

Basic Concepts of Income Tax

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Objective

- ▶ The objective of this presentation is to:
 - ▶ Develop an understanding of some fundamental principles of taxation;
 - ▶ Give an overview of the structure of the Income Tax Ordinance, 2001;
 - ▶ Identify the tax authorities and their jurisdiction

Contents

- ▶ **Some basic concepts**
 - ▶ Power to tax
 - ▶ Territorial jurisdiction of the tax laws
 - ▶ Special provisions of law to prevail over the general provisions
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 - ▶ Non income versus exempt income versus income taxable at 0%
 - ▶ Classes of income versus Heads of Income

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- ▶ Expenditure – general meaning
- ▶ Schemes of taxation
- ▶ Persons liable to tax
- ▶ Tax year
- ▶ **Overview of structure of Income Tax Ordinance, 2001**
- ▶ **Tax Authorities and Jurisdiction**

SOME BASIC CONCEPTS



Power to Tax

- ▶ Entry No. 47 and 48 of the Federal Legislature List as contained in Part I of the Fourth Schedule to the Constitution of Pakistan, 1973, empowers the Federal Government to impose tax on income and corporations respectively
- ▶ Entry No. 49 of the said List also empowers the Federal Government to levy taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed in Pakistan

Territorial Jurisdiction of Tax Laws

- ▶ The tax laws extends to whole of Pakistan. The territories of Pakistan under the Constitution means:
 - ▶ the four provinces viz Balochistan, KPK, Sindh, and Punjab;
 - ▶ the federal capital;
 - ▶ the Federally Administered Tribal Areas; and
 - ▶ such states or territories as are or may be included in the territories of Pakistan, by accession or otherwise

Territorial Jurisdiction of Tax Laws (Contd.)

- ▶ However, any Federal law, including tax laws, do not automatically apply to FATA and Provincially Administered Tribal Areas (PATA) unless the President or the Governor with the approval of the President, respectively, direct that a particular legislature is in force to the respective Federally or Provincially administered tribal area
- ▶ The income tax law of Pakistan does not apply to Azad Jumma & Kashmir, and Gilgit-Baltistan

Special Provisions of Law to Prevail Over General Provisions

- ▶ Where a law provides for a specific treatment in respect of a particular category of, say, income, person, or class of persons, the same would prevail over the general provisions of the law

Ordinance to Override Other Laws on Income Tax Matters

- ▶ Per section 3 read with section 54, the Income Tax Ordinance, 2001 has supremacy over all other laws in relation to tax matters

Income- General Meaning

- ▶ All receipts by a person do not necessarily constitute 'income'
- ▶ Generally income is the money received for work done or investment
- ▶ Generally, capital receipts are not taxable unless they are specifically provided in the tax law to be taxable
- ▶ Conversely, revenue receipts are generally almost always taxable (being income) unless they are explicitly provided as not to be taxable

Income- General Meaning (Contd.)

- ▶ Capital receipts generally arise out of Capital assets, e.g. disposal of a personal house, disposal of personal belongings, receipts without consideration, etc.
- ▶ Certain capital receipts deemed as “income” for tax purposes include:
 - ▶ Golden handshake payments on termination of services
 - ▶ Gain on disposal of capital assets, including jewellery, painting, immovable property including personal house, etc.

Income- General Meaning (Contd.)

- ▶ Certain revenue receipts which should otherwise be taxed but not taxed include:
 - ▶ Agricultural income
 - ▶ Income of diplomats and foreign government officials
 - ▶ Income of institutions like State Bank of Pakistan, Indus hospital, Shaukat Khanum hospital etc.

Income under the Ordinance

- ▶ As per Section 2(29) of the Ordinance, income has the following scope:
 - ▶ income as understood in normal parlance
 - ▶ any amount chargeable to tax under the Ordinance
 - ▶ any amount subject to collection or deduction of tax under the Ordinance as a final discharge of tax liability
 - ▶ any amount “treated” as income under the Ordinance
 - ▶ loss of income is also income

'Non income' Vs 'Exempt Income' Vs 'Income Taxable at 0%'

- ▶ As discussed above, certain incomes may not be income and therefore are not taxable
- ▶ Other category of receipt may be income but provided to be exempt from tax, as in the case of Second Schedule to the Ordinance
- ▶ There may be some other receipts which are taxable at 0%

Classes of Income Vs Heads of Income

- ▶ There are different classes of income, including:
 - ▶ salary (arising out of employment)
 - ▶ income from property (being rental income from immovable property)
 - ▶ royalty (on account of use of or right to use intellectual property)
 - ▶ profit on debt / interest (on funds lend to others)
 - ▶ dividend (from shares held by the investor)

Classes of Income Vs Heads of Income (Contd.)

- ▶ There are only five heads of income in which each of such class of income is to be classified. These heads are :
 - ▶ Salary
 - ▶ Income from Property
 - ▶ Income from Business
 - ▶ Capital gains
 - ▶ Income from Other Source

Classes of Income Vs Heads of Income (Contd.)

- ▶ Categorization of a particular class of income into a particular head of income is dependent on the person who is deriving such income and therefore may differ from one person to another

Expenditure- General Meaning

- ▶ The term 'expenditure' means 'spending' or 'paying out or away', i.e., something that goes out of the coffers of the taxpayer. It means something which is gone irretrievably [B.K. Khanna & Co. (P.) Ltd. v. CIT [2000] 113 Taxman 164 (Delhi)]
- ▶ Expenditure, not being capital or personal expenditure, is an allowable deduction to the taxpayer in the tax year
- ▶ Capital expenditure, in the form of depreciable assets and intangibles, is allowed in the form of depreciation and amortization

Schemes of Taxation

- ▶ Broadly, there are two schemes of taxation:
 - ▶ **Final Tax Regime** – whereby tax is levied on the gross amount, without allowability of any expense
 - ▶ **Normal Tax Regime** – whereby bottom line income, after allowing for all admissible deductions, are taxed at applicable rates

Persons Liable to Tax

- ▶ The Ordinance tends to tax the income derived by a person
- ▶ Following are the main categories of persons
 - ▶ Federal government
 - ▶ Foreign government
 - ▶ Political sub division of a foreign government
 - ▶ International organization

Persons Liable to Tax (Contd.)

- ▶ Individuals
- ▶ Association of Persons
- ▶ Companies

Tax Year

- ▶ Income derived by a person in a tax year is taxable
- ▶ Normal tax year is from 01 July to 30 June
- ▶ Adopting any other 12 months period may be allowed which is called as the special tax year
- ▶ The Government has prescribed special tax year for certain persons, including:
 - ▶ Insurance companies
 - ▶ Companies manufacturing sugar

Tax Year (Contd.)

- ▶ Companies manufacturing jute goods
- ▶ All persons manufacturing rice
- ▶ Interim period between the normal tax year and the special tax year is called the transitional tax year

OVERVIEW OF STRUCTURE OF INCOME TAX ORDINANCE, 2001



Basic Concepts of Income Tax

Structure of Income Tax Ordinance, 2001

- ▶ The Income Tax Ordinance, 2001 (the “Ordinance”) comprises of 241 Sections and Eight Schedules
- ▶ The Ordinance is supported by Income Tax Rules, 2002
- ▶ Broadly these sections could be categorized to two categories, viz; Charging provisions, and Administrative provisions
- ▶ Charging sections generally lay the principle as to how the income is to be computed and taxed. Mainly these provisions are captured from section 4 to 113C of the Ordinance.

Structure of Income Tax Ordinance, 2001 (Contd.)

- ▶ Primarily these sections represent:
 - ▶ Charge of Tax (sections 4 – 8)
 - ▶ Tax on Taxable Income (sections 9 – 65E)
 - ▶ Common Rules income (sections 66 – 79)
 - ▶ Provisions Governing Persons (sections 80 – 98C)
 - ▶ Special Industries (sections 99 – 100C)
 - ▶ International (sections 101 – 107)
 - ▶ Anti-Avoidance (sections 108 – 112)
 - ▶ Minimum Tax (sections 113, 113C)

Structure of Income Tax Ordinance, 2001 (Contd.)

- ▶ Administrative sections generally deal with the modus operandi of the charging provisions of the law. These provisions include:
 - ▶ Procedure (sections 114 – 206A)
 - ▶ Administration (sections 207 – 231)
 - ▶ Transitional Advance Tax Provisions (sections 231A – 236X)
 - ▶ Miscellaneous (sections 237 – 241)

TAX AUTHORITIES AND JURISDICTION



Basic Concepts of Income Tax

Tax Authorities and Jurisdictions

- ▶ FBR is the apex revenue collection/administration authority in the country
- ▶ FBR is currently headed by Chairman & Secretary Revenue Division; Tariq Mahmood Pasha
- ▶ The Chairman is supported by 4 subdivisions, viz:
 - ▶ Operational Members
 - ▶ Support Members
 - ▶ Functional Members
 - ▶ Director Generals

Tax Authorities and Jurisdictions (Contd.)

- ▶ Member Inland Revenue (IR) Operations is supported by various Chief Commissioners, who look after different tax jurisdictions. Each Chief Commissioner is supported by different Commissioners of Zones assigned to them.
- ▶ Zones are normally identified based on the Jurisdiction/Area, Name, and Industry type.
- ▶ Each Commissioner is supported by a number of Additional Commissioners IR, who operate over a range in a Zone.

Tax Authorities and Jurisdictions (Contd.)

- ▶ Additional Commissioners are supported by Deputy Commissioners who operate over a Unit / Circle in that particular range of a Zone.
- ▶ Commissioner Appeals is the first level of Appeal that can generally be approached by the taxpayer, within specified time, on an action/order against which he is dissatisfied.
- ▶ Appellate Tribunal is the second level of Appeals that can be approached either by the taxpayer or by the Commissioner, within a specified time.

Tax Authorities and Jurisdictions (Contd.)

- ▶ Appellate Tribunal is the last fact finding authority.
- ▶ High Court is the third level of appeal. Only point of laws can be referred to the High Court.
- ▶ Supreme Court is the final authority on point of law.
- ▶ Alternative Dispute Resolution Committee are also constituted wherein a taxpayer can refer a disputed matter.
- ▶ Federal Tax Ombudsmen can also be approached on any disputed matters beyond the ambit of the jurisdiction of the Income Tax Ordinance, 2001.

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