

BUDGET BRIEFING 2020

Comments on Finance Bill 2020—I

Income Tax

1. Self assessment

Section 120 Sub-section (2A)

The most significant feature of the Ordinance to date is the "self-assessment" scheme, whereby a complete return of income filed by a taxpayer is treated to be an assessment order issued by the tax authorities in respect of the income declared and tax thereon. The Bill however proposes to bring a paradigm shift in the concept of self-assessment whereby the return of income filed by the taxpayer would now be processed through automated system to arrive at correct amounts of total income, taxable income and tax payable by making adjustments for any arithmetical error in the return, any incorrect claim, disallowance of any loss, deductible allowance or tax credit, disallowance of carry forward of any loss under section 182A.

It has however been stated that no adjustment shall be made unless the taxpayer has been provided with an opportunity of being heard. The adjustments shall be incorporated if the taxpayer fails to respond within thirty days from the issuance of the notice. The Bill also provides that if no adjustments have been made within six months of the filing of the return, the return declared by the taxpayer shall be deemed to have been taken as adjusted.

For the purposes of this Section:-

"arithmetical error" includes any wrong or incorrect calculation of tax payable including any minimum or full tax payable

"an incorrect claim apparent from any information in the return" shall mean a claim, on the basis of an entry, in the return that the above provisions are borrowed from Section 65 of the Income Tax Ordinance, 1979 (since repealed) where they were taken from Section 34 of the erstwhile Income Tax Act, 1961. However, the concept of audit has been introduced via the Ordinance and therefore, the acquisition of 'definite information' was also linked to audits conducted by the tax authorities in addition to from any other source. As such, in order to make amendment in assessment in terms of sub-section (5) of Section 122, possession of 'definite information' either through audit or otherwise, is a pre-requisite.

The Bill proposes to amend the provisions of sub-section (5) of Section 122 to the effect that even if after an audit, definite information could not be acquired by the Commissioner, he can still amend the assessment on the basis of his best judgement and make disallowances without specific supporting evidence.

3. Alternative Dispute Resolution

Section 134A

The provisions of this Section were completely revamped through the Finance Act, 2018 as a result whereof, the form of Alternative Dispute Resolution (ADR) was converted into another appellate forum whose findings are however, not challengeable. The reason being that the order passed by the FBR in ADR proceedings has been made final for both the taxpayers and the tax authorities rather than being an option for a taxpayer to seek alternate remedy. In case, the recommendations made by the Committee formed for ADR purposes are not acceptable, the taxpayer was allowed to pursue the matter at other legal forums. The amendments made through the Finance Act, 2018 were generally criticized by businesses as well as professional forums and it was emphasized that the mechanism under ADR before such amendments should be restored.

In order to address the above concerns, the Bill proposes to make key amendments to the ADR mechanism. It is proposed that the taxpayer would no longer be required to withdraw his appeal pending before the appellate forum immediately after the constitution of the Committee. Instead, the taxpayer shall withdraw the appeal pending before the appellate forum only if he is satisfied with the decision of the Committee. FBR, it is further proposed that the decision of the Committee/FBR shall not be binding on the taxpayer but shall be binding on the Commissioner, provided that the order of withdrawal of appeal is communicated to the Commissioner within 60 days of the service of decision of the FBR upon the taxpayer. The amendments so proposed are welcome amendments that various industries and professional bodies have been seeking for the past two years.

Currently, the Committee for ADR consists of an officer of Inland Revenue not below the rank of a Commissioner, a person nominated by the taxpayer from a panel notified by the FBR and a third judge nominated through consensus by the other two members. Furthermore, the Committee decides the dispute by majority. The Bill now proposes that the Committee shall comprise of the Chief Commissioner having jurisdiction over the case and two persons from a panel notified by the FBR. Conversely, the Committee shall decide the dispute through consensus rather than majority.

The Bill also proposes that the Committee may, in case of hardship, stay the recovery of tax payable in respect of the dispute pending before it for a period not exceeding 120 days in aggregate or till the decision of the Committee or its dissolution, whichever is earlier.

Corresponding amendments in this regards should also be introduced in Rule 231C of the Rules.

4. Agreed assessment in certain cases

Section 122D

The Bill proposes to insert a new Section to the Ordinance to provide for agreed assessment in case where a notice under sub-section (9) of Section 122 has been issued to the taxpayer. The proposed Section 122D contains a complete code of agreed assessment, the salient features whereof are as under:-

- A taxpayer after issuance of a notice for amendment of assessment may file an offer of settlement in the prescribed form before the Assessment Oversight Committee (AOC) in addition to filing a reply to the Commissioner. The definition of AOC however, has not been proposed by the Bill however, it has been proposed that the FBR may make rules regulating the procedure and other related matters connected with or incidental to the proceedings of the AOC;
- The AOC after examining the offer made by the taxpayer as aforesaid, may call for the record of the case and after affording opportunity of being heard to the taxpayer, may decide to accept or modify such offer through consensus and communicate its decision to the taxpayer;
- Where the taxpayer is satisfied with the decision of the AOC, he shall:-
 - Deposit the amount of tax payable including any amount of penalty and default surcharge as per decision of the AOC;
 - The CIR shall amend assessment in accordance with the decision of the AOC after having satisfied that the tax as determined by the AOC has been paid by the taxpayer;
 - The taxpayer shall waive the right to prefer appeal against such amended assessment; and
- In no further proceedings shall be undertaken under the Ordinance in respect of the issues decided by the AOC unless the tax as per clause (i) above has not been deposited by the taxpayer.
- Where the AOC has not been able to arrive at a consensus or where the taxpayer is not satisfied with the decision of the AOC, the case shall be referred back to the CIR for decision on the basis of reply of the taxpayer made by him to the CIR notwithstanding proceedings or decision, if any, of the AOC;
- The AOC shall comprise of the following income tax authorities having jurisdiction over the taxpayer:
 - The Chief Commissioner;
 - The Commissioner;
 - The Additional Commissioner.
- It is lastly provided that in cases where concealment of income or where interpretation of question of law is involved having effect on other cases, the procedure of agreed assessment shall not be available.

5. Tax credit for NPOs, trusts and welfare institutions

Section 2(36), Section 100C and Clause (66), Part I of the Second Schedule

Through Clause (36) of Section 2 of the Ordinance, Non-Profit Organization ("NPO") has been defined to mean any person other than an individual which has been established for religious, educational, charitable, welfare or development purposes, or for the promotion of an amateur sport. The Bill has proposed to bring about a change in the above definition to remove the phrase "or development purposes" from the above definition and replace it with the expression "purposes for general public". This appears to be an attempt to rationalize the definition of NPO. The impact of the above proposed change would be that only the person (other than an individual) which have been established for benefit of general public and is involved in various activities listed above (excluding development purposes) would fall within the ambit of NPO.

The provisions of Section 100C of the Ordinance provides for a tax credit equal to one hundred percent of the tax payable, to an NPO, trust and welfare institution, subject to fulfillment of certain conditions. This section has undergone various amendments since its introduction in the Ordinance via the Finance Act, 2015 bringing in new conditions to be fulfilled by the entities falling under the Finance Act.

The Bill, apart from bringing some editorial changes, proposes to make the following amendments in Section 100C:-

- A statement of voluntary contributions and donations received in the immediately preceding year, in the prescribed form and manner, is required to be submitted. Keeping in view the country's culture and the religious sentiments where the donors (except corporate donors) prefer not to declare their name and identity, in our view, this condition may become impractical. Even where donation is deposited over the counter in banks, the donors' identification is not identifiable for, cash is deposited in the bank

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account directly;

(b) Currently, surplus funds of an NPO is subject to tax @10%. The scope of such taxation is proposed to be extended to the surplus funds of 'trusts and welfare institutions as well'; and

(c) For the purposes of computing surplus fund, amounts or monies that form part of restricted funds are excluded. The term 'restricted fund' means any fund received but not spent and treated as revenue during the year due to any obligations placed by the donor. The Bill proposes to replace the term 'donor' with the phrase 'a donor not being an associate of the organization'. This would mean that if this amendment is approved, only restrictions placed by a donor who is not an associate of the donee would be taken into consideration as restricted funds to the extent from the purview of surplus funds.

Apart from the above, Clause (66) of Part I of the Second Schedule to the Ordinance exempts any income derived by certain non-profit institutions, trusts and welfare organizations. The Bill proposes to replace this Clause by bifurcating the list into two sets of entities. The first list comprise of entities including relief funds established by governments and government sector welfare entities whose incomes (from whatever source) will remain exempt from tax without fulfillment of any conditions as before the proposed amendment. The second list mainly consist of NPOs, trusts and welfare institutions which are mainly involved in activities of welfare for general public. Such entities have been proposed to be subject to the provision of Section 100C of the Ordinance in order to qualify for the exemption in terms of Clause (66) referred above. However, a concession is proposed that this requirement of meeting the pre-requisites of Section 100C would apply from 01 July 2021.

6. Taxpayer's Profile

Sections 114A, 182 and 182A

In order to update and synchronize the taxpayers particulars, the Bill proposes to add a new Section 114A wherein following persons are required to furnish the tax profile in the prescribed form along with relevant annexures, statements or documents:

- every person applying for registration under Section 181;
- every person deriving income under the head "Income from Business"
- every person whose income is subject to final taxation
- any non-profit organization as per Clause (36) of Section 2
- any trust or welfare institution
- any other person prescribed by the Board

The particulars that are required to be submitted include bank accounts, utility connections, business premises including all manufacturing, storage or retail outlets operated or leased by the taxpayer, types of businesses and other prescribed information.

The deadline for furnishing the aforesaid profile is as follows:-

In case of a person registered before 30 September, 2020 - on or before 31 December, 2020

In case of a person not registered before 30 September, 2020 - within ninety days of registration.

In case there is a change in particulars, the profile is expected to be updated within ninety days of such change.

The Bill also provides a penalty of PKR 2,500 for each day of default, subject to minimum penalty of PKR 10,000, in case of non-furnishing of such profile. Further, non-furnishing of the tax profile may lead to non-inclusion of the name of the taxpayer in the ATL. However, the person shall be included in the active taxpayers' list subject to filing of profile after the date and payment of surcharge as under:

- PKR 20,000 in case of a company;
- PKR 10,000 in case of an association of persons; and
- PKR 1,000 in case of an individual.

7. Return of Income and Statement of Final Taxation

Section 114 and Section 115

Persons whose entire income is governed under the FTR are required to file a statement in lieu of return of income pursuant to Section 115(4) of the Ordinance.

The Bill now seeks to mandate such taxpayers to file the complete return of income pursuant to Section 114 of the Ordinance instead of the statement as above.

Consequential amendments are proposed to be made throughout the text of the Ordinance to give effect to this amendment.

Also, the Bill now proposes to empower the FBR to prescribe different forms of return for different classes of income or persons including persons subject to final taxation. As a result of the above, the privileges available to such persons who only file statement under section 115(4) in the past like no requirement to file proper accounts appear to have been withdrawn in view of the fact, that almost the entire final tax regime has been converted into minimum tax regime whereby comparison of taxes withheld and actual tax liability based on profits of the person is now required.

Similarly, in relation to revision of return of income, the Bill proposes to require the CIR to grant approval in case of a bonafide omission or wrong statement.

8. Tax audit

Section 177

Conventionally, tax audits are conducted physically whereby the CIR calls for records and documents which he deems appropriate including books of account either in paper or electronic form, from a taxpayer, in respect of a particular tax year. Considering the advent of technology and its revolutionizing impact on every facet of life, it has become imperative that other means of gathering information and conducting audit of the tax affairs of a person may be explored.

Accordingly, a new sub-section (2A) is proposed to be inserted in Section 177 of the Ordinance which empowers the CIR to conduct audit proceedings of a taxpayer electronically through video links or any other facility as may be prescribed by the FBR. We understand that for this purpose, the FBR would introduce a mechanism.

Though, this is a right step, implementation of a secure and effective system which is also acceptable to all stakeholders would be a challenging task for the FBR. Further, effective controls would also be required to be in place to ensure transparency and confidentiality of the information accessed through online systems.

It has also been proposed that where a taxpayer fails to furnish records, documents, books of accounts, has furnished incomplete records or is unable to provide sufficient explanation regarding any defects in the records, the CIR may determine its taxable income on the basis of sectoral benchmark ratios.

The sectoral benchmark ratios are defined as standard business sector ratios based on comparative cases, as notified by the FBR, and includes financial ratios, production ratios, gross profit ratio, net profit ratio, recovery ratio, wastage ratio etc.

9. Appeal to appellate authorities

Sections 127, 129 and 131

Pursuant to the proposed introduction of sub-section (2A) to Section 120 of the Ordinance providing for processing of a return of income through automated system, which would result in passing of an assessment order in terms of section 120 of the Ordinance, Section 127 of the Ordinance, which provides for an appeal to the CIR (Appeals), has also been proposed to be amended. The amendment proposed in Section 120 would provide for filing of an appeal in case the assessment so passed is not acceptable to the taxpayer.

The Bill also proposes to enhance fees for filing appeals with the CIR (Appeals) and with the ATIR. The below table depicts the existing fees and the proposed fees:-

Authority	Individual/AOP		Company	
	Appeal against assessment order PKR	Other order PKR (Appeals)	Appeal against assessment order PKR	Other order PKR
Existing	1,000	200	1,000	1,000
Proposed	2,500	1,000	5,000	5,000
Existing	ATIR	2,000	2,000	2,000
Proposed	2,500	2,500	5,000	5,000

It is not understandable as to what is the reason behind the proposal of enhancing the appeal fees for, the increase may not have substantial impact on revenue generation neither it would likely result in reduction in the number of appeals being filed owing to arbitrary assessments being framed.

In addition to the above, another set of amendments has been proposed in Section 127 and 131 of the Ordinance. Somewhat similar amendments were made in the repealed Ordinance when through the Finance Act, 1994, Sections 129 and 134 were amended which respectively dealt with filing of appeals before the CIR (Appeals) and the ATIR. The amendments so made related to mandatory payment of partial tax demands arising from the impugned orders. However, those amendments were omitted via the Finance Act, 1996. Thereafter, the Finance Ordinance, 2000 again amended Section 129 of the repealed Ordinance to the above effect however, with the advent of the Ordinance in the year 2003, such provisions were done away with. It is, after the lapse of almost 17 years that the Bill has proposed to amend Section 131 of the Ordinance which deals with the procedure of filing of appeals with the ATIR. The proposed amendments suggest that in order for an appeal with the ATIR to be admitted the taxpayer would be required to deposit ten percent of the tax as upheld by the CIR (Appeals), the proof whereof has to be provided at the time of filing of the appeal to the taxpayer. A related amendment has also been proposed in Section 127 of the Ordinance requiring the CIR (Appeals) to specify in his order, the amount of tax upheld by him.

The aforesaid amendments give rise to a serious issue of depriving the taxpayers of the right of appeal. Another ambiguity that arises is that the proposed amendment requiring payment of tax has been provided in a manner that refers to payment of the 'tax upheld' instead of the 'related tax demand'. In all fairness, this needs to be dropped from the table at the time of converting the Bill into an Act of Parliament.

10. Unexplained income or assets

Section 111

Currently, under Section 111 of the Ordinance, if the CIR is of the opinion that the taxpayer is unable to provide satisfactory explanation on account of the following items with respect to the nature and source of their investment, he may tax such items to the extent they are not adequately explained under the head 'income from other sources'. The Bill has now proposed a significant amendment with respect to the head of income under which such unexplained source of income/ investment/ expense

would be taxed. A comparison of which is tabulated below:-

S.No.	Particulars	Current head of taxation	Proposed head of taxation
1.	Amount credited in a person's books of account	Income from other sources	No change
2.	Investment/ ownership of money or valuable article	-do-	-do-
3.	Expenditure incurred	-do-	-do-
4.	Suppressed production/ sales	-do-	Income from business
5.	Any other suppressed item/ receipt liable to tax	-do-	-do-

The proposed change aims to rationalize the taxation of relevant items under the respective heads to which they relate.

11. Capital gains on disposal of immovable property

Section 12

The taxation of capital gains arising from disposal of capital assets is governed by Section 37 of the Ordinance. A separate mechanism for computation of capital gain on disposal of (i) open plot, and (ii) constructed property was introduced through the Finance Act, 2019. The capital gain was eligible for reduction of 25% based on holding period exceeding one year up to eight years for open plots and one year up to four years for constructed property. Furthermore, the gain arising after holding period of eight years in case of open plot and four years in case of constructed property was taken as zero.

In order to incentivize economic activity in the real estate sector, the Bill seeks to eliminate the separate mechanism for taxation of capital gains on immovable property by revamping the taxability of such capital gains and proposing as under:

- Eliminating classification of immovable property into open plots and constructed property.
- Reducing the holding period for 100 percent reduction in gain to four years.
- Progressive reduction in the amount of gain based on each year of the holding period.

The existing and proposed mechanism for taxation of capital gain on immovable property is as follows:

Holding Period for Open Plot	Reduction in gain	Existing Holding Period for Constructed property	Reduction in gain
Does not exceed one year	0%	Does not exceed one year	0%
Exceeds one year	25%	Exceeds one year but does not exceed two years	25%
Exceeds two years	25%	Exceeds two years but does not exceed three years	25%
Exceeds three years	25%	Exceeds three years but does not exceed four years	25%
Exceeds four years	25%	Exceeds four years	100%

The existing and proposed mechanism for taxation of capital gain on immovable property is as follows:

Holding Period for Immovable property	Reduction in gain	Existing Holding Period for Immovable property	Reduction in gain
Does not exceed one year	0%	Does not exceed one year but does not exceed two years	25%
Exceeds one year but does not exceed two years	25%	Exceeds two years but does not exceed three years	25%
Exceeds two years but does not exceed three years	25%	Exceeds three years but does not exceed four years	25%
Exceeds three years but does not exceed four years	25%	Exceeds four years	100%

A new Clause (114AA) has also been proposed to be introduced in Part I of Second Schedule to the Ordinance, whereby any capital gains derived by a resident individual from the sale of constructed residential property shall be treated as exempt from tax, if the following conditions are met:

- at the time of sale, the residential property is being used for the purpose of personal accommodation by the individual, spouse or dependents of the individual, and for which any of the utility bills is issued in the name of such individual;
- the land area of the property does not exceed 500 square yards in case of a house and 400 square feet in case of a flat; and
- such exemption has not been previously claimed by the individual, spouse or dependents of the individual.

12. Payment to non-residents

Section 152

The Finance Act, 2018, introduced the concept of Cohesive Business Operations to bring into the ambit of Pakistan taxation, any supply of goods from outside Pakistan, if an associate of the non-resident supplier is also engaged in the installation or commission of such goods. This created significant hurdles for projects in relation to remittance of payments due to the non-resident suppliers. In order to address this issue, the Finance Act, 2019 introduced sub-section (4B) which allowed the Commissioner to permit payment after deduction of tax equivalent to 2.1 percent (being thirty percent of the tax chargeable on such payment). The Bill now proposes to reduce the rate to 1.4 percent (being twenty percent of the tax chargeable on the payment to the non-resident supplier).

The Bill also proposes that the tax withheld, under sub-section (2A), from payments made to a permanent establishment of a non-resident shall be a minimum tax, except where payments are received for the sale of goods by a company being a manufacturer of such goods. This proposed amendment aims to rationalize the provisions of section 152 with the provisions of section 153, and create a level playing field for both resident companies and permanent establishments of non-resident.

Similarly while rationalizing the provisions relating to tax on services under section 153 of the Ordinance, through Finance Act, 2019, certain services were allowed a reduced rate of tax at 3% instead of a higher general rate of 8/10% of gross value of services. However, similar provisions were not adopted for permanent establishments of non-residents dealing in similar services. The Bill now seeks to provide similar mechanism for services rendered by permanent establishments of non-residents. However, it is pertinent to note that while introducing these provisions, engineering services which were part of the selected sectors has not been enlisted and in fact is also proposed to be abolished for resident service providers under section 153.

- The Bill also includes various rationalization measures by proposing that:
 - the tax deducted from payment for advertisement services to a non-resident media person relating from outside Pakistan is a minimum tax;
 - the exemption application made by a permanent establishment under sub-section (4A) is made in a prescribed form; and
 - the exemption application made by a payer shall include such other particulars as may be prescribed.

13. Restriction on deduction of profit on debt payable to associated enterprise

Section 106A

In line with Action Plan 4 of the OECD's recommendations on BEPS, the Bill proposes to introduce a new section which imposes a restriction on deduction of profit on debt payable to associated enterprise. The salient features of the new section are:

- Deduction of foreign profit on debt in excess of fifteen percent of taxable income before depreciation, amortization and foreign profit on debt shall be disallowed to a foreign controlled resident company (other than an insurance or banking company);
- The section shall not apply if the total foreign profit on debt claimed as a deduction is less than PKR 10 million for a tax year;
- Where the foreign profit on debt cannot be fully adjusted against the taxable income for a tax year, the excess amount shall be added to the amount of foreign profit on debt for the following tax year and shall be treated to be part of foreign profit on debt if there is no such deduction for that tax year, be treated as the deduction for that tax year and so on for three tax years following the year in which the foreign profit on debt was claimed as an expense;
- This section shall apply in respect of foreign profit on debt accrued with effect from the first day of July, 2020, even if debts were contracted before the first day of July, 2020;
- Foreign-controlled resident company means a resident company in which fifty percent or more of the underlying ownership of the company is held by a non-resident person either alone or together with an associate or associates; and
- Foreign interest paid or payable to a non-resident person or an associate of a foreign-controlled resident company, and includes a wide variety of financial instruments, including instruments which in substance are in the nature of financial instruments, and also includes fees, expenses and exchange gains / losses related to such instruments.

The section also discusses the interplay between its provisions and the provisions of section 106 relating to Thin Capitalization rules. However, the provisions are incomplete, and their intention is not comprehensible in the current proposed state. In all probability this will be clarified in the Finance Act.

It is important to note that the provisions of the proposed section are far more onerous than the existing Thin Capitalization rules, since the latter only apply when the foreign debt to foreign equity ratio exceeds 3:1 and the foreign debt is obtained from a foreign related party where the profit on debt is either exempt from tax in Pakistan or is subject to tax at a rate lower than the corporate tax rate. The restriction under the proposed section will apply to all foreign debt, whether or not it is exempt from tax or debt payments; even those obtained from third party lenders, so long as the borrower is a foreign controlled resident company and the profit on debt exceeds the monetary threshold of PKR 10 million.

14. Applicability of minimum tax on permanent establishment of non-resident persons

Section 113

Section 113 of the Ordinance levies minimum tax on a person based on his turnover where such person is not liable to pay tax due to various reasons listed therein. However, the levy of minimum tax in case of corporate taxpayers, is only applicable on resident companies. This means that foreign companies having a permanent establishment in Pakistan (including a branch) are not subject to minimum tax. The Bill has now proposed to include non-resident companies having a permanent establishment in Pakistan under the domain of minimum tax on turnover.

Consequently, such companies would be required to compute minimum tax under Section 113 of the Ordinance for determination of their ultimate tax liability. It may be

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