JUNE 2018

TAX PAK

NEWSLETTER BY TOLA ASSOCIATES

https://goo.gl/LFiWyx

https://goo.gl/QDM4ZM

ADDRESS

408, 4th Floor, Continental Trade Centre, Clifton Block-8, Karachi

Email: connect@tolaassociates.com Ph# 35303294-6

Website: www.tolaassociates.com

CONTENTS

Events on Amnesty Scheme

Sales Tax SROs

50% Tax Calculated to be Paid for Suits to be Entertained - SC

Topic of the Month
Controlled Foreign Company

CONTRIBUTORS

Mr. Ashfaq Tola - FCA
Editor in Chief

Mr. Muhammad Furqan - ACA - Managing Editor

Mr. Muhammad Amayed Ashfaq - Author Topic of the Month

Mr. Sameer Ahmed
Designer

EDITORIAL NOTE

Last issue of Tax Pak for tax year 2018 is in your hands which is the eighth edition. We have covered comments on notifications issued under Federal Sales Tax laws consequent to Finance Act, 2018, a recent judgment of Honourable Supreme Court and an article on newly introduced concept of Controlled Foreign Company.

During the month on June, 2018, we also issued FAQs on amnesty scheme which were very much appreciated by the readers and business community. E-copies of the same may be accessed through our website and mobile applications through following links:

1. www.tolaassociates.com
2. https://goo.gl/QDM4ZM **(iOS)**
3. https://goo.gl/LFiWyx **(Android)**

Lastly, readers are requested to install our mobile applications to stay updated of our publications and notifications.

Ashfaq Tola - FCA
Editor in Chief

Mr. Ashfaq Tola, President Tola Associates was invited as a speaker and presenter at various seminars on Amnesty Schemes both within and outside Pakistan. Following is a pictorial glimpse of these events.

LAHORE

Pictures taken after seminar on Amnesty hosted jointly by Lahore Tax Bar and ICAP - LTBA joint committee June 29, 2018.

Addressing Seminar on Amnesty Schemes at Karachi Wholesaler Grocers Merchants Association on June 28, 2018

KARACHI

DUBAI

Addressing Seminar on TAX AMNESTY at Hotel Metropolitan Dubai on June 23, 2018

ABU DHABI

Presentation at Alliott Hadi Shahid Chartered Accountants in Abu Dhabi on June 24, 2018

1. SALES TAX SROs

Subsequent to the amendments made in the Sales Tax Act, 1990 vide Finance Act,2018. The Federal Government has issued the following SRO's

1) SRO 775(I)/2018 dated 21 June 2018.

Vide the above SRO the Federal Government has made amendments in following Sales Tax Special Procedure Rules, 2007.

a) Special Procedure for Payment of Sales Tax by Importers

Currently, Chapter X of the Sales Tax Special Procedure Rules, 2007 provides exclusion from charging of value addition tax on import of:

i. Goods imported by a manufacturer for in-house consumption

ii. Petroleum products imported by Oil Marketing company for sale in the country

iii. Registered service provider for importing goods for their in-house use of for furtherance of taxable activity and not intended for further supply.

under sub-rule 1 the following entries have been added and excluded for value addition tax on such imports.

iv. LNG/RLNG

v. Second hand and worn clothing or footwear (PCT heading 6309.0000)

b) Special Procedure for Payment of Sales Tax by Steel Melters, Re-Rollers and Ship Breakers.

The existing rate of sales tax on steel-melter and steel re-roller is ten and a half rupees per unit of electricity consumed for the production of steel billets, ingots and mild steel which is the final tax liability. The rate of sales tax is enhanced to 13 %.

Further, in sub rule 2(A) for those steel melters and re-rollers discharging sales tax liability under sub-rule 1 of 58 H and Rupees Eighth Thousand for hundred per metric ton on import of re meltable iron and steel scrap has been enhanced to Rupees ten thousand four hundred per metric ton.

The local supplies of re-melt able iron and steel scrap has been enhanced from Rs 8,400 to Rs 10,400 per metric ton.

In sub-rule 4 of Rule 58 H the rate of sales tax against sales of re-rollable scrap and other material obtained from ship breakers at the time of import is enhanced from Rs 8,500 to Rs 9,500 per metric ton.

The rate of sales tax on steel melters and re-rollers producing electricity with the help of gas generators has been increased. Currently sales tax liability is calculated as a product of Hundred Cubic meter and Rs 2,494 less the sales tax paid on gas bill. The factor of Rs 2,494 is enhanced to Rs 3,088 in the given formula. Currently, Steel melters and re-rollers operating on self-generated electricity the sales tax liability is calculated as product of mill size and Rs 68,187 which has been enhanced to RS 84,422 in the given formula.

The sales tax invoices shall be issued by registered persons for the products and categories at the rates mentioned in the column.

https://goo.gl/LFiWyx
https://goo.gl/QDM4ZM

S. No.	Invoices issued by and for or to	Amount of sales tax to be mentioned on the invoices	
		Existing rate	New rate
1	By steel melters or composite units of melting, rerolling and MS cold drawing to registered re-rollers	Rs. 9,247 per metric ton	Rs. 11,247 per metric ton
2	By steel re-rollers, using ingots or billets of steel melters or composite units of melting, re-rolling and MS cold drawing to registered persons	Rs.10,612 per metric ton	Rs.12,937 per metric ton
3	By re-rollers, using billets of Pakistan Steel Mills or Peoples Steel Mills or Heavy Mechanical Complex or imported billets, to registered persons.	Rs.8,092 per metric ton	Rs.8,092 per metric ton
4	By re-rollers, using ship-plates and re-rollable scrap as raw material, to registered persons.	Rs.9,865 per metric ton	Rs.11,190 per metric ton
5	By re-rollers, to unregistered persons	Rs 1,365 per metric ton	Rs 1,690 per metric ton

In Rule 58K the *value of steel products* has *been enhanced in the following manner.*

S. No.	Invoices issued by and for or to	HS Code	Value of steel products for assessment of sales tax.	
			Existing rate	New rate
1	Billets supplied by Pakistan Steel Mills, Heavy Mechanical Complex and Peoples Steel Mills	Respective heading	Rs. 47,600 PMT	Rs. 47,600 PMT
2	Imported billets	Respective heading	US $ 514 PMT	US $ 514 PMT
3	Re-rollable scrap supplied by ship breakers	Respective heading	Rs.50,000 PMT	Rs.55,883 PMT
4	Imported re-rollable scrap	72.04	US $ 480 PMT	US $ 480 PMT

c) Special Procedure for Payment of Extra Sales Tax on Specified Goods.

In Chapter XIII of the Sales Tax Special Procedure Rules ,2007 levies extra tax @ 2% on value of supplies of all specified goods by manufacturer or importer. The specified goods on which extra tax has been paid in specified manner are exempt from payment of tax on subsequent supplies.

In the aforesaid Table Foam or spring mattress and other foam products for house hold use have been omitted from the table of specified goods. Hence, the same is not chargeable to extra sales tax.

2) SRO 776(I)/2018 dated 21 June 2018

Import of 200,000 metric tons of potatoes is during the period of 5th May 2014 to 31 July 2014 will be chargeable to sales tax @ zero percent. The above zero rating for the same period was earlier available through SRO 338(I)/2014 dated 02May 2014 which was rescinded on 26 June 2014 vide SRO 573(I)/2014. Through the said notification, the Federal Government intends to give retrospective effect of zero rating facility for potatoes imported during the period from 26 June 2014 to 31 July 2014.

3) SRO 777(I)/2018 dated 21 June 2018

S. NO	Description of goods and point of taxation	Rates of sales Tax	New rate of Sales Tax
1	**Goods useable as industrial inputs, specified in Table-1, including fabric.**		
	vii) Supplies of finished fabric to and by retailers; supplies of finished fabric to end consumers; other supplies of finished fabric.	6%	**9%**
	viii) Commercial import of finished fabric	6%	**9%**
3	**Locally manufactured finished articles of**		
	a) textiles and textile made ups including carpets	6%	**9%**
	b) leather and artificial leather.	6%	**9%**
4	**i) Imported finished goods of textile and leather sectors ready to use by general public.**	6%	**9%**
	ii)supplies thereof	6%	**9%**

Through the aforesaid SRO the rate of sales tax against serial no 1 (vii), (viii), 3 and 4 the rate of sales tax has been enhanced to 9%.

Further in condition no (x) the provision relating to inadmissibility of input tax and refund of packing material has been removed and a new condition has been inserted whereby the rate of sales tax for serial no vii will remain @ 6% where the registered persons are integrated in FBR system and the data is transmitted on real time basis.

4) SRO 778(I)/2018 dated 21 June 2018

Through this notification SRO 962(I)/2015 dated 30 September 2015 has been rescinded. By rescinding this notification, the sales tax charged on import and supply of furnace oil (PCT 2710.1941) chargeable to sales at the rate of 20% has been abolished.

5) SRO 779(I)/2018 dated 21 June 2018

The Federal Government has rescinded the SRO's through which it had earlier allowed zero rating on materials purchased for the construction of Karachi-Peshawar motorway and Lahore Orange Line.

6) SRO 780(I)/2018 dated 21 June 2018

By virtue of this SRO the Federal Government has amended SRO 648(I)/2013 dated 09 July 2013 and has excluded supplies of foam or spring mattress for house hold use from charging of further tax at the rate of 3%.

7) SRO 781(I)/2018 dated 21 June 2018

The Federal Government has made amendment in the Islamabad Capital Territory (tax on Services) Ordinance, 2001 and has provided reduced rating to IT and IT enabled services at rate of 5%.

8) SRO 830(I)/2018 dated 30 June 2018

By virtue of SRO 830(I)/2018, dated 30 June 2018, the Federal Government increased the rate of petroleum products. Hence, the amount of sales tax levied on petroleum products was also changed through the aforesaid SRO. Following is the comparison of rates of petroleum products from August 2017 to June 2018.

Date	SRO	Effective from	Products ST rate %				
			MS	HSD	LDO	HOBC	Kerosene
170731	**713**	Aug 1, 2017	23.5	40	0	17	0
170805	**757**	Aug 6, 2017	20.5	35.5	0	17	0
170831	**867**	Aug 31, 2017	17	30	0	17	0
170930	**984**	Oct 1,2017	17	31	0	17	0
171231	**1331**	Jan 1, 2018	17	25.5	6	17	6
180131	**98**	Feb 1, 2018	17	25.5	7.5	17	7
180228	**265**	Mar 1, 2018	17	25.5	17	17	17
180331	**414**	Apr 1, 2018	21.5	27.5	16.5	17	17

Date	SRO	Effective from	Products ST rate %				
			MS	HSD	LDO	HOBC	Kerosene
180430	560	May 1, 2018	15	27.5	11.5	17	12
180531	663	Jun 1, 2018	7	17	1	17	7
180611	729	Jun 12, 2018	12	24	9	17	12
180630	830	Jun 30, 2018	17	31	17	17	17

MS = Motor Spirit (Petrol)
HSD = High Speed Diesel
LDO = Light Diesel Oil
HOBC = High Octane Blending Component

2. 50% TAX CALCULATED TO BE PAID FOR SUITS TO BE ENTERTAINED - SC

In civil appeals NO.1171, 1179 TO 1187, 1190 to 1192, 1198 TO 1236, 1242, 1255, 1274 TO 1276, 1502 TO 1515 OF 2017 AND 114 OF 2013, Honorable Supreme Court has held that Suits, which are already pending or shall be filed in future, must only be continued/entertained on the condition that a minimum of 50% of the tax calculated by the tax authorities is deposited with the authorities.

Below is a (A) brief background to the judgment; (B) breakdown of the Supreme Court's conclusions; (C) possible interpretations of the judgment; and (D) the way forward.

A. Preamble

1. Importers who had imported certain equipment sought to have it cleared without payment of tax on the ground that the import of this equipment was exempted from payment of tax under a specific SRO. The customs authorities refused to release the equipment without payment of tax. The importers, therefore, approached a Single Judge of the High Court in a suit. The Single Judge decreed the suit in favor of the importers and declared that no tax was payable on the import of the equipment.

   The customs department filed an appeal before a Division Bench of the High Court which allowed the appeal on the ground that suits could not be filed in any tax matters, without touching merits of the case.

   The importers filed an appeal before the Supreme Court. A number of companies also filed intervenor applications before the Supreme Court to become party to this appeal as the outcome would have an impact on their pending suits before the High Court.

B. Decision

2. The Supreme Court allowed the appeals and held that –

   (i) Its earlier decisions, in which it had decided that suits can be filed in tax matters, were correct, provided the taxpayer could show that the authority passing the order or taking the action:
   (a) was not validly appointed or constituted;
   (b) did not have the jurisdiction to do so;
   (c) acted in a mala fide manner; or
   (d) had violated the principles of natural justice;

   (ii) The action against which the importers had approached the Single Judge did not fall under any of the above 4 exceptions;

   (iii) However, the importers could still have approached the Single Judge of the High Court and their suits were maintainable for the reason that the Single Judge had jurisdiction to hear any type of case under Section 9 of the Civil Procedure Code, except

https://goo.gl/LFiWyx
https://goo.gl/QDM4ZM

those where his jurisdiction was expressly barred;

(iv) As a guiding principle, to bring certainty and uniformity in the treatment of such suits, new and pending suits must only be entertained on the condition that a minimum of 50% of the tax calculated by the tax authorities is deposited with the authorities.

C. Analysis

3. There may be two possible interpretations of this judgment in our opinion:

   A. The decision in paragraph 2(iv) above applies to all suits in tax matters. This interpretation may create certain complications as in many suits the constitutionality of provision of law has been challenged and no notice has been issued or no assessment order has been passed. In such cases there is no amount of tax which has been calculated which raise the question of amount of tax to be deposited. Moreover, in most cases show cause notices have been challenged. While these notices do set out the alleged outstanding tax, this amount is in dispute and there is no assessment order in the field.

   B. The decision in paragraph 2(iv) above applies only to the cases which do not fall within any of the 4 exceptions described in paragraph 2(i) and there is an assessment order in which the tax has been calculated.

   This is a preferable interpretation as the Supreme Court did not overturn its earlier judgments, with respect to matters falling within the 4 exceptions, which are still in field. These judgments do not require the deposit of any amount of tax as a precondition for filing such suits.

   This interpretation, however, is likely to be contested by the FBR.

D. Options

4. The decision does not automatically vacate or modify the stay orders passed by the High Court. Each order will have to be individually examined to see whether it falls within the ambit of this decision.

   The FBR is now likely to move applications in all pending suits to have them fixed at an early date. On that date, the FBR will ask the court to modify its earlier stay order and direct the plaintiffs to pay 50% of the tax calculated or to vacate the stay.

   It is at that point that arguments will take place as to the correct interpretation of the Supreme Court judgment and why it does or does not apply to the facts of that particular case.

   If the court accepts the interpretation set out in paragraph 3(B) argument, then the stay orders in most cases will remain intact. If the court does not accept this argument (and upholds the interpretation in paragraph 3(A)), taxpayers will have three choices. They can (i) deposit 50% of the tax; (ii) withdraw the suit and file a petition (if eligible); or (iii) withdraw the suit and go through normal departmental hierarchy.

5. For the time being, each company should create three categories of suits:

   (i) Those where no notice has been issued, no assessment has been made and the suit has been filed challenging the constitutionality of a law, e.g. super tax, or the legality of an action from which no tax can be immediately demanded e.g. audit selection;

https://goo.gl/LFiWyx
https://goo.gl/QDM4ZM

(ii) Those where a show cause notice has been issued and a specified amount of tax has been demanded; and

(iii) Those where an assessment order has been passed and tax calculated e.g. stay against recovery cases.

In case the FBR tries to directly approach a company's banks to recover any amounts whose recovery has been stayed through suits, the banks may be informed that the High Court stay orders remain valid until they are specifically modified or vacated.

3. TOPIC OF THE MONTH

- CONTROLLED FOREIGN COMPANY

The concept of **Controlled Foreign Company** ("CFC") has been introduced in Pakistan through the Finance Act 2018.

General Definition:

A **CFC** is a **corporate** entity that is registered and conducts business in a different jurisdiction or country other than the residency of the controlling owners. The objective of introduction of this new concept is to prevent erosion of domestic tax collections due to avoidance or deferment by home companies on income earned from overseas businesses carried out through offshore subsidiaries or affiliates. (**Source**: Investopedia**)**

Role of the Organization for Economic Cooperation and Development ("OECD"):

International tax issues have never been higher on the political agenda than they are today. The increase in globalization has enhanced the variety of markets in which business can be done, causing strain on international tax rules. Weakness in taxation laws create opportunities for Base Erosion and Profit Shifting ("BEPS").

In response to the challenges of BEPS through CFCs, the OECD and G20 countries deliberated on this issue and set some actions or rules for the regulations of CFC. These rules only provide for minimum standards. Moreover, they are designed to ensure that jurisdictions that choose to implement them will have rules to effectively prevent taxpayers from shifting income to foreign subsidiaries.

A. PAKISTANI JURISDICTION

1. Introduction of the CFC regime:

As mentioned at the introduction of this report, the concept of a CFC in Pakistani law has been introduced for the first time through the Finance Act 2018. The Parliament has done this by introducing **Section 109A** into the **Income Tax Ordinance 2001** ("ITO") through enactment of the Finance Act 2018. It is pertinent to note that the concept of a CFC did not exist in the Pakistani Law before the enactment of the Finance Act 2018.

Furthermore, by virtue of the Finance Act 2018, now the income of a non-resident company should be included in taxable income of a resident person for a tax year.

2. Difference between Resident & Non-Resident Company:

As per **Section 83** of the **ITO 2001**, a Company shall be resident for a tax year if:

- It is incorporated or formed by or under any law in force in Pakistan;
- The control and management of the affairs of the company is situated wholly in Pakistan at any time in the year; or
- It is a Provincial Government or Local Government in Pakistan

3. Requirements for a company to be a CFC:

CFC means a non-resident company, if:

a) More than 50% of the capital or voting rights of the non-resident company are held, directly or indirectly, by one or more persons resident in Pakistan, or, more than 40% of the capital or voting rights of the non- resident company are held, directly or indirectly, by a single resident person in Pakistan;

b) Tax paid in respect of income derived or accrued in a foreign tax year is less than 60% of tax payable on the said income under this Ordinance;

c) A non-resident company does not derive "active business income". Income of the Non-resident company shall be active business income if the criteria mentioned below is met:

- More than 80% of the income of the company does not include income from dividends, interest, property, capital gains, royalty, annuity payment, supply of goods or services to an associate, sale or licensing of intangibles and management, holding or investment in securities and financial assets; and
- The company principally derives income under the head "Income from Business" in the country or jurisdiction of which it is a resident; and lastly

d) The shares of the company are not traded on any stock exchange recognized by the law of the country or the jurisdiction of which the non-resident company is a resident of for tax purposes.

Note: All the 4 conditions mentioned above need to be met for a non-resident company to be categorized a CFC under Pakistani law.

4. Calculation of Deriving income of Resident person from a Controlled Foreign

Company:

The attributable income of a controlled foreign company shall be charged to a resident person in the following manner:

A*(B/100)

A= The amount of income of the CFC.
B= The percentage of capital or voting rights, whichever is higher, held by the person, directly or indirectly, in the CFC.

Exceptions

However, there are some exceptions where the amount of the attributable income is exempt from being allocated to a resident person, and these are as follows: If the capital or voting rights of the resident person is less than 10 %; and/or

- Income of a controlled foreign company is less than 10 million Rupees.

5. Avoidance of Double Taxation

Since, the attributable income is taxed when it is earned or distributed by the CFC, and not when it is received in Pakistan, the question of getting taxed twice on the attributable income does not arise.

6. Rate of Tax Chargeability:

The Rates of Tax charged are the same as for dividend income as per Division III, Part I of First Schedule which are 15% for filers and 20% for non-filers.

B. INDIAN LAW

The Concept of a CFC was proposed in the Finance Bill 2010. However, it was never enacted into law, and currently under the Indian Jurisprudence, a 40% tax

liability is charged on the global income of a company whose place of effective management is in India.

C. CHINESE LAW

1. Introduction

The CFC regime was introduced in China through the enactment of the Enterprise Income Tax Law 2007 ("EITL") which came into effect on 1st January 2008. By virtue of EITL, profits from a CFC will be taxed as the income of the Chinese resident shareholder. However, there are two basic requirements which need to be met first. The first requirement is that the foreign company must be controlled by the Chinse resident. The second requirement is that the foreign enterprise must be in a low tax jurisdiction.

2. Control:

A Chinese resident shareholder has control if any of the following conditions are satisfied:

1. Each Chinese resident shareholder directly or indirectly holds at least 10% of the voting shares of the foreign company and more than 50% of all the shares together with other Chinese resident shareholders; or
2. The Chinese resident shareholder can exercise effective control over personnel, purchases, sales, shares, capital and business operations of the foreign company.

3. Low tax Jurisdiction:

According to the EITL, if the CFC is located in a jurisdiction where the tax rate is half of what is mentioned in the EITL, then it will be considered a low tax jurisdiction. The rate mentioned is 25%, hence the half of which would be 12.5%. Any jurisdiction having an effective tax rate below 12.5%, would be a low tax jurisdiction. It is pertinent to note, that since this is judged according to the "effective" tax rate of the jurisdiction, any incentive offered to the CFC by that jurisdiction will also be taken into account, hence the effective rate may be lower than the statutory rate applicable to the CFC.

Exceptions:

1. **White listed jurisdictions:** If the CFC is located in the list of white listed jurisdictions, then the Chinese resident will be exempt from paying tax on any profits of the CFC.
2. If the CFC in mainly engaged in active business operations. This may be proven by the Chinese resident shareholder by showing that majority of the income, excluding that which is derived of dividends, royalties etc, is derived from active business operations.
3. The annual profits of the CFC are lower than RBM 5 million. (Also termed as de minimis operation).

D. UNITED KINGDOM LAW

1. The CFC Regime

The Concept of a CFC is not something new in the UK, as it was in practice since before 2013. However, new legislation was introduced with effect from 1st January 2013 which changed the rules in relation to a CFC for the UK Jurisprudence.

A CFC has been defined under the rules as a non-resident company that is controlled, or deemed to be controlled, by a UK resident person or persons. A charge on the CFCs income is only imposed on profits which were diverted from the UK (i.e chargeable profits which do not fall within the exemptions mentioned below under the heading "Exemptions").

Control is determined by reference to:

- **Legal control**: This is determined by considering a person's shareholdings and other legal documents, for example determining how much voting power he has

by virtue of powers in the articles of association.

- **Economic control**: Even if a person does not have legal control, he can still have some control in the form of economic control, that is, by retaining a right to profits, or a right to proceeds in the event a sale of the CFC, or a right to distribution of the assets of the CFC in the event of winding up of Company. The presumption of an economic control may be strong if the Person would receive (directly or indirectly) more than 50% of the proceeds, amount distributed or distributable amount or assets.
- **Joint venture tests:** In case of a joint venture, the control is judged as follows:
  - One of the owners of the CFC is a UK resident and controls at least 40% of the CFC; and
  - One of the other owners is a non-UK resident and has control between 40% to 55% of the CFC.
- **Accounting standards:** A person has control for accounting purposes, if:
  a) Person is Company's parent undertaking; and
  b) at least 50% of C's chargeable profits would be apportioned to Person and its UK resident subsidiary undertakings.

2. Exemptions:

The following are exemptions which exonerate a CFC from a charge being imposed on its income:

- **Low profits exemption:** Where the CFC's accounting profits or its profits calculated on UK tax principles are £500,000 or less, and any non-trading income included in those profits is £50,000 or less;
- **Temporary exempt period exemption:** A foreign subsidiary under UK control, will be exempt from a CFC charge for the first 12 months of new ownership, provided that there was no subsequent CFC charge in the first accounting period after the first 12 months.
- **Low profit margin exemption:** Where the CFC's accounting profits for the period concerned, before the deduction of interest, are no more than 10% of its relevant operating expenditure;
- **Excluded territories exemption**: Where, in the relevant accounting period, the company is resident in an 'excluded territory' (a territory prescribed in regulations), and various categories of tax-advantaged income, taken together, do not exceed £50,000 or 10% of the CFC's accounting profits, whichever is greater;
- **Tax exemption**: Where the local tax liability on profits (excluding capital gains) in the resident country of the CFC, is at least 75% of the tax that would be charged in the UK;
- **Exempt period exemption**: which provides a temporary period of exemption, initially 12 months, for foreign subsidiaries that come under UK control for the first time and meet various conditions;
- **Trading Activities in the UK**: Trading activities of a UK permanent establishment because they would be taxed in the UK in any case;
  - **Capital gains**
  - **Property business profits**

- **Business profits other than those passing through the CFC charge gateway:** The business profits will pass through a CFC charge gateway if:

  a. It affects the tax purpose in the following manner:

  i. The main purpose of the arrangements is to reduce tax liability in the UK, and consequently the CFC anticipates its business profits to be higher as a result of this, or

  ii. It is expected that a person's UK or foreign tax liability will reduce or diminish as a result of the arrangements; or

  b. If the control and management of the CFC's assets or risks is carried on into the UK to a significant extent; or

  c. Where the CFC has UK managed assets or risks, and it could not have managed it themselves or outsourced management of the same to a third party.

If one or more of the conditions mentioned above are met, then the profits will be liable to a charge. However, there are certain exceptions whereby certain profits can be excluded if specific conditions are met. Nevertheless, this article does not go into that much detail on these.

- **Non-trading profits exemption (full and partial):**

  a) Where a CFC that carries on a trading business, has non-trading profits not exceeding 5% of its total trading profits and property business profits.

  b) A UK group can now create a foreign finance company to fund the group's overseas operations and expand it globally and claim either a partial (i.e 75%) or a full exemption on its qualifying loan relationship profits. Typically, such CFC finance companies will be set up in jurisdictions which have a low withholding tax rate on interest. Moreover, both the exemptions only apply to the CFC's qualifying loan relationship profits. This means, loans to non-UK group companies will be covered by the exemption. However, certain types of loans will not come within the ambit of both the exemptions. An example of such a loan could be lending to a CFC if its income is apportioned to the UK under the CFC rules, or lending that is funded from a bank or insurance company that is connected with the CFC, etc.

  To be eligible for these exemptions, a foreign finance CFC, must have business premises in the territory in which it is resident, to be used with a reasonable degree of permanence and from where it can conduct its business activities in that country.

3. When it is Taxable:

If a company is not within one of the above exemptions, its 'chargeable profits', which are liable to the CFC charge, are determined by aggregating its profits (as calculated on UK tax principles) insofar as they fall within various specified categories subject to the deductions also.

E. Strength of Pakistan Law v/s other laws:

- Under Pakistani tax law, a CFC charge would be imposed irrespective of whether it is set up in a high or a low tax jurisdiction.
- In order to give relief to the person who holds less than 10% of CFC capital or voting rights in a non-resident company, their income is not attributed to taxable income of the persons.
- A CFC charge under Pakistani Tax Law, will be imposed on non-active business income only. The active business criteria has been specified in the definitions under the Finance Bill 2018. Therefore, the basic purpose is to charge tax on income other than active business to avoid tax avoidance on their incomes like dividend, royalty, etc which will now be taxed.
- As per Pakistani Law, the income of a CFC will be taxed when it is earned only, thereby avoiding any tax liability when the same is received in Pakistan.

F. Shortcomings in other jurisdictions:

- In UK law, CFC income is exempt from tax if they fall within the specified territories. This helps the non-resident company to operate in those territories which are exempt from tax.
- In some countries, CFC losses can be set off against the profits of the parent company which will reduce the tax liability of the company.
- Under Chinese jurisprudence, there is a "white list" exemption whereby, the Chinese resident shareholder will be exempt from being taxed on the profits of a CFC if the CFC is located in one of the countries mentioned therein.
- Moreover, as per the EITL under Chinese Law, the CFC must have been incorporated in a low-tax jurisdiction, which restricts the scope of the law.

G. Impact of Introducing CFC law in Pakistan:

- Before introducing the concept of a CFC, the income of such companies was not taxed in Pakistan if the same was retained and not repatriated to Pakistan. However, now the income of such foreign CFCs will be taxed even prior to distribution of the same.
- As Pakistanis have ownerships and transactions of companies/Partnership and trusts held outside Pakistan in the form of (i) Pakistani residents holding shares in Pakistani listed entities through non-resident enterprises which will now be treated as CFC, (ii) there are many Pakistani residents who own properties in offshore jurisdictions, like the UAE, through entities incorporated in UAE, which will now be treated as CFC, (iii) There are many trading and other non-resident companies owned by residents. which supply goods to Pakistani enterprises, which will now be treated as CFC etc.

Therefore, now a resident of Pakistan can and will be taxed on their income from such non-resident companies unlike prior to enactment of Finance Act 2018 when there was no such concept of a tax on CFCs.

- CFC has not been designed to increase the tax base. The main purpose of introducing this concept is to protect revenue by ensuring that profits remain within the tax base of the parent.
- This may help further the documentation of the economy reducing administrative and compliance burdens on the Government of Pakistan

DISCLAIMER

This newsletter is the property of Tola Associates and contents of the same may not be used or reproduced for any purpose without prior permission of Tola Associates in writing.

The contents of this newsletter may not be exhaustive and are based on the laws as of date unless otherwise specified. Tax laws are subject to changes from time to time and as such any changes may affect the contents.

The comments in the newsletter are a matter of interpretation of law and is based on author's judgments and experience, therefore, it cannot be said with certainty that the author's comments would be accepted or agreed by the tax authorities. Furthermore, this newsletter does not extend any guarantee, financial or otherwise. Tola Associates do not accept nor assume any responsibility, whatsoever, for any purpose.

This newsletter is circulated electronically free of cost for general public to create tax awareness in the country.

OFFICES IN PAKISTAN

Karachi Address:
Office no. 408, 4th Floor, CTC Building, Clifton Block-8, Karachi
Tel #: +92 21-3530 3294-6

Islamabad Address:
144, 1st Floor, Street No.82
Sector E-11 / 2 FECHS
Islamabad 44000,
Tel #: +92 51-835 1551

Lahore Address:
202-E, 2nd Floor, Sadiq Plaza
69-The Mall Road, Lahore
Tel #: +92 42-3628 0403

https://goo.gl/LFiWyx

https://goo.gl/QDM4ZM