TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

OCTOBER 2019

TAX PAK

NEWSLETTER BY
TOLA ASSOCIATES

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

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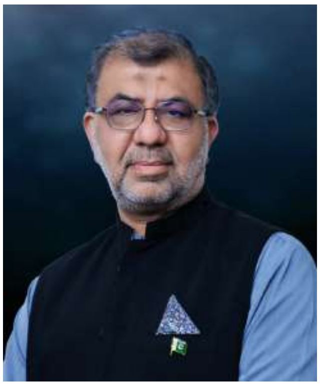

We are back yet again with our monthly issue of “Tax Pak”. This the 24th Edition of this newsletter, and by now we hope we have been able to keep you updated with the recent developments in the Tax world in Pakistan, and abroad too. By the blessing of Allah Almighty, we keep on striving with dedication and devotion, to keep all our readers updated with regards to major developments and recent legislations passed and their effect on the taxation system of Pakistan.

We have once again enlightened our readers with important developments, be it in the form of Statutory Regulatory Orders, new Regulations passed, or a landmark case decided by an Honorable Court within the jurisdiction of Pakistan. Furthermore, along with the above, we have also set forth vital economic indicators in our newsletter, which we hope would help corporate business leaders in their decision-making processes as investment and economics go hand in hand!

Just like always we end our Newsletter with an interesting topic of the month, which in this issue is “*Foreign source Dividend and Interest*” which would surely interest individuals who have invested in foreign companies, or non-residents of Pakistan who earn dividend/interest income in Pakistan.

Readers are requested to visit our website www.tolaassociates.com or download our mobile apps from the links mentioned below to access previous issues and other publications and to be notified in the future of such monthly issues and/or major developments.

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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 Presenting our recently issued report on Doing Business in Pakistan Compendious Study on Statutory Stipulations -2nd Edition to, Muhammad Mian Soomro Federal Minister for Privatization; and Zubair Gilani Chairman BOI.

You can access the document through the following link: **https://bit.ly/36Wf1dL**

1. NOTIFICATIONS/ CIRCULARS

1. CLARIFICATION CIRCULAR ISSUED BY FEDERAL BOARD OF REVENUE WITH RESPECT TO FILING OF REFUND CLAIMS.

The Federal Board of Revenue (hereafter "FBR") amended the Sales Tax Rules 2006 vide SRO 918(I)/2019 dated 7th August 2019 whereby Annexure H in the monthly Sales Tax Return was to be considered as submission of refund claim to allow speedy refund of the claims within 72 hours. However, the taxpayers are facing difficulties in filling Annexures and had requested the FBR, to allow them to revise their returns because the entries made in Annexure-F do not match with those appearing in Annexure H. Consequently, FBR vide its Sales Tax Circular No 4 of 2019 dated 21st October 2019 has had to offer clarification with regards to the said SRO, wherein it has explained that the refund is processed on the basis of entries in Annexure H. The entries made in Annexure F of the Return (having discrepancy with Annexure H) will have no bearing on refund claim except that the carry forward of value addition will be excluded from the refund amount. Hence, there is no need to revise the return in case of a difference between Annexure H & F.

2. FBR ISSUES STGO TO REMOVE MISCONCEPTIONS WITH RESPECT TO NTN/CNICS OF BUYERS.

Prior to Finance Act 2019 (hereafter "the Act"), sales to unregistered persons were only subject to further tax with no requirements of buyer's name, CNIC, address etc. on a sales tax invoice. Through the Act, it was made mandatory for seller to report CNIC/NTN of buyer if sales are made to unregistered persons otherwise the seller will not be allowed input. This, however, created fear for sellers about their potential liability which could have arisen if the CNIC detail provided by the buyer to seller was not valid. In this regard, the FBR issued clarification C. No ½-STB/2019 dated 22nd July 2019 in which it clarified that no action will be taken against 'sellers' if an error or incorrection is identified subsequently, provided the transaction has been made in GOOD FAITH. Subsequently, FBR vide Sales Tax General order No 106 of 2019 dated, 4th October 2019, has now specified conditions to be fulfilled as to what amounts to "Good Faith". These are the following;

- The tax invoices to comply with the requirements given in Section 23 "Tax Invoices" of Sales Tax Act 1990.
- If the seller wants to claim input tax from the sale made against an unregistered purchaser, the seller needs to deposit the amount received in cash against the tax invoice in his declared business bank account in order to claim input.
- The CNIC provided by the seller in lieu of purchaser should be authenticated by NADRA.
- The CNIC provided by the seller shouldn't belong to his employee or his associates as defined under Income tax Ordinance, 2001.

3. SALES TAX DEADLINE EXTENDED BY FBR

The FBR had issued Circular No. 9(11) ST-LPE/Misc/2016-261110-R dated 18th October 2019 extending the date of submitting the Sales Tax and Federal Excise Duty return for the tax period of September 2019. The due date for payment of Sales tax return and Federal excise duty had been extended from 15 October 2019 to 22 October 2019, whereas the due date to submit the return of Sales Tax and Federal Excise Duty had been extended from 18 October 2019 to 25 October 2019. FBR further extended the date for submission of returns for tax period September 2019 up to 08 November 2019 vide Circular no C.No. 9(11) ST-LPE/ Misc/2016 dated 31st

October 2019. FBR had extended the date for the convenience of filers as well as exporters due to the difficulties faced by the claimants in submitting their refund claims due to the confusion that arose with regards to the discrepancies between Annexures F and H, as discussed above.

4. RULES FOR DETERMINATION OF MINIMUM TAX LIABILITY-PUNJAB SALES TAX

Section 24A of Punjab Sales Tax on Services Act 2012 empowers officer of Punjab Revenue Authority (hereafter "PRA") to determine the minimum tax liability (hereafter "MTL") of a registered person who has failed to file a return, subject to rules prescribed by PRA. The PRA has now issued "The Punjab Sales Tax on Services (Determination of Minimum Tax Liability) Regulations 2019" through a Notification bearing No. PRA/Order.06/2017. Vol(V) dated 1st October 2019. As per the abovementioned Regulations;

- The MTL shall not be less than the highest amount of tax paid by registered person during last 12 months.
- In case tax paid in last 12 months was nil, the MTL shall be calculated on the basis of average monthly sales declared by such taxpayer in last submitted Income Tax Return.
- If no MTL arises on the basis of the above, other factors such as; location of business, type of business, nature and market value of services provided, number of persons employed, capital employed in the business, amount of utility bills, estimation on basis of sales ascertained through monitoring of business premises and including electronic monitoring, business turnover reflected in business bank account will be used to determine the MTL.
- The Show cause notice (hereafter "the SCN") shall be issued by an Officer not below the rank of Assistant Commissioner.
- If a person pays the amount voluntarily along with default surcharge within 1 month of issuance of the SCN, the SCN shall be deemed to have been withdrawn.
- If a person fails to pay, the officer will finalize the assessment order on the basis of SCN, at least after 30 days of issuance of SCN.
- The MTL shall not be the final liability and actual liability may arise in any subsequent audit/ investigation.

5. SPECIAL PROCEDURE FOR COLLECTION OF TAX NOTIFIED UNDER PRA

Section 14A of Punjab Sales Tax on Services Act 2012 empowers the PRA to prescribe special procedures for collection of tax by certain persons (in the value chain) not necessarily the service provider or service recipient, and to collect and deposit such tax in the account of PRA. With regards to this, PRA has issued notification No. PRA/Order.06/2017.Vol(V)/1434-37 dated 1st October 2019 whereby the following persons (collecting agents) will collect tax @16%:

- Oil Marketing Companies will collect tax on value of commission / margin from persons providing commission services from selling, distributing or marketing of refined oil products at outlets or filling stations.

- Aircraft Operators will collect tax on value of commission from persons providing travel agency service.

- Electricity Distribution companies (DISCOs) will collect tax on value of Gross charges from payments made or accrued to power transmission company (NTDC) on account of wheeling charges, transmission line charges etc.

These collecting agents must be registered with the PRA, and file Monthly statement for payment of tax in the prescribed manner.

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2. SEARCH WARRANT FROM A MAGISTRATE IS REQUIRED TO INVOKE SECTION 38 OF SALES TAX ACT, 1990 - ATIR

The Inland Revenue Corporate Regional Tax Office, Islamabad (in S.T.A. No. 147/IB/2019), pursuant to the report of the Directorate General I&I, Islamabad passed an Order authorizing the Assistant Commissioner Inland Revenue and other seven officials u/s 38 of the Sales Tax Act 1990 (hereafter "the Act") to visit the premises and conduct an inquiry/investigation to identify sales tax fraud and evasion for the period of July 2015 to June 2018. The concerned officers raided the premises of the taxpayer and seized the record without obtaining a search warrant from the concerned Magistrate as required u/s 40 of the Act. Feeling aggrieved, the taxpayer filed a first appeal before the Appellate Tribunal Inland Revenue (hereafter "ATIR") u/s 46(1)(b) of the Act on the grounds that the powers u/s 38 of Act cannot be delegated to officers below the rank of Assistant Commissioner to enter the premises, and no such raid can be conducted on business premises for purposes of search and seizure of record without issuance of search warrants by a Magistrate u/s 40 of the Act.

The ATIR held that obtaining a search warrant from a Magistrate is a prerequisite to enter into the premises of a taxpayer to invoke jurisdiction under Section 38. Moreover, it was also held that although the wordings of Section 38 allow free access, it cannot be exercised arbitrarily and without any restrictions. Furthermore, the ATIR went on to state that such free access and free inspection provisions without essential safeguards will be against the rights of taxpayer guaranteed under Articles 9, 14, 15, 18, 23 and 24 of the Constitution of Islamic Republic of Pakistan, 1973. The argument of department that Sections 38 and 40 are independent was held to be invalid as this would have been tantamount to rendering section 40 as redundant. In addition to lacking search warrants, the Deputy Commissioner Inland Revenue's Order was held not to be a Speaking Order as it lacked reasonable cause for arriving at the conclusion that premises should be visited for the purpose of carrying out inspection u/s 38. It was held that the department cannot use section 38 to enter into a given premises without reasonable cause and then subsequently look for or create cause to take record and documents into custody. Hence, the order was declared invalid, illegal and without jurisdiction.

In addition to above, the following are other guidelines for invoking Section 38 of Act:

- All searches to be made under the Act must be carried out in accordance with sections 96,98,99-A and 100 of Code of Criminal Procedure1898 (hereafter "the CCP" whereby a search warrant is to be obtained from the Illaqa Magistrate before conducting a search of the concerned premises.
- As per Section 103 of the CCP, two or more respectable persons of locality are also required to attend and witness the search.
- A list of all articles taken into possession shall be prepared and copy of it shall be delivered immediately.

3. ECONOMIC INDICATORS

KARACHI INTER-BANK OFFERED RATE (ALSO KNOWN AS "KIBOR"): -

The 3-month, 6-month and 1-year KIBOR rate for the month of **September 2019** was 13.87%,13.97% and 14.13% respectively, which subsequently declined in **October 2019** to 13.86%, 13.90% and 14.03% respectively.

TREASURY BILLS: -

The 3-month rate for the Treasury Bills for the month of **September 2019** was 13.75% which declined to 13.72% during **October 2019**. Moreover, the 6-month rate for the month of **September 2019** was 13.96%, which declined to 13.89% during **October 2019**. The rate for 1 year for the month of **September 2019** was 14.10%, which declined to 13.92% in **October 2019**.

PSX 100 INDEX:

At the end of **September 2019**, the index closed at 31,244.20 points. Whereas, at the end of **October 2019** the index closed at 32,254.32 points indicating a jump of 3.13%.

RATE OF CRUDE OIL: -

The rate for Crude Oil in the Organization for Petroleum Exporting Countries basket, at the end of **September 2019** was $ 62.31 per barrel, whereas, the rate at end of **October 2019**, was $ 53.62 per barrel. The decrease in price was 13.94%.

RATE OF GOLD: -

The rate of Gold per troy ounce in the month of **September 2019** was $1,516.60, whereas, the same saw a decline of about 1.82% for the month of **October 2019**, leading to a fall in price to $1,489.00.

OTHER KEY ECONOMIC INDICATORS: -

- The rate of Sugar at end of **September 2019** was 0.32 US$/KG which slightly increased to 0.34 US$/KG in the month of **October 2019**.
- The rate of Palm Oil in the month of **September 2019** was 505.50 US$/MT which decreased in the month of **October 2019**, by 0.56% to 502.63 US$/MT.
- The US$ parity to Chinese Yuan at the end of **September 2019** was 7.12 whereas in the month of **October 2019** it was 7.15 showing an increase of 0.42%.
- The US$ parity to Indian rupee at the end of **September 2019** was 71.38 whereas in the month of **October 2019** it was 71.08.
- The US$ parity to Bangladesh Taka at the end of **September 2019** was 84.53 whereas it remained stagnant at the end of **October 2019**.
- The US$ parity to Pakistan Rupee at the end of **September 2019** was 156.60 which slightly increased to 156.90 at end of **October 2019** by a mere 0.19%.
- The stock of currency in circulation was Rs. 5,253.17 billion as on **28th September 2019** which increased by Rs. 1.3 billion up to Rs. 5,385.171 billion till **26th October 2019**.
- The net Government-sector borrowings at end of **28th September 2019** were Rs. 12,734.43 billion which decreased by Rs. 95.71 billion up to Rs. 12,638.72 billion by **26th October 2019**. The net Government-sector borrowings were used for the purpose of budgetary support (Rs. 11,969.09 billion), commodity operations (Rs. 828.35 billion) ; and supported by others (Rs. -14.74 billion).
- The credit to private sector by **28th September 2019** was Rs. 6,729.96 billion which saw an increase to the tune of Rs. 102.63 billion, with the final figure standing at Rs. 6,832.59 billion as of **26th October 2019**.
- Workers' remittances for the month of **September 2019** and **October 2019** were USD 1,854 millions and USD 1,948 millions respectively, a increase of 5.07%.

4. TOPIC OF THE MONTH

- FOREIGN SOURCE DIVIDEND AND INTEREST

A. PREAMBLE

With Dividend and Interest being a complex matter to deal with, from the viewpoint of International Taxation, we offer our readers a detailed analysis over the applications, related complications and apprehension over its litigation process.

This comprehensive article, will amongst other things, assist investors who are resident in Pakistan but deriving dividend and interest income from their investment outside Pakistan and vice versa.

B. DIVIDENDS

Dividend refers to the share of profits and retained earnings a company pays out to its shareholders. When a company generates a profit and accumulates retained earnings, those earnings can be either reinvested in the business or paid out to shareholders as a dividend. Dividends can be issued in various forms, such as cash payment, stocks or any other form. A company's dividend is decided by its board of directors and it requires the shareholders' approval. However, it is not obligatory for a company to declare dividend. Dividend is usually a part of the profit that the company shares with its shareholders.

The taxability of dividends in international taxation is based on the principles of Double taxation avoidance agreement (hereafter "DTAA") which means countries cooperate in order to avoid double taxability of dividends arising from the resident company in one State, which is to be paid to a resident individual in the other State.

The controversy arises here because dividend is a part of the profit of the company which is distributed. Profit is the income on which tax is paid (as corporate tax). Further, when dividend is paid to shareholders, there could be a divided tax (in the form of a tax on distribution) or income tax on dividend (for the shareholder) which is levied on such income – hence there could be double taxation. But distinctively there are 2 types of double taxation which arises in the taxability of Dividend namely, Economic double taxation and Juridical double taxation.

C. ECONOMIC DOUBLE TAXATION

Economic double taxation refers to the taxation of two different taxpayers with respect to the same income (dividend being in this case). Economic double taxation occurs, for example, when income earned by a corporation is taxed both to the corporation and to its shareholders when distributed as a dividend.

Illustration:

For example, A ltd a Pakistani company has earned profits of Rs 100 million during the year. Such profits are subjected to corporate income tax at the rate of 29%. The company declared dividend of Rs 40 million out of its profits. Such dividends are subjected to dividend distribution tax at the rate of 15%. Such dividends are distributed to its shareholders. One such shareholder is Mr. A, a UAE resident who holds 30% shares in A Ltd. Therefore, he receives dividend of Rs. 12 million from the company. Say this amount is taxable in UAE at the rate of 30% - since UAE has exercised its right to tax global income of residents and has levied such tax.

From the example illustrated above, it can be seen that the dividend before reaching its shareholder is subject to tax three times, first Corporate tax on the profits of the company at 29%, secondly, dividend distribution tax at dividend distribution by the company at 15% and lastly under domestic laws of UAE against the income received by its resident at 30% thus, presenting the case of "**Economic Double Taxation**".

D. JURIDICAL DOUBLE TAXATION

Juridical double taxation refers to circumstances where a taxpayer is subject to tax on the same income (in this case dividend) in more than one jurisdiction.

Illustration:

For example, Mr. A, a Pakistani resident has investments in a company in UAE from which dividend income of Rs. 10,000 is derived during the year. This income is taxable in UAE as per the domestic taxation laws, for example at the rate of 20%. Pakistan, by using its right to tax global income of residents also levies tax on such dividend income. However, by virtue of the Pakistan-UAE DTAA, the taxes paid at UAE are available as credit in Pakistan to eliminate double taxation.

From the example illustrated above, it can be deduced that the income of the Pakistani Resident is being taxed in 2 different jurisdictions (countries) i.e. Pakistan and UAE. The UN model convention through DTAAs ensures that such double taxation doesn't takes place, and therefore protecting the investors and as well as keeping the sustainable investment and income intact.

The UN model convention aims at elimination of juridical double taxation in general rather than economic double taxation.

E. TAXABILITY OF DIVIDENDS UNDER UN CONVENTION

According to the model convention, the dividends paid by a company of Contracting state to a resident of the other Contracting State **may** be taxed in that other state. The reason of highlighting the word may is that, the taxability of dividends can be done in the other contracting state, but it doesn't deprive the contracting state from charging the tax on dividend in their own jurisdiction.

In case the Contracting state in which the company declaring dividends is situated decides to charge tax on dividends, the tax cannot exceed a certain percentage of the gross amount of dividends if the beneficial owner is a company which holds 10 percent of capital of the company paying the dividends. These rates are left for countries to agree to whilst negotiating bilaterally. An example could be the DTAA between UAE and Pakistan, wherein if the source country decides to tax the dividends;

1. The tax should be charged 10 percent on the gross number of dividends if the recipient of the dividend is a company (other than a partnership) which holds directly at least 20 percent of the capital of the company paying the dividends.

2. In all the other cases except where the recipient of the dividend is a company, 15 percent should be charged on the gross number of dividends.

3. The taxability of dividends specified above will not affect the taxability of company's income by the country in which the company declaring dividend is a resident.

If the recipient of the dividend income (resident of Pakistan) has a Permanent Establishment or is providing personal services from a fixed base in UAE(the country in which the income is being generated), the dividend will be taxable in UAE according to provisions of Article 7 "Business Profits" or Article 15 "Taxability of income from Independent Personal Services"

F. INTEREST

As per the UN Convention, Interest is defined in Article 11.3 as an income arising from debt claims of every kind, whether or not carrying a right to participate in the debtor's profits, particularly income, premiums and prizes from government securities, bonds and debentures. Under the aforementioned model, payment of penalty charges against overdue debt will not be regarded as Interest for the purpose of this definition.

As far as taxability of interest is concerned, Article 11.1 is phrased in such a way so as to give the country of residence a primary right to tax, whereas the country of source shall have an additional right to tax. However, per Article 11.2, if the beneficial owner of the interest is a resident of the other Contracting State (country of residence), then the tax liability shall be capped at a maximum percentage rate of the gross amount of the interest. The maximum rate has been left open for negotiations between the two member states. For purposes of general information of our readers, this percentage stands at 15% as per the DTAA between the United Kingdom and Pakistan (Article 11.2 of the same).

Moreover, it is interesting to see, that as per the DTAA signed between the UAE and Pakistan, the requirement of a person being a resident of the other Contracting State has been excluded. Article 11.2 of the DTAA signed between UAE and Pakistan states that the Country of Source may tax interest but provides for a cap of 10% of the gross amount of the interest, if the recipient is a 'beneficial owner'. This may imply that interest income may even get taxed in the hands of individuals other than the beneficial owner in the Country of Source, without there being a maximum percentage.

In addition, if the beneficial owner or recipient of interest belongs to either Government of the Contracting State (Pakistan) where Interest is arising or a political/local authority from other Contracting State (UAE) or Central Bank of the other Contracting State (UAE), then such an Interest would be exempt from tax in such Contracting State (Pakistan).

Article 11.4 of the UN Convention states that in case the recipient of the interest is a resident of the contracting state (Pakistan) but is carrying a business through PE or performing personal services through a fixed base in the other contracting state (UAE) in which the interest arises, the provisions under the model convention with respect to interest will not apply but rather provision of Business profits (which states that "*the interest may be taxed in the Other State but only so much of them as is attributable to other business activities carried on in that other State of the same or similar kind as those affected through that permanent establishment*") or Article 14 "*Taxability of income from Independent Personal Services*" will apply accordingly.

G. CONCLUSION

In general, interest and dividend are taxable in the State where the beneficial owner of such income is resident.

Interest and dividend may also be taxed in the State from where such incomes are generated, subject to certain conditions.

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