Memorandum on the Tax Laws (Second Amendment) Ordinance, 2019

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INCOME TAX

TAX ON FOREIGN INVESTMENT IN PAKISTAN'S CAPITAL MARKET

Foreign investors particularly Foreign Institutional Investors invest in Pakistan's capital market through Foreign Portfolio Investment (FPI) scheme, which allows such investors to invest in equity and debt securities (including Government Bonds, Term Finance Certificates, Pakistan Investment Bonds) without any physical presence. The FPI scheme makes it mandatory for foreign investors to open Special Convertible Rupee Account (SCRA). The requirement for non-residents to open SCRA is provided in Chapter 20 of the Foreign Exchange Manual issued by the State Bank of Pakistan (SBP). The funds available in SCRA can be transferred outside Pakistan or credited to a foreign currency account of non-resident investor maintained in Pakistan at any time without prior approval of SBP. Such non-resident corporate investors not having a Permanent Establishment in Pakistan are hereinafter referred to as NRI.

The tax incidence applicable on NRI on return from their investment in equity instruments, either as dividend or capital gains, is largely aligned and same (being 15%).

However, tax incidence applicable on return from investment in debt securities by NRI is not aligned. Interest income from debt investment is subject to final tax upon tax withholding at 10% whereas capital gains from disposal of debt instruments are taxable at corporate rate of tax which is presently 29%. The Second Amendment Ordinance has aligned and rationalised the tax incidence through following amendments, apart from relieving NRI from certain compliances:

(i) Banking company / financial institution maintaining SCRA of NRI is now required to deduct tax from capital gains arising on disposal of debt instruments and Government securities (including Treasury

Bills and Pakistan Investment Bonds) @ 10%. Such tax deduction constitutes final tax on such capital gains. It appears that tax withholding is required to be made at the time when proceeds from disposal are accounted for in the SCRA and also that no adjustment for any capital loss may be made by the Banking company / financial institution while deducting capital gains tax @ 10% from capital gains earned by NRI on disposal of debt securities.

(ii) The requirements to obtain tax registration [under Section 181 of the Income Tax Ordinance, 2001 ('ITO 2001')] and also to file statement of final taxation [under Section 115(4)] will no longer apply, in case capital gains or profit on debt is earned from investments made through SCRA (maintained with a banking company or financial institution) in debt instruments and Government securities (including treasury bills and Pakistan investment bonds). Despite not appearing on Active Taxpayers List (ATL), they will not be subjected to higher tax withholding under the Tenth Schedule on interest income and capital gains relating to such securities.

(iii) Advance tax under section 147(5B) will also be not payable in respect of capital gains arising on investment made through SCRA (maintained with a banking company or financial institution) in debt instruments and Government securities (including treasury bills and Pakistan Investment Bonds).

(iv) Tax withholding applicable on banking transactions by those not appearing on ATL (under section 236P) will not apply to SCRA. This is a blanket exemption for companies maintaining SCRA regardless of whether investment is made in equity or debt securities.

TAX CONCESSIONS FOR TRADERS

Pursuant to the agreement between representatives of Federal Government and trade bodies on October 30th, 2019; certain concessions have been allowed to traders through the Second Amendment Ordinance.

The term "trader" has been defined to mean an individual engaged in business of buying and selling of goods in the same state, including a retailer and a wholesaler but excluding a distributor.

The concessions provided to traders are as under:

(i) The general rate of minimum tax payable (under section 113 of the ITO 2001) has been reduced from 1.5% to 0.5% for tax year 2020 for traders having turnover up to Rs. 100 million. However, for traders who have filed income tax returns for tax year 2018, the tax liability for tax years 2019 and 2020 should not be less than the tax liability for tax year 2018, to become eligible for reduced rate of Minimum Tax of 0.5%.

(ii) Individual having turnover of Rs. 50 million or more in any of the preceding tax years is liable to deduct tax under section 153 while making payments against supply of goods, services and contracts. Through the Second Amendment Ordinance, traders being individuals having turnover upto Rs. 100 million have been exempted from deducting tax under section 153 while making payment against supply of goods, services and contracts. The Board is expected to clarify the year with respect to which turnover of Rs. 100 million will be calculated by the trader.

TAX CONCESSIONS FOR EXPORT ORIENTED SECTORS

Through Second Amendment Ordinance, following amendments have been made to provide for concession and removal of anomalies:

(i) (a) At present, traders of yarn are not subject to withholding tax on their supply of goods and services to the taxpayers falling in following categories, provided they discharge minimum tax on their turnover on monthly basis @ 0.1%:

- Textiles and articles thereof;
- Carpets;
- Leather and articles thereof (including artificial leather footwear);
- Surgical goods; and
- Sports goods.

Through Second Amendment Ordinance, the above scheme has been replaced. Now, the supply of goods and services by yarn traders to afore-mentioned categories of registered taxpayers shall be subject to withholding tax @ 0.5%.

(b) For traders of yarn being individuals, the reduced rate of minimum tax (payable under section 113 of the ITO 2001) has been prescribed at 0.5% for tax year 2020.

(ii) The concessionary rate of tax withholding on certain payments and non-applicability of provisions of section

111 for suppliers and service providers [under Clause (45A) contained in Part IV of the Second Schedule to the ITO 2001] were available to those who were registered upto June 30, 2011.

Through the Second Amendment Ordinance, the aforesaid condition for registration upto June 30, 2011 has been removed.

(iii) Through Finance Act 2019, zero rating regime for sales tax applicable for exporters or manufacturers of leather, sports, surgical and textile related goods was done away with. The elimination of zero-rating regime created an anomaly in the applicability of exemption from collection of advance tax on electricity consumption provided to exporters / manufacturers of afore-mentioned goods under the ITO 2001. It is for this reason that reference to zero rating regime of sales tax contained in Clause (66) of Part IV of the Second Schedule to the ITO 2001 has been removed and it has been made clear that the exemption from collection of advance tax on electricity consumption is available to taxpayers registered for sales tax as manufacturer or exporter of leather, sports, surgical and textile related goods.

INTER-CORPORATE DIVIDEND IN GROUP COMPANIES

Inter corporate dividend is exempt from tax in case of companies eligible for group relief under section 59B of the ITO 2001. At present, the said exemption is partially available in an anomalous manner to the extent of percentage holding of parent company in the subsidiary company.

Through the Second Amendment Ordinance, the requirement for percentage of holding has been omitted. As a result, partial exemption provided with regard to percentage of holdings has been replaced with complete exemption in its original position of 2008.

We expect that exemption from tax withholding, with regards to the above, would also be restored in due course.

EMPOWERING FBR TO PRESCRIBE PROCEDURE FOR CLOSURE OF INCOME TAX AUDIT OF PERSONS AUTOMATICALLY SELECTED UNDER OMITTED SECTION 214D

Through the Finance Act, 2015, Section 214D was inserted in the ITO 2001 which enabled the FBR to automatically select a taxpayer (other than persons registered as retailers under Sales Tax Special Procedures Rules 2007) under section 177 of the Ordinance if:

- Complete return of income is not filed within the due date; and
- Tax payable as per return is not paid.

The above-referred section allowing automatic selection for tax audit was deleted through the Finance Act, 2018. To enable closure of tax audits already initiated under section 214D for prior years, a new section 214E was inserted through the Finance Supplementary (Amendment) Act, 2018 enabling FBR to close the audit proceedings (initiated under omitted section 214D) after payment of certain amount of tax / penalty by due date.

For those cases of audit selection which are not yet closed, necessary amendment has been made in section 214E so as to enable the FBR to prescribe the procedure for conclusion of such audits (including empowering FBR to accept the income declared by taxpayer subject to such conditions as may be prescribed by FBR).

ENABLING THE FMU TO REQUIRE NECESSARY INFORMATION FROM PUBLIC SERVANTS

Under Section 216 of the ITO 2001, public servant are barred from disclosing any information relating to income tax filings, evidences or proceedings of any taxpayer. Certain exceptions to this general prohibition are also contained in the said section whereby information may be disclosed to specified persons, organisations or authorities.

By way of an amendment made through the Second Amendment Ordinance, Financial Monitoring Unit (FMU) established under the Anti-Money Laundering Act, 2010 has been included in the list of such exceptions which do not fall within the ambit of confidentiality clause contained in Section 216. This amendment is intended to enable FMU to better implement anti-money laundering procedures by directly obtaining necessary information from public servants.

PROCEDURE PRESCRIBED FOR TRANSFER PRICING AUDIT

Section 230E was introduced in the ITO 2001 through the Finance Act, 2017 for establishing a separate Directorate for conducting transfer pricing audit of taxpayers. Through the Finance Supplementary (Second Amendment) Act, 2019, Section 230E was substituted so as to establish Directorate General of International Tax. However, no specific procedure or mechanism for transfer pricing audit was prescribed in the said section which was causing ambiguity amongst the field officers and taxpayers.

Through the Second Amendment Ordinance, necessary amendment has been made in Section 230E to prescribe that transfer pricing audit is to be conducted as per the procedure laid down in section 177 and other provisions of the Ordinance. This way, the ambiguity relating to the transfer pricing audit procedure has now been removed.

Apart from the above, section 230E has further been amended to provide that transfer pricing audit initiated under section 230E would not preclude the concerned Commissioner Inland Revenue from determining transfer price at arm's length while conducting audit proceedings under section 177 or 214C or amendment proceedings under section 122.

AUTOMATIC RENEWAL OF WITHHOLDING EXEMPTION CERTIFICATE UNDER CLAUSE (72B)

Clause (72B) contained in Part IV of the Second Schedule to the ITO 2001 allows a taxpayer to obtain a withholding exemption certificate from the concerned Commissioner Inland Revenue so as to avoid tax collection at import stage.

Due to procedural issues, hardships were being faced by taxpayer in getting such withholding exemption certificates renewed, which are generally issued for 6-months validity although tax liability for the entire year as prescribed is discharged.

To facilitate the taxpayers, the relevant clause has now been amended to provide for automatic approval of application filed on FBR's IRIS portal for renewal of the certificate in case no action is taken by the Commissioner by the expiry of prescribed time period. The concerned Commissioner has, however, been empowered to cancel or modify any such certificate automatically issued on IRIS but any such cancellation or modification may be made after granting the taxpayer an opportunity of being heard and for reasons to be recorded by the Commissioner in writing.

BUSINESS LICENSE SCHEME - POWERS TO IMPOSE FINES AND CANCELLATION OF BUSINESS LICENSE

Through Finance Act 2019, the concept of business license scheme was introduced in the Ordinance, whereby every person engaged in any business, profession or vocation was required to obtain and display a business license. Through the Second Amendment Ordinance, the following fines have been prescribed for persons who fail to obtain business license:

- Rs. 25,000, where the person is deriving income chargeable to tax under the Ordinance; or
- Rs. 5,000 in any other case.

These fines are prescribed in addition to any other fine or penalty that may be applicable under the Ordinance or any other law.

Furthermore, the Commissioner has been empowered to cancel the business license in cases where a person:

- fails to notify any change in particulars within 30 days of change; or
- is convicted of any offence under any federal tax law.

GREENFIELD INDUSTRIAL UNDERTAKING

Under clause (126O) of Part I to the Second Schedule to the ITO 2001, the profits and gains of a company from a greenfield industrial undertaking incorporated on after July 1, 2019 is exempt from tax for a period of five years.

The term 'greenfield industrial undertaking' was not previously defined in the ITO 2001; hence, there was uncertainty about the undertakings qualifying for this exemption.

The Second Amendment Ordinance has now defined the term 'greenfield industrial undertaking' to mean a new industrial undertaking which is:

(i) setup on land which has not been previously utilized for any commercial, industrial or manufacturing activity and is free from constraints imposed by any prior work;

(ii) built without demolishing, revamping, renovating, upgrading, remodelling or modifying any existing structure, faciality or plant;

(iii) not formed by splitting up or reconstruction of an undertaking already in existence or by transfer of machinery, plant or building form an undertaking established in Pakistan prior to commencement of new business and is not part of expansion project;

(iv) using any process or technology that has not earlier been used in Pakistan and is so approved by Engineering Development Board; and

(v) is approved by the Commissioner Inland Revenue on an application made in the prescribed manner.

The above definition has been made applicable from July 1, 2019.

Similar definition has been introduced in the Sales Tax Act , 1990 whereunder exemption has been allowed on certain imports of Plant & Machinery by 'Greenfield Industry'.

SALES TAX

TIER -1 RETAILER

Definition of the term Tier I retailer has been elaborated to include a retailer falling in any one or more of the categories contained in said definition.

A retailer whose cumulative electricity bill for last 12 consecutive months exceeded Rs 600,000 was included in definition of Tier I retailer. The said limit of Rs 600,000 has been enhanced to Rs 1,200,000.

Further, FBR has been empowered to prescribe any person or class of persons to be considered a Tier-I Retailer. The amended definition of Tier-I Retailer is as under:

"Tier-1 retailer" means a retailer falling in any one or more of the following categories, namely:-

(a) a retailer operating as a unit of a national or international chain of stores;

(b) a retailer operating in an air-conditioned shopping mall, plaza or centre, excluding kiosks;

(c) a retailer whose cumulative electricity bill during the immediately preceding twelve consecutive months exceeds Rupees twelve hundred thousand;

(d) a wholesaler-cum-retailer, engaged in bulk import and supply of consumer goods on wholesale basis to the retailers as well as on retail basis to the general body of the consumers;

(e) a retailer, whose shop measures one thousand square feet in area or more; and

(f) any other person or class of persons as prescribed by the Board.

NEW PENALTIES

New penalties have been inserted from Serial No. 24 to 27 in the Table contained under section 33 as set out in Annexure I.

GOODS SUPPLIED FROM TAX EXEMPT AREAS

A new section 40D has been inserted containing provisions / control measures relating to monitoring of goods supplied from tax exempt areas to Pakistan.

The term 'tax exempt areas' has been defined as Azad Jammu and Kashmir, Gilgit Baltistan, Tribal Areas and other prescribed areas.

RESTRICTION AS TO INPUT TAX ON SUPPLIES TO UNREGISTERED PERSONS

Through the Finance Act, 2019, input tax attributable to supplies made to unregistered person has been disallowed, on pro rata basis, where supplies are made to an unregistered person and for which sales invoices do not bear the NIC number or NTN of the recipient. The said restriction, with certain exceptions, was introduced in section 8 of the Act.

Now through Second Amendment Ordinance, it has further been provided that if a registered manufacturer will make taxable supplies to a person (who is not registered under the Act) exceeding Rs. 10 million in a month and Rs. 100 million in a financial year, then input tax adjustment (as attributable to such excess supplies to the unregistered person) will not be allowed. The said restriction has been placed through a new sub-section introduced in section 73.

There is apparently an overlapping or duplication in the disallowance of input tax under sections 8 & 73 in certain situations where supplies are made to unregistered persons.

GREENFIELD INDUSTRY

Certain imports of Plant & Machinery by 'Greenfield Industry' are exempt from sales tax under serial no 150 of Table I of the Sixth Schedule. The term 'Greenfield industry' (which was previously not defined) has now been defined in the manner similar to the one defined for income tax purposes.

EXEMPTIONS AND REDUCED RATE

Import or local supply of edible oil and vegetable ghee, including cooking oil, on which FED is charged, levied and collected in sales tax mode by registered manufacturer or importer was exempt. It has now been clarified that the said exemption shall not be available on local supplies by importer in line with supplies made by distributor, wholesaler or retailer.

An amendment has been made to remove anomaly due to co-existent entries in Sixth Schedule and Eight Schedule. Now, meat and frozen, prepared or preserved sausages and similar products of meat, poultry meat or meat offal of all types including poultry meat and fish sold in retail packing under a brand name or a trademark is subject to reduced rate of sales tax at 8 percent. These items if sold otherwise than in retail packing under a brand name or a trade mark will remain exempt.

Rate of sales tax on import of raw cotton and ginned cotton has now been increased from 5 percent to 10 percent.

NINTH SCHEDULE - CELLULAR MOBILE PHONES

The sales tax on import or local supplies and at the time of registration of cellular mobile phones or satellite phones has been reduced in respect of following two categories

Category	Previous	New
Value not exceeding USD 30	Rs 135	Rs 130
Value exceeding USD 30 but not exceeding USD 100	Rs 1320	Rs 200

TENTH SCHEDULE - SALES TAX ON BRICKS

Through FA 2019, section 3 (1B) of the ST Act was substituted along with introduction of Tenth Schedule whereby fixed sales tax on manufacture and sale of bricks was required to be paid on monthly return.

Now PCT heading for bricks has been corrected from 6901.1000 to 6901.0000. Further, requirement of monthly return has been omitted.

TWELFTH SCHEDULE

A new entry (x) has been inserted in Clause (2), Procedures and conditions, in Twelfth Schedule whereby value addition tax at 3 percent ad valorem shall not be charged on plant, machinery and equipment falling in Chapter 84 and 85 of the First Schedule to the Customs Act, 1969, as are imported by manufacturer for in house installation or use.

Refund of excess input tax over output tax attributed to the minimum value addition tax paid under twelfth schedule has now been allowed to registered person in case items imported are used for making zero-rated supplies. Previously, no such refund was allowed.

Annexure I

Offences	Penalties	Section of the Act
24. Any person, who is integrated for monitoring, tracking, reporting or recording of sales, production and similar business transactions with the Board or its computerized system, conducts such transactions in a manner so as to avoid monitoring, tracking reporting or recording of such transactions, or issues an invoice which does not carry the prescribed invoice number or barcode or bears duplicate invoice number or counterfeit barcode, or any person who abets commissioning of such offence	Such person shall pay a penalty of five hundred thousand rupees or two hundred per cent of the amount of tax involved, whichever is higher. He shall, further be liable, upon conviction by a Special Judge, to simple imprisonment for a term which may extend to two million rupees, or with both. Any person who abets commissioning of such offence, shall be liable, upon conviction by a Special Judge, to simple imprisonment for a term which may extend to one year, or with additional fine which may extend to two hundred thousand rupees or with both	Sub-section (9A) of Section 3 and section 40C
25. Any person, who is required to integrate his business for monitoring, tracking, reporting or recording of sales, production and similar business transactions with the board or computerized system, fails to get himself registered under the Act, and if registered, fails to integrate in the manner as required under law	Such person shall be liable to pay a penalty up to one million rupees, and if continues to commit the same offence after a period of six months after imposition of penalty as aforesaid, his business premises shall be sealed and an embargo shall be placed on his sales	Sub-section (9A) of section 3 and section 40C
26. Any person, being a manufacturer, or importer of an item which is subject to tax on the basis of retail price, who fails to print the retail price in the manner as stipulated under the Act	Such person shall pay a penalty of ten thousand rupees or five per cent of the amount of tax involved, whichever is higher: Further, such goods shall also be liable to confiscation. However, the adjudication authority, after such confiscation, may allow redemption of such goods on payment of fine which shall not be less than twenty percent of the total retail price of such goods	Sub-section (27) of section 2 and clause (a) of subsection (2) of section 3
27. Any person, being owner of the goods, which are brought to Pakistan in violation of section 40D	Such person shall pay a penalty of ten thousand rupees or five per cent of the amount of tax involved, whichever is higher. Further, such goods shall also be liable to confiscation. However, the adjudication authority, after such confiscation, may allow redemption of such goods on payment of fine which shall not be less than twenty percent of value, or retail price in case of items falling in the Third Schedule, of such goods	Section 40D

CUSTOMS DUTY

DECLARATION BY PASSENGER OR CREW OF BAGGAGE

Recovery or seizure of any baggage and any article contained therein, of the passenger or of any crew member, subsequent to false declaration or failure to declare shall be treated at par with 'smuggled' goods'.

OFFENCES AND PENALTIES

Briefly, through the Second Amendment Ordinance, certain penalties have been specified for persons who smuggle goods comprising currency, gold, silver, platinum or precious stones in any form. These include confiscation of smuggled goods (exceeding the permissible limit, if any). Further, such persons are also made liable to additional penalty or imprisonment or both in the following manner, depending upon the quantity of smuggled goods thereof:

Excess over permissible limit	Currency Penalty not exceeding	Imprisonment upon conviction
Upto USD 10,000 or equivalent in value	Value of excess currency	—
USD 10,001 to 20,000 or equivalent in value	Two times the value of excess currency	—
USD 20,001 to 50,000 or equivalent in value	Three times the value of excess currency	Upto two years
USD 50,001 to 100,000 or equivalent in value	Four times the value of excess currency	Upto seven years
USD 100,001 to 200,000 or equivalent in value	Five times the value of excess currency	Three to ten years
USD 200,001 & above or equivalent in value	Ten times the value of excess currency	Five to fourteen years

Quantity of goods	Gold, Silver, Platinum or precious Stones Penalty not exceeding	Imprisonment upon conviction
Upto 15 tola gold or equivalent in value	Value of goods	—
16 tola to 30 tola gold or equivalent in value	Two times the value of currency	—
31 tola to 50 tola gold or equivalent in value	Three times the value of goods	Upto one year
51 tola to 100 tola gold or equivalent in value	Three times the value of goods	Upto three years
101 tola to 200 tola gold or equivalent in value	Four times the value of goods	Upto five years
201 tola to 500 tola gold or equivalent in value	Five times the value of currency*	Three to ten years
501 tola gold & above or equivalent in value	Ten times the value of goods	Five to fourteen years

** Apparent legislative intent is "goods" (and not currency)*

The above penalties are also made applicable to 'owner' of baggage who fails to declare or makes false declaration with respect to such baggage or articles carried by him or refuses to answer the question by appropriate officer or fails to produce baggage or articles for examination, in case goods carried by him include currency, gold, silver, platinum or precious stones in any form.

Previously, such owner of baggage was liable to penalty not exceeding three times the value of goods along with confiscation of same, in respect of all kind of goods, the penal provisions are now relevant only in case of goods other than currency, gold, silver, platinum or precious stones in any form.

Furthermore, under Sr. No. 47A of the Table to section 156 of the Customs Act, 1969, owners of goods who fail to file goods declaration within the prescribed period were subject to a certain 'penalty' as specified therein; however, through the Second Amendment Ordinance, following importers have been excluded from applicability of such penalty:

(i) individuals without NTN or STRN importing/receiving goods as 'gifts' through courier, air cargo or diplomatic cargo; and

(ii) imports by Federal Government or Provincial Government or Local Government.

THINGS SEIZED HOW DEALT WITH

Any seized goods liable to confiscation produced before a Court of Special Judge Customs during an inquiry or trial may be ordered by the Court to be sold or disposed of if such goods are subject to speedy or natural decay.

In case of dangerous drug, intoxicant, intoxicating liquor or any other narcotic or psychotropic substance seized or taken into custody, the Court may obtain such number of samples as it may deem fit for safe custody and cause destruction of the remaining portion of the property under a certificate issued by it.

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