TAXPAK

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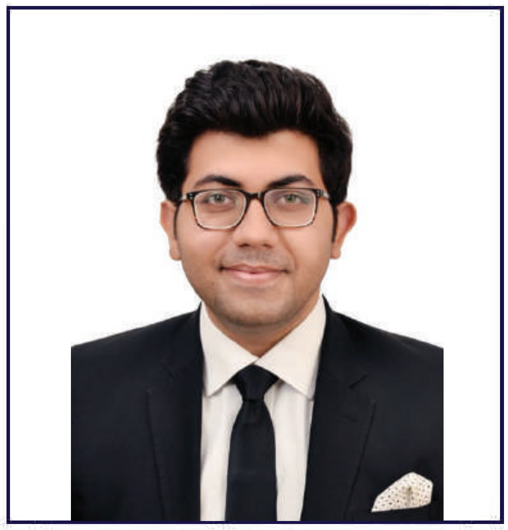

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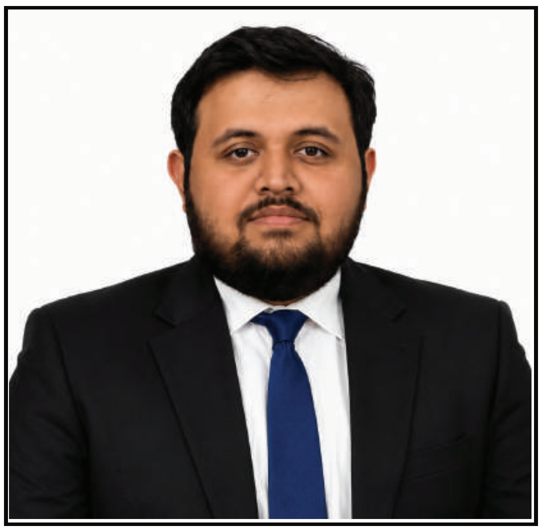

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Chairman's Message

Assalam-o-alaikum. We hope this monthly issue of TaxPak finds you in good spirits and immaculate health! Tola Associates welcomes you to another edition of TaxPak, our monthly publication the purpose of which is to provide a monthly update on the ongoing tax related developments in Pakistan. Alhamdulilah, so far, we have been successful in our mission to educate about, and keep the public-at-large updated of these developments on a monthly basis. Moreover, we would like to apprise the readers of what information you can expect in this document. This newsletter contains an elaboration of important Notifications and Circulars issued by the Federal Board of Revenue ("FBR") and its provincial counterparts. Further, Notifications from the Corporate regulatory body i.e., SECP are also discussed. As our main aim is to keep the masses updated regarding the developments in the Pakistani tax law, we usually discuss a (relatively) recent judgement passed by the courts of law. This edition of TaxPak consists a discussion of one judgment. The judgment discussed, was passed by the Hon'ble Appellate Tribunal Inland Revenue ("ATIR"), wherein it was held that exempt dividend income under Section 100D of the Income Tax Ordinance, 2001 ("ITO") cannot be included in the computation of income for the purpose of levy of Super Tax under Section 4C of the ITO.

Towards the end of the newsletter, we have discussed our Topic of the month titled as "Intercompany Transactions in Pakistan. Transfer Pricing Risks Beyond Multinational Groups". The said topic gives a brief overview of the applicability of Pakistan's transfer pricing rules to intercompany transactions, the associated tax risks, and the importance of arm's length pricing, proper documentation, and compliance to mitigate FBR scrutiny.

All our readers are requested to visit our website www.tolaassociates.com, or download our mobile application in order to access previously published editions of TaxPak along with other publications, and to stay updated of future notifications. Lastly, we request our readers to circulate this e-copy within their circle, as our primary aim is to benefit the masses. Feedback is always welcomed.

Warm Regards,

Ashfaq Yousuf Tola - FCA, FCMA
Chairman
Tola Associates.

FEDERAL BOARD OF REVENUE ("FBR") NOTIFICATIONS

A. INCOME TAX NOTIFICATIONS

1) EXEMPTION OF DEFAULT SURCHARGE AND PENALTIES AGAINST CURRENT TAX LIABILITY OF PIACL UNDER SECTION 183 OF THE INCOME TAX ORDINANCE, 2001

The Federal Government, vide S.R.O. 1129(I)/2026 dated 24 July 2026, and in supersession of S.R.O. 799(I)/2026 dated 4 May 2026, has exempted the default surcharge and penalties payable by Pakistan International Airlines Corporation Limited (PIACL) with respect to specified current income tax liabilities.

It has been notified that the exemption shall apply to default surcharge and penalties relating to withholding tax (other than salary) for the period April to December 2024 and advance income tax for the period May 2024 to June 2025, involving aggregate current income tax liabilities of approximately PKR 4.29 billion. The notification further provides that the exemption is intended to facilitate the successful completion of the Government's divestment process of PIACL and the timely execution of the transaction documents.

*For further insight: **FBR***

2) SPECIAL PROCEDURE FOR SMALL SHOPKEEPERS

The FBR, vide S.R.O. 1166(I)/2026 dated 27 July 2026, has notified the Special Procedure for Small Shop-keepers under section 99B of the Income Tax Ordinance, 2001. The procedure has been finalized following the publication of the draft issued vide S.R.O. 1109(I)/2026 dated 14 July 2026.

It has been notified that the special procedure shall apply, on an optional basis, to individuals deriving income mainly through retail shops having an annual turnover of up to PKR 200 million for Tax Year 2026. The procedure excludes, inter alia, persons whose turnover exceeded PKR 200 million in any of the preceding three years, individuals owning more than one shop, Tier-1 retailers, jewellery sellers, and providers of professional services. Eligible shopkeepers may register through the IRIS portal, a dedicated mobile application, or by visiting the nearest tax office.

Under the notified procedure, eligible shopkeepers shall be liable to tax at the rate of 1% of gross turnover, subject to payment of a minimum tax of PKR 25,000. The procedure also provides for simplified return filing, exemption from withholding obligations under section 153, non-applicability of minimum tax under section 113 and tax at the rate of 1.25%, exemption from POS integration and digital invoicing requirements, and issuance of a "Green Plate" bearing a QR code to qualifying shopkeepers.

The notified procedure seeks to provide a simplified tax compliance regime for small retailers by encouraging documentation of the retail sector. Similar to the earlier draft, the procedure provides that taxpayers opting for the scheme shall generally not be subject to audit, however, proceedings may still be initiated where the FBR receives third-party information relating to, inter alia, "significant or unusual economic transactions." Since the notification does not define this expression or prescribe any objective threshold for its application, the scope of this exception remains open to interpretation and may create uncertainty regarding the extent of protection available under the scheme.

For further insight: ***FBR***

3) RULE 231CB - INDEPENDENT CASE SCRUTINY COMMITTEES.

The FBR, vide S.R.O. 1165(I)/2026 dated 27 July 2026, has notified amendments to the Income Tax Rules, 2002 by inserting Rule 231CB, thereby establishing Independent Case Scrutiny Committees. The notification has been issued following the publication of the draft amendments vide S.R.O. 1138(I)/2026 dated 21 July 2026.

It has been notified that three Independent Case Scrutiny Committees shall be constituted to examine and recommend whether references should be filed before the High Courts or petitions before the Supreme Court or the Federal Constitutional Court against adverse appellate orders. Each Committee shall comprise a retired Judge as Chairman, an Advocate having at least fifteen years' experience in tax and commercial litigation, and a senior serving or retired Inland Revenue officer of BS-20 or above. The Committees shall also review pending litigation, maintain a database of settled legal issues, identify systemic issues requiring legislative or administrative intervention, and exercise jurisdiction over specified field formations across the country.

The notification further provides that every case shall be referred to the relevant Committee within ten days of receipt of an order of the Appellate Tribunal Inland Revenue ("ATIR") or the High Court, and that the Committee shall ordinarily finalize its recommendation within fifteen days. In cases involving imminent expiry of the limitation period or substantial revenue implications, the Chairman may approve the filing of a reference or petition on an emergency basis, subject to post-facto review by the full Committee. The notification also prescribes provisions relating to confidentiality, conflict of interest, publication of anonymized annual summaries, maintenance of a searchable database, tenure and remuneration of Members, and annual reporting to the Board.

The notified framework introduces an mechanism for independent scrutiny,with the objective of ensuring that only legally sustainable and revenue significant matters are pursued. While the framework is expected to promote consistency in litigation strategy and reduce avoidable litigation, the notification also provides that where a Committee fails to render its recommendation within the prescribed timeline, the case shall be deemed to have been cleared for filing. Consequently, in time-sensitive matters, references or petitions may still be instituted without the benefit of substantive scrutiny, potentially limiting the practical effectiveness of the newly established mechanism.

For further insight: ***FBR***

4) AMENDMENTS IN INDEPENDENT SCRUTINY COMMITTEES RULES

The FBR, vide S.R.O. 1239(I)/2026 dated 30 July 2026, has proposed amendments to Rule 231CB of the Income Tax Rules, 2002 relating to the territorial jurisdiction of the Independent Case Scrutiny Committees.

It has been proposed to revise the jurisdiction of the Committees by removing CTO Islamabad from the jurisdiction of Committee No. 1, replacing RTO Lahore with RTO-I Lahore and RTO-II Lahore under Committee No. 2, and replacing CTO Karachi with CTO-I Karachi and CTO-II Karachi under Committee No. 3.

The proposed amendments are limited to updating jurisdictional references and do not affect the composition, powers, or functions of the Committees.

For further insight: ***FBR***

5) AMENDMENTS IN THE INLAND REVENUE REWARD RULES, 2021

The FBR, vide S.R.O. 1226(I)/2026 dated 30 July 2026, has proposed amendments to the Inland Revenue Reward Rules, 2021 under the relevant provisions of the Income Tax Ordinance, 2001, the Sales Tax Act, 1990, the Federal Excise Act, 2005 and the Islamabad Capital Territory (Tax on Services) Ordinance, 2001. Comments or suggestions on the draft amendments have been invited within seven days of publication in the Official Gazette.

It has been proposed to amend Rule 8 of the Inland Revenue Reward Rules, 2021 by reducing the prescribed percentages relating to rewards, replacing 5% with 2% and 2.5% with 1%. The proposed amendments seek to revise the reward mechanism prescribed under the Rules.

For further insight: ***FBR***

B. SALES TAX NOTIFICATIONS

1) EXEMPTION OF WHOLE OF THE AMOUNT OF DEFAULT SURCHARGE AND PENALTY ON ACCOUNT OF SALES TAX AND FED OF PIACL.

The Federal Government, vide S.R.O. 1134(I)/2026 dated 17 July 2026, has exempted the default surcharge and penalties payable by PIACL with respect to specified sales tax and federal excise duty liabilities.

It has been notified that the exemption shall apply to default surcharge and penalties relating to sales tax and federal excise duty liabilities amounting to PKR 1.003 billion and PKR 3.469 billion, respectively, pertaining to September, October and December 2025. The exemption is subject to the condition that the underlying liabilities shall be paid within four years, following a one-year grace period, in equal annual instalments after the first completion as defined in the Share Purchase and Subscription Agreement between the Government of Pakistan and the successful bidders.

For further insight: ***FBR***

2) INDEPENDENT CASE SCRUTINY COMMITTEES FOR SALES TAX

FBR, vide S.R.O. 1169(I)/2026 dated 21 July 2026, has introduced Chapter IX-A in the Sales Tax Rules, 2006, establishing Independent Case Scrutiny Committees for Sales Tax under section 47AAA of the Sales Tax Act, 1990.

It has been notified that the Committees shall examine and recommend whether references under section 47 of the Sales Tax Act, 1990 should be filed before the High Courts or petitions before the Supreme Court or Federal Constitutional Court against appellate orders. The Committees shall comprise a retired Judge as Chairman, an Advocate having at least fifteen years' experience in tax and commercial litigation, and a senior serving or retired Inland Revenue officer of BS-20 or above.

The notified framework largely mirrors the Independent Case Scrutiny Committee mechanism introduced under the Income Tax Rules, 2002, including provisions relating to pre-filing scrutiny, review of pending litigation, confidentiality, emergency filing approvals, timelines for recommendations, and publication of anonymized summaries of decisions. The Committees shall finalize recommendations within fifteen days of referral, failing which the matter shall be deemed cleared for filing, subject to compliance with other legal requirements.

The introduction of the mechanism aims to strengthen litigation management under the sales tax regime by ensuring independent review before pursuing matters before superior courts and promoting consistency in departmental litigation decisions. However, similar to the income tax framework, the deemed clearance provision where the Committee fails to decide within the prescribed timeline may limit the effectiveness of pre-filing scrutiny in time-sensitive cases.

*For further insight: **FBR***

3) AMENDMENTS IN INDEPENDENT CASE SCRUTINY COMMITTEES FOR SALES TAX

The FBR vide S.R.O. 1237(I)/2026 dated 30 July 2026, has amended Chapter IX-A of the Sales Tax Rules, 2006 relating to the territorial jurisdiction of the Independent Case Scrutiny Committees for Sales Tax.

It has been notified that the jurisdiction of the Committees has been revised by omitting CTO Islamabad from Committee No. 1, replacing RTO Lahore with RTO-I Lahore and RTO-II Lahore under Committee No. 2, and replacing CTO Karachi with CTO-I Karachi and CTO-II Karachi under Committee No. 3. The amendments are limited to updating jurisdictional references and do not affect the composition, powers, or functions of the Committees.

*For further insight: **FBR***

4) IMPOSITION OF FIXED SALES TAX ON STEEL MELTERS AND RE-ROLLERS ON THE BASIS OF PER UNIT OF ELECTRICITY CONSUMED

The FBR, vide S.R.O. 1245(I)/2026 dated 31 July 2026, has prescribed a special procedure for categorization of steel manufacturers and collection and payment of sales tax on the basis of electricity consumed by steel melters, re-rollers and composite units under the provisos to section 6(2) of the Sales Tax Act, 1990.

It has been notified that different rates of sales tax per unit of electricity shall apply depending upon the source of scrap used by the manufacturer. Manufacturers predominantly using imported scrap or scrap supplied by EFS licensees may avail a concessional rate of Rs.5 per unit, subject to the prescribed conditions, while other manufacturers shall be liable to pay sales tax at the notified rates.

The notification further provides that sales tax paid on electricity consumption shall be adjustable against output tax, prescribes categorization of manufacturers based on electricity consumption, requires DISCOs to collect the prescribed sales tax through electricity bills, and mandates quarterly review of eligible manufacturers. The notification shall take effect from 1 July 2026.

For further insight: ***FBR***

C. JURISDICTION ORDER

1) Creation and Re-Designation of Inland Revenue Field Formations

The FBR, vide Order F.No.57(2)Jurisdiction/2026-77469-R dated 16 July 2026, issued under clause (r) of sub-section (1) of section 4 of the Federal Board of Revenue Act, 2007, has announced changes in the structure and nomenclature of certain Inland Revenue field formations.

It has been notified that Regional Tax Office-II, Lahore has been established, Corporate Tax Office, Islamabad has been abolished, and two Corporate Zones, namely Corporate Zone-I and Corporate Zone-II, have been created under the Regional Tax Office, Islamabad, along with one Corporate Zone under the Regional Tax Office, Rawalpindi. Further, certain field formations have been re-designated, including Corporate Tax Office-I Karachi and Corporate Tax Office-II Karachi, and Regional Tax Office-I Lahore.

For further insight: ***FBR***

CASE LAW 2: HON'BLE APPELLATE TRIBUNAL INLAND REVENUE ("ATIR"), KARACHI BENCH, HOLDS THAT EXEMPT DIVIDEND INCOME UNDER SECTION 100D OF THE INCOME TAX ORDINANCE, 2001 ("ITO") CANNOT BE INCLUDED IN THE COMPUTATION OF INCOME FOR THE PURPOSE OF LEVY OF SUPER TAX UNDER SECTION 4C OF THE ITO, AS SECTION 4C IS AN ADDITIONAL CHARGE ON INCOME AND DOES NOT CONVERT EXEMPT INCOME INTO TAXABLE INCOME.

INTRODUCTION

For Tax Year 2023, the taxpayer filed its return of income under Section 114(1) of the ITO, which was deemed assessed under Section 120 of the Ordinance. The department issued a show cause notice under Section 4C of the ITO dated 05.03.2024 for recovery of Super Tax and subsequently passed an order dated 30.05.2025. Being aggrieved, the taxpayer filed an appeal against the order dated 30.05.2025 passed by the Assistant / Deputy Commissioner Inland Revenue ("DCIR"), under Section 4C of the ITO and the matter was subsequently chal lenged before the Hon'ble ATIR.

ARGUMENTS BY THE COUNSEL FOR THE TAXPAYER

The counsel for the taxpayer contended that the impugned order was passed by incorrectly including the entire dividend income of PKR 531,894,352 for the purpose of computing Super Tax, despite the fact that PKR 436,973,032 represented dividend income exempt under Section 100D of the ITO.

It was argued that Section 4C creates an additional charge of tax on income and does not create a separate category of income or convert exempt income into taxable income. Therefore, income which is expressly exempt under the ITO cannot be brought within the ambit of Section 4C.

Reliance was placed on the judgment of the Hon'ble Federal Constitutional Court of Pakistan ("FCC") in Civil Appeals No.1243 of 2020 and connected matters, wherein it was held that where a particular class of income is exempt from tax under the Ordinance, Super Tax shall also not be payable on such income.

FINDINGS OF THE HON'BLE ATIR

The Hon'ble ATIR observed that the controversy was no longer res integra and the issue stood settled by the Hon'ble Constitutional Bench of the FCC in Civil Appeals No.1243 of 2020 and connected matters.

The Hon'ble ATIR noted that the Hon'ble FCC, while examining the constitutional validity and scope of Section 4C of the Income Tax Ordinance, 2001, held that Super Tax is an additional tax on income drawing its legislative sanction from Entry 47 of Part-I of the Federal Legislative List. It was held that where a particular class of income is exempt from tax under the ITO, Super Tax shall likewise not be payable in respect of such exempt income.

The Hon'ble ATIR further observed that the Hon'ble FCC illustrated that exempt capital gains, exempt gains on securities, exempt gains on immovable property and every other category of income specifically exempt under the ITO remain outside the ambit of Super Tax. The principle laid down by the Hon'ble FCC leaves no distinction between exempt dividend income and any other exempt class of income.

The Hon'ble ATIR observed that the declaration of law is binding upon all subordinate judicial and executive forums by virtue of Article 189 of the Constitution of the Islamic Republic of Pakistan, 1973.

The Hon'ble ATIR observed that the department cannot deviate or ignore binding decisions and that, in the absence of an express charging provision, no tax can be imposed by implication.

The Hon'ble ATIR further observed that the impugned computation proceeded on an erroneous factual assumption by treating the entire dividend income as taxable, whereas a substantial portion thereof stood exempt under Section 100D of the ITO. It was held that once the exempt component is excluded, the computation of Super Tax requires fresh determination in accordance with law and the principles laid down by the Hon'ble FCC.

Therefore, the Hon'ble ATIR held that the dividend income exempt under Section 100D of the ITO cannot legally be included in the computation of income for levy of Super Tax under Section 4C. The action of the Assessing Officer in including exempt dividend income in the Super Tax base was held to be illegal, contrary to law, and unsustainable.

The Hon'ble ATIR accordingly set aside the impugned order dated 30.05.2025 to the extent it included exempt dividend income under Section 100D in the computation of Super Tax and directed the Assessing Officer to recompute the taxpayer's liability under Section 4C after excluding exempt dividend income of PKR 436,973,032.

It was further held that if, after such exclusion, the taxpayer's income does not satisfy the statutory threshold prescribed under Section 4C, no Super Tax shall be chargeable.

The grounds of appeal relating to inclusion of exempt income were allowed, and the remaining ancillary grounds were held to be either rendered academic or requiring no separate adjudication. The appeal was disposed of accordingly.

TOTM: INTERCOMPANY TRANSACTIONS IN PAKISTAN. TRANSFER PRICING RISKS BEYOND MULTINATIONAL GROUPS

For many Pakistani businesses, transfer pricing is still viewed as an issue relevant only to multinational corporations. This perception often leads local business groups to overlook the tax implications of transactions between companies under common ownership or control. In reality, the transfer pricing provisions of the Income Tax Ordinance, 2001 apply to transactions between associated persons, regardless of whether they operate across borders or entirely within Pakistan.

Family-owned groups commonly buy and sell goods between related companies, provide management services, share employees, finance one another through intercompany loans, or allocate common expenses across the group. While these arrangements often make commercial sense, they also create opportunities for profits to shift from one company to another. This is precisely why the Federal Board of Revenue (FBR) increasingly examines related party transactions during tax audits.

For CFOs and finance managers, the objective should not simply be compliance. Every intercompany transaction should be structured, priced and documented in a manner that reflects commercial reality and withstands scrutiny if selected for audit.

Section 108 of the Income Tax Ordinance, 2001 empowers the Commissioner to adjust the consideration of transactions between associates where the agreed price differs from what independent parties would have charged under similar circumstances. In other words, the FBR is entitled to disregard an artificial price and substitute an arm's length value if it believes the transaction has shifted taxable profits.

Consider a simple example. A profitable manufacturing company sells its products to a related trading company at an unusually low price. The trading company then sells those products to customers and earns most of the group's profit. If the trading company has accumulated tax losses or enjoys a lower effective tax burden, the arrangement reduces the overall tax payable by the group. Similarly, excessive management fees, inflated service charges or interest-free financing between associated companies may also alter the distribution of taxable income. Such arrangements often become the focus of audit proceedings.

One misconception among domestic business groups is that transfer pricing applies only to the sale of goods. In practice, the FBR reviews a much wider range of transactions. Management fees, administrative support, shared employees, rental of assets, licensing of trademarks, cost allocations and intercompany financing all receive attention because they are often difficult to value and relatively easy to manipulate.

Among these, management service charges frequently present the greatest challenge. Many groups operate with a central management company that provides accounting, finance, legal, human resource or information technology services to other group entities. Charging for these services is commercially acceptable, but businesses should be prepared to demonstrate that the services were genuinely rendered, the recipient benefited from them, and the amount charged reflects market conditions. Agreements, invoices and accounting entries alone are rarely sufficient. Supporting evidence such as benchmarking reports, correspondence, meeting records or employee time allocations often proves equally important.

Intercompany loans deserve similar attention. It is common for one company within a group to finance another without charging interest. While commercial considerations may justify such funding, businesses should carefully assess whether an independent lender would have agreed to the same terms. Where the arrangement lacks commercial justification, the FBR may examine whether an adjustment under Section 108 is appropriate. Documenting the business purpose of the financing and periodically reviewing its terms helps reduce unnecessary disputes.

Cost allocation is another area where many businesses encounter difficulty. Groups often incur expenses centrally before distributing them among various entities. Rent, software subscriptions, payroll costs or administrative overheads are typical examples. These allocations should follow a logical and consistent methodology based on objective factors such as employee headcount, turnover, floor area or actual usage. Arbitrary percentages without supporting calculations are difficult to defend during an audit.

Fortunately, many transfer pricing disputes are avoidable. The strongest defence is not an elaborate tax structure but sound documentation prepared before questions arise. Written intercompany agreements should clearly describe the nature of the transaction, the pricing methodology, payment terms and the responsibilities of each party. Management should also review these arrangements periodically to confirm they continue to reflect the actual conduct of the business rather than outdated commercial practices. Businesses should also remember that intercompany transactions are not solely an income tax issue. Where goods or taxable services are supplied between related companies, the Sales Tax Act, 1990 generally applies in the same manner as transactions with independent customers. Proper tax invoices, correct valuation and timely accounting for sales tax remain equally important.

In recent years, the FBR has invested heavily in digitalisation and data analytics. Information reported through income tax returns, sales tax returns, withholding statements and financial statements enables the tax authorities to identify unusual patterns in related party transactions with far greater ease than before. Significant differences in profitability between associated companies, recurring management charges, persistent losses in one group entity and substantial intercompany balances are all likely to attract greater attention during risk-based audits.

Before finalising the Tax Year 2026 income tax return, finance teams should review all related party transactions with the same level of scrutiny applied to transactions with independent customers. They should ask whether the transaction has a genuine commercial purpose, whether the pricing reflects market conditions and whether sufficient evidence exists to support both the transaction and the amount charged. If the answer to any of these questions is uncertain, corrective action should be taken before filing the return rather than during audit proceedings.

Transfer pricing is no longer an issue confined to multinational corporations. Domestic business groups are equally exposed where transactions between associated companies influence the allocation of taxable profits. For CFOs and finance managers, the focus should be on establishing commercially defensible pricing policies, maintaining strong documentation and reviewing related party arrangements on a regular basis. Businesses that adopt these practices are far better positioned to manage tax risk, reduce disputes and demonstrate compliance when the FBR comes knocking.

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