Government of Pakistan
Federal Board of Revenue
(Revenue Division)
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No.C.4(1)ITP/2008-EC Islamabad, the August 27, 2008

To : All Director Generals, Large Taxpayer Units.
All Director Generals, Regional Tax Offices.

Subject: **CORRIGENDUM TO THE CIRCULAR NO.5 OF 2008 DATED JULY 5, 2008.**

In paragraph 17.2 of the Circular No.05 of 2008 dated July 5, 2008, the words "Nil or" shall be deleted.

2. It is also clarified that in the wake of amendment made in sub-section (5) of section 152 of the Income Tax Ordinance, 2001 vide Finance Act, 2008, the taxpayer is not required to give notice to the Commissioner in respect of 'payments liable to reduce rate under the relevant agreement for avoidance of double taxation'. This amendment does not absolve the taxpayers from the disclosure of such payments in the quarterly/annual statement of deduction of tax u/s 152 of the Ordinance as prescribed under rule 58 of the Income Tax Rules 2002. All payments made to a non-resident person; whether exempt or liable to reduce rate of tax are required to be recorded in the aforesaid statement to be filed by the payer.

(Ali Husnain)
Secretary (IT Policy)
Ph : 9205561

Government of Pakistan
Federal Board of Revenue
(Revenue Division)
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Circular No. **05** of 2008
INCOME TAX.

No.C.4(1)ITP/2008-EC Islamabad, the July 5, 2008

Subject: **EXPLANATORY CIRCULAR ON THE AMENDMENTS MADE IN THE INCOME TAX ORDINANCE, 2001 THROUGH FINANCE ACT, 2008.**

The changes brought about in the Income Tax Ordinance, 2001 read with Income Tax Rules, 2002 through Finance Act, 2008 are explained as under:-

1. **BRANCH REMITTANCE TAX ON TRANSFER OF PROFITS ABROAD. [Section 2(19)(f)].**

A non-resident can form a Pakistani company for operation in Pakistan or conduct business activity through its branch in Pakistan. After tax profits, in the case of a foreign controlled resident company are distributed through payment of dividend which attracts 10% income tax whereas, such profits in the case of a branch of a non-resident company are remitted outside Pakistan without payment of any tax. This had created disparity of taxation between the said two situations.

1.1 After tax profits so transferred by a branch of a foreign company out of Pakistan has been treated as dividend income, under sub-clause (f) of clause (19) of section 2 of the Income Tax Ordinance, 2001 (hereinafter to be referred as "Ordinance") and chargeable to tax @ 10% of gross amount, vide the Finance Act, 2008. It will be in line with the international best practices prevalent in European Countries, USA, and Canada. It will also check outflow of foreign exchange and provide level playing field to non-residents operating by incorporating a Pakistani company or through branch of a foreign company.

2. **TAXATION OF PROPERTY INCOME ON PROGRESSIVE RATES [Section 15 & 155].**

Gross rental income from property was chargeable to tax at a fixed rate of 5%, which, on the one hand had created hardship for small tax payers and on the other hand higher income bracket was taxed at a very low rate.

2.1 To remove this distortion and ensure universally accepted principle of progressive taxation of income, it has been subjected to progressive rates of tax

i.e. 5%, 10% and 15%. No tax would, however, be deducted/paid on rent upto Rs.150,000/- per annum, in the case of individuals and AOPs having no other source of income.

2.2 Rental income, in the case of Individuals/Association of persons would be chargeable to tax under section 15 read with Division VI of Part I of the First Schedule and subjected to WHT under section 155 read with Division V, Part III of the First Schedule, as follows:-

S.No.	Gross amount of Rent	Rate of Tax
(1)	Where the gross amount of rent does not exceed Rs.150,000	Nil;
(2)	Where the gross amount of rent exceeds Rs.150,000 but does not exceed Rs.400,000	5 per cent of the gross amount exceeding Rs.150,000
(3)	Where the gross amount of rent exceeds Rs.400,000 but does not exceed Rs.1,000,000	Rs.12,500 plus 10 per cent of the gross amount exceeding Rs.400,000
(4)	Where the gross amount of rent exceeds Rs.1,000,000	Rs.72,500 plus 15 per cent of the gross amount exceeding Rs.1,000,000

2.3 In case of company, the rental income would be chargeable to tax and liable to WHT (Section 15 read with Division VI of Part I and section 155 read with Division V of Part III of First Schedule – respectively) as per following Table:-

S.No.	Gross amount of Rent	Rate of Tax
(1)	Where the gross amount of rent does not exceed Rs.400,000	5 per cent of the gross amount of rent.
(2)	Where the gross amount of rent exceeds Rs.400,000 but does not exceed Rs.1,000,000	Rs.20,000 plus 10 per cent of the gross amount of rent exceeding Rs.400,000.

(3)	Where the gross amount of rent exceeds Rs.1,000,000	Rs.80,000 plus 15 per cent of the gross amount of rent exceeding Rs.1,000,000.";

3. **ENHANCEMENT OF SALARY LIMIT TO BE PAID IN CASH BY THE TAXPAYERS. [Section 21(m)].**

Before amendment of clause (m) of section 21, vide Finance Act, 2008, any salary paid or payable exceeding Rs.10,000 per month, if not paid through crossed cheque or direct transfer to the employee's bank account, was an inadmissible deduction against business income of the employer. Earlier this limit was enhanced from Rs.5000 in the year 2004. Considering inflationary trend in the economy, this limit has been further enhanced to Rs.15,000 per month.

4. **FIRST YEAR ALLOWANCE FOR INDUSTRIES IN SPECIFIED AREAS. [Section 23A].**

Special incentive schemes i.e. tax holiday had been introduced in the past, to encourage industrial development with reference to rural areas, under-developed areas, industrial zones or for social reasons of promoting economic activity and generating employment opportunities. It also helped to some extent in spreading of industries across the country.

4.1 To encourage industrial investment in rural and under developed areas, instead of tax holiday, First Year Allowance @ 90% of the value of industrial assets has been allowed under section 23A to the industrial undertakings established in specified areas to be notified by the Federal Government.

5. **SUBSTITUTION OF THE TERM "LOCAL AUTHORITY" WITH THE TERM "LOCAL GOVERNMENT" IN THE INCOME TAX ORDINANCE, 2001.**

Section 49 of the Ordinance, exempt income of Federal Government, Provincial Government and Local Authority from income tax. The term "Local Authority" was not defined in the Ordinance, due to which some organizations like National Highway Authority, Port Qasim Authority etc. tried to stretch the definition given in the General Clauses Act to avail exemption. The intention of the legislature was to provide exemption to a Municipal Committee, District and Tehsil Government etc. alongwith Federal Government, Provincial Government.

5.1 In order to bring clarity and avoid misinterpretation of the provision, the relevant provisions of the Ordinance have been amended, substituting the term "Local Authority" by the term "Local Government" so that, exemption is applicable as intended by the legislature. This would be in line with Article 165A of the Constitution as already stated in sub-section (4) of section 49.

6. **WITHDRAWAL OF EXEMPTIONS AVAILABLE UNDER OTHER STATUTES. [Section 54].**

Exemption from tax available through other statutes of the Government was withdrawn by virtue of overriding provision of section 54 of the Ordinance. Such exemptions included pension of a former President of Pakistan and his widow under President's Pension Act 1954, State Bank of Pakistan Act 1956, State Bank of Pakistan Banking Services Ordinance, 2001, RDFC, Pakistan Broadcasting Corporation, Small Business Finance Corporation, Federal Bank for Cooperative, ADBP, Pakistan Telecommunication Authority, National Telecommunication Corporation, Pakistan Telecommunication Employees Trust, PTCL, International Financial Corporation (IFC), etc. However, a proviso to section 54 was inserted through Finance Act 2003 to protect such exemptions provided under other statutes and not incorporated in Second Schedule to the Income Tax Ordinance, 2001. The said protection apart from discriminatory had a revenue cost impacting tax to GDP ratio. The FBR has been reviewing exemptions under the Ordinance and 35 exemptions have been withdrawn through Finance Act, 2008. It was also not possible to know exact number of exemptions allowed under other statutes and review their retention.

6.2 The proviso to section 54 has, therefore, been omitted to do away with all such exemptions so as to improve tax to GDP ratio, improve taxation and enforce the overriding provisions of section 54. However, exemption to the pension of a former President of Pakistan and his widow under President's Pension Act 1974, State Bank of Pakistan Act, 1956 and State Bank of Pakistan Banking Services Ordinance, 2001 have been specifically provided vide sub-clauses (xix) and (xx) of clause (66) of Part I of the Second Schedule to the Ordinance, respectively.

7. **SET-OFF OF BUSINESS LOSS CONSEQUENT TO AMALGAMATION OF BANKING COMPANIES, NON BANKING FINANCE COMPANIES, INSURANCE COMPANIES AND MODARABAS. [Section 57A].**

Under section 57A, assessed loss (excluding capital loss) for the "tax year", other than brought forward and capital loss, can be set-off in the case of amalgamation of two companies for a period upto six years, succeeding the year of amalgamation. However, un-absorbed depreciation is allowable as per the provisions of sub-section (4) and (5) of section 57.

7.2 To encourage amalgamation of Banking Companies, NBFCs, Modarabas and Insurance Companies, the facility of carry forward of "accumulated loss" under the head "income from business" (not being speculation business losses) for a period of six years succeeding the tax year in which the loss was first computed in the case of amalgamated company or amalgamating company or companies has been allowed. It will facilitate the amalgamation of one or more such companies and modarabas as was available from the tax year, 2002,

through the Finance Act, 2002. However, this facility will be available again to NBFC, insurance and modarabas from tax year 2008, and for Banking companies from tax year 2007 and onwards.

8. **RATIONALIZATION OF TAX RATE ON INCOME OF COOPERATIVE SOCIETIES. [Section 80(2)].**

A Cooperative Society is defined under section 80(2) of the Ordinance as "company". However, a separate rate of tax was provided in the paragraph (ii) of Division II of Part I of the First Schedule to the Ordinance, whereby income of a finance society, a cooperative society or any other society was chargeable to tax at the rates applicable to a company or an individual whichever was beneficial to the taxpayer.

8.2 The said paragraph (ii) of the aforesaid Division/Part of the said Schedule has been omitted. Now the cooperative society or any other society covered by the definition of a "company" shall be taxed at the same rate as is applicable to a company.

9. **APPLICATION OF THIN CAPITALIZATION RULE TO BRANCH OPERATION OF NON-RESIDENT COMPANIES. [Section 106].**

Profit on foreign debt payable by a foreign controlled resident company in excess of three to one foreign debt equity ratio is not an admissible expense under section 106 of the Ordinance. However, there was no such restriction on branches of foreign companies not incorporated under Companies Ordinance, 1984. To provide level playing field to all operations of foreign companies "Thin Capitalization" rule has been made applicable to the branches of foreign companies operating in Pakistan.

10. **WITHDRAWAL OF MINIMUM TAX PAYABLE ON DECLARED TURNOVER. [Section 113].**

A resident company was not required to pay income tax due to loss or exemption from tax (under the Second Schedule) or as per other provisions of the Ordinance but where tax payable was less than 0.5% of the declared turnover, it had to pay minimum tax @ 0.5% of its declared turnover. Where tax so paid exceeded the actual tax payable for a year, the excess amount of tax paid was allowed to be carried forward for adjustment against tax liability upto succeeding five tax years. Loss incurring companies at times would pay minimum tax out of equity. This tax has, therefore, been abolished.

11. **INTRODUCTION OF INVESTMENT TAX. [Section 120A].**

In order to encourage and promote investment in business and industry, a time bound scheme of investment tax has been introduced allowing any past and

present investment made in the business, industry, moveable or immovable assets to be declared in accordance with the scheme and tax paid @ 2% on the fair market value of investment as declared under the scheme. The declarant shall not be liable to any pecuniary or penal action, in respect of such income/assets, under the Ordinance.

11.1 New taxpayers availing the scheme would be required to file returns of income for the tax year 2008, at least for three subsequent tax years. However, they would neither be asked to file return of income for the last five years nor sources of acquisition of assets during the said period of five years as declared under the scheme would be questioned. This scheme would prove to be instrumental in substantially improving the tax base. The scheme has been released by the Board vide Circular No.03 of 2008 dated July 1, 2008.

12. **PROVIDING LIMITATION ON COMMISSIONER (APPEALS) TO MAKE ORDER IN CASES SET-ASIDE BY ITAT. [Section 124(2)].**

No limitation for making a fresh order by Commissioner (Appeals) was provided in sub-section (2) of section 124 where an order has been set-aside by the Income Tax Appellate Tribunal for re-adjudication by CIT (A). Such cases were generally not decided by the Commissioner (Appeals) promptly, causing unnecessary hardship to the appellant taxpayers.

12.2 Limitation period as provided in sub-section (2) of section 124 of the Ordinance for making order consequent to directions of the Tribunal, would now be applicable to CIT (A) as well for making order remitted back to him by ITAT. This amendment would mitigate the grievance of the taxpayers.

13. **DUE DATE FOR PAYMENT OF TAX. [Section 137(2)].**

Before the amendment of sub-section (2) of section 137, a taxpayer was required to pay the amount of tax due to him within 30 days from the date of service of demand notice. In order to secure early recovery of tax due from taxpayers, the period of 30 days has been curtailed to 15 days.

14. **SCHEME FOR WAIVER OF ADDITIONAL TAX, PENALTY ETC. ON PAYMENT OF PRINCIPAL AMOUNT OF TAX IN ARREARS. [Section 146].**

At present, tax arrears of Rs.20.25 billion are outstanding. Similarly tax withheld by the withholding agent at times is not deposited due to fear of additional tax and levy of penalty. In order to effect speedy recovery of such tax arrears an opportunity has been provided to the defaulter taxpayers and withholding agents to settle the arrears under Tax Arrears Settlement Incentive Scheme (TASIS) 2008. Under this scheme, if the taxpayer pays the principal outstanding tax liability, surcharge, additional tax or penalty levied or leviable on such amount would be waived off and a certificate of settlement of arrears shall

be issued to the taxpayer. The TASIS has been issued vide Circular No.04 of 2008 dated July 1, 2008.

15. <u>RATIONALIZATION OF WITHHOLDING TAX RATES ON IMPORTS [Section 148].</u>

Under the erstwhile provisions of section 148, withholding tax rate was 5% on imports. Tax so deducted was final tax in respect of commercial importers. However, withholding tax @ 1% on raw material and capital goods imported for own use, collected from manufacturers was adjustable, subject to the provisions of the Ordinance. The direct and indirect exporters covered under the DTRE scheme and manufacturer exporters could import goods without payment of withholding tax. There were consistent complaints of misuse of exemption certificate and low withholding tax rate for manufacturers who reportedly sell the imported goods in open market instead of their own use putting the commercial importers in a disadvantageous position.

15.2 The withholding tax regime has been reviewed as a whole and a uniform rate of 2% withholding tax has been provided for commercial as well as manufacturer importers, being final tax in the case of former and adjustable in the case of latter. It will not only curb the tendency of misuse of this facility by the manufacturer resulting in the loss of revenue but would also provide a level playing field to all the stakeholders.

15.3 For the convenience of the importers, relevant provisions of Part II, III and IV of the Second Schedule to the Ordinance are explained hereunder to state the changes brought about in the WHT regime for imports:-

15.3.1 Under clause (9) of Part II of the Second Schedule, tax under section 148 was payable @ 1% on the import of fibers, yarn and fabric, but, "pure cotton or its yarn or its fabrics" were exempt from this levy. To give equal treatment to various items in textile sector, tax at a uniform reduced rate of 1% shall also be collected on the aforesaid items i.e. pure cotton or its yarn or its fabrics, at import stage.

15.3.2 Under clause (13) of Part II of the Second Schedule, tax under section 148 was payable @ 1% on the import of capital goods and raw material imported exclusively for own use by a manufacturer registered with Sales Tax Department. The aforesaid clause has been omitted. Now the importer of capital goods and raw material even if imported for own use by a manufacturer shall be liable to WHT @ 2%.

15.3.3 Under clause (13A) of Part II of the Second Schedule, providing reduced rate of 1% on the import of phosphatic fertilizer has been omitted to collect WHT @ 2% at import stage.

15.3.4 Clause (13B) of Part II of the Second Schedule providing 2% levy on import of certain items has been omitted because it had become redundant as general rate on import has been fixed at 2% instead of 5%.

15.3.5 Under clause (13G) of Part II of the Second Schedule, tax payable @ 1% on the import of the items mentioned at sub-clauses (i) to (xxiv). The sub-clauses (i) to (iii) and (viii) to (xxiv) have been omitted. Tax @ 2% shall be collected on the items, falling under the aforesaid clauses (i) to (iii) and (viii) to (xxiv) instead of reduced rate. However, gold, mobile telephone sets and silver imported under sub-clauses (iv) to (vi) respectively shall continue to pay tax @ 1% of the import value.

15.3.6 Clause (13H) of Part II of the Second Schedule has been omitted because reduction in general rate on import from 5% to 2% has rendered this clause redundant.

15.3.7 Clause (56) of Part IV of the Second Schedule has been substituted. The provisions of section 148, regarding withholding tax on imports shall not apply to the following items:-

(i) the goods classified under Pakistan Customs Tariff falling under Chapters 27, 86 and 99.

(ii) goods imported by direct and indirect exporters which are covered under sub-chapter 7 of Chapter XII of Pakistan Customs Laws read with SRO.450(I)/2001 dated June 18, 2001.

(iii) goods temporarily imported into Pakistan for subsequent exportation are exempt from income tax which are exempt from customs duty and sales tax under SRO.1065 (I)/2005 dated October 20, 2005.

16. WITHHOLDING TAX ON INSURANCE AND REINSURANCE PREMIUM PAID TO OVERSEAS COMPANIES. [Section 152(1AA)].

Reinsurance premium paid to overseas companies was Rs.10.157 billion in the year 2007. Premium of life and goods insurance from Pakistan is being remitted to overseas insurance companies operating from abroad but this part of their Pakistan source income is not subjected to tax. Commission paid to non insurance companies is, however, subjected to withholding tax.

16.2 After this amendment, insurance and reinsurance premium paid to overseas insurance companies would now be subjected to 5% withholding tax at the time of remittance by invoking provision of sub-section (1AA) of section 152

of the Ordinance. The Fourth Schedule and section 169 of the Ordinance have accordingly been amended, to make this charge a final tax.

17. **WITHHOLDING TAX ON PAYMENTS TO NON-RESIDENTS COVERED BY AVOIDANCE OF DOUBLE TAXATION TREATY. [Section 152(5)].**

Before the amendment of sub-section (5) of section 152 of the Ordinance, any person making payment to a non-resident person without deduction of tax, was required to give, complete particulars of the non-resident as well as nature and amount of the payment, to the Commissioner, for allowing him to make payments without deduction of the tax. Such exercise, however was, futile where Avoidance of Double Taxation Agreements provide exemption or a reduced rate of tax for a particular payment.

17.2 The said provisions have been amended. Now these would not be applicable where payments are subjected to "nil" or "reduced tax rate" as per the provisions in the Avoidance of Double Taxation Treaty. This measure would reduce the unnecessary hassle of the taxpayers of getting exemption certificate for remittance of such amounts with deduction of tax or deduction as per the provision of the treaty.

18. **FURNISHING OF IMPORT DOCUMENTS AT THE TIME OF REMITTING AMOUNT FOR IMPORTS - [Section 152(7)].**

Under sub-section (7) of section 152, an import of goods where title to the goods passes outside Pakistan was not required to be backed by any import document etc. Through this amendment, it has been made mandatory, to provide import documents to the banker for remitting the amount exclusively against imports. The other conditions would remain unchanged.

19. **INCLUSION OF INDIVIDUAL AND AOPs IN THE PRESUMPTIVE TAX REGIME (PTR). [Section 153(6A) & (6B)].**

Tax deducted at source on account of supply of goods was adjustable in the case of companies engaged in manufacturing activity whereas such deduction was final discharge, if the supplies were made by an individual, AOP or companies supplying goods not manufactured by them. Prior to Finance Act 2007, this deduction was adjustable without any exception. Sub section (6B) to section 153 inserted through Finance Act 2007 restricting the adjustability of withholding tax to all manufacturer companies has created confusion with regard to intent of the provision of law.

19.2 In order to remove the confusion, sub-section (6B) has been omitted and sub-section (6A) has suitably been amended to clearly stating that tax withheld on supply of goods would be adjustable against final tax liability in the case of a

company engaged in manufacturing and final tax in the case of other company, an individual or association of persons.

20. **TAXATION OF "SMALL COMPANY". [Section 153(9)(b) read with section 2(59A)].**

Prior to June 30, 2008, under the provisions of, clause (b) of sub-section (9) of section 153, of the Ordinance, a small company was not required to deduct tax on payments made on sale of goods, services rendered and execution of contracts. The said clause has been amended to make a "Small Company" also liable to withhold tax under the Ordinance like all other corporate taxpayers and AOPs.

20.2 "Small Company" as defined in sub-section (59A) of section 2 of the Ordinance, is one that has paid up capital not exceeding Rs.25 million, employees not exceeding 250 and annual turnover not exceeding Rs.250 million. Income of a Small Company is chargeable to tax @ 20% against general rate of 35% applicable to other companies. Where the turnover exceeds the prescribed limit of Rs.250 million the company looses its status of "Small Company" and all its income becomes taxable at normal rate of 35%.

20.3 In order to facilitate growth of a "small company" if the turnover exceeds Rs.250 million, the income attributable to turnover exceeding the said limit shall be charged to tax at progressive slab rates i.e. 25%, 30% and 35%, so that the company is able to progress, still retaining its incentivised status of a "Small Company". The new rates are as under:

i)	Taxable income attributable to turnover upto Rs.250 million.	20% plus tax on
ii)	Taxable income attributable to turnover exceeding Rs.250 million but does not exceed Rs.350 million	25% plus tax on
iii)	Taxable income attributable to turnover exceeding Rs.350 million but does not exceed Rs.500 million plus.	30% plus tax on
iv)	Taxable income attributable to turnover exceeding Rs.500.	35%

21. **ASSOCIATION OF PERSONS (AOPs) TO DEDUCT TAX AS WITHHOLDING TAX AGENTS. [Section 153(9)].**

Before amendment only AOPs constituted by or under the law were required to deduct tax at source under section 153(9)(c) relating to payments in respect of supplies, services rendered and execution of contracts. The number of such AOPs were very limited, and other AOPs including those formed as a result of de-corporatization of the existing companies which were handling huge

businesses and engaged in different commercial activities like running industries, private hospitals, educational institutions and doing business on whole sale basis were not required to act as withholding agent. This anomaly was causing revenue loss besides discouraging corporatization and documentation of economy.

21.2 In view of this, AOPs having turnover exceeding Rs.50 million in tax year 2007 and onwards have been included in the definition of "Prescribed Person", under sub-section (9) of section 153, who would be required to deduct tax at the time of making payments on account of sales, services rendered and execution of contracts, as the case may be.

22. DEFINITION OF "MANUFACTURER" FOR THE PURPOSE OF WITHHOLDING TAX UNDER SECTION 153.

Tax deducted from payments received on account of supply of goods is adjustable in the case of a company being a manufacturer, whereas in the case AOP and individual taxpayers, it is final tax. The term "Manufacturer" has not been defined in the Ordinance due to which the application of the said provisions become difficult as there was always difference of opinion on the status of a person being a manufacturer or otherwise.

22.2 For clarity in the law, and to avoid un-necessary litigation, the term "Manufacturer" has been defined in section 153 of the Ordinance. This would help taxpayers as well as tax department in clear application of the provisions of sub-section (6A) of section 153 of the Ordinance.

23. WITHHOLDING TAX ON ADVERTISING THROUGH ELECTRONIC MEDIA. [Section 153(A)].

There was serious discrimination regarding taxation of advertisement receipts between media companies relaying from Pakistan and outside Pakistan. Payments made to media companies outside Pakistan are invariably restricted for taxation due to treaty protection or monitoring mechanism. To provide level playing field to the media companies and to enforce withholding tax @ 10% on all advertising payments made from Pakistan, the amendment in the law has been made and a new section (153A) inserted, to collect tax on such payment so that tax collected be treated as final tax as provided in section 169 of the Ordinance.

24. RATIONALIZATION OF TAX RATES ON EXPORTS – [Section 154].

To encourage exports, a reduced tax rate regime was provided under section 154 read with clauses (14) and (15) of Part II of the 2nd Schedule to the Ordinance, whereby export of branded rice, canned fish, precious and semi-precious stone etc. was subjected to reduced rate of 0.75% against normal rate of 1%. The discrimination in tax rates had not only been objected to by different

export houses but such treatment was also considered as unfair. To remove this distortion and provide level playing field to the entire export sector, the clauses (14) and (15) of Part II of the 2nd Schedule have been omitted, by virtue of which withholding tax on all exports under section 154 would be subjected to tax @ 1%. However, it would remain as final tax for such exports as before.

25. **EMPOWERING FBR TO ALLOW EXEMPTION FROM WITHHOLDING TAXES. [Section 159(3)].**

In order to allow speedy relief in suitable cases, necessary amendments have been made in sub-section (3) of section 159 of the Ordinance, empowering FBR to exempt persons, class of persons, goods or class of goods or payments etc. from the application of any provisions of the Ordinance relating to withholding taxes. The main objective of this amendment is to allow relief in hardship cases at Board's level.

26. **INSTALLATION OF ELECTRONIC TAX REGISTER AT SELECTED SALES OUTLETS. [Section 174(5)].**

To ensure correct recording of sales, the Commissioner, under sub-section (5) of section 174 of the Ordinance may require any person to install Electronic Tax Registers (ETR) at selected sale outlets with known high volume business houses as decided by him. This technology is being used in a number of countries like Italy, Greece, Poland, Ukraine, Bulgaria, Finland, Malta, Serbia, Lithuania, Hungary, Turkey, Brazil etc. Income Tax Rules, 2002 have accordingly been amended to enforce the provisions of section 174.

27. **TAXPAYER'S REGISTRATION**

Part IX section 181 has been substituted to provide procedure for registration of the taxpayers as against the procedure for issuance of National Tax Number Certificate provided in the original section. The substituted section 181, also requires the existing taxpayers holding NTNC as well as the new taxpayers for registration on the prescribed form and in the prescribed manner. The purpose of this registration is to use the data so provided for issuance of a Common Tax Identifier in future which will be used for all the federal taxes i.e. Income Tax, Customs duty and Sales Tax. This step has been taken to facilitate the taxpayers. The existing National Tax Number Certificate will be used till the registration certificate is issued under the new scheme, which is being issue under Income Tax Rules.

28. **CONSEQUENTIAL RELIEF IN THE AMOUNT OF PENALTY IMPOSED FOR CONCEALMENT OF INCOME. (Section 184).**

Under section 184 of the Ordinance, the income tax authorities are empowered to impose penalty upon a person equal to the amount of tax which

the person sought to evade by concealment of income. In some cases the appellate authorities reduce the quantum of concealed income resulting into reduction of tax on such income. However, no provision for consequential relief in the quantum of penalty was available in the Ordinance. So, a new sub-section (5) has been inserted to allow consequential, proportionate reduction in amount of penalty to taxpayers as a result of appellate decision, if required.

29. **ENHANCEMENT OF WITHHOLDING TAX ON CASH WITHDRAWAL FROM BANKS. [Section 231A read with Division VI of Part IV of the First Schedule].**

Withholding tax on cash withdrawal @ rate of 0.1% was introduced through Finance Act, 2005 which was adjustable against final tax. Subsequently, the rate of deduction was enhanced to 0.2% in the year 2006. This was also adjustable advance tax. In fact this tax was imposed to encourage documentation of economy and broadening the tax base. It was also an attempt to encourage payment of tax in advance for adjustment against final tax. The rate of withholding tax on cash withdrawal from banks has been enhanced to 0.3%, which would remain adjustable as before.

30. **TREATMENT OF WITHHOLDING TAX IN RESPECT OF MEMBERS OF REGISTERED STOCK EXCHANGES – (Section 233A).**

Tax collected under clauses (a) and (b) of sub-section (1) of section 233A, by the Registered Stock Exchanges from the Members @ 0.1% on purchase value and @ 0.1% on the sale value of shares, in lieu of commission income of the Member was final tax. Under clause (c), sub-section (1) of section 233A, tax @ 0.1% is also collected on the traded value of shares for adjustment against income of the Member from trading of shares. However, taxes collected under all the three categories did not invariably match with the commission and business income of these taxpayers.

30.2 Sub-section (2) of section 233A, has, therefore, been amended to make all the three categories falling under clauses (a), (b) and (c) of the aforesaid section as minimum tax against commission income and business income respectively. Now they will have to file annual return of income accordingly.

31. **RATIONALIZATION OF WITHHOLDING TAX COLLECTED AT THE TIME OF RENEWAL OF REGISTRATION OF PRIVATE MOTOR CARS AND REGISTRATION OF NEW CAR/JEEP– (Sections 234 and 231B).**

As per the then provisions of section 234, withholding tax ranging from Rs.500 to Rs.3000 was collected, from private motor cars at the time of renewal of registration on the basis of engine capacity. These rates were originally introduced in 1992. Due to inflation, prices of cars have substantially increased but there was no corresponding increase in the tax rates. The withholding tax

rates, fixed on the basis of engine capacity have, therefore, been revised upward. However, the tax so collected shall remain adjustable as before against final tax liability of owner of the cars.

31.2 WHT to be paid under section 234 at the time of annual renewal of registration of motor cars or jeeps is as under:-

Engine Capacity		Amount of Tax
(a)	upto 1000cc	750
(b)	1001cc to 1199cc	1250
(c)	1200 to 1299cc	1750
(d)	1300cc to 1599cc	3000
(e)	1600cc to 1999cc	4000
(f)	2000cc and above	8000

31.3 Previously, every manufacturer or authorized dealer of Motor cars was required under section 231B to collect advance tax @ 2.5% of the value of the vehicle. The manufacturer used to collect such tax at the time of booking of a car whereas delivery of the vehicle was normally made after a period of 3 to 6 months. In order to facilitate the taxpayers (buyers of vehicles) now such tax shall be paid by the owner at the time of registration of car or jeep by the Motor Vehicle Registration Authority.

31.4 Advance tax to be paid under section 231B at the time of registration of a new motor car or jeep by the owner would be as under:-

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

31.5 The provisions of section 231B, shall, however, not be applicable in the case of –

(i) the Federal Government or the Provincial Governments; and
(ii) a foreign diplomat or a diplomatic mission in Pakistan.

32. WITHHOLDING TAX THROUGH ELECTRICITY BILLS. [Section 235(4)].

Retailers and whole sellers constitute 19.2% of GDP but contribution of this sector towards income tax is not more than 2% which, obviously, means

under taxation. Withholding tax on electricity bills of commercial and industrial consumers was collected every month at the rates ranging from Rs.60 to Rs.2000 depending upon the amount of bill. The average rate of withholding tax collected on electricity bills upto to Rs.4500 was about 14% of the bill amount whereas this percentage on the higher amount of bills' upto Rs.20,000 per month was about 9%.

32.2 The provisions of sub-section (4) of section 235 of the Ordinance have been amended whereby withholding tax on bill amount upto Rs.20,000 per month would be collected as per the existing treatment, whereas, for the bill amount exceeding Rs.20,000 p.m. withholding tax would be collected @ 10% in respect of all commercial and industrial consumers. The tax so collected would be adjustable against final tax liability.

32.3 However, no tax on electricity bills would be collected from the following five sectors falling under zero rating regime of Sales Tax of exporters-cum-manufacturers as per provisions of clause (66) of Part IV of the 2nd Schedule to the Ordinance:

(i) carpets;
(ii) leather and articles thereof including artificial leather footwear;
(iii) surgical goods;
(iv) sports goods; and
(v) textile and articles thereof.

33. **APPLICATION OF A UNIFORM RATE OF WITHHOLDING TAX ON LAND LINE TELEPHONE BILLS – (Section 236).**

Withholding tax under section 236 read with Division V, Part IV, of the First Schedule was collected on monthly telephone bills exceeding Rs.1000 at different rates, the maximum rate of collection was Rs.300 per month.

33.2 By virtue of the amendment made in Division V of Part IV of the First Schedule to the Ordinance, all telephone subscribers have been subjected to a uniform rate of withholding tax @ 10% on the bills exceeding Rs.1000 per month. The tax so collected is adjustable against final tax as before.

34. **WITHDRAWAL FROM EXEMPTION REGIME.**

The Second Schedule to the Ordinance, provides exemptions to different categories of taxpayers. Scrutiny of the Second Schedule revealed that some of the exemptions were unjustified while others had become redundant due to expiry of limitation. In some cases the purpose of exemption had been achieved or such exemptions had very limited application. The following clauses of the Second Schedule have, therefore, been omitted:

Part-I:

Clauses (2), (6), (21), paragraph (x) of sub-clause (3) of clause (57), (62), (63A), (63B), sub-clause (iii) of clause (72), (77), (82), (83), (132A), (133A), and (138).

Part-II:

Clauses (6), (9A), (10), (13), (13A), (13B), sub-clauses (i) to (iii) and (vii) to (xxiv) of clause (13G), (13H), (14), (15) and (16).

Part-III:

Clause (3).

Part-IV:

Clauses (3A), (11), (33), (36), (41A), (42A) and (58).

35. **EXEMPTION OF WITHHOLDING TAX ON SUPPLY OF PETROLEUM PRODUCTS BY P.E. OF NON-RESIDENT E&P COMPANIES.- [Clause (46) of Part-IV of the Second Schedule]**

Last year, clause (43A) of the second schedule was amended to provide exemption from withholding tax on supply of petroleum products by Permanent Establishment (PE) of Non-resident Petroleum, Exploration and Production Companies. However, due to drafting deficiency, the amendment was prone to misinterpretation. By amending clause (46) of Part-IV of the Second Schedule, exemption from deduction of tax under section 153 on payments relating to supplies made by PE of non-resident E&P companies has been provided.

36. **CAPPING OF MAXIMUM TAX RATE AT 10% FOR PROFIT ON PENSIONER'S BENEFIT SCHEME AND BEHBOOD FUND.**

Under clause (36A) of Part IV of the 2nd Schedule to the Ordinance, no tax is deducted from profit paid on investment in Pensioner's Benefit Scheme and Behbood Fund. However, the income earned therefrom is chargeable to tax at normal rates which may go upto 20% of the profit. Profit on debt on investment schemes of CDNS as well as bank deposits is subject to withholding tax @ 10% as final tax. This anomalous position for pensioners and senior citizens could not be the intention of the legislature, which existed, due to ambiguity in the law. In order to provide relief to pensioners and senior citizens, a new clause (5) has been inserted in Part III of the 2nd Schedule to the Ordinance, by virtue of which profit earned under both the schemes would be taxed at normal rates as a separate block of income but maximum tax rate, in any case, shall not exceed 10% of the profit.

37. **EXEMPTION OF DISTRIBUTION OF "CAPTIAL GAINS" BY MUTUAL FUNDS ETC. – [Clause (103)].**

Any income received by a taxpayer out of "capital gains" of National Investment (Unit) Trust or a collective investment scheme authorized or registered under the NBFC (Establishment and Regulation) Rules, 2003 or a

private equity and venture capital fund, was exempt subject to the condition that tax has been paid on the said gains. Exemption from tax on "Capital Gains", available under clause (110) has been extended upto tax year ending on June 30, 2010. In view of this extension, the condition of payment of tax under clause (103) has also been waived off and now, distribution of income relating to capital gains by the said entities would be exempt under clause (103) even if no tax is paid thereon.

38. **EXEMPTION OF INTER-CORPORATE DIVIDEND TO COMPANIES ELIGIBLE FOR GROUP RELIEF – [Clause (103A)].**

Inter Corporate dividend was exempted through Finance Act, 2007 where subsidiary companies are 100% owned by the Holding Company under a group covered by the provisions of section 59AA of the Ordinance. Clause (103A) of the Second Schedule has been amended to exempt inter-corporate dividend received by a company from another company in the group eligible for group relief under section 59B of the Ordinance. The ownership in a subsidiary – holding relationship should be 55% or more holding where one of the group companies is a company listed on a registered stock exchange and 75% or more holding where none of the company in the group is a listed company. The percentage ownership in both the cases has to be direct holding in the group.

39. **EXCLUSION OF UNREALIZED GAINS OF NON-LIFE INSURANCE COMPANIES FOR COMPUTATION OF INCOME – [Rule 5(b) of Fourth Schedule].**

The computation of the taxable income of insurance business is made under the provisions of Fourth Schedule to the Ordinance. Rule 5 of the said Schedule, explains the computation of profit and gains in respect of non-life insurance companies. Under Rule 5(b) unrealized gains hitherto had to be accounted for in the accounting income and chargeable to tax accordingly which was not justified. Due to this provision, the non-life insurance companies were unable to adopt the International Accounting Standard (IAS) 39 because it would hypothetically increase the taxable income of such companies.

39.2 Rule 5(b) has been amended to exclude unrealized gains on investment disclosed under IAS 39 for computation of income chargeable to tax under the Ordinance.

40. **WITHHOLDING TAX ON WITHDRAWALS FROM SUPERANNUATION FUNDS – [Rule 5 of Sixth Schedule].**

Under the erstwhile provisions of Rule 5 of Part II of the Sixth Schedule to the Income Tax Ordinance, 2001, any payment made, out of contribution to the Superannuation Fund by the employer, to an employee during his life time, was liable to WHT at average rate of the preceeding three tax years. Since tax rates

have been considerably reduced, so the Rule 5, of Part II of the Sixth Schedule has been amended to make the trustee required to withhold tax on such payments at the rate applicable to the year of withdrawal.

41. **DEDUCTIONS AGAINST TAXABLE INCOME OF BANKING COMPANIES ON ACCOUNT OF PROVISION FOR BAD DEBTS.**

The Seventh Schedule for computation of income of banking companies, inserted through Finance Act, 2007, applicable from tax year 2009, as provided in section 100A, allows deduction on account of provision for "doubtful" and "loss" categories of Non-Performing Loans (NPL) in accordance with Prudential Regulations issued by the State Bank of Pakistan. Under the provisions of SBP's Circular No.7 dated October 12, 2007, banks are required to make provisions for NPL without considering the Forced Sale Value (FSV) of the securities pledged against loans. The banks, therefore, may claim unprecedented amounts as deductions against taxable income still having lien to recover the NPL through disposal of the collateral involved and assets pledged. Such extraordinary claim was not expected at the time of insertion of the Seventh Schedule, which would fundamentally effect the accounting profit of the banking company in negative term.

41.2 The existing rules of the Seventh Schedule have, therefore, been amended to provide that provisions for classified advances and off balance sheet items shall be allowed only as per provisions of sections 29 and 29A of the Ordinance and sub-rules (d), (e) and (f) of the Seventh Schedule stand omitted.

(Ali Husnain)
Secretary (Income Tax Policy)

[Majid Yusuf]