance
- C. Investment in Health Insurance
- D. Contribution to approved pension fund

#### **(A). DONATION FOR CHARITABLE PURPOSE**

A tax credit shall be granted to a person in respect of any amount or property given by him as donation if the following conditions are fulfilled:

##### **(1) Approved Organization or Fund**

The Donation should be given to the following

- (a) Any Board of Education or University in Pakistan established under any federal or provincial law.
- (b) Any Hospital in Pakistan established or run by Government or by a local authority.
- (c) Relief fund approved by government
- (d) Non-profit organization approved by tax authorities

##### **(2). Forms of Donation**

###### **(a) Cash by Cross Cheque:**

If cash is given as donation then concession shall be given only if the amount is paid by a cross cheque.

###### **(b) Property:**

If property is given as donation then concession shall be given on the fair market value of property

###### **(c) Good or Articles:**

If goods or articles are donated then the value shall be ascertained by the Board.

##### **(3). Maximum Limit**

In case of a company

- (a) Actual donation or
- (b) 20% of taxable income whichever is less will be allowed for relief

In case of individual or AOP

- (a) Actual donation or
- (b) 30% of taxable income whichever is less will be allowed for relief

### **(B). INVESTMENT IN SHARES OR SUKUKS AND LIFE INSURANCE**

As a measure to promote savings and investments in the country, incentive has been provided through this tax credit scheme. A tax credit is given if the following conditions are fulfilled.

#### **(1). Kinds of Shares**

The taxpayer other than a company has made investment for the purchase of:

- New Shares or Sukuks offered by the public or listed company or
- Shares purchased from Privatization Commission of Pakistan

#### **(2). Original Allotment:**

The taxpayer should be the original allottee of the shares

#### **(3). Surrender of Right**

If a person sells or transfer these shares within two years of the purchase then amount of relief allowed shall to be surrendered (give up).

#### **(4). Maximum Limit**

The amount eligible for relief on shares / Life insurance is restricted up to:

- Actual investment
- 20% of taxable income or
- Rs. 15,00,000 whichever is less will be allowed for relief

### **(C) INVESTMENT IN HEALTH INSURANCE**

Through Finance Act, 2016 tax credit (concession) has been allowed for a person if he pays any premium to an insurance company. Tax credit will be allowed only on “salary” and “income from business” subject to the following details.

- a) The person should be a resident
- b) It is not allowed to companies
- c) The insurance company should be registered under the insurance Ordinance 2000.
- d) Tax concession will be allowed on actual payment or 150,000 or 5% of taxable income whichever is less

### **(D). CONTRIBUTION TO AN APPROVED PENSION FUND**

Any Pakistani individual salaried person or businessman who contributes a premium in approved pension fund during the year is entitled to a tax incentive on such payment. The details are as follows:

#### **(1) Valid NTN or CNIC**

The person contributing should possess a valid National Tax Number (NTN).

#### **(2) For One Scheme Only**

The concession is available for contributing to only one approved employment pension or annuity scheme.

#### **(3) Maximum Limit**

The amount eligible for relief will be restricted to 20% of taxable income.

- (i) Actual Contribution
- (ii) 20% of taxable income
- (i) or (ii) Whichever is less will be allowed for relief

**(4) Extension in Limit**

If contribution is made at the age above 40 years then limit of 20% will increase by 2% for each year. However this limit shall not exceed 30%



### **QUESTION # 4**

What do you meant by agricultural income and what are different types of agricultural income? Give some examples of agricultural and non-agricultural income. Also give some examples of incomes partly agricultural and partly non-agricultural.

### **ANSWER**

#### **AGRICULTURAL INCOME**

The agricultural income means income

- (i) Derived from land
- (ii) Land is situated in Pakistan and
- (iii) Land is used for agricultural purpose

If any income fulfill above mentioned conditions then it will be agricultural income. The most important point here is that the land must be used for agricultural purpose. Its mean is that some human effort must be employed on land. If a produce is grown spontaneously without human effort then this income while grown on Pakistani land will not be treated as agricultural income.

#### **EXAMPLE**

A person sale tree grown spontaneously on land situated in Pakistan will not be agricultural income because no human effort is employed.

A person grows trees and crops on his land derive income therefrom then such income shall be agriculture income.

#### **TYPES OF AGRICULTURAL INCOME**

Agricultural income is classified into five categories:

##### **1. Rent**

Rent received by landlord for providing land for cultivation is agricultural income. Rent may be in cash or in kind.

##### **2. Revenue**

Revenue means yield, return or income of the tenant in form of cash or kind. That will also be agricultural income.

##### **3. Sale of produce**

The cash received from the sale of produce by the landlord or the tenant is also agricultural income.

##### **4. Necessary process**

Necessary process means the process required to make the produce fit for the market. Income from necessary process and income from land on which any process which is ordinarily employed by a cultivator or receiver to make produce fit for market will be agricultural income e.g. Thrashing etc.

##### **5. Building**

Income derived from any building required for agricultural purpose.

Income from building will be treated as agricultural income if it fulfill following conditions,

- (a) Building is occupied by the cultivator or **the recipient of agricultural income**.
- (b) Building is in the immediate vicinity (surrounding area) of agricultural land.
- (c) Building is required as a dwelling house (residence), store room or other out-building.

Agricultural income is exempt from tax in Pakistan. So it is necessary for tax purpose to identity whether an income is agricultural or non-agricultural. Following are some example of agricultural and non-agricultural incomes.

### **EXAMPLES OF AGRICULTURAL INCOME**

Some examples of agricultural income are as follows:

- 1. Rent received by lessor (owner of land) of agricultural land.
- 2. Income received by lessee (tenant) of agricultural land by cultivation
- 3. Income from cultivation of tobacco, wheat, sugarcane, etc.
- 4. Income from growing tea.
- 5. Land revenue assigned to Zamindar.
- 6. Income from building used for agricultural purposes.
- 7. Fee paid by tenant for renewal of lease.
- 8. Income from any land used for carrying on any process necessary to make the agricultural produce fit for market.
- 9. Income from sale of honey or its produce.
- 10. Receipt of an amount for compromise of a dispute regarding agricultural land.

### **EXAMPLES OF NON-AGRICULTURAL INCOME**

Some examples of non-agricultural incomes are as follows:

- 2. Income from fisheries
- 3. Royalty income of mines
- 4. Income from land used as a market
- 5. Income from a flour mill
- 6. Profit from a contract of cutting and selling trees
- 7. Income from butter and cheese making
- 8. Income from spontaneous forest
- 9. Dividend paid by a company out of its agricultural income
- 10. Income received from a cotton ginning factory
- 11. Income from land used for storing timber

### **EXAMPLES OF PARTLY AGRICULTURAL AND PARTLY NON-AGRICULTURAL INCOME**

- 1. Income of a person who grows tea leaves on his own farms in Pakistan and then manufactures it into tea.
- 2. Income of a sugar mill which grows sugarcane and manufactures sugar.
- 3. Income of a cigarette company growing tobacco on its own lands and manufacturing cigarettes.

### QUESTION # 5

What are the legal provision governing the residential status of various assesses (taxpayers) in Pakistan?

### ANSWER

#### **RESIDENT PERSON**

For tax purpose all the persons have been divided into two categories. One is resident and second is non-resident. The non-resident person will pay tax only on Pakistan source income and resident person will pay tax on both Pakistan source income and foreign source income. Resident person can be divided into following categories.

1. Resident Individual
2. Resident Association of Person
3. Resident Company

#### **1. RESIDENT INDIVIDUAL**

A person will be a resident individual in Pakistan if he or she fulfills any of the following conditions.

1. He is in Pakistan for a period or periods amounting, in all, to 183 days or more.
2. He is an employee or official of the Federal Government or a Provincial Government posted abroad in the tax year.

#### **EXPLANATION**

A person will become a resident in the tax year if his stay in Pakistan is 183 days or more. Following are some points which must be clear.

##### **1<sup>st</sup> POINT: Continuous stay of 183 days is not necessary**

For example a person come to Pakistan in a tax year and stay 100 days and then go back and again come to Pakistan in the same tax year and remain here for 50 days and then go back and then in the same tax year come here and spend 33 days in Pakistan, he will be a resident person because his total stay is 183 days.

##### **2<sup>nd</sup> POINT: Purpose of stay is immaterial**

It will not be considered why the person has come to Pakistan. Only stay of 183 days is sufficient for becoming resident individual.

#### **EXAMPLE**

A person is in Pakistan for business purpose and stay here 183 days he will be a resident individual.

A person came to Pakistan for visit and stay here 183 days he will be a resident individual.

A person came to Pakistan and falls ill due to which he is admitted into hospital where he remain for 183 days he will be resident individual.

### **3<sup>rd</sup> POINT: Place of stay**

Stay at one place is not necessary. If a person spends 183 days at different places in Pakistan he will be a resident individual.

### **4<sup>th</sup> POINT: Pakistan citizenship is not necessary to become resident individual**

One most important point here is that a Pakistani citizen can be a non-resident if he did not spend 183 days in Pakistan and foreigner can be a resident individual if he spends 183 days in Pakistan.

## **2. RESIDENT ASSOCIATION OF PERSON**

An association of person (AOP) will be resident association of person if its partial or whole control and management is in Pakistan at any time during a tax year.

### **Explanation**

An association of persons shall be a resident even its partial control is situated in Pakistan. It means an association of persons will only be a non-resident if its whole control is situated outside the Pakistan. Moreover, the residential status of the members of AOP is immaterial in this regard.

### **Nature of Control and management**

Control and management wholly in Pakistan

### **Status**

Resident

Control and management partly in Pakistan

Resident

Control and management wholly outside Pakistan

Non-resident

## **3. RESIDENT COMPANY**

A company shall be a resident company for a tax year if it fulfills any one of the following conditions:

- (a) It is incorporated or formed by or under any law in Pakistan.
- (b) The control and management of the company is situated wholly in Pakistan at any time in the year.
- (c) It is a Provincial Government or local authority in Pakistan.

### **EXPLANATION**

A company will be a resident company if it is registered in Pakistan. It is immaterial whether the company is working in Pakistan or outside the Pakistan.

If a company is incorporated outside the Pakistan but its whole control is in Pakistan at any time it will be a resident company.

The whole control and management of a foreign company in Pakistan is necessary for becoming a resident company. If partial control and management is in Pakistan then it will not be a resident company.

The main difference for becoming resident for company and AOP is that for company whole control and management is necessary and for AOP partial control and management is sufficient.

### **QUESTION # 6**

What is provident fund and its different types? Explain the treatment of different types of provident fund for inclusion in the total income and exemption from income tax.

### **ANSWER**

#### **PROVIDENT FUND**

Provident fund means the fund maintained by an employer for the benefit of his employee. In this fund both employer and employee contribute some amount which is invested in some profitable business or in bank. A fixed rate of interest is credited to fund of each employee every year. At the time of retirement the lump sum amount is withdrawn from fund and paid to employee. If he becomes invalid or discharge from service before retirement then this fund is also paid to him. If he died then this fund is paid to his heir (family).

#### **Employee's Contribution**

The amount contributed by employee in provident fund is called employee's contribution. This amount is deducted from his or her salary before payment.

#### **Employer's Contribution**

Equal amount is contributed by employer to provident fund. For example if Rs. 5000 is contributed by employee the employer also contributes Rs. 5000. It is called employer contribution.

#### **Interest Credited**

This amount is invested in a profitable business or in bank from where interest or profits is received which is added in this fund. It is called interest credited.

#### **Accumulated balance**

At the time of retirement or death of employee the whole amount is withdrawn and paid to him or his family. This total amount is called accumulated balance.

#### **TYPES OF PROVIDENT FUND**

For income tax purpose provident fund can be divided into three categories.

1. Government Provident Fund
2. Recognized Provident Fund
3. Unrecognized Provident Fund

#### **1- Government Provident Fund**

A provident fund maintained by a government or semi-government organization is known as government provident fund or a statutory provident fund. The provident fund Act. 1925 applies to such provident funds.

#### **Examples**

Provident fund maintained by following organization is government provident fund.

Pakistan Armed Forces  
Central or Provincial Government  
Railways and WAPDA etc.

## **2- Recognized Provident Fund**

If a provident fund maintained by a private organization and the Commissioner of income Tax grants recognition to such funds, it is known as recognized provident fund.

The application shall be submitted to the Commissioner of the area by the employer. The application shall contain the following information.

- Name and particulars of employer
- Nature of business
- Place of business
- Name of employees
- Verification of all particulars

### **Conditions for Approval:**

- (a) At least 90% employees of the organization should be employed in Pakistan
- (b) The employer should deduct every month a definite portion from the salary of the employees.
- (c) The employer contribution should not exceed the employee contribution
- (d) The accumulated balance shall be payable to the employee on the day he ceases to be an employee.

## **3- Unrecognized Provident Fund**

If a provident is maintained by private organization and the recognition is not given by Income Tax Authorities, it is known unrecognized provident fund.

Following are some reasons due to which a provident fund may not be recognized.

1. The conditions which are given in law are not fulfilled.
2. No application for recognition is given.
3. The application is given but rejected due to some technical grounds.

## **TREATMENT OF PROVIDENT FUND**

The following table has been designed to help you understand the treatment of different items in different types of provident funds.

### **1. Government Provident Fund**

- (i) Employee's Contribution – Already included in taxable income
- (ii) Employer's Contribution – Not Included in taxable income
- (iii) Interest Credited – Not included in taxable income
- (iv) Accumulated Balance – Not included in taxable income

### **2. Unrecognized Provident Fund**

- (i) Employee's Contribution – Already included in taxable income
- (ii) Employer's Contribution – Not Included in taxable income
- (iii) Interest Credited – Not included in taxable income
- (iv) Accumulated Balance – 50% of balance will be taxable

### **3. Recognized Provident Fund**

- (i) Employee's Contribution – Already included in taxable income
- (ii) Employer's Contribution – 10% of (Basic Salary + Dearness Allowance) or 150,000 whichever is less will be exempt from employer's contribution
- (iii) Interest Credited – 16% or 1/3 of (Basic Salary + Dearness Allowance) whichever is less will be exempt from Interest Credited
- (iv) Accumulated Balance – Not included in taxable income



### QUESTION # 7

- (a) What do you meant by rent chargeable to tax?
- (b) List down the income from property exempt from tax
- (c) List down the income from property not taxable under section 15.

### ANSWER

#### **(a) RENT CHARGEABLE TO TAX**

Rent means any amount received or receivable by the owner of land or a building for its use or the right to use its occupation.

It is the second source of income. Rent received or receivable from property is chargeable to tax under the head "**Income from property**" Section 15.

The scope of word "Property" is very wide, but the ordinance has used it as a term for a limited purpose. Under section 15, the term "Property" means only land or building and all other properties are excluded from the scope of property.

#### **Land**

Means vacant (empty) plot used for erecting (creating) temporary huts or for storing materials.

#### **Building**

Means block of brick or stone work covered by roof.

The amount of rent shall not be less than **fair market rent**.

#### **Calculation of Rent chargeable to tax for Individual**

Income from property consists on following items.

1. Rent.....	Rs. 000
2. Token money forfeited.....	Rs. 000
3. Unadjusted advance $\times \frac{1}{10}$ .....	Rs. 000
4. Any expense of owner paid by tenant .....	<u>Rs. 000</u>
<b>Rent Chargeable to tax.....</b>	<b><u>Rs. 000</u></b>

#### **1- Rent**

Rent means any amount received or receivable by owner of land or building for its use or the right to use its occupation.

#### **2- Token Money forfeited**

At time of contract of sale of land or building some amount is received in advance to ensure the contract. This amount is called **Token Money**. If the buyer does not fulfill the contract then this amount is forfeited by owner of property which is called **Token Money forfeited**.

#### **3- Unadjusted Advance**

Some time when a property is given on rent some lump sum amount is received from tenant. If this amount is not adjusted against rent, it is called unadjusted advance. If unadjusted advance is received by owner its  $1/10^{\text{th}}$  portion will be added in rent chargeable to tax.

#### **4. Any Expense of owner paid by tenant**

Any expense or obligation of the owner regarding property like property tax and fire insurance premium etc. is paid by the tenant according to the provisions of agreement between the tenant and owner.

#### **LIBILITY IN CASE OF CO-OWNER**

Where any property to which section 15 applies is owned by two or more persons and their respective shares are definite and ascertainable, such person shall not be assessed as an association of person. In this case, each person will be taxed separately.

#### **INCOMES FROM PROPERTIES EXEMPT FROM TAX**

Rental income from following property is exempt from tax.

- 1- Income from agricultural building
- 2- **Income from property held under Trust**
- 3- Any income of a trust or welfare institution or non-profit organization from property as expended in Pakistan for the purpose of welfare activities.

#### **INCOMES WHICH ARE NOT CHARGEABLE TO TAX UNDER SECTION 15**

Rent of following properties is taxable under the head “Income from other source” Instead of “Income from Property”

- 1- Ground rent
- 2- Rental income from building kept on lease together with plant and machinery
- 3- Rent income derived by subletting a building or land by a tenant
- 4- Mining right and royalty
- 5- Any amount received in respect of amenities, utilities or any other service charges connected with building

#### **QUESTION # 8**

What is meant by “Income from Property” and discuss its allowable deductions under section 15-A of the Income Tax Ordinance 2001.

#### **ANSWER**

#### **DEDUCTIONS ALLOWED IN CASE OF COMPANY**

No deductions are allowed for individual and AOP. But in case of Company following deductions are allowed from rent chargeable to tax.

##### **1. Repair allowance**

1/5 of rent chargeable to tax is allowed as repairs allowance. This amount will be calculated before any deduction is made. It is a fixed amount irrespective of actual expenditure on repairs which may be more or less.

**2. Insurance premium**

The amount of any premium paid or payable by the company in the year to insure the building against the risk of damage or destruction will be allowed.

**3. Municipal and other local taxes**

Any local rate, tax, charge or cess in respect of the property paid or payable to any local authority or government in the year, not being a tax payable under the Income Tax Ordinance, 2001.

**4. Ground rent**

Where the property is subjected to a ground rent, the amount paid or payable by the company in the year on account of such ground rent is allowable deduction.

**5. Profit or interest paid on loan borrowed for construction**

Any profit or interest paid or payable by the person in the year on money borrowed for the purchase, construction, renovation, extension or reconstruction of the property can be deducted.

**6. Share of Rental Income paid to Financial Institution**

Any share of rent paid on capital contributed by House Building Finance Corporation (HBFC) or scheduled bank, for the purchase, construction, renovation, extension or reconstruction is allowable deduction.

**7. Profit paid or payable on Mortgage**

Where the property is subject to mortgage, the amount of profit paid or payable on such mortgage is allowable deduction.

**8. Administration and Collection Charges**

Any amount paid or payable on account of administration and collection charges to collect the rent or 5% of RCT whichever is less will be allowed for deduction.

**9. Legal expenses**

Any amount paid or payable by the company in the tax year for legal services acquired to defend the person's title of the property or any suit connected with this matter in a court of law can also be deducted from rent chargeable to tax.

**10. Unrealized rent**

If the rent payable by a tenant cannot be recovered by the owner of the property, such unrealized rent is deductible subject to following conditions.

1. The tenancy is bona fide.
2. The defaulting tenant has vacated or steps have been taken to compel him to vacate the property.
3. The defaulting tenant is not in occupation of any other property of the company.
4. The company has taken all reasonable steps for the recovery of the unpaid rent.

### QUESTION # 9

How would you differentiate between capital and revenue expenditures and receipts?

OR

Why the distinction between capital and revenue is necessary from income tax viewpoint. Briefly explain tests for differentiating capital and revenue.

### **IMPORTANCE OR NECESSITY OF DIFFERENTIATION**

Tax is paid on net profit of the business. To calculate true profit or loss of the business transactions taking place during the year has to be analyzed. Business transactions may be divided into following two classes.

- a) Capital
  - Expenditures
  - Receipts
- b) Revenue
  - Expenditures
  - Receipts

#### **Capital Expenditures:**

Capital expenditures are non-admissible and they are recorded in the asset side of balance sheet.

#### **Revenue Expenditures:**

Revenue expenditures are admissible and they are recorded on debit side of profit or loss account

#### **Capital Receipts:**

Capital receipts are not taxable and shown on the liability side of the balance sheet

#### **Revenue Receipts:**

Income tax is payable on revenue receipts and they are recorded on credit side of profit or loss account.

From the above discussion we can understand the importance of distinction between capital and revenue transactions.

### **DIFFERENCE BETWEEN CAPITAL AND REVENUE EXPENDITURES**

Income Tax Ordinance does not define terms "Capital Expenditures" and "Revenue Expenditures". So there is no hard and fast rule to declare expenditures as Capital or Revenue. However there are some criteria's on the basis of which we can differentiate capital and revenue expenditures up to some extent.

#### **1. PURCHASING OF ASSET**

##### **(a) Capital Expenditure**

If fixed asset is purchased, it is capital expenditure. Fixed asset means an asset purchased for long term use in business.

**Example**

Land, Building and Machinery etc

**(b) Revenue expenditure**

If circulating or floating asset is purchased it is revenue expenditure. Floating assets means an asset purchased for resale purpose in the same condition or after some modification.

**Example**

Raw material, Machinery for resale purpose etc

**2. INITIATION (START) OF BUSINESS**

**Capital expenditure**

All expenditures incurred at the time of starting business are capital expenditures

**Example**

Registration of business, Preparation of partnership deed

**3. EXTENSION OF BUSINESS**

**Capital expenditure**

Expenditures incurred on extension of business are capital expenditures.

**Example**

Construction of new building, Purchase of new machinery

**4. PERIOD OF BENEFIT**

**(a) Capital expenditure**

If the benefit of expenditures is for a long time (more than one year) it is capital expenditures.

**Example**

Advertisement expenditures for informing the customers about business

**(b) Revenue expenditures**

If the benefit of expenditures is for a short time period (less than one year) it is revenue expenditures.

**Example**

Advertisement expenditures relating to a product, salary paid to employees.

**5. PRINCIPLE OF EARNING CAPACITY**

**(a) Capital expenditure**

If due to expenditures the earning capacity of the business increased it is capital expenditure.

**Example**

A new part install in a machine due to which its production capacity increased from 10000 units to 20000 units. Cost on installation of new part will be capital expenditure.

**(b) Revenue expenditure**

If due to expenditure earning capacity of the business did not increased, it will be revenue expenditure.

**Example**

A part of the machine is worn out which is changed but due to this change the production capacity is remained 10000. It is revenue expenditure.

**DIFFERENCE BETWEEN CAPITAL AND REVENUE RECEIPTS**

**1. SALE OF ASSET**

**(a) Capital Receipt**

Amount received on sale of fixed assets is a capital receipt.

**Example**

Machinery purchased for use in business is sold. Amount received is capital receipt.

**(b) Revenue Receipt**

Amount received on sale of floating asset is revenue receipt.

**Example**

Cash received on sale of goods.

**2. SURRENDER OF RIGHTS**

**(a) Capital Receipt**

If a person is an owner of a right, e.g. trademark, copyright etc. and he completely surrendered his right the amount received against it will be a capital receipt.

**Example**

Amount received from the sale of book rights is capital receipt.

**(b) Revenue Receipt**

If a person gives his right for use for a specific period, the amount received will be a revenue receipt.

**Example**

Royalty received against the use of book rights is revenue receipt.

**3. SUBSTITUTION OF SOURCE OF INCOME**

**(a) Capital Receipt**

An amount received under a termination of source of income is a capital receipt.

**Example**

An employee under a termination agreement gets some amount and left his job. It is a capital receipt because he received the amount against his source of income.

**(b) Revenue Receipt**

If the amount is substitution of income alone it will be revenue receipt.

**Example**

An employee badly injured in an accident and certain amount received by him as compensation will be treated as revenue receipt.

**4. RECEIPT TO BE JUDGED IN THE HANDS OF RECIPIENT**

The amount will be judged in the hand of recipient and not from the point of view of person who is giving it.

**Example**

Fee received by a legal practitioner for drafting partnership deed is revenue receipt for him while it is capital expenditure for businessman.

**5. LUMPSUM AMOUNT**

The fact that amount is being received in lumpsum or in installments should never be considered while distinguishing between capital and revenue receipts.

**Example**

Ali sold a patent for Rs. 100,000. The amount will be received in installment of Rs. 10000 per year. It is capital receipt because right is completely surrendered. On the other hand the salary of a person is become due for 12 months Rs. 100,000. He received lumpsum amount Rs. 100,000 at the end of 12 months. It will be revenue receipt.

**6. PURPOSE OF TRANSACTION**

**(a) Capital Receipt**

If the purpose of transaction is not profit earning then amount received will be capital receipt.

**Example**

A person purchased computer for use in business. In future due to some reasons he sells the computer and earns some profit. It will be a capital receipt because purpose of transaction was not profit earning.

**(b) Revenue Receipt**

If the purpose of transaction is profit earning then the amount received will be revenue receipt.

**Example**

A person is doing business of computers. The amount received on the sale of computer will be revenue receipt because his purpose is profit earning.

### QUESTION # 10

Explain various types of depreciation allowances and conditions of their admissibility under the Income Tax Ordinance.

### ANSWER

#### **DEPRECIATION**

In income tax ordinance depreciation has not been define so we will consider its general meaning as used in other subjects.

“Depreciation means a decrease in the value of an asset through wear and tear, or obsolescence”

#### **CONDITIONS FOR THE ALLOWABILITY OF DEPRECIATION**

In computing taxable income of a business the income tax law permits (allow) the deduction of depreciation if following conditions are fulfilled.

##### **1. Depreciable Asset**

Depreciation can be charged only on depreciable assets. Depreciable asset means any tangible movable property (plant, ship, aircraft etc.), immovable property (any building), or structural improvement to immovable property (road, railway, car park etc)

- (a) that has a normal useful life exceeding one year
- (b) is likely to lose value as a result of normal wear and tear, or obsolescence
- (c) is used wholly or partly by the person in deriving income from business chargeable to tax.

##### **2. Business Use**

Depreciation can only be charged on those depreciable assets which are used for business purpose in a tax year. Depreciation on personal assets is not allowed for deduction.

##### **3. Asset Partly used in Business**

Where a depreciable asset is used in a tax year partly for business purpose and partly for another purpose, the depreciation allowance shall be restricted to the fair proportionate part of the asset, which relates to the business.

##### **4. Rate of depreciation**

In income tax ordinance some specific rates are given for depreciation such as for building 10%, Furniture 15%. Depreciation can only be charged according to those prescribed rates.

##### **5. Written Down Value Method (WDV)**

For income tax purpose depreciation can only be charged by written down value method. Depreciation for whole year is allowed even if the asset is used for a part of year.

##### **6. Determination of Written Down Value or Book Value**

In first year of use

$$\text{WDV} = \text{Cost of asset} - \text{Initial allowance}$$

In next year

$$\text{WDV} = \text{Cost of asset} - (\text{Initial allowance} + \text{Total depreciation})$$

### **7. Depreciation allowance shall not be exceed original cost**

Total depreciation shall not exceed the original cost of the asset. For example if the depreciable value is Rs. 100,000 the total depreciation shall not be more than Rs. 100,000.

### **8. Disposal of Asset use for business**

No depreciation will be allowed in a tax year in which the asset is sold.

### **9. Gain or loss on sale of asset**

If the asset is sold more than WDV then it will be a gain which is taxable. On the other hand if the sale price is less than WDV it will be a loss and will be allowed for deduction from "income from business".

### **10. Depreciation allowance in case of leased asset**

Depreciation allowance on leased asset shall be allowed to leasing institutions only against their income from lease rentals. Any unabsorbed depreciation shall be adjusted in next periods.

### **11. Passenger Transport not plying for hire**

The maximum cost of a passenger transport vehicle not plying for hire, should not exceed 2,500,000 rupees to calculate depreciation allowance. If the cost of asset exceeds 25 million rupees we will charge depreciation only on 25 million rupees and in case the actual cost is less than 25 million rupees then depreciation will be calculated on actual cost.

### **12. Depreciation Allowance in case of immovable property**

For depreciation purpose the cost of immovable property shall not include the cost of land.

### **13. Depreciation allowance to Lessor**

Where any asset owned by the lessor like, a leasing company; investment bank etc. is leased to another person, depreciation allowance in respect of leased asset is allowed to such institutions only.

### **14. Sale value of Immoveable property exceeds the cost**

Where the consideration received on the disposal of immovable property exceeds the cost of the property, the consideration received shall be treated as the cost of the property.

### **15. Export of asset used in Pakistan**

Where the consideration received on the disposal of exported property exceeds the cost of the property, the consideration shall be treated as the cost of the property.

## **KINDS OF DEPRECIATION ALLOWANCE**

### **1. INITIAL ALLOWANCE**

In addition to a normal depreciation allowance, an additional allowance against income from business is allowed on exported assets. Such additional allowance is called initial allowance.

### **CONDITIONS**

In order to avail initial allowance, one should fulfill the following conditions.

#### **(a) Eligible Depreciable assets**

Initial allowance is allowed on eligible depreciable assets only. (135p)

**(b) Only on 1<sup>st</sup> use**

Initial allowance is allowed on exported assets only once in a life when it is 1<sup>st</sup> time used in Pakistan and not after that.

**(c) Rate of initial allowance**

It is allowed @ 25% of the cost of asset.

**(d) Asset must be owned by person**

For admissibility of initial allowance, asset must be owned by the person whose taxable income is being determined.

**2. FIRST YEAR ALLOWANCE (FYA)**

FYA shall be allowed subject to following conditions:

- (a) The first year allowance will be provided at the rate of 90% of the cost however the asset will not be entitled for initial allowance.
- (b) This allowance is admissible on plant, machinery and equipment installed by an industrial undertaking owned and managed by a company.
- (c) The asset must be put to use after July 1, 2008
- (d) Asset must be installed in rural and under developed area as specified by the Federal Government

The FYA has been provided in order to accelerate the industrial process in rural and under developed areas.

**3. Accelerated Depreciation**

Accelerated depreciation shall be allowed subject to following conditions

- (a) The accelerated depreciation rate in lieu of initial allowance is 90% of the cost of the asset
- (b) The accelerated depreciation allowance is admissible on plant, machinery and equipment installed for generation of alternate energy by industrial undertaking, owned and managed by a company.
- (c) The asset must be put to use after July 1, 2009 anywhere in Pakistan.

**4. Normal Depreciation**

Normal depreciation is to be calculated according to the following prescribed rates for various types of assets on the written down value of a depreciable asset.

Class of asset	Description	Rate
I	Buildings (all types)	10%
II	Furniture (including fittings), plant and machinery, motor vehicles, ships, technical or professional books	15%
III	Computer hardware including printer, monitor and allied items, machinery and equipment used in manufacture of IT products, aircrafts and aero engines	30%

**QUESTION # 11**

What is amortization and what are the conditions for the allow ability of amortization.

**ANSWER****AMORTIZATION**

In income tax ordinance amortization has not been define so we will consider its general meaning as used in other subjects.

“The decrease in the value of intangible asset is called amortization.”

**CONDITIONS FOR THE ALLOWABILITY OF AMORTIZATION****1. Eligibility for Amortization** (136p)

A person shall be allowed an amortization deduction in a tax year for the cost of the person's intangibles if:

- (a) They are wholly or partly used by the person in deriving income from business chargeable to tax.
- (b) They have a normal useful life of exceeding one year.

**2. Amortization Deduction not allowed**

No deduction in respect of amortization shall be allowed where it has been allowed under another section of the ordinance for the entire cost of the intangible.

**3. Computation of Amortization**

The amortization deduction of a person for a tax year shall be computed according to the following formula:

Where

[A/B]

A = Cost of the intangible

B = Normal useful life of the intangible

**4. Life of Intangible**

If an intangible has a normal useful life of more than ten year or its useful life is not ascertainable then it shall be treated as it has a normal useful life of ten years.

**5. Intangibles Partly Used for Business**

Where an intangible is used in a tax year partly in deriving income from business chargeable to tax and partly for another use, the deduction allowed for that year shall be restricted to the fair proportional part of the amount.

**6. Intangibles not Used for Whole Year**

Where an intangible is not used for whole of the tax year in deriving income from business chargeable to tax, the deduction allowed under this section shall be computed according to the following formula.

Number of days for the intangible used in Business

× Amount of amortization

Number of days in the tax year

**7. Amortization should not exceed the cost**

The total deductions allowed as amortization to a person in the current tax year and all previous tax years in respect of an intangible should not exceed the cost of intangible.

**8. Disposal of Intangible**

Where, in any tax year, a person disposes of an intangible, no amortization deduction shall be allowed for that year.

**9. Gain on disposal of intangible**

If the consideration received by the person exceeds the written down value of the intangible at the time of disposal, the excess shall be the income of person chargeable to tax in that year.

**10. Loss on disposal of intangible**

If the consideration received is less than the written down value of the intangible at the time of disposal, the difference shall be allowed as a deduction in computing the person's income.

**11. Written Down Value on Disposal:**

The written down value of an intangible at the time of disposal shall be the cost of the intangible reduced by the total deductions allowed to the person in respect of the intangible.

## QUESTION # 12

Explain allowable and not allowable deduction under the head “Income from Business”

### ANSWER

#### **ALLOWABLE DEDUCTIONS**

In computing the income under the head “Income from Business” the following allowances and deductions shall be made.

#### **1. Expenditures relating to business**

Any expenditure incurred by the person during the tax year is allowable as deduction if it relates to the business. Following is the example of some expenses which are allowable as deduction.

1. Repair and insurance of machinery
2. Bonus or Commission to employees
3. Employer's Contribution to recognize provident fund etc.

#### **2. Depreciation and Amortization**

In ordinance specific rates and rules are given for depreciation and amortization such as for Building 10% and for Furniture 15%. A businessman can deduct depreciation and amortization if he applies these rules and depreciation rates given in ordinance.

#### **3. Amalgamation expenditures**

When two or more than two companies merged with each other and a new company is build, it is called amalgamation. All expenses relating to amalgamation are allowed as deduction under head “Income from Business”. Some examples of amalgamation are as follow.

1. Legal expenses
2. Financial Advisory Service
3. Administrative cost relating to planning and implementation of amalgamation

#### **4. Pre-commencement expenditures**

Pre-commencement expenditures means any expenditures incurred before the start of business. Pre-commencement expenditures are allowed as deduction.

#### **Example**

1. Cost of feasibility study
2. Construction of prototypes (sample)
3. Cost of trial production activities

#### **5. Employee's training and facility**

A person shall be allowed as deduction for any expenditure incurred in a tax year in respect of

1. Any educational institution or hospital in Pakistan established for the benefit of the person's employees and their dependents.
2. Any institution in Pakistan established for the training of industrial workers recognized, aided, or run by the Federal Government or a local authority.
3. The training of any person, being a citizen of Pakistan, in connection with a scheme approved by the FBR.

### **6. Profit on Debt and Lease Payment**

Any expenditure incurred by a person during the tax year shall be allowed a deduction under the head income from business if it relates to:

**Profit on debt:** Profit on debt is allowable deduction if debt is used for business purpose. (Profit on debt means any interest, discount, premium or other amount payable on debt)

**Lease Payment:** When an asset is taken on lease from schedule bank, Modarba Company or any other leasing company approved by the federal board of revenue the lease payment made to them is allowable deduction.

### **7. Bad Debts**

A person shall be allowed a deduction for a bad debt during the tax year if the following conditions are satisfied, namely:

1. The amount of the debt was previously included in the person's income from business chargeable to tax.
2. In case of financial institution, it represents an amount lent for deriving taxable income.
3. The debt or part of the debt is written off during the tax year.
4. There are reasonable grounds that the debt is irrecoverable.

### **8. Scientific Research expenditure**

Under the income tax ordinance a person is allowed a deduction for scientific research expenditure against "Income from business" if the following conditions are fulfilled.

1. The expenditure is incurred in Pakistan
2. The institution is approved by FBR
3. The expenditure is incurred wholly and exclusively for the purpose of scientific research business.

### **9. Worker's Welfare Fund**

Any amount paid for workers welfare fund will be excluded from total income. This amount is necessary to be paid by every industrial establishment, with a total income of Rupees one Lac or more.

### **10. Worker's Participation Fund**

Contribution made to Worker's Participation Fund under the Companies Profit Act, 1968, is also allowed to be deducted.

### **DEDUCTION NOT ALLOWABLE**

While calculating taxable income of business following expenditures are not allowed to be deducted.

#### **1. Fine or Penalty**

Any fine or penalty paid or payable by the person for the violation of any law, rule or regulation.

#### **2. Personal expenditures**

Any personal expenditure incurred by the person is not allowed as deduction.

**3. Amount transfer to Reserve Fund or Capitalized**

Any amount transfer to a reserve fund or capitalized is not allowed as deduction.

**4. Salary exceeding Rs. 15000 per Month**

It is necessary to pay salary exceeding Rs. 15000 through crossed cheque or direct transfer to employee's bank account. If it is paid in cash then it is not allowed for deduction.

**5. Cess, Rates, Taxes**

Any amount paid or payable by the person in Pakistan or outside Pakistan on account of any cess, rate or tax levied on the profits or gains of the business.

**6. Tax deducted at source**

Any amount of tax deducted at source from salary, dividends, royalty etc.

**7. Payment to Non-Resident**

Any sum paid to a non-resident on account of salary, rent, brokerage or commission, profit on debt, payment for services or fee or any other sum chargeable to tax is not allowed as deduction. However if tax is deducted and paid on these payments before paying to non-resident then these are allowed for deduction.

**8. Entertainment Expenditures**

Any entertainment expenditure in excess of prescribed limit is not allowed as deduction.

**9. Sum paid to Unrecognized Fund**

Any contribution made by the person towards unrecognized provident fund, pension fund or gratuity fund which is not approved is not allowed as deduction.

**10. Employer's contribution to a Provident Fund or Other Fund**

Tax is also paid on recognized provident fund if it is more than 10% of salary. It is the duty of employer to deduct tax at source while paying fund to employee. If he does not make an arrangement then he is not allowed to deduct the amount which he contributed to that fund.

### **QUESTION # 13**

What are the items which fall in final tax regime & how much tax is charged on each of them?

### **ANSWER**

#### **ITEMS UNDER FINAL TAX REGIME**

##### **1. Dividend Income**

Tax shall be deducted @ 10% of gross dividend which shall be considered full and final tax for a person.

##### **2. Royalty and Fee for Technical Services**

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.

##### **3. Imports**

The Collector of customs shall collect income tax from every importer at the prescribed rates on value of import. Further detail is as follow.

- 12% of the value of foreign produced film imported for screening and viewing.
- 5% in case of industrial undertaking
- 5% in case of companies
- 5.5% in other cases.

##### **4. Profit on Debt**

Tax shall be deducted @10% on the amount of profit on debt to a resident person. Profit on debt include following.

- Profit on Defense Saving Certificate and Post Office Saving Account
- Bank profit including profit and loss sharing account
- Profit on debentures issued by a company or financial institution

##### **5. Insurance Premium**

Insurance premium or re-insurance premium paid to a non-resident person is subject to tax deduction @ 5% of the gross amount which shall be final tax liability of the recipient.

##### **6. Payment to Non-resident Media Person**

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% which shall be final tax liability of the recipient.

##### **7. Supply of Goods**

Withholding tax rate in case of supply of goods is 3.5% of the gross amount including sales tax in case of supply of goods by a company. Tax rate is 4% in case of supply of goods by a person other than a company.

##### **8. Performance of Contracts**

Withholding tax rate in case of execution of contracts is 6% where the contractor is a company and 6.5% is for a contractor other than a company.

### **9. Export**

Tax shall be deducted @ 1% as final tax from export proceeds in respect of direct exporter, indirect exporters and undertakings located in Export Processing Zone.

Every authorized dealer in foreign exchange shall deduct income tax @ 5% as final tax at the time of realization of commission due to an agent.

### **10. Prizes and Winnings**

- (a) Tax shall be deducted on the gross amount of the following:
  - (i) 15% on Prize on prize bond and cross-word puzzle.
  - (ii) 20% on Raffle, Lottery, Prize on Winning a quiz or Prize offered by companies on promotion of sales.
- (b) If the said prize or winning is not in cash then the payer is required to collect tax at the specified tax rate of the FMV of prize from the recipient of prize.

### **11. Petrol Pump Operators**

Every person selling petroleum products to a petrol pump operator shall collect tax @ 10% as final tax on the gross amount of commission to the petrol pump operator.

### **12. Commission or Brokerage**

- (a) Tax shall be deducted @ 10% from commission or brokerage paid by government including local government, company or AOP constituted under the law.
- (b) Tax shall be deducted @ 5% of commission to advertising agents.

### QUESTION # 14

Write notes on the following

1. Deduction of tax at source
2. Advance payment of tax.

**OR**

Explain the provisions of Income Tax Ordinance regarding deduction of Tax at source.

**OR**

Discuss the provision regarding the payment of advance tax under the Income Tax Ordinance 2001.

### ANSWER

#### **DEDUCTION OF TAX AT SOURCE**

It is necessary for certain persons to deduct the amount of tax at specific stages out of amounts due to taxpayers and deposit this amount with the tax authorities. Cases where deduction of tax at source is necessary are discussed below in detail.

##### **1. Tax deduction from Salary**

It is necessary for every employer, whether in public or private sector that while making any payment in respect of salary, provided that salary is taxable, income tax must be deducted. While deducting tax from salary any tax withheld or tax credit should be taken into consideration.

##### **2. Dividend Income**

Tax shall be deducted @ 10% of gross dividend which shall be considered full and final tax for a person.

##### **3. Royalty and Fee for Technical Services**

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.

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- (b) Tax shall be deducted @ 5% of commission to advertising agents.

## **ADVANCE PAYMENT OF TAX**

### **1. Who should pay advance Tax (226p)**

(i) All the companies and association of persons are liable to pay advance tax quarterly based on their turnover and tax paid during last year.

The formula adopted for this purpose is

$$\text{Turnover for the quarter} \times \left[ \frac{\text{Last year Tax}}{\text{Last year turnover}} \right] - \text{Tax already deducted in the quarter}$$

*Note: A company or association of persons shall also be liable if there is no last assessed income or declared turnover. The quarterly advance tax shall be computed based on the estimated profit of the quarter.*

(ii) In case of an individual, advance tax is payable quarterly only if his latest assessed taxable income was Rs. 500,000 or more.

### **The formula adopted for this purpose is**

$$(\text{Last year tax} / 4) - \text{Tax already deducted in the quarter}$$

(iii) The following shall not be considered for the purpose of advance tax:

- Income from salary
- Income from FTR

### **2. Payment dates for the Company and AOP**

A company and AOP have to pay advance tax according to the following schedule:

<b>Quarters</b>	<b>Due Date</b>
September Quarter (July to September)	25 <sup>th</sup> day of September
December Quarter (October to December)	25 <sup>th</sup> day of December
March Quarter ( January to March)	25th day of March
June Quarter (April to June)	15th day of June

### **3. Payment dates for Individuals**

An individual taxpayer has to pay advance tax according to the following schedule:

<b>Quarters</b>	<b>Due Date</b>
September Quarter (July to September)	15 <sup>th</sup> day of September
December Quarter (October to December)	15 <sup>th</sup> day of December
March Quarter ( January to March)	15th day of March
June Quarter (April to June)	15th day of June

**4. Revised Estimates:**

- (a) If the taxpayer is of the view that his income for the current tax year would likely be less than his last tax year then he may file an estimate of his income to the Commissioner and can pay advance tax for the current year accordingly.
- (b) If the taxpayer is of the view that his income for the current tax year would likely be more than his last tax year then he may file an estimate of his income to the Commissioner and can pay advance tax for the current year accordingly.

**5. Less Advance Tax Paid:**

If a taxpayer files an estimate and his advance tax paid is less than 90% of actual tax liability of the relevant tax year then he shall be liable to pay default surcharge @ 18% per annum.

**6. Failure to Pay Advance Tax**

If a taxpayer fails to pay the advance tax required then he shall be liable for the default surcharge @ 18% per annum.

### QUESTION # 15

What is set off and Carry forward of losses? What are different losses which can be set off and carry forward under the provision of Income Tax Ordinance?

### ANSWER

#### **SET OFF THE LOSSES**

It is not sure that there will always be a profit some time there may be a loss. If there is a loss the income tax authorities allow a person to adjust that loss against income of same head or other heads in the same year. Such adjustment is called “Set off the losses”.

#### **Example**

Mr. A has earned a profit of Rs. 10,00,000 from Business in Lahore but at the same time he sustains a loss of Rs. 300,000 from Business in Sialkot. Here he will pay tax on Rs. 700,000 ( $1,00,00,000 - 300,000$ ). This adjustment of loss is called set off of losses.

Some losses can only be set off against the income of same head while some losses can be set off against income of other heads.

#### **SET OFF THE LOSSES WITHIN SAME HEAD**

- (i) Capital loss can be set off against capital gains only
- (ii) Loss of speculation business can be set off against profit of speculation business only.

#### **SET OFF THE LOSSES AGAINST OTHER HEADS**

- (i) Loss from property
- (ii) Loss from non-speculation business
- (iii) Loss from other sources

#### **RULES FOR SET OFF THE LOSSES**

##### **1. Companies operating Hotels**

If a company is registered in Pakistan or Azad Jammu and Kashmir (AJ&K), and it operates Hotels at both the places, and it sustains a loss from business at one place, the loss can be adjusted against company's income at the other place.

##### **2. Property Loss**

Loss from property can be set-off against any other head of income other than salary and FTR incomes. Moreover any other loss cannot be set-off against property income.

##### **3. Speculation loss**

Loss from a speculation business can be set off against profits of another speculation business only. It means loss from speculation business cannot be adjusted against any other head of income.

##### **4. Set off Capital loss**

Like speculation loss capital loss can only be set off against capital gains received by the person. It cannot be set off against any other income.

### **5. Loss on sales of immovable Property**

Loss on sale of immovable property cannot be set-off against any other head of income. Similarly, loss of any other head of income cannot be set-off from the gain on sale of immovable property.

### **6. Foreign Source Loss**

Foreign source loss can only be adjusted against foreign source income. It cannot be adjusted against any Pakistan source income.

### **7. Loss of AOP**

Loss incurred by an AOP shall not be set-off against the other incomes of its members but an AOP can set-off its losses against its own other heads of incomes according to rules.

### **8. Loss Consequent to Amalgamation**

The loss of amalgamating (merging) company or companies, other than capital loss and brought forward loss, shall be set off against business profits and gains of the amalgamated company and vice versa.

### **CARRY FORWARD OF LOSSES**

If a taxpayer sustains a loss in a tax year then the law allows him to adjust such loss against income from other heads of income or income from same head. If the income is insufficient to adjust the loss then the taxpayer has the option to adjust such loss against the income of next years. This procedure is called as carry forward of losses.

However, a taxpayer can carry forward only such losses which are assessable under the following heads.

- (i) Non-Speculation Business
- (ii) Speculation Business
- (iii) Capital gains

### **RULES FOR CARRY FORWARD OF LOSSES**

#### **1. Non-speculation Business**

If any loss was left un-adjusted in the same year then it can be carried forward to the next year but in the next year it can only be adjusted against the profits or gains of the non-speculation business. This loss can be carried forward up to 6 years. If loss is not fully adjusted during six years then remaining loss becomes dead loss.

#### **2. Speculation Business loss**

Loss from speculation business can be adjusted only against the income from speculation business. If it is not adjusted in the year of loss then it can be carried forward to next 6 years after that it will become dead loss.

#### **3. Capital Loss**

Capital loss can be adjusted only against the capital gain. If due to any reason it is un-adjusted then it can be adjusted against the capital gain of next year. It can be carried forward up to 6 years.

**4. Property loss**

Any loss sustained by a taxpayer under the head “Income from Property” in a tax year can be set off against any other head of income in the same year but any unadjusted loss cannot be carried forward to next year.

**5. Loss on Sales of Immovable Property**

Any loss sustained by a person on the sale of immovable property cannot be carried forward to next year.

**6. Other Sources Loss**

Loss sustained under the head “Income from other source” can be set off against other income of same head or any other head income in the same year but any unadjusted loss cannot be carried forward to next year.

**7. Foreign Loss**

Foreign source loss can be adjusted only against other foreign source incomes. Any unadjusted loss can be carry forward to next 6 years.

**8. Loss of Association of Person**

Any loss of AOP which remain unadjusted can be carry forward to next 6 years.

**9. Loss of Amalgamating Companies**

The unadjusted loss of amalgamating company or companies other than capital loss and brought forward loss can be carry forward up to the period of 6 years.

### **QUESTION # 16**

What type of penalties can be imposed on a person if he not follows the provisions / rules of the Income Tax Ordinance.

### **ANSWER**

#### **CONCEPT OF PENALTIES**

The objective of any law can only be achieved if the people accept and follow its provisions or rules. So, the authorities impose penalty (punishment) in order to avoid the violation of any provision of the law. Similarly, the tax authorities also impose penalties on the taxpayers for the violation of the rules of income tax law.

#### **PENALTIES ON VIOLATION OF ORDINANCE**

A person may be penalized (punished) for the following defaults under the Income Tax Ordinance 2001.

##### **1. Failure to Furnish a Return**

If a person fails to furnish (provide) a return of income within due date then such person shall pay a penalty equal to 0.1% of the tax payable for each day of default. Minimum limit of penalty in this case is Rs. 20,000 and a maximum 50% of tax payable of that year.

##### **2. Failure to Furnish a Statement**

If a person fail to furnish a statement as required under section 115, 165 within due date then such person shall pay a penalty of Rs. 2500 for each day of default. Minimum level of penalty in this case is Rs. 10,000

##### **Under Section 115**

*If a person has only income from salary he is not required to file return of income. Annual Statement of Deduction of Income tax from salary filed by the employer of such person will be treated a return of income furnished by the taxpayer.*

##### **Under Section 165**

*Every person who collect or deduct tax from a payment shall furnish a statement to the commissioner. The statement should contain the name and address of person from whom tax has been collected. Total amount of payment from which tax has been deducted and the amount of tax deducted.*

##### **3. Failure to Furnish a Wealth Statement**

If a person fails to furnish a wealth statement or wealth reconciliation statement then such person shall pay a penalty of Rs. 100 for each day of default.

##### **4. Failure to Issue Invoice / Receipt**

Any person who fails to issue cash memo or invoice or receipt when required under the ordinance then such person shall pay a penalty of Rs. 5000 or 3% of the amount of the tax payable whichever is higher.

##### **5. Failure to Apply for Registration**

Any person who is required to apply for registration under the Ordinance but fails to make an application for registration then such person shall pay a penalty of Rs. 5000.

### **6. Failure to Notify Material Changes**

Any person who fails to notify the changes of material nature in the particulars of registration then such person shall pay a penalty of Rs. 5000.

### **7. Failure to Deposit the Tax Due**

Any person who fails to deposit the amount of tax due or any part thereof in time or manner laid down under the Ordinance then such person shall pay a penalty equal to:

- (i) 5% of the amount of tax in default, on first default
- (ii) 25% of the amount of tax in default, on 2<sup>nd</sup> default
- (iii) 50% of the amount of tax in default on 3<sup>rd</sup> default.

### **8. Repeats Mistakes in Calculation**

Any person who repeats mistakes in calculation in his return for more than one year whereby the amount of tax is less paid than actual. Such person shall pay a penalty of Rs. 5000 or 3% of the amount of tax, whichever is higher.

### **9. Failure to maintain records**

Any person who fails to maintain records required under the Ordinance then such person shall pay a penalty of Rs. 10,000 or 5% of the amount of tax payable, whichever is higher.

### **10. Failure to Furnish Information**

Any person who fails to furnish the information required by Commissioner under section 176 shall pay a penalty of:

- (i) Rs. 25000 on first default
- (ii) Rs. 5000 for each subsequent default.

#### Under Section 176

*The commissioner may, by notice in writing, require any person to furnish any information relevant to any tax charged under this ordinance or to attend at the time and place designated in the notice for the purpose of being examined etc.*

### **11. Failure to Produce Documents:**

Where a taxpayer who without any reasonable cause fails to produce the record or documents required for audit under section 177 shall pay a penalty of

- (i) Rs 25000 on receipt of first notice
- (ii) Rs. 50000 on receipt of second notice
- (iii) Rs. 100,000 on receipt of third notice

### **12. Making False Statement**

Any person who makes a false statement to an Inland Revenue Authority either in writing or orally or electronically shall pay a penalty of Rs. 25000 or 100% of the amount of tax shortfall, whichever is higher.

**13. Denying the Access to Premises and Accounts etc.**

Any person who denies (refuse) or obstruct (bloc) the access of the Commissioner or any officer authorized by the Commissioner to the premises, place, accounts, documents, computers or stocks then such person shall pay a penalty of Rs. 25000 or 100% of the amount of tax, whichever is higher.

**14. Concealment of Income**

If a person has concealed income or furnished inaccurate particulars (information) of such income or claimed any deduction for any expenditures not actually incurred shall pay a penalty of Rs. 25000 or an amount equal to the tax which the person sought to avoid whichever is higher.

**15. Offence not Given in the Ordinance**

Any person who contravenes (breaks) the provision of the ordinance for which no penalty has, specifically, been provided in the ordinance such person shall pay a penalty of Rs. 5000 or 3% of the amount of tax payable, whichever is higher.

**16. Failure to Collect and Deposit the Tax**

Any person who fails to collect or deduct tax as required under any provision of the Ordinance or fails to pay the tax collected or deducted to tax department then such person shall pay a penalty of Rs. 25000 or the 10% of the amount of tax, whichever is higher.

### QUESTION # 17

Write in detail the legal provisions governing the filling of return of total income under income tax law.

### ANSWER

#### **PROVISIONS FOR FILLING THE RETURN OF INCOME**

##### **1. Persons Required to Furnish a Return**

It is necessary for following person to furnish the return of income:

- (a) Every person whose total income during the tax year exceeds the taxable limit
- (b) Every company irrespective of its income
- (c) Any non-profit organization
- (d) Any approved welfare institution
- (e) Any person who has been charged to tax for any of the two tax years immediately preceding the previous tax year
- (f) Any person who claimed a loss carried forward from a previous tax year
- (g) Any person who
  - (i) Owns a motor vehicle having engine capacity above 1000 cc.
  - (ii) Has obtain National Tax Number
  - (iii) Owns immovable property, with land area of 250 squares yard or more.

Above mentioned persons are not required to file the return if they belong to any of the following categories

- (i) A widow
- (ii) An orphan below the age 25 years.
- (iii) A non-resident person
- (iv) A disabled person.

##### **2. Requirement of the Return**

A return of income:

- (a) Shall be in the prescribed form and accompanied by such statements or documents as may be prescribed.
- (b) Shall fully state all the relevant particulars or information as specified in the form or return.
- (c) Shall be signed by the person, or the person's representative.

##### **3. Electronic Filling of Return**

A return of income filed electronically on the web or any magnetic media or any other computer readable media as may be specified by the Board shall also be deemed to be a return.

##### **4. Return by Notice**

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

- (i) The person has died.
- (ii) The person has become bankrupt or gone into liquidation
- (iii) The person is about to leave Pakistan permanently.
- (iv) The Commissioner considers it appropriate due to any other reason.

### **5. Non-Furnishing of Return**

The Commissioner may issue a notice to a person to furnish a return of income, who in the opinion of Commissioner is required to furnish a return but has failed to do so. The return must be filed within thirty days from the date of issuance of notice or a longer period as may be specified in the notice.

### **6. Revision of the Return**

If a person has furnished a return but later on he discovered any omission or wrong statement therein, may file revised return subject to the following conditions:

- (a) It is accompanied by the revised accounts
- (b) The reasons for revision of return, in writing and duly signed, by the taxpayer are filed with the return.

### **7. Submission of wealth statement**

- (i) The Commissioner may require by a written notice any person to furnish a wealth statement on a specific date. The statement should be in the prescribed form and verified in the prescribed manner. Wealth statement may contain the following information.
  - (a) The person's total assets and liabilities.
  - (b) The total assets and liabilities of the person's spouse, minor children, and other dependents.
  - (c) Any asset transferred by the person to any other person during the period and the consideration (price) for the transfer.
  - (d) The total expenditures incurred by the person, and the person's spouse, minor children, and other dependents during the tax year.
- (ii) Every resident taxpayer being an individual filing a return of income for any tax year shall furnish a wealth statement and wealth reconciliation statement along with such return.
- (iii) Every member of an AOP shall also furnish wealth statement and wealth reconciliation statement along with return of income of association.
- (iv) Every person (other than a company or AOP) falling under final tax regime (FTR) for the tax year shall file a wealth statement and wealth reconciliation statement.

### **8. Return of Discontinued Business**

Any person discontinuing a business shall give the Commissioner a notice in writing to that effect within fifteen days of the discontinuance.

Where no notice has been given by the person but the Commissioner has reasonable grounds to believe that a business has discontinued or is likely to discontinue, he may serve a notice on the person who has discontinued the business or is likely to discontinue the business to furnish a return, within the time specified in the notice.

### **9. When to furnish the return of income**

A taxpayer should furnish the return of income according to the following details;

- (a) The companies whose tax year ends between 1<sup>st</sup> January and 30<sup>th</sup> June, the return of income must be furnished up to 31<sup>st</sup> December of the same year.
- (b) A salaried person should file the return of income electronically or if complete tax has been paid by his employer should file the prescribed certificate up to 31<sup>st</sup> August of the same tax year.
- (c) All other persons should furnish the return of income up to 30<sup>th</sup> September next to the end of their tax year.

### **10. Extension of Time for furnishing return**

The Commissioner has the powers to extend the date of furnishing the return provided that an application for extension in time is presented by the due date of furnishing the return. If on receipt of such an application the Commissioner is satisfied that an extension is necessary because of the taxpayer's absence from Pakistan, his sickness or other misadventure or any other genuine difficulty, the Commissioner will grant an extension of time for a period not exceeding fifteen days.

However, under exceptional circumstances justifying the delay, a longer extension of time may be granted by the Commissioner.

### **11. Penalty for failure to furnish the return**

Where any person fails to furnish the return of income within the prescribed time, the Commissioner shall impose penalty upon such person. The amount of penalty will be equal to 0.1% of the tax payable for each day of default subject to a minimum of 10,000 rupees and a maximum of 50% of tax payable.

### QUESTION # 18

What is assessment and what are different types of assessments?

### ANSWER

#### **ASSESSMENT**

Assessment means a complete scrutiny (checking) of the information provided by the taxpayer in his return.

#### **TYPES OF ASSESSMENT**

Following are the different types of assessments made by the Commissioner Inland Revenue.

##### **1. Return of income as Assessment**

This assessment may be divided into following two categories:

###### **(a) Complete return**

When a taxpayer furnishes a return of income for a tax year,

1. The taxpayer's return will be accepted as such without any question.
2. The return itself will be treated as an assessment order (final decision for tax) by the commissioner.
3. The calculation made by the taxpayer of total income, exemptions claimed and computation of tax due thereon will be accepted.

###### **(b) Incomplete return**

Where the return of income furnished is not complete

1. The Commissioner shall issue a notice to the taxpayer informing him of the deficiencies and directing him to provide such information.
2. If a taxpayer fails to comply with notice, the return furnished shall be treated as invalid.
3. If taxpayer fully complied with the requirements of the notice, the return furnished shall be treated to be complete on the day it was furnished.

##### **2. Best Judgment Assessment**

If a person is required to furnish the return of income or any other statement but fails to furnish the return or any other statement, the commissioner can himself make an assessment on the basis of available information. The order may include

1. The taxable income
2. Tax payable
3. Tax already paid.

If the taxpayer is not agreed with this assessment order then he can make an appeal. The time, place and manner of appeal are also mentioned in this order.

This order can be issued within five years after the end of tax year to which it relates.

### **3. Amended Assessment**

Where modification (change) is made by the Commissioner in the assessment order already issued by him is called amended assessment order. The commissioner can make amendment if in his opinion

1. Any income chargeable to tax has escaped assessment.
2. Wrong tax rate has been applied
3. Wrong tax relief was calculated in the original assessment order.

Before making an amendment it is necessary to give a chance to taxpayer for explanation. The amended assessment order may include.

1. The amended taxable income of the taxpayer
2. The amended amount of tax due
3. The amount of tax paid, if any

The order can be passed by the Commissioner within five years of the original order.

### **4. Provisional Assessment**

Where a taxpayer fails to furnish the return of income in spite of a notice by the Income tax Authorities, the Commissioner can issue temporary assessment order on the basis of available information. Such temporary assessment order is known as provisional assessment order. This order may include taxable income and tax payable.

It is not a final order. The taxpayer is allowed to submit a return within 60 days from the date of order. If the taxpayer does not submit return and other documents within specified period then the provisional assessment order will be treated as final assessment order.

### **5. Assessment after Decision of an Appeal**

There may be grievances between income tax authorities and taxpayer. The aggrieved party can make an appeal. If the taxpayer is not agree with the decision of Commissioner he can make an appeal to Appellate Tribunal, High Court or Supreme Court. If these authorities issued an order then a new assessment is made within one year.

### **6. Assessment of disputed property**

When the ownership of any property, the income from which is chargeable to tax, is disputed and the case is pending in any civil court in Pakistan, the assessment in respect of such property may be postponed by the Commissioner. In such cases the assessment order in respect of such income should be passes within one year of the court's decision.

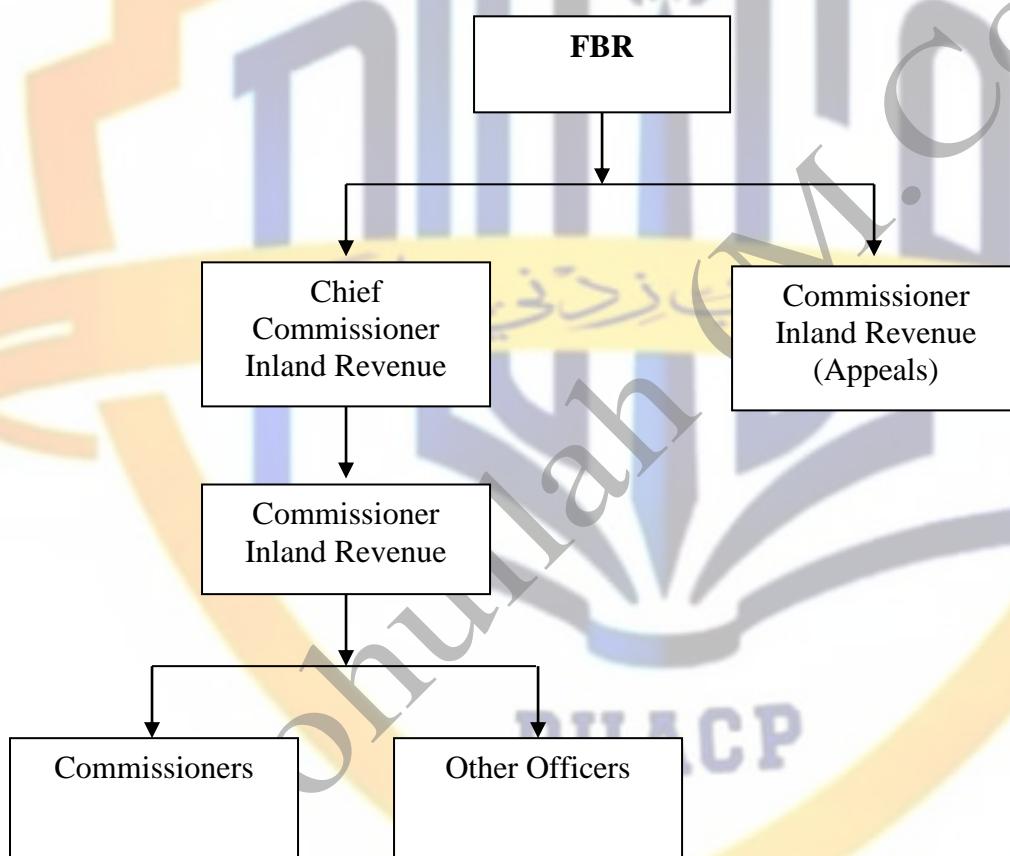
**QUESTION # 19**

What are composition and functions of Federal Board of Revenue? **Or**

Federal Board of Revenue is the highest executive authority in the administration of Income Tax Law. Discuss in detail.

**ANSWER****FEDERAL BOARD OF REVENUE (FBR)**

Federal Board of Revenue is the highest tax authority in Pakistan. Its old name was central board of revenue (CBR). It is constituted under the provision of the Federal Board of Revenue Act, 2007. All other tax authorities are appointed by Board and are subordinate to it.

**POWERS AND FUNCTIONS OF FBR****1. Appointment**

The board may appoint as many Chief Commissioner Inland Revenue, Commissioner Inland Revenue, Commissioner Inland Revenue (Appeals) and other Commissioners and officers as may be necessary.

**2. Appointment of Auditor**

The board can appoint a firm of Chartered Accountants or Cost and Management Accountants to conduct the audit of any person.

**3. Certification of Research Institution**

The FBR is authorized to certify an institution as conducting scientific research in Pakistan.

**4. Approval of Leasing Companies and Modarabas**

Lease payments to such leasing companies and Modarabas which are approved by FBR are allowed for deduction from income from business. The FBR has power to approve leasing companies and Modarabas.

**5. Method of Accounting**

There are two methods of accounting cash basis and accrual basis. FBR may specify the method of accounting for certain companies.

**6. Approval of Securities**

The FBR may specify any security that the profit received on it by a non-resident person shall be exempt from tax.

**7. Approval of Charitable institution**

Income of charitable institutions approved by FBR is exempt from tax. FBR has the power to approve charitable institutions.

**8. Decision of Application**

The FBR is authorized to decide an application submitted by a person against the decision of Commissioner Inland Revenue for granting or withdrawing the permission regarding use of a special tax year.

**9. Procedure of filling return**

FBR determine the procedure for furnishing return and other documents.

**10. Unexplained income or asset**

Make the rules for valuation and taxation of unexplained income or asset.

**11. Power to collect information regarding exempted income**

FBR can authorize any department or agency of the Government to collect and compile data regarding incomes of industrial and commercial undertakings exempt from tax.

**12. Transfer**

The FBR has the power to transfer income tax authorities from one place to another.

**13. Authority of Approval**

The FBR can authorize Chief Commissioner Inland Revenue or Commissioner Inland Revenue to grant approval on behalf of Board.

**14. Preparation of forms**

FBR has the power to prepare prescribed forms, etc. for the purpose of the Income Tax Ordinance.

**15. Supervision of Subordinate authorities**

The FBR supervise the functions of its subordinate authorities.

**16. Fiscal Policy**

FBR functions include formulation and administration of fiscal policies. Fiscal policy is a plan of collecting and spending money to meet government expenditures.

**17. Declare Tax Period**

The Federal Board of Revenue can declare a period to be treated as specific tax year in case of any person.

**18. Distribution of Work**

It can allocate functions and distribute the work to be performed, if the same function has been assigned to two or more income tax authorities.

**19. Approval of Fund**

The Federal Board of Revenue has power to approve provident fund, superannuation funds and gratuity funds.

**20. Circular Issued by Board**

For the purpose of the interpretation of the Income Tax Ordinance, Board may issue circulars for the guidance of tax payers and its officials.

### **QUESTION # 20**

What are the powers and functions of Commissioner Inland Revenue?

#### **POWERS AND FUNCTIONS OF COMMISSIONER INLAND REVENUE**

The Federal Board of Revenue is the appointing authority for Commissioner Inland Revenue. Normally, the Commissioner is appointed for a specific area known as a zone but law allows FBR to appoint the Commissioner without any territorial restrictions.

Commissioner Inland Revenue enjoys the following powers and has to perform the following functions under the law.

##### **1. Tax on Golden Handshake**

Sometime companies or government organization offer to employees to give up his job and against it he is paid a lump sum amount, that amount is called golden handshake. Commissioner has the power to allow a person to pay tax on golden handshake on normal rate or on the basis of average rate of tax bases on three preceding years.

##### **2. To change method of accounting**

There are two methods of accounting such as Cash basis and Accrual basis. The Commissioner has the power to allow a person to use Cash basis or Accrual basis. For companies it is compulsory to use accrual basis of accounting.

##### **3. Permission to use stock valuation method**

Following are four different methods of stock valuation.

- (i) Prime cost method
- (ii) Absorption cost method
- (iii) First in First Out (FIFO)
- (iv) Average cost method

The Commissioner has the power to allow a person to use stock valuation method among above four methods.

##### **4. Permission to use different tax years**

The commissioner has power to allow using normal or special tax year.

- (i) Normal tax year (July 1<sup>st</sup> to June 30)
- (ii) Special tax year (All tax years other than normal tax years)

##### **5. Withdraw the permission**

The Commissioner has the power to withdraw the permission given to a person to use special tax year.

##### **6. Tax on Unexplained income**

If a taxpayer did not show any income and later on it is discovered the Commissioner has the power to impose tax on that unexplained income.

##### **7. Order to furnish the return of income**

The Commissioner has the power to issue an order to a taxpayer or his representative to furnish the return of income and wealth statement and also other documents.

**8. Return of discontinuing business**

If a person is going to close his business the Commissioner can issue an order to submit the return.

**9. Relaxation in time for furnishing return**

The Commissioner can extend the time period to furnish the return of income.

**10. Assessment order**

It is necessary for a taxpayer to submit his return of income. In case the taxpayer did not submit the return of income then the Commissioner can himself on available information make an assessment and can issue an assessment order.

**11. Recovery of tax**

If a taxpayer did not pay his tax liability the Commissioner has the power to recover the tax from that defaulter taxpayer.

**12. Recovery of tax from Liquidator**

When the company is going to wind up a person is appointed for its winding up that person is called liquidator. The Commissioner can give notice to liquidator and can recover tax from him.

**13. Payment without tax deduction at source**

Some employers are bound by law to deduct tax from the salaries of employees and then make the payment to them. This deduction from salary is called tax deducted at source. The Commissioner has the power to allow an employee to make payment without deducting tax at source.

**14. Adjustment of tax**

If a person has paid advance tax and after assessment his tax liability is less than advance tax then the Commissioner will refund the amount which is more than actual tax.

**15. Imposing Penalty**

The Commissioner has the power to impose penalty for different defaults.

**16 Issuance of notice**

The CIR enters and search premises, issues notice in order to obtain information or evidence.

**17. Approval of Translator**

The CIR approves a person as translator in case a taxpayer keeps the accounts, etc. in a language other than Urdu or English.

**18. Delegate power**

CIR has a power to delegate any of his power to any officer of Inland Revenue.

**19. Appointment**

Appoint any of his subordinate authority with the approval of Board.

**20. Appointment of auditor**

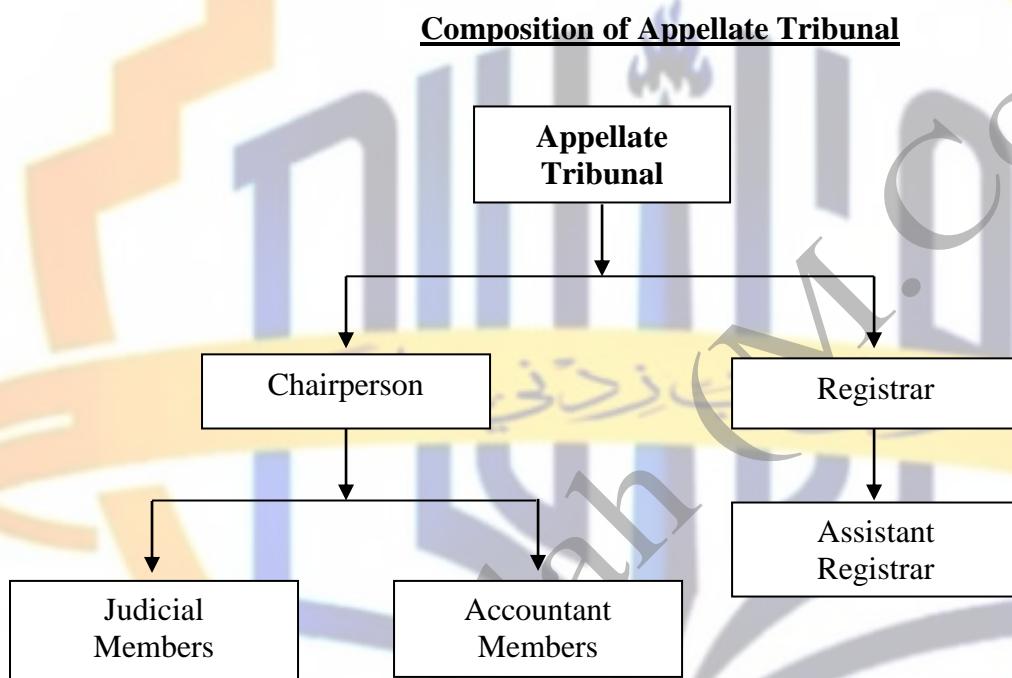
Appoint an expert for the purpose of valuation, audit etc.

**QUESTION # 21**

What is the composition (structure) and function of Appellate Tribunal? Why Appellate Tribunal is called final fact finding authority?

**ANSWER****APPELLATE TRIBUNAL INLAND REVENUE (ATIR)**

Appellate Tribunal is the second court of appeals. Taxpayer or tax department if not satisfied with the decision of Commissioner Inland Revenue (Appeals) can make an appeal to Appellate Tribunal. It is appointed by Federal Government.

**JUDICIAL MEMBERS**

The Federal Government may appoint a person as judicial member of the Appellate Tribunal Inland Revenue if:

- He has exercise the power of a District Judge and is qualified to be a judge of a High Court, or
- He is or has been an advocate of High Court and is qualified to be judge of High Court.

**ACCOUNTANT MEMBERS**

The Federal Government may appoint following person as Accountant member of the Appellate Tribunal Inland Revenue.

- An officer of Inland Revenue who is equivalent in rank of Chief Commissioner Inland Revenue
- Commissioner Inland Revenue or Commissioner Inland Revenue (Appeals) having five years experience

**CHAIR PERSON**

One of the judicial members can be appointed as chair person of the tribunal.

**REGISTRAR**

Registrar receives the appeals and look after the working of tribunal. He is subordinate the chair person. He also fixes the dates for hearing of appeals.

**FUNCTIONS OF APPELLATE TRIBUNAL**

The Tribunal hears appeals against the orders of the Commissioner Inland Revenue (Appeals).

The decision of the Tribunal is final if the case involves point of fact. If the case involves point of law then the case can be referred to High Court.

The chairman may divide the Tribunal into benches to perform the powers and functions of it.

A bench is usually consists of equal number of judicial and accountant members but it is not necessary. But Federal Government may authorize the Chairman or any member to alone hear and decide the case.

If there is difference in opinion of members on any point then decision of majority is accepted but if the number is equal on both sides then matter is referred to the Chairman. Then Chairman appoints one or more member of the Tribunal to hear the disputed case and the case is decided with the opinion of majority members including those who first heard.

## QUESTION # 22

What is the procedure to be followed for appealing before Commissioner Inland Revenue (Appeals)?

### ANSWER

#### **PROCEDURE OF APPEAL**

A dispute may be created between taxpayer and Income Tax authorities. If the taxpayer is not satisfied with the decision of Commissioner Inland Revenue (CIR) or other taxation officers he can make an appeal to Commissioner Inland Revenue (Appeals).

For making an appeal before Commissioner Inland Revenue (Appeals) following terms must be fulfilled.

#### **1. Prescribed form**

The application must be filled on a prescribed form.

#### **2. Time of appeal**

The appeal must be filed within 30 days of the receipt of order from Commissioner Inland Revenue or other taxation officer. However the Commissioner Inland Revenue (Appeals) can extend this period.

#### **3. Description of grounds of appeal**

An appeal shall state precisely the ground upon which the appeal is being made.

#### **4. Payment of tax liability**

Before making an appeal the person must pay the amount of tax liability admitted by him in his return of income.

#### **5. Payment of appeal fee**

It is necessary for taxpayer to pay appeal fee. There are different fees for different appeals.

##### **(a) Appeal against any Assessment**

Fee against assessment order is Rs. 1000

##### **(b) Appeal against other than Assessment**

Fee for companies Rs. 1000 and for other persons Rs. 200

#### **6. Attachment of Challan form**

Fee etc. is deposited in Bank through Challan form. Challan form shall be attached with application.

#### **7. Copy of order**

The copy of order issued by Commissioner Inland Revenue or other taxation officer shall be attached with application.

#### **8. Communication of appeal**

After fulfilling above conditions the taxpayer shall dispatch the application form to Commissioner Inland Revenue (Appeals). The CIR (Appeals) can make the decision in following way.

**9. Fixation of date**

The Commissioner Inland Revenue (Appeals) fixes a date for hearing the appeal.

**10. Intimation**

The CIR (Appeals) sends intimation to the taxpayer and Commissioner Inland Revenue.

**11. Demand for further information**

The Commissioner Inland Revenue (Appeals) can call for any particulars (information) and can ask the Commissioner Inland Revenue to make further inquiry.

**12. Decision of appeal**

Different decision can be made in different cases.

**(a) In case of an order of assessment**

1. Confirm the assessment
2. Decrease the assessment
3. Increase the assessment
4. Make a new assessment

**(b) In case of penalty orders**

1. Confirm the penalty
2. Cancel the penalty
3. Increase the penalty
4. Decrease the penalty

**(c) In other cases**

In other cases the CIR (Appeals) can make a decision as he think fit.

### QUESTION # 23

What is the procedure to be followed for appeal before Appellate Tribunal?

### ANSWER

#### **Appeals to the Appellate Tribunal**

If the taxpayer is not satisfied with the decision of Commissioner Inland Revenue (Appeals) he can make appeal to Appellate Tribunal. It is the second court of appeal. If the CIR is also not satisfied with the order of Commissioner Inland Revenue (Appeals) he can also make an appeal to Appellate Tribunal.

#### **FEATURES**

Following are the main features for filling an appeal to Appellate Tribunal.

##### **1. Right of Appeal**

The taxpayer and tax department both have a right to file the appeal with the appellate tribunal.

##### **2. Against decision of CIR (Appeals)**

This appeal is filed by the taxpayer or tax department against the decision of Commissioner Inland Revenue (Appeals).

##### **3. Period of Appeal**

The appeal should be made within 60 days from the communication of orders. The Appellate Tribunal can extend the time period of appeal. The Appellate Tribunal is authorized to extend the period if there is a genuine reason for delay.

##### **4. Prescribed Form**

The appeal should be filed on the prescribed form and the documents required should be attached.

##### **5. Fee limit**

If the taxpayer is filing the appeal, it should pay a fee of Rs. 2000. If the appeal is made by tax department then no fee will be paid.

##### **6. Fixation of date**

The Tribunal fixed the date for hearing the appeal. Intimation is send to both parties.

##### **7. Hearing of Appeal**

The Appellate Tribunal gives an opportunity of being heard to both parties of appeal either in person or through an authorized representative.

##### **8. Absence of one party**

In case any of the party does not appear before the Tribunal, the Appellate Tribunal may give decision in the favour of one side only on the basis of available record.

### **9. Decision of appeal**

The Appellate Tribunal may

1. Reject the appeal
2. Decrease the assessment
3. Increase the assessment
4. Decrease the penalty
5. Increase the penalty

### **10. Time for Decision of Appeal**

The appeal should be decided by the Appellate Tribunal within 6 months of its filing even if it is made by the tax department.

### **11. Final Decision**

The decision of the Appellate Tribunal on a **point of fact** is final. If any of the party is not satisfied with the decision involving a **point of law**, he may refer the case to the High Court.

### **12. Communication of Decision**

The Appellate Tribunal shall communicate its decision to the taxpayer and the Commissioner as soon as practicable.

### QUESTION # 24

Explain the procedure for filing an appeal before the High Court and Supreme Court.

#### ANSWER

##### **APPEAL TO HIGH COURT**

If either the taxpayer or the Commissioner Inland Revenue is not satisfied with the decision of the Appellate Tribunal, he may give application to High Court. The application can only be given to High Court if the decision involves a point of law.

##### **FEATURES**

Following are the main features of appeal to High Court

###### **1. Right of Appeal**

The taxpayer and income tax department both have a right to give appeal to High Court.

###### **2. Period of Appeal**

The appeal to High Court can be made within 90 days of the communication of orders of the Appellate Tribunal.

###### **3. Prescribed form**

The application should be made in the prescribed form and all necessary documents should be attached with the application.

###### **4. Fee**

If the application is given by taxpayer a fee of **Rs. 100** should be paid. No fee is required to be paid if the appeal is being made by the Commissioner Inland Revenue.

###### **5. Bench for hearing appeal**

A bench of at least two judges of the High Court heard the case. The High Court will decide the question of law raised by the reference.

###### **6. Communication**

The Court will send a copy of the judgment under the seal of the Court to the Appellate Tribunal.

If the reference has been filed before the High Court it will not affect the recovery of tax which will be payable in accordance with the assessment made as modified by the order of the Appellate Tribunal. However, if the recovery of the tax has been stayed by the High Court, by an order, such a recovery will not be made.

##### **APPEAL TO SUPREME COURT**

The taxpayer or tax department both has a right to make appeal before Supreme Court. But the appeal can only be made if High Court certify that the case is fit one for appeal to Supreme Court.

Normally High Court refers those cases to Supreme Court where it feels that such decision will benefit not only the two parties but also other persons involved in similar situations.

The decision of the Supreme Court is final in all cases.

### APPEAL FLOW CHART

<b>Appeal against the order of</b>	<b>Authority to whom appeal is made</b>
Commissioner Inland Revenue or other officers	Commissioner Inland Revenue (Appeals)
Commissioner Inland Revenue (Appeals)	Appellate Tribunal
Appellate Tribunal	High Court
High Court	Supreme Court

**Note:**

A common question may be asked instead of above 3 questions. In this case above three questions will be combined. The question may be.

Discuss the procedure for filing of appeals and references under the Income Tax Ordinance with fee and limitations.

### QUESTION # 25

Define and explain the following term with reference to Sales Tax Act 1990

#### **1. Input tax**

“Input tax” in relation to a registered person, means:

- (a) Tax levied on supply of goods to the person
- (b) Tax levied on the import of goods by the person
- (c) Federal Excise duty in sales tax mode on goods and services to the persons.
- (d) Provincial sales tax levied on services rendered or provided to the person.

#### **Explanation:**

It is the amount paid by the registered person on business purchases and imports. It is calculated by multiplying rate of tax with the value of purchases.

#### **2. Output Tax**

“Output Tax” in relation to a registered person, means:

- (a) Tax levied under this Act on a supply of goods, made by the person.
- (b) Federal Excise duty in sales tax mode on the manufacture or production of the goods, or the rendering or providing of the services by the person.
- (c) Provincial sales tax levied on services rendered or provided by the person.

#### **Explanation:**

It is the amount paid by the registered person on business sales. It is worked out by multiplying rate of tax with the value of supplies.

#### **3. Return**

“Return” means any return required to be furnished under Chapter-V of this Act, i.e.

- (i) Monthly Return
- (ii) Annual Return
- (iii) Special Return
- (iv) Final Return

#### **4. Tax Invoice**

It means a document required to be issued under section 23 of the Sales Tax Act, 1990.

#### **Explanation:**

Section 23 requires that every registered person while making a taxable supply is required to issue a serially numbered tax invoice at the time of supply of goods containing:

1. Serial Number
2. Name, address and registration number of the supplier.
3. Name, address and registration number of the recipient.
4. Date of issue of invoice.
5. Description and quantity of goods.
6. Value exclusive of tax.
7. Amount of sales tax.
8. Value inclusive of tax.

### **5. Registered Person**

“Registered person” means a person who is registered or is liable to be registered under Sales Tax Act.

Provided that a person liable to be registered but not registered under this Act shall not be entitled to any benefit available to a registered person under any of the provision of this Act or the rules made there under.

### **6. Exempt Supply**

Exempt supply means a supply which is exempt from tax under section 13 of The Sales Tax Act 1990.

#### **Explanation:**

It means a supply, which is exempted from the levy of the Sales Tax by the Federal Government. A complete list of such exempted supply has been provided in Sixth Schedule. The Federal Government is empowered under the above mentioned section to make any change in this list and the conditions mentioned for exemption. However, it is necessary that such changes should be notified in the official gazette.

### **7. Zero Rated Supply**

Zero rated supply means a taxable supply which is charged to tax at the rate of zero percent.

#### **Explanation:**

It is different from exempt supply in the sense that in case of exemption no sales tax is leviable whereas zero rated goods are chargeable to sales tax but at the rate of zero percent. In case of zero-rated supply the person making the supply is entitled to get refund for input tax paid on his business purchases, while a person making an exempted supply is not entitled to get refund of input.

### **8. Manufacture or Produce**

“Manufacture” or “Produce” includes

- (a) Any process in which an article singly or in combination with other articles, materials, components, is either converted, changed, transformed or reshaped that it becomes capable of being put to use differently.
- (b) Process of printing, publishing, lithography and engraving and
- (c) Process and operations of assembling, mixing, cutting, diluting, bottling, packaging, repacking or preparation of goods in any other manner.

### **9. Value of Supply**

For sales tax purposes, ‘value’ means the value on which amount of sales tax is calculated. In case of local supply, the value is the amount paid for the goods or services including all the federal and provincial taxes but excluding the amount of sales tax.

13. Zero Rating
14. Sales Tax Returns
15. Tax Invoice
16. Tax credit not allowed
17. De-registration

**10. Arrears:**

Means unpaid sales Tax including;

- additional tax
- default surcharge
- fine
- penalty
- fee
- or any other sum under the sales tax laws at any particular day.

**11. Defaulter**

Defaulter means a person who fails to pay the arrears. Person is a

- proprietor
- partner in case of a firm
- director in case of a company
- and also includes a guarantor or successor

**12. Distributor**

Distributor means a person appointed by a manufacturer, importer, or any other person for a specified area to purchase goods from him for further supply and includes a person who is also engaged in supply as a wholesaler or retailer.

**13. Due Date:**

In relation to the furnishing of a return, due date, means the 15th day of the month, following the, end of the tax period or such other date as the FBR may specify.

**14. Manufacturer or Producer:**

Means a person who engages in the manufacture or production of goods whether or not the raw materials are owned by him.

**15. Associated Persons or Associates**

Associates means;

- (i) Where the relationship between the two is such that one may reasonably be expected to act in accordance with the intention of the other, or both persons may reasonably be expected to act in accordance with the intentions of a third person.
- (ii) Two persons shall not be associates solely by reason of the fact that one person is an employee of the other or both persons are employees of a third person.
- (iii) The following shall be treated as associates, namely;
  - (a) "An individual and a relative of the individual.
  - (b) Members of an association of persons.
  - (c) A member of an association of persons and the association, where the member, either alone or together with an associate or associates, controls 50% or more of the rights to income or capital of the association;
  - (d) A trust and any person who benefits or may benefit under the trust.
  - (e) A shareholder in a company and the company, where the shareholder, either alone or together with an associate or associates, controls the
    - 1. 50% or more of the voting power
    - 2. 50% or more of the rights to dividends or
    - 3. 50% or more of the rights to capital

- (f) Two companies, where a person, either alone or together with his associates controls
  - 1. 50% or more of the voting power in both companies
  - 2. 50% or more of the rights to dividends in both companies or
  - 3. 50% or more of the rights to capital in both companies
- (iv) Two persons shall not be associates where the CIR is satisfied that neither person may reasonably be expected to act in accordance with the intentions of the other.

### **16. Wholesaler**

“Wholesaler” includes a dealer and means any person who carries on, whether regularly or otherwise, the business of buying and selling goods by wholesale or of supplying or distributing goods, directly or indirectly, by wholesale for cash or deferred payment or for commission or other valuable consideration or stores such goods belonging to others as an agent for the purpose of sale and includes a person supplying taxable goods to a person who deducts income tax at source under the income tax Ordinance 2001

**QUESTION # 26**

What are the requirements relating to registration of a person under the Sales Tax Act 1990? Also explain the procedure for de-registration of a registered person.

**OR**

Briefly explain the following with reference to Sales Tax Act 1990.

- (a) Procedure of registration
- (b) De-registration
- (c) Black listing and suspension of registration

**ANSWER**

**REGISTRATION**

Registration means the registration of a person under The Sales Tax Act 1990.

It is necessary for every person to get registration to which the FBR issue a notice in Official Gazette. Rules regarding the registration of a person change time to time.

**PERSONS REQUIRED TO BE REGISTERED**

The following persons engaged in making of taxable supplies in Pakistan (including zero rated supplies) are required to be registered under the Sales Tax Act, 1990.

Person	Condition
Manufacture	Turnover exceed Rs. 5000,000
Retailer	Turnover exceed Rs. 5000,000
Importer	Should be registered compulsory (no limit)
Wholesaler, Dealer and Distributor	Should be registered compulsory (no limit)
Commercial exporter	Who intends to obtain Sales Tax refund against his zero rated supplies

**TYPES OF REGISTRATION**

Following are different types of registration.

**1. Through Application**

Where a person is required to be registered under the Sales Tax Act 1990 submit application for registration, is called registration through application.

**2. Voluntary Registration**

Where a person, who is not liable for registration but he gives application for registration to get various benefits, is called voluntary registration.

**3. Compulsory Registration**

If a person, who is required to be registered under Sales Tax Act 1990, does not apply for registration shall be registered compulsory.

## **PROCEDURE OF REGISTRATION**

### **1. Application for Registration**

Application for registration is made in the prescribed form. This form is available at the sales tax offices as well as on the FBR website.

### **2. Who submit an application for registration?**

Application shall be filed by owner, member or director of any entity whose business is liable to be registered.

### **3. How to fill in the form**

Guidelines to fill in Form are available at the back of the Form.

### **4. Documents required**

No documents are required to be attached with application.

### **5. Time for application**

The application shall be submitted before making taxable supplies.

### **6. Mode of filing application**

The application form, duly filled in shall be submitted through registered mail, courier service or electronically to the Central Registration Office (CRO).

### **7. Registration and issuance of registration number**

After complete satisfaction about applicant, the CRO shall register the applicant and shall issue sales tax registration number and certificate.

## **PROCEDURE FOR COMPULSORY REGISTRATION**

If a person, who is required to be registered under the Sales Tax Act does not apply for registration with the sales tax department, the department shall register that person compulsorily, and it will be called compulsory registration.

### **1. Issuance of notice**

After appropriate inquiry, if the Local Registration Office is satisfied that such person is required to be registered shall issue a notice on a prescribed form. The notice shall contain time and manner to make a reply.

### **2. In case of compliance of notice**

If the person to whom the notice is issued make a reply of the notice then the Local Registration Office (LRO) will give an opportunity on the request of the person for personal hearing and after that it will be decided weather the person is liable to compulsory registration or not. A copy of the said order shall be provided to the said person.

### **3. In case of non-compliance of notice**

Where the person to whom the notice for compulsory registration is issued, does not make a reply within the time specified in the notice, the Local Registration Office will send the particulars (detail) of the person to the Central Registration Office, which shall compulsory register the said person and allot him a registration number.

#### **4. Effect of compulsory registration**

Where a person is compulsory registered, he is bound to comply (obey) with all the provisions of the Sales Tax Act. In case of his failure to fulfill the requirements of the Act, the Local Registration Office may take any legal action against such person.

#### **5. Cancellation of compulsory registration**

Where subsequently it is established that the person compulsory registered was wrongly registered due to error the Central Registration Office on the recommendation of the Local Registration Office shall cancel the registration of such person, and such person shall not be liable to pay any tax or penalty under the Sales Tax Act.

### **PROCEDURE FOR DE-REGISTRATION**

There are following two ways to get de-registered:

#### **1- De-registration on taxpayer's application**

Every registered taxpayer shall apply to the Local Registration Officer for cancellation of his registration if his business comes to an end, supplies become exempt, taxable turnover comes down the registration limit such as 5,000,000 rupees for retailer.

#### **Steps for De-registration**

1. The application for de-registration shall be made in prescribed form by the registered person to the LRO.
2. An officer of sales tax shall examine and audit the records and ascertain the position of the case.
3. Where the LRO is satisfied then he will issue an order to pay any outstanding liability of tax.
4. The LRO may recommend to the CRO to cancel the registration of that person.

#### **2- De-registration by department**

If a registered person fails to file tax return for six consecutive months, the LRO can issue a notice to that person and after giving an opportunity of being heard may recommend the CRO for cancellation of the registration.

### **BLACKLISTING AND SUSPENSION OF REGISTRATION**

1. Where a Commissioner come to know that a registered person committed tax fraud or issued false invoices he can suspend the registration.
2. After that the Commissioner will made an inquiry and will give an opportunity to person for explanation. If after inquiry he is satisfied that the person has committed fraud he can blacklist such person.
3. The inquiry shall be completed within 90 days.
4. The order of blacklisting or suspending will be issued to person and CRO.

### **IMPACT OF SUSPENSION OR BLACKLISTING**

1. During period of suspension if any refund claim is made it will not be accepted.
2. During period of blacklisting any refund claim which is made before and after will not be entertained.

### QUESTION # 27

Explain the procedure given in The Sales Tax Act 1990 for different types of filing of returns.

### ANSWER

#### **RETURN**

It means any return required to be furnished under the Sales Tax Act 1990.

Under chapter V, the Sales Tax Department may require the filing of following returns.

- (i) Monthly return u/s 26
- (ii) Special return u/s 27
- (iii) Final return u/s 28
- (iv) Return deemed to have been made u/s 29

#### **MONTHLY RETURN (Section 26)**

A return, which is furnished by every registered person within the due date (15<sup>th</sup> day of the next month) for the purchases and supplies made during a tax period (one month), is called monthly return.

##### **1. Who furnishes return?**

Every registered person shall furnish a sales tax return.

##### **2. Document to furnish return**

Return is furnished in the form prescribed by the FBR.

##### **3. Office for furnishing return**

Return is filed with a designated bank or any other office specified by the FBR.

##### **4. Return, where tax rate is changed**

If there is a change in the rate of tax during a tax period, a separate return in respect of each portion of tax period showing the application of different rates of tax shall be furnished.

##### **5. Sales tax return is compulsory return**

Every registered person, irrespective of the fact whether he has made any taxable supply during a tax period or not, shall be liable to furnish the sales tax return for every tax period.

#### **SPECIAL RETURN (Section 27)**

A return filed by a registered person for period and date notified by the FBR for a particular purpose is called special return.

##### **1. Who furnish special return?**

The Commissioner may require any person whether, registered or not, to furnish a return.

##### **2. When special return is furnished?**

Special return is furnished within such period and within such date as may be notified by the FBR.

##### **3. In which documents special return is furnished?**

Special return is furnished in the form prescribed by the FBR.

#### **4. Contents of special return**

The special return shall indicate the following information.

- (i) Quantity manufactured
- (ii) Purchases
- (iii) Goods supplied
- (iv) Payment of arrears made
- (v) Any other information required by the Board

#### **FINAL RETURN (Section 28)**

A registered person may apply for de-registration, if the supplies made by such person are declared exempt from sales tax by the Federal Government. Before the De-registration the return filed by him is considered as final return.

#### **1. Who furnish a final return?**

A person who applies for de-registration in terms of section 21.

#### **2. Who requires final return?**

The Commissioner may require a person applying for de-registration to furnish a final return.

#### **3. In which document final return if filed?**

A final return is filed in the form prescribed by the FBR

#### **4. When final return is filed?**

The Commissioner specifies the time within which the final return is to be filed.

#### **5. In which office final return is furnished?**

The final return is filed with a bank or any other office specified by the FBR.

#### **RETURN DEEMED TO HAVE BEEN MADE (Section 29)**

A person who is required to furnish a return under any provision of the sales tax act 1990 may file the return himself or through his authorized representative. A return furnished by an authorized representative of a registered person is deemed to have been made by such person.

#### **IMPACT OF NON-FILING OF RETURN OR FILING OF AN INCORRECT RETURN**

Where a person who is required to file a tax return and pay the tax, due to any reason fails to do so, he shall be liable to pay the **penalty or default surcharge** under the section 33 & 34 of the Sales Tax Act 1990. The following provisions relate to such penalty or default surcharge.

##### **1- Failure in furnishing a return within the due date**

Such person shall pay a penalty of Rs. 5000. However, if a person files a return within 15 days of the due date, he shall pay a penalty of Rs. 100 for each day of default.

##### **2- Submission of false statement**

Such person shall pay a penalty of Rs. 25,000 or 100% of the amount of tax involved, whichever is higher. Further, such person is liable to imprisonment up to 5 years or a fine up to an amount equal to the loss of tax involved or both.

**3. Repetition of erroneous calculation in the return during a year whereby amount of tax has been short paid**

Such person shall pay a penalty of Rs. 5000 or 3% of the amount of the tax involved, whichever is higher.

**4. Any person who fails to furnish the information required by the FBR**

Such person shall pay a penalty of Rs. 10,000.

