



AUGUST 2019

# TAX PAK

NEWSLETTER BY  
TOLA ASSOCIATES

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## EDITORIAL NOTE

Presenting you with the Twenty Second Edition of our Newsletter for the month of August 2019. By the blessing of Almighty Allah, we are able to achieve the feat as we continue our trend to publish our Newsletter. With dedication, determination and devotion, my team and I are able to collect, compile and finally present you this monthly document.



The Newsletter highlights wide array of changes occurring in the dynamic tax world as continuous changes take place in different Tax laws i.e. Income Tax, Sales Tax etc. We enlighten our readers with important cases and the verdicts giving them valuable insight regarding complex issues arising with regards to Taxation matters. Like always, we present to you our analysis on a specific topic, covered in the "Topic of the Month" section which is towards the end of this newsletter. Briefly speaking, the topic of the month is "Business Profits" which is an extension to our previous issue "Permanent Establishment" which will interest many business professionals as well as practitioners, in the backdrop of taxation laws applicable on cross border operations.

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1. <https://goo.gl/QDM4ZM> (iOS)
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Readers are also requested to circulate this e-copy within their circle, as our primary aim is to benefit the masses. Feedback is always welcomed.

**Ashfaq Tola - FCA**  
Editor in Chief

Mr. Ashfaq Tola, President Tola Associates attending SAFA conference in Colombo, Sri Lanka and Tax session on Finance Act 2019-20 which was arrange at OICCI. Following is a pictorial glimpse of these events.



Presentation at SAFA conference in Colombo, Srilanka on 30th July 2019

A special Tax session was arranged at Overseas Investors Chamber of Commerce and Industry ("OICCI") on August 31st, for OICCI members to get a better understanding of the key taxation measures in the Finance Act 2019-20, and the subsequent amendments made by the FBR. Ashfaq Tola, apprised the participants on the impact of the key taxation measures in the Finance Act



## 1. NOTIFICATIONS/ CIRCULARS

### 1. AMENDMENT IN SALES TAX RULES, 2006

Vide SRO 918(I)/2019 dated 7th August 2019, the following amendments have been made:

- Retailers not being in Tier-1 are excluded from filling of Return on Form STR-7.
- The following items are added in requirement to file Annexure J **viz. details of such goods manufactured or produced, and goods supplied**, using the units mentioned of monthly returns:

S.No.	Product	Unit of measurement
44	Steel billets	M. Tons
44A	Steel ingots / bala	M. Tons
44B	Ship plates	M. Tons
44C	Steel bars	M. Tons
44D	Other long re-rolled products of steel	M. Tons
44E	Other iron and steel products (including stainless steel products)	M. Tons
46	Cotton yarn	M. Tons
46A	Other yarn	M. Tons
46B	Processed fabric	"000" Meters

- Special dates for filling of return and deposit of sales tax which were previously covered under the repealed Sales Tax Procedure Rules, 2007 have been inserted in STR for Electric distribution companies, independent power producers, gas transmission and distribution companies, Petroleum exploration and production companies and CNG dealers (on quarterly basis).
- Special dates for filling of return and deposit of sales tax which were previously covered under repealed Sales Tax Procedure Rules, 2007 have been inserted in STR as follows:
  - Rule 23 allows return of goods by a buyer on the ground that the same are unfit for consumption and are required to be destroyed, then the same shall be

destroyed under the supervision of the sales tax department and the input tax credit in respect of goods so destroyed **shall not be admissible**. However, relief is now provided in case of companies manufacturing perishable food items having an expiry date, if such items are returned on account of becoming unfit for consumption and are then destroyed in the manner above, the corresponding credit notes may be issued within fifteen days of the return of such goods by inserting new sub Rule 4A in Rule 22.

- A new Rule 22A is inserted whereby if there is any change in value of supplies of electricity or natural gas by the distribution companies for which bill has already been issued in previous tax periods, the distribution companies are allowed to adjust the Output tax charged related to that on subsequent bills **instead of issuing credit/debit notes**.

- Rules 26A to 31 relating to establishment of **refund division, processing and payment** have been substituted. The distinctive features of the new Rules are follows:

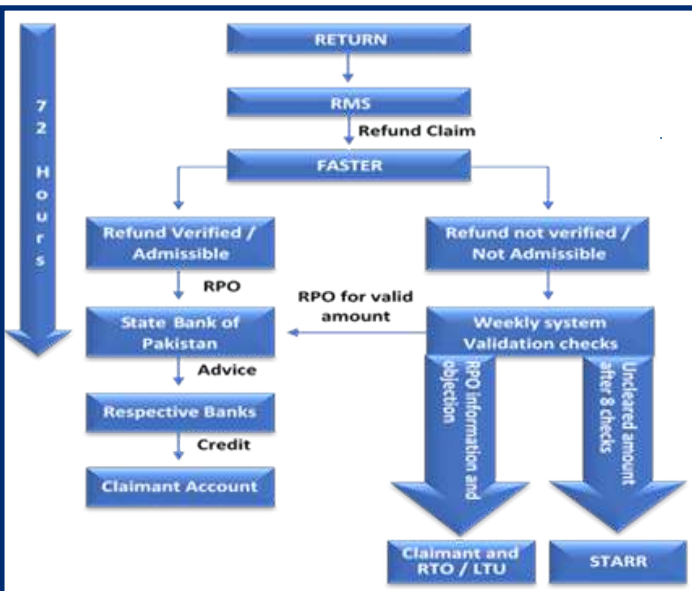
o From 1st July 2019 onwards, the data provided in the monthly return (**as Annexure H**) shall be treated as data in support of refund claim and no separate electronic data shall be required. However, in case of zero-rated supplies and export, the return can be submitted without Annexure H which can be submitted within 120 days as STR-7A. In case of commercial exporters, the claim can be filed within 120 days of later of either after return or date of issuance of BCA.

o FBR's Risk Management System will route it to FASTER (Chapter V-A) or ERS (if it does not fulfil parameters of FASTER and having Medium Risk) or STARR (if it does not fulfill criteria of FASTER or ERS)

- Rule 34 which deals with refund of non-zero rated and export sectors is amended by making it mandatory to file Refund claim electronically in STR 7A along with Audited Account (In case required u/s 8B(2)) within 120

days of Return in which refund original claimed as Annexure H.

- Sanction of refund claims of import-related sales tax will be done by the collectorates of customs claimed within the period provided u/s 66 of ST Act 1990 subject to a NOC from the concerned RTO or LTU.
- Chapter V-A has been inserted for Refund to Five Export-Oriented Sectors with the following features;
  - o The RMS will route the refund under these sectors to Fully Automated Sales Tax e-Refund [FASTER].
  - o The refund amount shall be determined by input consumed in exports or supplies.
  - o The Refund Payment Order [RPO] shall be communicated to SBP within 72 Hours of submission of the claim.
  - o If the amount remains uncleared after prescribed 8 validations, then the same will be processed under STARR module.
  - o Other requirements of Chapter V will also apply in this Chapter.



- Rule 52A has been added by virtue of which, if supplies are made by a Tier-1 retailer to diplomats and diplomatic missions, then the same shall be charged to

sales tax at zero rate if exemption certificate issued by Ministry of Foreign Affairs is provided mentioning the description and quantity of goods to be purchased.

- The Rules related to Alternate Dispute Resolution in Chapter X have been substituted to bring them in line with the amendment(s) made by the Finance Act 2019 to the ST Act 2019.
- Through the Finance Act 2019, supplies of textile and leather finished goods through retail outlets are subject to a reduced rate of 14% [Eight Schedule entry no. 66] if integrated with FBR systems for real time reporting of sales. Now this is made effective through insertion of Chapter XIV-AA.
- The special procedures under chapter XIV “Special Procedure for goods specified in S.No. 12 of 5th Schedule”, chapter X “Special Procedure for Payment of Sales Tax by Importer” have been inserted as Chapter XV and Chapter XVII in ST Rules respectfully.
- A new chapter for provision of services under Islamabad Capital Territory (Tax on Services) Ordinance, 2001 (ORDINANCE NO. XLII OF 2001) has been added as Chapter XVI in which special procedures relating to advertisement on television and radio and customs agents have been prescribed.
- A miscellaneous chapter XVIII has been added which provides procedures for Accounting for advance payments against supplies, **Input tax credit against supplies made by the persons registered in AJK**, Supply of Sugar to Trading Corporation of Pakistan by the sugar mills and Making of zero-rated supplies to a duty-free shop.

## 2. CONSTITUTION OF FINANCIAL ACTION TASK FORCE [FATF] IN FBR:

The FBR vide Notification no. C.No. 6(51) (IR-Operations) 2019/106213 - R dated 9th August 2019 has constituted FATF Cell under Directorate General,



Intelligence & Investigation-IR, Islamabad. The pertinent Cell may require information from FBR, field formations, Directorates etc. to complete completion of FATF related Action Plan.

### **3. PAYMENT OF DUE TAX BEFORE EXTENSION OF INCOME TAX RETURN/STATEMENTS FOR TAX YEAR 2019 AND FINAL INCOME TAX RETURN FORMS FOR COMPANIES NOTIFIES:**

The FBR has issued Letter C.No2(1)Cond/I.Tax/2018 dated 5th September 2019 whereby it has instructed all Chief Commissioners to ensure that admitted tax liability is paid before 30th September 2019 before granting of extension in the date of filing of Income Tax Returns for the Tax Year 2019 in cases where last date of filling of Income Tax Returns is 30th September 2019.

The FBR through SRO 1000(I)/2019 dated 6th September 2019, has issued final form for companies for tax year 2019. The Companies having special tax year can now file Returns within due date i.e. 30th September 2019 or take extension as above after payment of admitted tax liability before 30th September 2019 as per the notification.

### **4. MINIMUM VALUES NOTIFIED FOR STEEL SECTOR FOR CHARGING FED ON SUPPLIES:**

Before FA 2019, steel products were subject to the repealed special regime of sales tax under which sales tax was payable on flat rates, applied on units of electricity and raw material consumed. Through FA, this regime was replaced with excise duty in sales tax mode @ 17% of value of supply subject to a minimum duty regime and FBR was empowered to prescribe minimum values for supplies. Now FBR has, through SRO 992(I)/2019 dated 4th September 2019, has prescribed minimum values for steel bars and other long profile as Rs 83,000 per metric ton[MT], Steel billets as Rs 74,000 per MT, Steel ingots/bala as Rs 72,000 per MT, Ship plates as Rs 72,000 per MT, Other re-rollable iron & steel scrap as Rs 71,000 per MT. It may be noted if actual

value of supply is higher than prescribe rates, the FED will be charged on actual rates.

The FBR has earlier issued SRO 697(I)/2019 dated 29th June 2019 w.e.f. 1st July 2019. whereby the same minimum rates were prescribed for charging and payment of Sales Tax ad val. basis which is now withdrawn vide SRO 993(I)/2019 dated 4th September 2019 w.e.f. 4th September 2019.

### **5. AMENDMENT IN EXPORT ORIENTED UNITS (“EOU”) AND SMALL AND MEDIUM ENTERPRISES RULES, 2008**

The FBR has amended Export Oriented Units and Small and Medium Enterprises Rules, 2008. The amendments, which are incorporated in WeBOC, are as follows;

- The retention period of plant, machinery and capital goods is reduced from 10 years to 5 years. If sold before expiration of this period, then different slabs of duty and taxes will be applicable.
- The Spares and replacement parts are allowed to be disposed off after three years.
- The new Regulatory Authority [RA] is created i.e. Additional Collector which can grant, revalidate or amend EOU licenses.
- For redressal of grievances the taxpayer can approach Chief Collector of Customs.
- Now if ratio in the analysis certificate is similar to the ratio determined in previous year, then RA will issue the license without seeking recommendations from Input Output Coefficient Organization (IOCO) or Engineering Development Board (EDB). Also, provisional analysis certificate can be issued by RA in case of delay by IOCO/EDB.

### **2. ATIR HELD - NO DISALLOWANCE OF CASH EXPENSES MERELY ON PRESUMPTION BASIS**

In the case Umer Din Auto Industries (Pvt) Limited, Lahore vs. CIR, Zone-II, CRTO, Lahore [ITA No. 3672/L-B/18], the factual narrative is such that the taxpayer

was a private limited company deriving income from business of manufacturing of auto parts, which its Income Tax return for the Tax Year 2013. The Additional Commissioner [“AC”] amended the previous assessment u/s 122(5A) of Income Tax Ordinance, 2001 [“ITO”] on basis of discrepancies noticed, which in his opinion, lead to an erroneous assessment order and was prejudicial to the interest of the Revenue. Among other issues highlighted through the Show-cause notice issued u/s 122(9) of ITO, one was of deduction of tax u/s 231A amounting to Rs 78,248/= which means, allegedly cash of Rs 39,124,000/-, was withdrawn from banks which was used for meeting various expenses. The AC after deducting allegedly allowable expenses on **proportionate basis** at Rs. 18,066,168/- disallowed the remaining amount of expenses of Rs 21,057,832/- and added back u/s 21(I) of ITO. The taxpayer feeling aggrieved, appealed against the revised assessment to the Commissioner Appeals, which was dismissed by the same. The taxpayer filed a second appeal with Appellate Tribunal Lahore Bench[“ATIR”]. The main ground taken by the Appellant was that section 122(9) of the ITO was invoked against him without jurisdiction, as the AC had only mentioned in show cause notice that “certain discrepancies were noticed” implying that only certain adjustment(s)/correction(s) in the expenses undertaken was/were sought in the assessment which was already completed u/s 120 of the ITO. It was argued in the present case, that the assessment order u/s 120 **may be prejudicial to the interest of revenue but that is not erroneous in law or fact.** That the two conditions necessary to invoke section 122(5A) of the ITO 2001 had not been met, hence the Order is liable to be quashed. The Counsel of the Appellant also submitted that these expenses were petty in nature and below taxable limit, and that the complete ledger of expenses were provided at the assessment stage.

The ATIR held that the following expenses incurred such as; lower staff salaries, day to day repair maintenance, fuel and power, cash withdrawal for withholding tax deposit and for meeting miscellaneous expenses throughout the year on which no deduction of withholding tax is to be made, are petty in nature and usually paid in cash, and these were added back on

just presumptions, even though such expenses were supported by relevant record and ledgers which were submitted before the AC at the. Moreover, these were also duly mentioned in the body of order. Henceforth, the additions were deleted by the ATIR.

### 3. ECONOMIC INDICATORS

- The 3-month, 6-month and 1-year KIBOR rate for the month of July 2019 was 13.41%, 13.54 % and 13.96%, respectively, which hiked in August 2019 to 13.93%,14.09% and 14.48%, respectively.
- The 3-month T-Bills rate for the month of July 2019 was 13.40% which hiked to 13.75% in August 2019. The 6-month T-Bills rate for the month of July 2019 was 13.54% which rose to 14.06% in August 2019. The rate for 1 year for the month of July 2019 was 13.76% which rose to 14.31% in July 2019.
- The PSX 100 index at the end of July 2019 was 33,139 points and at the end of August 2019 was 31,884.45 points indicating a decrease of 3.78%.
- The rate for Crude Oil in the OPEC basket at the end of July 2019 was \$ 64.71, whereas, at the end of August 2019 was \$ 65.53. The increase in price was 1.25%
- The rate of Gold per troy ounce in the month of July 2019 was \$1,418.19 whereas in the month of August 2019 it increased to \$1,551.80 per troy ounce by 8.6%.
- The rate of Sugar at end of July 2019 was 0.32 US\$/KG which slightly increased to 0.33 US\$/KG in the month of August 2019.
- The rate of Palm Oil in the month of July 2019 was 467.03 US\$/MT which increased in the month of August 2019 to 536.23 US\$/MT by 13%.
- The US\$ parity to Chinese Yuan at the end of July 2019 was 6.88 whereas in the month of August 2019 it was 7.17 showing an increase of 4.04%.
- The US\$ parity to Indian rupee at the end of July 2019 was 68.77 whereas in the month of August 2019 it was 72.02.



- The US\$ parity to Bangladesh Taka at the end of July 2019 was 84.52 whereas at the end of August 2019 it was 84.53.
- The US\$ parity to Pakistan Rupee at the end of July 2019 was 159.26 which increased to 159.70 at end of August 2019 by 0.27%.
- The stock of currency in circulation was Rs. 4,975.80 billion as on 27th July 2019 which increased by Rs. 237.21 billion up to 5,254.47 billion till 24th August 2019.
- The Net Government Sector borrowings at end of July 27th, 2019 were Rs. 12,020.15 billion which decreased by Rs. 94.84 billion up to August 24th, 2019 to Rs. 11,925.31 billion. The net government sector borrowings were used for the purpose of budgetary support (Rs. 11,515.57 billion) and commodity operations (Rs. 746.95 billion); and supported by others (Rs. -10.25 billion).
- The credit to private sector at the end of July 27th, 2019 was Rs. 6,617 billion which rose by Rs. 19.84 billion up to August 24th, 2019 to Rs. 6,636.84 billion.
- Workers' remittances for the month of July and August 2019 were USD 2,039.3 million and USD 1,690.87 million respectively, a decrease of 17.08%.

## 4. TOPIC OF THE MONTH

### - TAXATION TREATIES - BUSINESS PROFITS

#### A. PREAMBLE

Before we deliberate over our topic of the month i.e. "Business Profits", we will briefly define the term Permanent Establishment (hereafter "PE") which is interlinked with the aforementioned topic. Moreover, the concept of a PE would complement, and hence help us understand Business Profits in a more coherent manner. As globalization takes its toll on the

global markets, many companies intertwiningly branch out into many other Countries, in order to sustain and grow in the competitive environment of today. However, presuming that they are non-resident companies for a particular Country, their activities may lead them to having operations classified as a PE in that Country. This transaction generates profits, thereby necessitating the need for Legislation for the purposes of their regulation and accountability of such Profits arising from them. We will understand the term Business Profits in detail below.

#### B. DEFINITION

##### 1. Permanent Establishment ("PE")

The term PE divides the businesses who trade with a country from the businesses who trade within a country. The Business which acquires a PE in a Country is tantamount to the business operating in that country itself. The term PE helps to determine the right of the Country in which the non-resident business is operating to tax its profits.

(Explained in our previous issue)

##### 2. Business Profits

As Business Profits are usually taxed in the country in which the Business Operates, the Profits of a non-resident entity operating in the source country is taxable based on the fact whether it acquires the status of PE or not. The taxability of the business profits in its resident country and in the source country in which it operates is further elaborated in detail below.

##### 3. Source Country

Source country is the term used for the country in which a non-resident entity establishes itself as a PE or an independent agent.

##### 4. Residence Country

Residence country is the term used for the country from which an entity originates or undertakes its primary business.

### C. BUSINESS PROFIT TAXABILITY

Business profits for an entity whose PE is situated in the source country, is taxable fundamentally in the source country, and additionally in the resident country. Whereas business profits for an entity whose PE is not situated in the source country is only taxable in the resident country with the source country having no right to tax such profits.

#### **Illustration:**

*If an Indonesian Based Entity operates in Pakistan and has acquired PE, the right to tax the Business Profit lies fundamentally with Pakistan and additionally with Indonesia, whereas if the Indonesian Entity operating in Pakistan does not acquire PE, the right to the Business Profit only lies with Indonesia with Pakistan having no right to tax such profits.*

The taxability of Business Profit of the business which acquires PE in the source country constitutes several scenarios, such as the source country may have the right to tax the following profits;

- (i) Profits which are attributable directly to the PE situated in the source country.
- (ii) Profit which are attributable to sale of similar goods by the owner of PE in the source country as the PE even when it is sold by the owner itself.
- (iii) Profit which are attributable to rendering of similar services by the owner of PE in the source country as the PE even when it is rendered by the owner itself.

#### **Illustration:**

*For Example, A Inc. an Indonesian company is running an entity selling garments. The same A. Inc operates in Pakistan also selling garments as a PE with the name B Inc. The profits arising from B Inc. would directly be attributable to tax in Pakistan. Furthermore, if A Inc decides to sell garments in Pakistan as an independent agent with B Inc already established in Pakistan as PE, the profit arising from the Independent agent of A Inc in Pakistan would also be attributable to tax in*

*Pakistan. The same applies to the service sector too.*

For purposes of clarification, the word “may”, was used in relation to taxability of Business profits made by PE in the source country, which means that the taxes will be levied on the profits made by PE only if taxability on Business Profits is being practiced with respect to the domestic laws of taxability in the source country. Furthermore, the Business Profits arising from the PE is not only taxable in the source country but if the domestic laws of the residence country require, the entity will also pay tax to the resident country on the Business Profits arising through PE in the source country. Obviously, the entity will be required to pay the difference between the tax liability already paid in the source country and the tax liability payable in the residence country.

The attribution of Business Profits to a PE for the purpose of taxability shall be done within the scope of the arm’s length principle. The abovementioned principle requires that parties to a transaction are independent and on equal footing. To clarify if a PE is extracting more profits by charging rates in its dealing with associated enterprises different or in excess to that of market rate, the profit attributable to tax will be increased accordingly in order to ensure that the tax base of the source country is not eroded.

### D. ALLOWANCES

While determining the taxable Business Profit of a PE, certain deductions are allowed, while some are disallowed (including payments made to head office or any other office of the enterprise except reimbursement of expenses). These are as follows:

#### **(i) Expenses Allowed:**

1. Executive expenses
2. General Administration Expenses
3. All expenses incurred in relation to the business carried on.

#### **(ii) Expenses Disallowed (payments made to head office or any other office of the enterprise):**

1. Royalties, fees or other similar payments for use of

patents or rights.

2. Commission for specific services performed.
3. Interest on money lent (except if payment is made to a banking enterprise).

## E. CONSISTENCY

The reason for applying consistent tax treatment is that it gives assurance to both the source country and the residence country with respect to the tax revenues which are expected to be earned. For example, A Ltd, a Dubai based company is carrying out its operations through B Inc its PE in Pakistan. During the year, A Ltd has earned profits of Rs. 250 million. It is customary to allocate 10 % of profits to its PE which has been followed year after year. The profits attributable to the PE as determined under the arm’s length principle are Rs. 50 million. The profits to be attributed to B Inc. will be Rs. 25 million (10% of Rs. 250 million) since there is already a customary method which is being followed for such allocation.

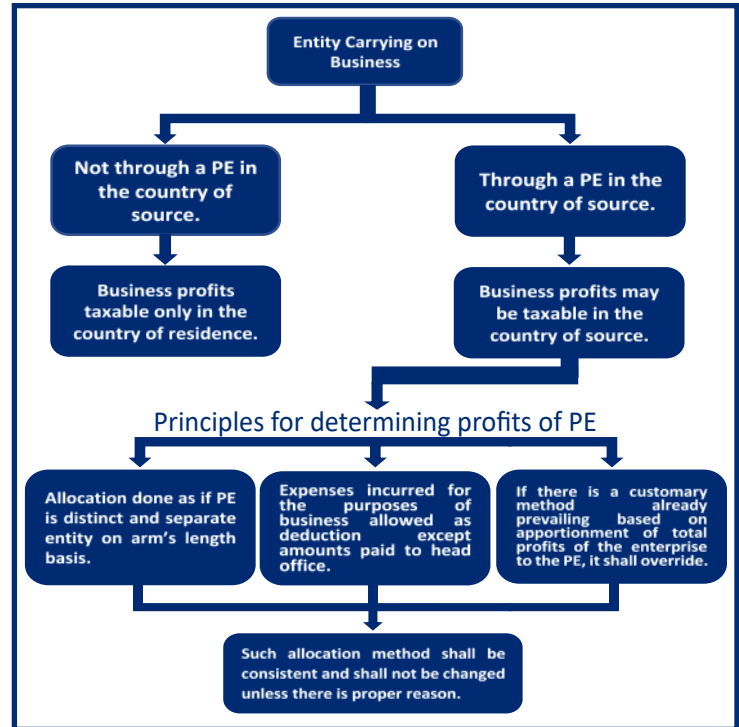
In the next year, profit earned by A Ltd is Rs. 350 million. Profit to be attributed to B Inc in accordance with arm’s length principle is Rs. 20 million. In this case, method of allocation will not be changed from the customary method of allocation to allocating profits as per arm’s length principle just because such method of allocation gives favourable results unless there is proper reason for such change. Therefore, profit to be attributed to PE would be Rs. 35 million (10% of Rs. 350 million) during the year in order to maintain **Consistency**.

## F. UN MODEL CONVENTION AND DOUBLE TAX TREATIES

With Pakistan becoming a member of United Nations [hereafter “UN”] on 30th September 1947, it is an obligation for Pakistan to follow the principles of the UN model conventions with respect to PE and the taxability of its business profits. Under the UN Model Conventions Pakistan has signed double tax treaty with various countries in order to avoid dual taxability of Profits

arising from companies which intends to operate in more than one country.

## G. BUSINESS PROFIT FLOWCHART



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