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SUPREME COURT SETTLES TAX TREATMENT OF DIVIDEND INCOME RECEIVED BY CORPORATES

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INTRODUCTION

The Supreme Court of Pakistan has delivered an important judgment clarifying the tax treatment of dividend income received by companies under the Income Tax Ordinance, 2001. In Civil Petition Nos. 5257 to 5265 of 2024, decided on 3 July 2026, the Court dismissed the Federal Board of Revenue's (FBR) petitions and upheld the decisions of the Islamabad High Court and the Income Tax Appellate Tribunal. The Court held that dividend income received by a company is taxable under Section 5 of the Ordinance and cannot be assessed under Section 39 as "Income from Other Sources" at the normal corporate tax rate.

The dispute related to several corporate taxpayers, including Saudi Pak Industrial and Agricultural Investment Company, Fauji Foundation, Fauji Fertilizer Company, CAPGAS (Private) Limited and State Engineering Corporation. The FBR argued that because of the proviso inserted in Section 8 through the Finance Act, 2007, dividend received by a company did not qualify for final tax treatment. According to the department, such dividend should instead form part of taxable income under the normal tax regime and be taxed under Section 39 at the applicable corporate tax rate. The taxpayers challenged this position before the Tribunal, which decided in their favour. The Islamabad High Court upheld those decisions, leading to the appeals before the Supreme Court.

LEGAL BACKGROUND

The controversy arose from the interaction between Sections 5, 8 and 39 of the Income Tax Ordinance, 2001. Section 5 specifically imposes tax on dividend income and provides its own method of computation and tax rate. Section 39 is a residual charging provision for income not falling under any other head. Section 8 sets out the consequences of taxes imposed under certain provisions, including their treatment as final taxes. A proviso inserted through the Finance Act, 2007 excluded dividend received by companies from the application of Section 8. This proviso remained in force until it was omitted by the Finance Act, 2013.

DECISION

Section 5 is a complete and independent charging provision

After examining the statutory framework, the Supreme Court concluded that Section 5 is a complete and independent charging provision for dividend income. It not only creates the charge to tax but also prescribes a separate mechanism for computing tax by applying the specified rate to the gross amount of the dividend. The Court observed that bringing dividend income under Section 39 would render Section 5 redundant, which would be contrary to settled principles of statutory interpretation. Since Section 39 applies only to income that is not included under any other head, it cannot be invoked where dividend is already specifically covered by Section 5.

A machinery provision cannot override a charging provision.

A significant aspect of the judgment is the distinction drawn between substantive charging provisions and machinery provisions. The Court held that Section 5 is a substantive charging provision, whereas Section 8 is merely a machinery provision dealing with the consequences of taxation. As a matter of established legal principle, a machinery provision cannot override or dilute a substantive charging provision. Consequently, the proviso inserted in Section 8 during the period from 2007 to 2013 did not alter the legal character of dividend income or permit the tax authorities to assess it under Section 39.

Other Key Findings

In dismissing the FBR's petitions, the Supreme Court reaffirmed several important principles of tax law. A specific charging provision prevails over a general or residual provision. Every statutory provision must be interpreted harmoniously so that none becomes redundant. Machinery provisions governing the collection or administration of tax cannot amend or restrict the operation of a substantive charging provision unless the legislature expressly provides otherwise.

CONCLUSION

The judgment settles a long-standing controversy surrounding the taxation of corporate dividend income for the relevant tax years. It confirms that dividend income received by companies is chargeable under Section 5 of the Income Tax Ordinance, 2001 and cannot be taxed as income from other sources under Section 39 at the normal corporate tax rate. Accordingly, the Supreme Court dismissed all petitions filed by the FBR and affirmed the decisions of the Islamabad High Court and the Income Tax Appellate Tribunal.

It should also be noted here that during the tax year 2008 to tax year 2013, the dividend tax rates were 10%, however, as per the current position of the law, the dividend income is taxed at 0%, 7.5%, 15%, and 25% depending upon the nature of business of the company paying the dividend.

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