



TOLA ASSOCIATES
TAX & CORPORATE ADVISORS



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TAX PAK

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EDITORIAL NOTE

Presenting you with the Twenty Third Edition of our Newsletter for the month of September 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 briefing.



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 "*Profits from Shipping, Inland Waterways Transport and Air Transport*" which will interest many enterprises involved in such transportation of Goods, 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)
2. <https://goo.gl/LFiWyx> (Android)

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



Addressing a Q&A on September 13, 2019 on Privatisation Program and Outlook in Karachi which was attended by Minister for Privatisation Minister/ Chairman PC Muhammadmia Soomro, Secretary PC, Rizwan Malik, Consultants PC, and few Members of the PC Board, including Etrat Rizvi, Zafar Sobani, Ashfaq Tola, Eng. Jabbar Memon.

Mr. Ashfaq Tola Giving presentation on topic of Controlled Foreign Company at ICAP auditorium. The presentation was also broad casted live in Islamabad and Lahore.



1. NOTIFICATIONS/ CIRCULARS

1. DETAILS, INCOME ATTRIBUTABLE TO CFC: THERE WILL BE 'PENAL CONSEQUENCES' FOR NON-DISCLOSURE

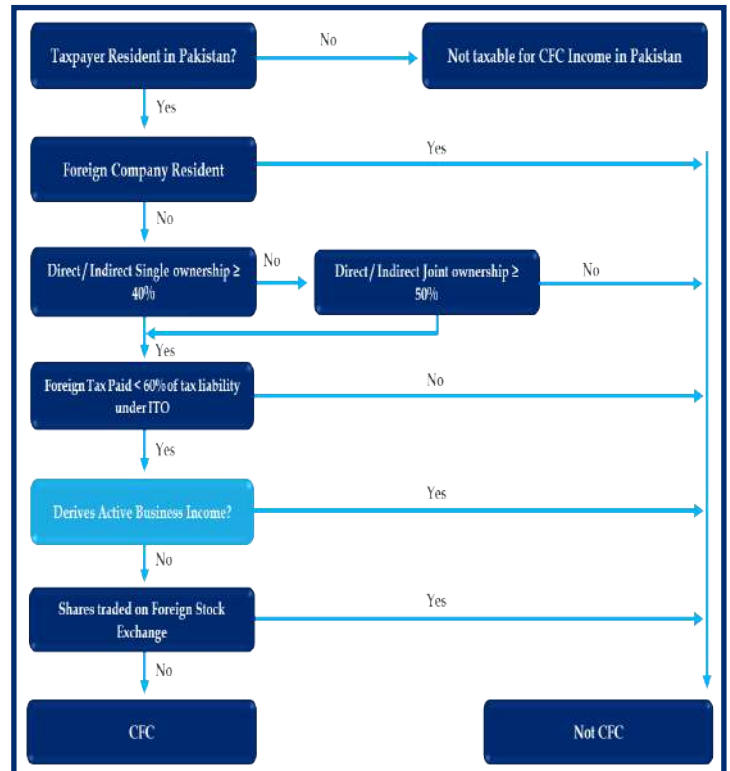
The Federal Board of Revenue (hereafter "FBR") through its Circular 13 of 2019 dated 20th August 2019 offered an explanation of Section 109A of the Income Tax Ordinance 2001 (hereafter "ITO 2001") which specifies the conditions which need to be met for how a foreign company operating in Pakistan to be considered as a Controlled Foreign Company (hereafter "CFC") for the purpose of taxation.

Chairman FBR Mr. Shabbar Zaidi, indicated on Friday that non-disclosure of details and income attributable to Controlled Foreign Company (CFC) in tax returns due on 30th September 2019 will have penal consequences for individuals and entities operating CFCs in terms of Section 109A ITO 2001, particularly those companies operating in the United Arab Emirates (UAE) and other tax havens.

We may once again remind our readers, that the concept of a CFC is a fairly recent and upcoming phenomena under the jurisdiction of Pakistan. Nonetheless, it is a good initiative to tax income attributable to such entities, as other developed Countries such as the UK, have already enacted such legislation, and implemented the same years ago.

For a brief picture of what amounts to a CFC under the jurisdiction of Pakistan, a flow chart is provided below for our readers;

You may also access the presentation on CFC through link: <https://bit.ly/2MxkQF5>



2. DUTY AND TAX PAYMENT MANDATORY: EPZ INVESTORS CAN DISPOSE OF MACHINERY IN TARIFF AREAS

The Federal Board of Revenue (hereafter "FBR") vide Statutory Regulatory Order 994 (hereafter "SRO") dated 4th September 2019 has specified certain Duty and Tax rates which will be applicable to investors disposing of machinery imported by investors within the Export Processing Zones (EPZ). This has been done by amending Rule 226 of the **Customs Rules 2001**. (hereafter "CR 2001").

As per the amendment, now the investors in EPZ, can avail the available exemption provided previously through SRO. 881 (I)/80 (as mentioned in Rule 226 of CR 2001), only if they retain the pertinent machinery for a period of 5 years from the date of its import into the Zone.

Moreover, the investors in Export Processing Zone, shall

have to file a Goods Declaration before disposal of the imported machinery.

If machinery is sold or otherwise disposed off before the expiration of 3 years from the date of import in EPZ, full duties and taxes would be charged by the FBR. FBR will charge 75 percent of the duties and taxes if the same is disposed off after 3 and before 4 years from the date of import in the EPZ.

FBR will charge 50 percent of the duties and taxes if sold or otherwise disposed off after 4 and before 5 years from the date of import in EPZ.

However, if the machinery is sold or otherwise disposed off after five years from the date of import in EPZ, the import is fully exempt from any duties and/or taxes.

3. SALES TAX REGISTRATION MADE COMPULSORY FOR COTTON TRADERS – ET

Federal Government has made it mandatory for cotton traders to register themselves with the Sales Tax department. Moreover, cotton ginners have been advised to submit invoices and details of their supply of taxable cotton products.

As per the new tax rules, cotton traders are required to furnish details pertaining to purchases and related sales tax returns on a monthly basis. Those failing to submit the details of purchases and supplies within the stipulated time frame, would not be entitled to input tax refund claims.

FBR, vide SRO 1087 dated 19th September 2019 directed that the sales tax returns must be filed by the traders instead of cotton ginners. Consequently, sale and purchase of cotton by non-registered traders has been banned and they will not be able to make purchases from ginners. Furthermore, the cotton ginners will have to issue invoices as per **Section 23** of the **Sales Tax Act 1990** (hereafter “STA 90”). The invoice

must state, among other details, the value of cotton supplied to the traders and the applicable sales tax.

Registered traders would have to ensure that payment challans against their purchase invoices bear details of supplies, the name of supplier, registration number and related returns will be submitted to the FBR.

Traders who fail to make tax payments in time would no longer be entitled to the input tax refund claims of the FBR until clearance of their dues along with additional taxes and penalties as per Sections 33 “**Offences and Penalties**” and 34 “**Default Surcharge**” of **STA 90**.

4. S.R.O1160(I)/2019 - MANUAL - FINAL INCOME TAX RETURN FORM FOR INDIVIDUAL

Rule 73 “**Furnishing of documents and returns etc.**” of the Income Tax Rules 2002, provides the criteria for filing the return electronically.

FBR vide SRO 1160 dated 27 September 2019 has issued instructions for filing the Return Form & Wealth Statement as well as Format for filling the Manual Income Tax Returns for Individuals.

The Format can be accessed by via the link below;

<http://download1.fbr.gov.pk/SROs/2019101151017301SRO1160.pdf>

5. S.T.G.O 106/2019 – DEFINITION/ RULES FOR CNIC/GOOD FAITH FOR SALES TAX

FBR vide Sales Tax General Order No. 106 of 2019 dated 4th October 2019, has issued definition/rules for the reporting of sellers with respect to NIC/NTN against taxable supplies being made to unregistered persons.

Certain conditions have been listed in the Notification in order to satisfy the definition of Good Faith, which

are as Follows;

- a. The tax invoice complies with the requirements of section 23(b) of the Sales Tax Act, 1990 ("ACT").
- b. Payment made by or on behalf of the unregistered purchaser of the amount of the tax invoice, inclusive of sales tax and applicable further tax, is deposited into the supplier's declared business bank account.
- c. The CNIC provided by the purchaser is found authenticated by the National Data and Registration Authority (NADRA).
- d. The CNIC/NTN provided is not of the employee of the seller or of his associates as defined under the Income Tax Ordinance, 2001.

Any registered person being a seller who fails to comply on account of any matter arising out of the CNIC provided by a purchaser will be issued a show cause notice. However, an opportunity to be heard by the FBR shall be provided, prior to issuance of such notice. Consequently, only after the approval of the Member (IR-Operations) such a show cause notice will be issued.

2. ATIR GUIDELINES FOR INVOKING SECTION 161/205 OF INCOME TAX ORDINANCE, 2001[ITO]

In the case of **M/s Kashmir Flour & General Mills, Islamabad vs The CIR, RTO, Islamabad**, which has been reported as **2019 SLD 2261**, the Assistant Commissioner had initially held that the taxpayer was liable to deduct tax under Section 161/205 of the Income Tax Ordinance 2001 (hereafter "ITO"), at the time of making payments under various provisions of ITO, and was held to have failed to deduct the same. Being aggrieved of the above, the taxpayer preferred an appeal with Commissioner Appeals (hereafter "CIRA") who concurred with the Assistant Commissioner by upholding the impugned order. A second appeal was preferred thereafter, before Hon'ble Appellate Tribunal

(hereafter "ATIR") on the grounds that the impugned order was passed without jurisdiction. It was further argued that the burden of proof is on the department alleging the default in view of Articles 117 and 118 of Qanun-e Shahadat Order, 1984. A composite reading of Sections 161, 177, 120 and 122C shows that these sections are clearly interconnected. The direct invoking of Section 161 without audit u/s 177 constitutes a fishing and roving inquiry and has the effect of increasing the taxable income assessed under section 120, being in violation of Section 120(1) and (1A) of ITO. The levy of default surcharge u/s 205 of ITO without identifying date of deduction and corresponding date of deposit cannot be justified. In the absence of the terminal end and without determination of the default period, the levy of default surcharge is not possible, as both the opening deductible event, and, terminal end is missing.

The ATIR accepting the above grounds struck down the earlier Orders of the CIRA and ACIR, and held that no transaction can be held to have escaped deduction u/s 161, unless the following is established;

- (i) Taxpayer is a withholding agent; and
- (ii) A particular transaction is liable to deduction/withholding and (iii) that a specified tax of a specific person was to be withheld, who could take credit of the tax recoverable u/s 161.

It was further held by the ATIR that, Section 161(2) declares that a person held personally liable u/s 161(1) shall be entitled to recover the tax from the person, from whom the tax should have been collected or deducted. These provisions will become useless, if a person is held personally liable without identifying the person whose tax was not collected or deducted and without identifying the amount of such tax. The ATIR further held that Section 161 can be invoked only if audit u/s 177 is not legally permissible, and not as matter of routine or pick and choose and fishing expeditions, or a leverage to impose heavy burden of tax on the taxpayer for perhaps administrative reasons.

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 **August 2019** was 13.93%, 14.09% and 14.48% respectively, which subsequently declined in **September 2019** to 13.87%, 13.97% and 14.13% respectively.

TREASURY BILLS: -

The 3-month rate for the Treasury Bills for the month of **August 2019** was 13.75% which remained stagnant at 13.75% during **September 2019**. Moreover, the 6-month rate for the month of **August 2019** was 14.06%, which declined to 13.96% during **September 2019**. The rate for 1 year for the month of **August 2019** was 14.31%, which declined to 14.10% in **September 2019**.

PSX 100 INDEX:

At the end of **August 2019**, the index closed at 31,884.45 points. Whereas, at the end of **September 2019** was 31,244.20 points indicating negative growth of 2.0%.

RATE OF CRUDE OIL: -

The rate for Crude Oil in the Organization for Petroleum Exporting Countries basket, at the end of **August 2019** was \$ 65.53 per barrel, whereas, the rate at end of **September 2019**, was \$ 62.31 per barrel. The decrease in price was 4.91%.

RATE OF GOLD: -

The rate of Gold per troy ounce in the month of **August 2019** was \$1,551.80, whereas, the same saw a decrease of about 2.26% for the month of **September 2019**, leading to a fall in price to \$1,516.60.

OTHER KEY ECONOMIC INDICATORS: -

- The rate of Sugar at end of **August 2019** was 0.33 US\$/KG which slightly decreased to 0.32 US\$/KG in the month of **September 2019**.
- The rate of Palm Oil in the month of **August 2019** was 536.23 US\$/MT which decreased in the month of **September 2019**, by 5.73% to 505.50 US\$/M.
- The US\$ parity to Chinese Yuan at the end of **August 2019** was 7.17 whereas in the month of **September 2019** it was 7.12 showing a decrease of 0.69%.
- The US\$ parity to Indian rupee at the end of **August 2019** was 72.02 whereas in the month of **September 2019** it was 71.38.
- The US\$ parity to Bangladesh Taka at the end of **August 2019** was 84.53 whereas it remained stagnant at the end of **September 2019**.
- The US\$ parity to Pakistan Rupee at the end of **August 2019** was 159.70 which decreased to 156.60 at end of **September 2019** by 1.94%.
- The stock of currency in circulation was Rs 5,254.47 billion as on **24th August 2019** which decreased by Rs. 1.3 billion up to 5,253.17 billion till **28th September 2019**.
- The net Government-sector borrowings at end of 24th August 2019 were Rs. 11,925.31 billion which increased by Rs. 809.12 billion up to Rs. 12,734.43 billion by 28th September 2019. The net Government-sector borrowings were used for the purpose of budgetary support (Rs. 12,027.92 billion), commodity operations (Rs. 723.9 billion); and supported by others (Rs. -17.4 billion).
- The credit to private sector by 24th August 2019 was Rs. 6,636.84 billion which saw an increase to the tune of Rs. 93.12 billion, with the final figure standing at Rs. 6,729.96 billion as of 28th September 2019.
- Workers' remittances for the month of August and September 2019 were USD 1,539 million and USD 1,832 million respectively, a increase of 19.03%.

4. TOPIC OF THE MONTH

- PROFIT FROM SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT

A. PREAMBLE

Since we apprised our readers, in our previous monthly issue, as to how Income from Business Profits is treated in terms of International Taxation, it only makes sense to analyze how Income from Shipping, Inland Waterways Transport and Air Transport is treated in terms of the same. Hence, this Article aims to provide a useful analysis as to how profits arising from the goods and services are taxable under Shipping, Inland Waterways Transport and Air Transport. The UN Model Convention provides two alternative versions with respect to such income namely; Alternative A and Alternative B. Alternative A of the UN Model is a leaf taken out of the OECD Model. Moreover, Alternative B is a reformed version of Alternative A. Alternative A accounts for the profits of ships and aircrafts in international traffic as a single unit, whereas, Alternative B accounts for profit from operations of aircrafts and ships in two separate units or paragraphs. We are pleased to offer our analysis below.

ALTERNATIVE A

As discussed earlier in the preamble Alternative A is reproduced from the OECD Model. It states that *“Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the “Place of Effective Management” POEM of the enterprise is situated”*. A bare perusal of the above makes it clear, as per this Alternative, the fundamental right to tax the profits arising from the operations of **both ships and aircraft** in international traffic, is possessed by one country only. The word “only” before going on to state which Contracting State has the right to tax implies that there exists only a fundamental right to tax in the Contracting State wherein the POEM of the Enterprise is located. Hence, it can be concluded that there is no additional

right to tax for the other Contracting State. The POEM is a crucial factor while deciding the taxability of the profits arising from water and air transport. The OECD model offers some guidance on the meaning of this term, which is reproduced as below;

The POEM is the place where key management and commercial decisions that are necessary for the conduct of the enterprise’s business are in substance made. The POEM will ordinarily be where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the enterprise as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management, but it can have only one POEM at any one time.

Many countries which do not have their own shipping companies, disagree with the principles of Alternative A with respect to Shipping profits which are wholly exempt from tax at source.

Such Countries would prefer Alternative B, since they have water boundaries, but ports are used mainly by ships from other countries.

In this way, the benefit arising from the operations is limited, rather than mutual, as the Country owning the shipping vessel benefits from the use of port of the other country and the country facilitating the ships using its ports get deprived off any major financial benefits arising from the usage of its ports.

TAXABILITY UNDER ALTERNATIVE A

The Income arising from the following activities fall within the scope of taxability under Alternative A namely;

- Profits obtained by leasing a ship or aircraft on charter fully equipped, manned and supplied must be treated like the profits from the carriage of passengers or cargo.
- The sale of passage tickets on behalf of other enterprises;
- The operation of a bus service connecting a town with its airport;

- Advertising and commercial propaganda;
- Transportation of goods by truck connecting a depot with a port or airport.
- Inland transportation if an enterprise engaged in international transport is engaged in delivery of goods directly to the consignee in the other Contracting State.
- Profits derived by an enterprise engaged in international transport from the lease of containers, which is supplementary or incidental to its international operation of ships or aircraft fall within the scope of this article, since “containerization” has come to play an increasing role in the field of international transport.

There are certain other activities which do not fall within the scope of this Alternative A namely;

- A clearly separate activity such as the keeping of a hotel as a separate business; In certain cases, however, circumstances are such that the provision must apply even to a hotel business e.g. the keeping of a hotel for no other purpose than to provide transit passengers with night accommodation, the cost of such a service being included in the price of the passage ticket.
- A shipbuilding yard operated in one country by a shipping enterprise having its POEM in another country.
- Taxability of profits under Alternative A, arising from the operations of a vessel engaged in fishing, dredging or hauling activities on the high seas may be bilaterally agreed between Contracting State and the other Contracting State.
- Investment income of shipping, inland waterways or air transport enterprises (e.g. income from stocks, bonds, shares or loans).

ILLUSTRATION OF ALTERNATIVE A

DEX Maritime, a shipping company is engaged in the business of container shipping in international as well as domestic traffic. The company has its place of effective management in Pakistan.

Case 1

One of its ship carries containers of oil from UAE to Pakistan. Here the profits earned from the business will

be taxed in Pakistan since the place of effective management is in Pakistan. Hence UAE cannot claim their rights over such income.

Case 2

Considering an exceptional case where specific instruction is given to the shipping company departing from UAE and arriving at Karachi port to deliver the container to Mr. Z of Gwadar. Here the transportation of goods from the port to Mr. Z’s place through any mode of transportation will be considered as ‘International traffic’ since the commentary includes “Inland transportation goods if an enterprise engaged in international transport is delivered directly to the consignee in the other Contracting State”. Therefore, the profits from such an operation will be taxable in Pakistan, being the POEM.

ALTERNATIVE B

Alternative B of the UN Model convention is divided into two parts. The first part relates to profits arising from the operation of aircrafts in international traffic. The first part is dealt with in the same manner as Alternative A. However, there is a difference in terms of how profits arising from the operation of ships in international traffic, are dealt with, which is covered by the Second Part of Alternative B.

Profits arising from the operation of ships in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated, **unless** the shipping activities arising from such operation in the other Contracting State are **more than casual**. If such activities are more than casual, such profits may be taxed in that other State. The profits to be taxed in that other State shall be determined based on an appropriate allocation of the overall net profits derived by the enterprise from its shipping operations.

The emphasis or difference fulcrum is based on the phrase **more than casual**. **The highlighted phrase** means if there is a sequenced, scheduled or planned visit of a ship to the other Contracting state to pick up freight or passengers, this will give a fundamental right of taxation to the other Contracting State (country of source),

whereas the State in which the POEM is located will only have an additional right to tax, subject to such right being available in its domestic legislation.

SIGNIFICANCE OF ALTERNATIVE B

The significance of Alternative B is that the other Contracting State also benefits from the income arising from the shipping businesses being carried out in its ports. The profits arising from the shipping operations will be calculated on a uniform basis through bilateral negotiations between the two Contracting States. The tax computed on such profits will be reduced to a certain percentage in order to give benefit to the Contracting State or the country of place of effective management (residence) since it is the one orbiting the originated managerial and capital inputs. In this way, profits from the operation of ships in International traffic will be allocated between the countries of place of effective management and the country of source.

ILLUSTRATION OF ALTERNATIVE B

Case 1

A Pakistani company is engaged in shipping business carrying both goods and passengers transmitting between Pakistan and UAE. The place of effective management is in Pakistan.

The profits arising from the above will be taxable in Pakistan since the POEM is in Pakistan.

Case 2

On one journey it had to drop passengers in Iran.

The visit to Iran is planned, it comes within the definition of “more than usual” and is also an irregular visit. Therefore, the profits on the business will be allocated between Pakistan (country of residence) and Iran (country of source).

Case 3

On another occasion the ship had to stop in Sri-Lanka due to cyclone.

This visit was not planned and does not come under the definition of “more than usual”. Hence, the right to tax on such profits from the business of shipping vests in Pakistan and not Sri Lanka.

TABULAR ILLUSTRATION - TAXATION OF PROFITS FROM OPERATION OF SHIPS OR AIRCRAFTS SOLELY BETWEEN TWO PLACES IN THE OTHER CONTRACTING STATE

Particulars	Alternative A and B
Profit from operation of ships or aircrafts solely between two places in the other Contracting State	Profits from ships or aircrafts will fall under the scope of business profits
(i) Has PE in other Contracting State	Country of source – primary right to tax Country of residence – additional right to tax
(ii) Does not have PE in other Contracting State	Country of source – No right to tax Country of residence – Only right to tax

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