Key definitions, Residential status, Charge of tax, Source of income, Taxation regimes and Maintenance of Tax Records

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Objective

- Today's session has been planned with the objective to discuss and develop some of the fundamental principles of taxation as applicable under the Income Tax Laws in Pakistan.

Contents

RESIDENTIAL STATUS

Resident and Non-Resident person (S:81)

- A resident person for a tax year is:
  - A resident individual
  - A resident company
  - A resident Association of persons
  - The Federal Government
- A person shall be a non-resident person for a tax year if the person is not a resident person for that year.

Resident individual (S:82) (Cont'd…)

- Residential status of an individual is based on number of days he is physically present in Pakistan during a tax year. Therefore, a foreigner can also be a resident person and a Pakistani national may become non resident for tax purposes.

- An individual shall be a resident individual if he is present in Pakistan for an aggregate period of one hundred and eighty three days (183 days) or more in a tax year.

- An individual who is an employee or official of the Federal Government or a Provincial Government posted abroad in a tax year is always considered as resident irrespective of his physical stay in Pakistan.

Resident individual (S:82)

- To work out number of days, Rule 14 provides that part of a day that an individual is present in Pakistan counts as a whole day including-

  - A day of arrival / departure in / from Pakistan
  - A public holiday
  - A day of leave (including sick leave)
  - A holiday spent in Pakistan before, during or after any activity in Pakistan
  - A day that the individual's activities in Pakistan are interrupted due to strike, lock-out etc.

- However, a day in Pakistan solely by reason of being in transit will not be counted.

Resident company (S:83)

- A company shall be a resident company, if:

  - It is incorporated in Pakistan
  - It is a Provincial Government or a Local Government

- A company shall also be a resident company, if the control and management of the affairs of the company is situated wholly in Pakistan at any time in the year, even if it is not incorporated in Pakistan.

Resident Association of persons (S:84)

- An association of persons shall be resident in Pakistan if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year.

SOURCES OF INCOME AND CHARGE OF TAX

Income – General meaning

- All receipts by a person does not necessarily constitute 'Income'.
- Generally, income connotes a periodical monetary return, 'coming in' with certain regularity from a definite source.
- Revenue receipts are almost always taxable (being income) unless they are explicitly provided as not to be taxable.

Income [S:2(29)]

- "Income" includes:
  - Any amount chargeable to tax under the Ordinance
  - Any amount subject to collection / deduction of tax under various sections of the Ordinance (e.g.148, 150, 153, 154, 233 etc.)
  - Any amount treated as income under any provisions of the Ordinance
  - Any loss of income

Total income (S:10)

- The total income of a person for a tax year shall be the sum of:

  - Person’s income under following heads of income:
    - Salary; (Sec. 12)
    - Income from Property; (Sec. 15)
    - Income from Business; (Sec. 18)
    - Capital Gains; (Sec 37 and Sec 37A)
    - Income from other sources; (Sec. 39)

  - Person‘s income exempt from tax under any of the provisions of this Ordinance.

Taxable income (S:9)

- Taxable income of a person for a tax year shall be the total income of the person for the year, excluding exempt income, reduced by the total of any deductible allowances allowed under the Ordinance for the year.

- However, the total income cannot be reduced below zero by reason of any deductible allowances.

- For resident persons, Pakistan source as well as foreign source income is chargeable to tax.

- For non-resident persons, only Pakistan source income is taxable.

Deductible allowance

- A deductible allowance represent an amount that directly reduces the total income to arrive at the taxable income for the year.

- Following deductible allowances are available in a tax year, to an individual-

  - Zakat paid by the person
  - Any amount paid to Worker's Welfare Fund by the person
  - Any amount paid to Worker's Participation Fund by the person
  - Profit or share in rent and share in appreciation for value of house in a tax year on a loan utilized for the construction of a new house or the acquisition of a house
  - Tuition fee paid provided that the taxable income of the individual is less than one million rupees
  - Charitable donation paid to institutions prescribed under Clause 61, Part I of the Second Schedule to the Ordinance

Tax [S:2(63)]

- The term “tax” means any tax imposed under the Ordinance.

- This includes:
  - Any penalty
  - Any fee
  - Any other charge; or
  - Any sum or amount

leviable / payable under the Ordinance

Tax credits

- "Tax credits" represent amounts that reduces the tax liability for the year.

- Following tax credits are available under the Ordinance-
  - Tax credit on charitable donations.
  - Tax credit for investment in shares and insurance.
  - Tax credit for investment in health insurance.
  - Tax credit for contribution to an approved pension fund.
  - Tax credit for employment generation by manufacturers.
  - Tax credit for investment.
  - Tax credit for enlistment
  - Tax credit for newly established industrial undertakings
  - Tax credit for existing industrial undertakings

Salary income (S:12)

- Salary means any amount received by an employee from any employment (whether of revenue or capital nature) and also includes the following –

  - All allowances received by an employee in relation to his employment.
  - All perquisites (benefits in kind) provided to an employee in relation to his employment (taxable at fair market value (FMV).
  - Tax borne by the employer being a perquisite.
  - Income from Stocks Option plans.

- Salary is chargeable to tax on receipt basis.

- Salary below Rs.400,000 per annum is not taxable for the tax years 2017 and 2018.

Income from property (S:15) (Cont'd…)

- Income from property comprises of:

  - Rent received or receivable by a person for a tax year (other than rent exempt from tax).
  - Any amount received which is not adjustable against the monthly rent – Taxable in 10 yearly installments.

- Income from property is chargeable to tax at the rates prescribed in Division VIA, Part I of the First Schedule after allowing certain deductions as provided in section 15A.

Income from property (S:15)

- "Rent" means any amount:
  - received or receivable
  - by the owner of land or a building
  - as consideration for the use or occupation of, or the right to use or occupy, the land or building.
- Rent also includes any forfeited deposit paid under a contract for the sale of land or a building.

Income from business (S:18) (Cont’d…)

- “Income from Business” includes:
  - the profits and gains of any business carried on by a person
  - any income derived by any trade, professional or similar association from the sale of goods or provision of services to its members
  - any income from the hire or lease of tangible movable property
  - the fair market value of any benefit or perquisite derived by a person by virtue of, a past, present, or prospective business relationship
  - any management fee derived by a management company
  - any profit on debt derived by a person where the person‘s business is to derive such income

Income from business (S:18)

- Deduction in respect of any expenditure incurred by the person in the year, wholly and exclusively for the purpose of business, is allowed.

- Special provisions have also been laid down for specified deductions / allowances which inter alia include:
  - Depreciation on fixed assets
  - Amortization of intangibles
  - Amortization of pre-commencement expenditure
  - Bad debts expense
  - Profit on debt, financial costs and lease payments.

- Certain expenditure may not be allowed as a deduction unless specified conditions are met. These are commonly known as “inadmissible deductions”.

Capital gains (S:37 and 37A) (Cont'd…)

- **Section 37**: Gain derived from disposal of a "capital asset" is chargeable to tax under the head 'Capital Gains'.

- Where disposal is made after holding the capital asset for more than one year, 25% of such gain is not chargeable to tax.

- The term 'capital asset' includes property of every kind, whether or not connected with a business, excluding specified items such as stock-in-trade, consumable stores / raw material, any immovable property held for personal use etc.

Capital gains (S:37 and 37A)

- **Section 37(1A)**: Gain arising on disposal of immovable property is chargeable to tax under the head "Capital gains" at the rates prescribed in the Division VIII, Part I of the First Schedule.

- **Section 37A:** Capital gain arising from disposal of securities [as specified in section (37A)] is chargeable to tax at the rates prescribed in Division VII, Part I of the First Schedule.

Income from other sources (S:39)

- Any income received by a person in a tax year not specifically included in any other head of income (excluding exempt income) is chargeable to tax under the head ‘Income from Other Sources’.

- Income from other sources include –
  - Dividend income
  - Profit on debt
  - Royalty
  - Ground rent
  - Rent from sub-lease of land or a building

- In computing the income from other sources, deductions as specified in section 40 are allowed for any expenditure incurred in deriving such income.

SCHEME OF TAXATION

Schemes of taxation

- The Income Tax Ordinance, 2001 (“Ordinance”) provides for two distinct schemes of taxation i.e.
  - Normal Tax Regime (NTR); and
  - Final Tax Regime (FTR)

Normal Tax Regime - NTR

- Under the Normal Tax Regime, tax is imposed on the “taxable income” under various heads of income of a taxpayer by applying the rates as prescribed in the First Schedule.

- The computation of income and tax under NTR is governed by the provisions of sections 9, 10 and 11 of the Ordinance.

- For each head of income, certain deductions are allowable while computing income under the respective head. Moreover, against the tax liability under NTR, certain specified tax credits including credit of the amount of tax deducted from the taxpayer is available.

Final Tax Regime – FTR (Cont'd…)

- Under section 4(5) of the Ordinance, amounts subject to tax under FTR are not to be included in the computation of "taxable income".

- Sections 8 and 169 of the Ordinance, being the governing sections prescribe the following distinct features of income governed under FTR:

  - Income falling under FTR shall not be chargeable to tax under any head of income;
  - No deduction is allowable for any expenditure incurred in deriving the income falling under FTR i.e. income is taxable on gross basis
  - The income shall not be reduced by any deductible allowance or any set off of losses
  - The tax payable on the gross income shall not be reduced by any tax credits

Final Tax Regime - FTR

- Examples of income that are subject to FTR include but not limited to the following:

  - Dividend income earned by a shareholder
  - Export of goods and receipt of indenting commission
  - Royalty and Fee for Technical Services of a non-resident person.
  - Commercial imports made by an importer
  - Prizes and winnings
  - Sale of goods by a trader not being a public company listed on a registered stock exchange in Pakistan
  - Brokerage and commission

MAINTENANCE OF TAX RECORDS

Records (S:174) (Cont'd…)

- All prescribed accounts, documents and records (i.e. records) are required to be maintained in Pakistan by every taxpayer.

- The records required to be maintained by a taxpayer shall be kept at:

  - the place where the taxpayer is carrying on the business; or
  - at the principal place of business (where the business is carried on in more than one places); or
  - at each separate place of business, if separate books of accounts are maintained.

- The records are to be maintained by a company in accordance with the International Accounting Standards and as required under the Companies Ordinance, 1984.

Records (S:174) (Cont'd…)

- The records are required to be maintained for six (06) years after the end of the tax year to which they relate.

- In case any proceedings are pending before any authority or court, the records are required to be maintained till the final decision of the proceedings.

- The records required to be maintained by a taxpayer may be kept on electronic media, provided sufficient steps have been taken to ensure the sanctity and safe keeping of such accounts, documents and records.

Records (S:174) (Cont'd…)

- Every taxpayer deriving "Income from Business" shall maintain proper books of account, documents and records with respect to:
  - All sums of money received and expended and related matters thereto.
  - All sales and purchases of goods and all services
  - All assets and liabilities
  - In case of a taxpayer engaged in assembly, production processing, manufacturing, mining or like activities, all items of cost relating to the utilization of materials, labour and other inputs.

Records (S:174)

- Taxpayers deriving income from salary shall maintain salary certificate indicating the amount of salary and tax deducted therefrom.

- Taxpayers deriving income from property shall maintain, tenancy agreement, receipt for amount of rent received and evidence of deductions claimed in respect of rental income.

- Taxpayers deriving income from capital gains shall maintain, evidence of cost of acquiring the capital asset, and evidence for consideration received on disposal of capital asset.

- Taxpayers deriving income from other sources shall maintain relevant records of income received under this head (e.g. dividend, profit on debt etc.)

THANK YOU