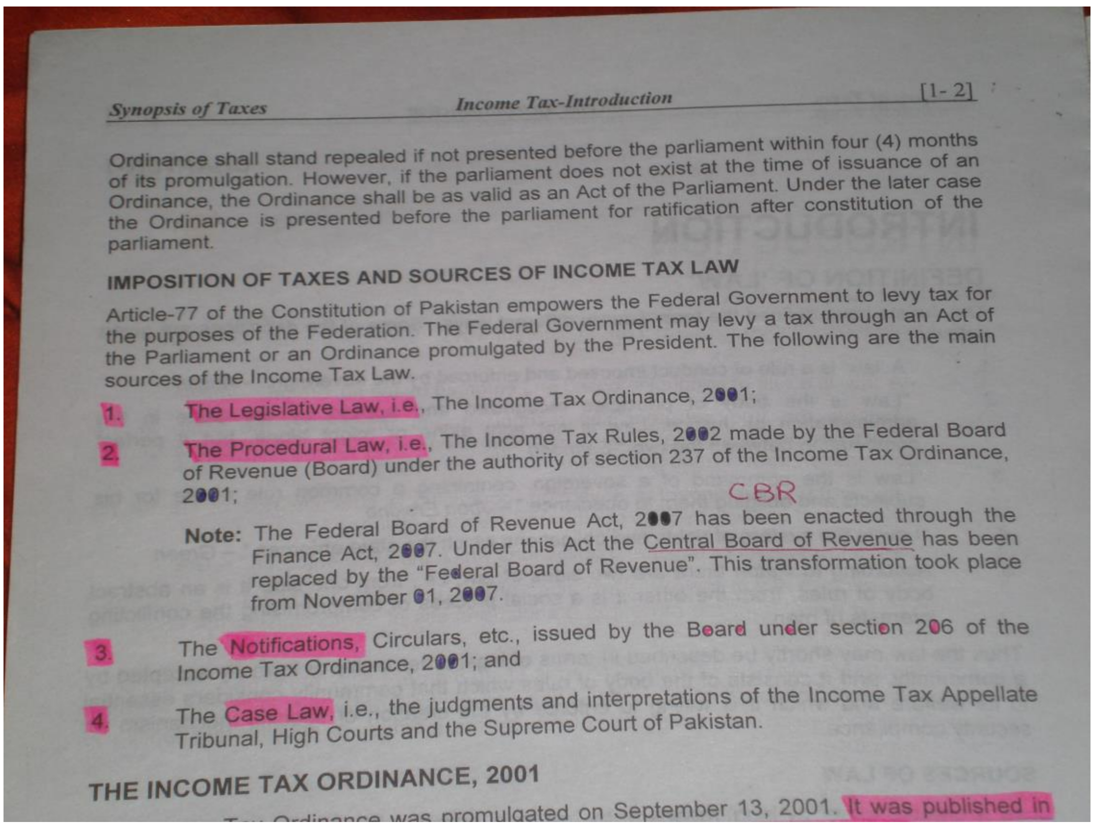
FIN723 Taxation Management

Current Mid Papers Spring 2016

Reference book: - CAF6-PrinciplesofTaxation_2015-ST page # 226

Web link: - http://www.icap.org.pk/wp-content/uploads/students/srbook/spack2015/CAF6-PrinciplesofTaxation_2015-ST.pdf

1. **Describe 4 source of law about income tax which treated in Pakistan according to ordinance 2001?**



Synopsis of Taxes *Income Tax-Introduction* [1- 2]

Ordinance shall stand repealed if not presented before the parliament within four (4) months of its promulgation. However, if the parliament does not exist at the time of issuance of an Ordinance, the Ordinance shall be as valid as an Act of the Parliament. Under the later case the Ordinance is presented before the parliament for ratification after constitution of the parliament.

IMPOSITION OF TAXES AND SOURCES OF INCOME TAX LAW

Article-77 of the Constitution of Pakistan empowers the Federal Government to levy tax for the purposes of the Federation. The Federal Government may levy a tax through an Act of the Parliament or an Ordinance promulgated by the President. The following are the main sources of the Income Tax Law.

1. The Legislative Law, i.e., The Income Tax Ordinance, 2001;
2. The Procedural Law, i.e., The Income Tax Rules, 2002 made by the Federal Board of Revenue (Board) under the authority of section 237 of the Income Tax Ordinance, 2001;

   CBR

   Note: The Federal Board of Revenue Act, 2007 has been enacted through the Finance Act, 2007. Under this Act the Central Board of Revenue has been replaced by the "Federal Board of Revenue". This transformation took place from November 01, 2007.
3. The Notifications, Circulars, etc., issued by the Board under section 206 of the Income Tax Ordinance, 2001; and
4. The Case Law, i.e., the judgments and interpretations of the Income Tax Appellate Tribunal, High Courts and the Supreme Court of Pakistan.

THE INCOME TAX ORDINANCE, 2001

... Ordinance was promulgated on September 13, 2001. It was published in

2. **Statements was given and find out that the resident person or nonresident?**
3. **& question was also about resident status of companies**
4. **residential status batna tha**
5. **What are the provisions for deciding the resident status of INDIVIDUAL and COMPANY under sec: 82 and 83 of ITO 2001. (it is from lesson 14)**

RENT [2(49), 15(2) to (5), 16] *Refer to Chapter "Income from Property"*

RESIDENT & NON-RESIDENT

Residential status of a person is very important under the Income Tax Law. It is the residential status, not the nationality, which determines the scope of a person's income chargeable to tax during a tax year. The Income Tax Ordinance, 2001 introduces following classes of persons based on their residential status:

1. Non-resident person [2(37)];
2. Non-resident taxpayer [2(38)];
3. Resident association of persons [84];
4. Resident company [2(50)];
5. Resident individual [2(51)];
6. Resident person [2(52)]; and
7. Resident taxpayer [2(53)].

Non-Resident Person [2(37) & 81(2)]

A person shall be treated as non-resident for a tax year in which he is not a resident person.

Non-Resident Taxpayer [2(38)]

'Non-resident taxpayer' means a taxpayer who is a non-resident person.

Resident Association of Person [84]

An AOP shall be resident in a tax year if the control and management of its affairs is situated wholly or partly in Pakistan during the tax year.

Resident Company [2(50) & 83]

For a tax year a company shall be a resident company if any of the following conditions is satisfied:

1. The company is formed under any law in force in Pakistan;
2. The control and management of the company's affairs is situated wholly in Pakistan in the tax year;
3. It is a Provincial Government; or
4. It is a Local Government in Pakistan.

Resident Individual [2(51) & 82]

An individual shall be resident if he satisfies any of the following conditions:

1. He is in Pakistan for a period of one hundred and eighty three (183) days or more during the tax year, or
2. He is an employee or official of the Government posted abroad in the tax year.

Notes: Stay of 183 days (Not once means if 1st

1. It is immaterial that the period of stay in Pakistan is continuous or with intervals.
2. The number of days a person is in Pakistan shall be determined in the light of the following rules: [Rule-14]

he stay for 20 days, 50 days then He stay for 50 days) but with in Tax year)
If total of no. of days Stays = 183 Then He is a Resident Person

آدھا دن بھی Count ہوگا
as a full day.

i) A part of day a person is in Pakistan shall be taken as full day.

ii) A public holiday, a day of sick leave or any day in which an individual is in Pakistan (due to any reason except when he is in transit between two different places outside Pakistan) shall also be counted for computing his presence in Pakistan.

Resident Person [2(52) & 81(1)]

A person shall be resident for a tax year if:

1. For the tax year the person is:
   i) A resident individual;
   ii) A resident association of persons; or
   iii) A resident company; or
2. The person is the Federal Government. ,if stays outside the Pak.

Resident Taxpayer means a taxpayer who is a resident person. [2(53)]

6. **Aid agreement to salary income**

Exemptions under International Agreements Section 44

44. Exemptions under international agreements

(2)Any salary received by an individual (not being a citizen of Pakistan) shall be exempt from tax under this Ordinance to the extent provided for in an Aid Agreement between the Federal Government and a foreign government or public international organization, where:

(a) The individual is either not a resident individual or a resident individual solely by reason of the performance of services under the Aid Agreement;

(b) If the Aid Agreement is with a foreign country, the individual is a citizen of that country; and

(c) The salary is paid by the foreign government or public international organization out of funds or grants released as aid to Pakistan in pursuance of such Agreement.

Exemptions under Tax Treaty

Any salary received by an individual (not being a citizen of Pakistan) shall be exempt from Tax to the extent provided for in an Aid Agreement.

Section 45 President's Honor

(1) Any allowance attached to any Honor, Award, or Medal awarded to a person by the President of Pakistan shall be exempt from tax under this Ordinance.

(2) Any monetary award granted to a person by the President of Pakistan shall be exempt from tax under this Ordinance.

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7. **Foreign losses section104**

Related questions from past papers

If Mr. Kamal resident of Pakistan suffered a foreign loss against the income received from foreign country in tax year. What is the treatment of such foreign loss? Which section deals this kind of loss? Such losses can be carried forward up to how many years? 5marks

Foreign source loss will be deducted from the taxable income of Mr. Kamal only against that head of income. For example Mr. Kamal has lost in the head of income from business whose PE is aboard, the said loss can be set off against the abroad income from business only.

Foreign losses Sec.104:

Deductible expenditures incurred by a person in deriving foreign source income chargeable to tax under a head of income shall be deductible only against that income.

The accumulated loss under the head “Income from Business” (not being a loss to which section 58 applies) of an amalgamating company or companies shall be set off or carried forward against the business profits and gains of the amalgamated company and vice versa up to a period of six tax years immediately succeeding the tax year in which the loss was first computed in the case of amalgamated company amalgamating company or companies.

8. **Calculation of taxable income of a person who used his agricultural produce (cotton) in his cotton ginning business. (it was same as exercise given in lesson 11,in ppts)**

Question from Lecture#11

Computation of tax where agricultural income is to be clubbed for rate purposes.

Mr. Aslam is running a rice husking mill and he used agricultural produce grown on his land. During the tax year 2006 he got 9, 000 kgs. Of raw rice from his land and used it in his mill for husking. He would get Rs. 400 per 40 kg if he had sold it directly to the market. Declared particulars of said business are given here under:

	RS.	
Sale		300,000
Operating expenses		
Salaries and wages	50,000	
Rent	36,000	
Utilities	50,000	136,000
Net Profit		164,000
Calculate tax payable by Mr. Aslam		

Solution/:- Rs. 400 per Kg. So 1 kg will be 400/40 = 10 Rs.

Used Raw Material = 9000 Kg

9000 *10 = 90,000

	RS	
Sale		**300,000**
Operating expenses		
Salaries and wages	**50,000**	
Rent	**36,000**	
Utilities	**50,000**	**136,000**
Net Profit		**164,000**
Less Deduction		90000
Total taxable income		74000

9. **What is the legal status of the company?**

"Company" means---

- ✓ A company as defined in companies' ordinance, 1984
- ✓ A small company as defined in sec. 2(59A)
- ✓ A body corporate formed by or under any law in force in Pakistan;
- ✓ A modarba
- ✓ A body incorporated by or under the law of a country outside Pakistan, relating to incorporation of companies;
- ✓ A trust, a cooperative society or a finance society
- ✓ A foreign association whether incorporated or not, which the central board of revenue has, by general or special order, declared to be a company for the purpose of this ordinance;
- ✓ A provincial government
- ✓ A local authority in Pakistan

Handouts page # 11-12

10. **Five statements were given and identify the Company?**

Question from past paper just to clear the concept

- ⇒ Virtual University ofPakistan (company)
- ⇒ A joint family of Mr.Arun(a Hindu), Comprising Mr. Hamel, His sons
- ⇒ Mr. Kumar & Mr.Deepak (Hinduundivided family)
- ⇒ Government ofPunjab,Pakistan(company)
- ⇒ EdhiWelfareTrust (company)
- ⇒ FederalGovernment (person)
- ⇒ Mr.Suleman& his wife Joint Owners in aHouse (Association of persons)
- ⇒ Alpha Cooperative HousingSociety (company)
- ⇒ Mr. Ali &BabarJoint Owners inBuilding (Association of persons)
- ⇒ Mr.ImranServing as a Manager in a TextilesCompany (Individual)
- ⇒ HabibModaraba (company)
- ⇒ Banking Company of UK operating branch in Pakistan (Company)
- ⇒ housing society under housing society act in Pakistan (Company – Society)
- ⇒ chartered accountant firm in Pakistan (Firm – AOP)
- ⇒ Federal Governments (Person)

11. **Five statements were given and identify the Agriculture income?**

From past paper just to clear the concept

Landlord owe loan, and gave standing crops as an interest. His interest?

- (Agricultural income)

Mr. A buys from Mr. B standing crops and sold in market at profit, his profit (1st schedule rates taxation)

- Agricultural income for Mr. B but non-agricultural income for Mr. A

Mr. A acquires land in sahiwal and make butter and cheese and export to Dubai

- Non-agricultural income for Mr. A

Mr. A collect fee from Mr B for grass cattle eat in his change manga jungle

- Agricultural income for Mr. A if he is payment rent to change manga authorities for growing grass on the land.

Land rent out and received rent

- If the land used for agricultural purposes and situated in Pakistan then agricultural income otherwise not

12. **Five statements are given and identify the "Business from income" this question is given from lecture 18.**

"**Business** includes any trade, commerce, manufacture, profession, vocation but doesn't include employment"

Following incomes (except exempt income) shall be charged to tax under the head 'Income from Business'.

- Profits & Gains from any business in a tax year.
- Income derived from any trade, profession, sale of goods or provision of any services.
- Income from hire or lease of tangible movable property.
- FMV of Perquisites derived by a person by virtue of business relationships.
- Management Fee derived by a management company.

Income from Business also includes:

Any profit on debt derived by a person. (it is only applicable to such person, whose is business is to derive such income. e.g.; a banking company)

Any amount received by schedule bank from mutual fund, as share of profit.

Profit earned on debts in course business shall be chargeable to 'income from business'.

Income on leasing by lessor, being banks, leasing companies etc.

Income derived from any trade, profession, sale of goods or provision of any services.

Income from hire or lease of tangible movable property

FMV of Perquisites derived by a person by virtue of business relationships.

Management Fee derived by a management company

Exemptions on Business income Under Part 1 of second schedule

Clause Exempt Income

(91) Income of a Text-Book Board.

(92) University or Educational Institution established not for profit purpose.

(93) Recognized Computer Training Institution.

(93A) Recognized Vocational Institute.

(98) Income of Recognized Sports Board.

(100) Income of Modaraba Companies.

Speculation Business shall be charged under the head income from business (Separate Treatment)

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Following Incomes are taxable under the head Income from Business even in cases where no business is carried on by taxpayer.

- Recovery against any deduction/expenses previously allowed (Add back to income).
- Gain on sale of depreciable asset.
- Recovery of bad debt/or written off loan.

- Trading liabilities not paid within expiration of three years.
- Amount received after discontinuance of business.

13. Two statement are given and tell the foreign loss sec and how to treat under pak I.T.O 2001. sec is 104.

Foreign tax losses

Section 104 of the Ordinance deals with treatment of foreign losses and it states that:

1. Deductible expenditures incurred by a person in deriving foreign source income chargeable to tax under a head of income shall be deductible only against that income.

2. If the total deductible expenditures exceed the total foreign source income for a tax year chargeable to tax under a head of income (hereinafter referred to as a "foreign loss"), the foreign loss shall be carried forward to the following tax year and set off against the foreign source income chargeable to tax under that head in that year, and so on, but no foreign loss shall be carried forward to more than six tax years immediately succeeding the tax year for which the loss was computed.

3. Where a taxpayer has a foreign loss carried forward for more than one tax year, the loss for the earliest year shall be set off first.

Reference book:- CAF6-PrinciplesofTaxation_2015-ST page # 226

14. Determine tax year(5 accounting periods were given, just like given in Exercise 1 and 2 of lesson 6)

The given example is from Reference book:- CAF6-PrinciplesofTaxation_2015-ST page # 49

Example

The normal tax year of ABC Limited was the period from 01 July 2014 to 30 June 2015. On an application by ABC Limited, Commissioner granted approval to adopt special tax year of 30 September each year. The period from 01 July 2015 to 30 September 2015 will be treated as transitional tax year.

Exercise:

Determine the tax year in respect of each accounting periods mentioned below:

a) 1.09.2014 to 31.08.2015

b) 1.01.2015 to 31.12.2015

c) 1.04.2015 to 31.03.2016

d) 1.05.2015 to 30.04.2016

e) 1.07.2015 to 30.06.2016

Answer

For all the three cases (a), (b) and (c) mentioned above, relevant tax year will be 2016 i.e. calendar year relevant to normal tax year [1.07.2015 to 30.06.2016) in which the closing date (31.08.2015, 31.12.2015, 31.03.2016) of special year falls.

For case (d) mentioned above, relevant tax year will be 2016 i.e. calendar year relevant to normal tax year in which the closing date (31.04.2016) of special tax year falls.

For case (e) mentioned above, relevant tax year will be 2016 i.e. calendar year in which the closing date (31.06.2016) of normal tax year falls.

15. Foreign source income 102 & permanent establishment 105 ma head office k expenditure as nonresident person under section 105.

Taxation of Foreign-Source Income of Residents:

Foreign Source Salary of Resident Individuals Sec. 102

(1) Any foreign-source salary received by a resident individual shall be exempt from tax if the individual has paid foreign income tax in respect of the salary.

(2) A resident individual shall be treated as having paid foreign income tax in respect of foreign-source salary if tax has been withheld from the salary by the individual's employer and paid to the revenue authority of the foreign country in which the employment was exercised.

- Foreign losses Sec.104: Deductible expenditures incurred by a person in deriving foreign source income chargeable to tax under a head of income shall be deductible only against that income.

Taxation of Non-Residents

Taxation of a permanent establishment in Pakistan of a non-resident person Sec. 105:

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

  - The profit of the permanent establishment shall be computed on the basis that it is a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the non-resident person of which it is a permanent establishment;

Taxation of Non-Residents-Deductions

- Subject to this Ordinance, there shall be allowed as deductions any expenses incurred for the purposes of the business activities of the permanent establishment including executive and administrative expenses so incurred, whether in Pakistan or elsewhere;

- No deduction shall be allowed for amounts paid or payable by the permanent establishment to its head office or to another permanent establishment of the non-resident person (other than towards reimbursement of actual expenses incurred by the non-resident person to third parties) by way of:

- Royalties, fees or other similar payments for the use of any tangible or intangible asset by the permanent establishment

  - Compensation for any services including management services performed for the Permanent establishment; or

  - Profit on debt on moneys lent to the permanent establishment, except in connection with a banking business; and

Taxation of Non-Residents Deductions

- Compensation for any services including management services performed by the permanent establishment; or
- Profit on debt on moneys lent by the permanent establishment, except in connection with a banking business.

  - No account shall be taken in the determination of the income of a permanent establishment of amounts charged by the permanent establishment to the head office or to another permanent establishment of the non-resident person (other than towards reimbursement of actual expenses incurred by the permanent establishment to third parties) by way of:

  - Royalties, fee or other similar payments for the use of any tangible or intangible asset;

(2) No deduction shall be allowed in computing the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head "income from Business" for a tax year for head office expenditure in excess of the amount as bears to the turnover of the permanent establishment in Pakistan the same proportion as the non-resident's total head office expenditure bears to its worldwide turnover.

(3) In this section: head office expenditure: means any executive or general administration expenditure incurred by the non-resident person outside Pakistan for the purposes of the business of the Pakistan permanent establishment of the person, including

(4) No deduction shall be allowed in computing the income of a permanent establishment in Pakistan of a non-resident person chargeable under the head "Income from Business" for-

- Any profit paid or payable by the non-resident person on debt to finance the operations of the permanent establishment; or
- Any insurance premium paid or payable by the non-resident person in respect of such debt.
- Any rent, local rates and taxes excluding any foreign income tax, current repairs, or insurance against risks of damage or destruction outside Pakistan;
- Any salary paid to an employee employed by the head office outside Pakistan;
- Any traveling expenditures of such employee; and
- Any other expenditure which may be prescribed.

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