

TAX PAK

NEWSLETTER BY
TOLA ASSOCIATES



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EDITORIAL NOTE

Dear All,

Hope this newsletter finds everyone in good health. At the very outset of this month's edition, I would like to urge everyone reading this, to please stay safe, and stay at home during this tough time. It is our social and moral obligation to not only save ourselves, but to also keep everybody else safe, especially our family members.



With that being said, I, with the blessing of Allah Almighty, welcome you on behalf of my entire team, to yet another monthly issue of TAXPAK. Since, it has been quite a topsy-turvy month, there have been a lot of Notifications passed by the FBR, PRA, and SRB, with regards to fixation of cases/appeals, and filing thereof. We have tried our best to include all those Notifications, so as to, keep you posted with the relevant updates in relation to functioning of the aforesaid Revenue Authorities.

Moreover, my team has also compiled the recent notifications passed by the SECP. We have also discussed a recent judgment passed by the High Court of Sindh, that relates to suspension of a taxpayer's registration, without receiving a prior notice by virtue of Section 21 of the Sales Tax Act 1990, read with Rule 12 of the Sales Tax Rules 2006. Furthermore, at the end of our newsletter, is our all important 'topic of the month'. In this month's issue, we have discussed the concept of transfer pricing, and how the 'arm's length principle' plays a key role in the tax authorities drive to stop tax evasion.

Lastly, I would like to extend, on behalf of myself and my entire team, our warm regards to all of you, during this tough lockdown. You can visit our website www.tolaassociates.com, or download our mobile Application, in order to access previous versions of this newsletter, or more of our monthly publications. The aforesaid application can be downloaded from the links below:

1. <https://goo.gl/QDM4ZM> (IOS)
2. <https://goo.gl/LFiWyx> (Android)

It is requested that you may circulate this e-copy within your circle(s), as our primary aim is to benefit the masses. Feedback is always welcomed.

Ashfaq Tola - FCA
Editor in Chief

1. TAX NOTIFICATIONS/ CIRCULARS

i. VALUE OF MINERALS FOR PURPOSE OF SECTION 236V NOTIFIED:

Section 236V of Income Tax Ordinance 2001 (hereafter "ITO"), deals with advance tax on extraction of minerals. The said Section was added in ITO through the Finance Act of 2016. The collecting authority shall be the Provincial Authority collecting royalty per metric ton from the non-filer lease-holder of mines or any person extracting minerals. Moreover, advance tax will be levied on the value of minerals extracted, produced, dispatched and carried away from the licensed or leased areas of mines. The value of minerals shall be determined by the Federal Board of Revenue (hereafter "FBR"), in terms of **Section 236V (4)** of ITO.

The FBR, through SRO 140(I)/2020, dated 2nd March 2020, has added Rule 231I in the Income Tax Rules 2002, and prescribed the value for 56 minerals for the purposes of the said Section.

ii. EXEMPTION ON IMPORT OF MEDICAL ITEMS:

The FBR has, vide SRO 236(I)/2020, dated 20th March 2020, exempted from income tax for 3 months, import under Section 148 of ITO of medical items related to the COVID-19 pandemic. This has been done by inserting clause 12B in Part IV of the Second Schedule to ITO w.e.f. 20th March 2020. The said exemption may be extended by the FBR for another 3 months, if recommended so, by the Ministry of National Health Services, Regulation & Coordination.

In light of the aforesaid pandemic, the FBR has, through SRO 237(I)/2020, dated 20th March 2020, exempted a total of 61 medical items, for 3 months, from sales tax at the import stage and its subsequent supply. The FBR has done this by exercising the powers conferred to them under Section 13 of Sales Tax Act 1990 (hereafter "STA").

iii. CHANGES IN THE STRUCTURE OF THE LICENSING COMMITTEE:

Chapter XIV-B of Sales Tax Rules 2006 (hereafter "STR") contains rules related to electronic monitoring,

tracking of the production, import, and supply-chain of products, inter-alia, tobacco products, beverages and sugar on a real time basis. Rule 150ZG(d) of the STR prescribes the structure of the licensing committee. The said committee comprises of the following;

- (a) Commissioner (Zone-I), LTU, Islamabad;
- (b) Commissioner (Zone-I) LTU Karachi;
- (c) Commissioner Mardan Zone, RTO Peshawar;
- (d) Director, Intelligence and Investigation-IR, Islamabad;
- (e) Chief IR (Operations-I), FBR Headquarters, Islamabad; and

Any other officer or authority designated by the FBR. The licensing committee, is, inter-alia, responsible for evaluating the licensing application and recommending the FBR as to the grant or rejection of a license.

The FBR through, SRO 223(I)/2020 dated 16th March 2020, has now stated that the licensing committee will now comprise of at least three members of the Inland Revenue Officers. The said officers will not be below the rank of BPS-20 of the FBR Headquarters, and will be assisted by a technical, or IT expert, and any other officer or authority designated by the FBR.

iv. VALUE OF SUPPLY (IN CASE OF SUGAR):

As per Section 3 of STA, sales tax is charged at the rate of 17% on the value of a taxable supply, made by a registered person, in the course or furtherance of any taxable activity. The FBR is empowered under Section 2(46) to fix the value of any imported goods or taxable supplies or class of supplies and for that purpose fix different values for different classes or description of same type of imported goods or supplies.

FBR, had previously through SRO 812(1)/2016, dated 2nd September 2016, notified the value of supply of imported white crystalline sugar to be at least US\$725 per MT. Now, through SRO 233(I)/2020, dated 18th March 2020, this entry has been deleted, and the value of supply of imported white crystalline sugar will be the value determined under Section 25 of the Customs Act 1969, including the amount of customs-duties and central excise duty levied thereon as per Section 2(46)(d) of STA.

v. EXTENSION IN THE DATE FOR SUBMISSION OF SALES TAX AND FEDERAL EXCISE RETURNS ALONGWITH ANNEXURES FOR THE TAX PERIOD OF JANUARY, 2020 AND FEBRUARY 2020:

The FBR vide circular No. C No. 9(11) ST-LPE/Misc/2016, dated 24th March 2020, has extended the dates as follows:

Tax Period	Due Date	Extended Date
January 2020		
Submission Date	18.02.2020 (extended up to 28.02.2020)	15.04.2020
February 2020		
Payment Date	15.03.2020	31.03.2020
Submission Date	18.03.2020 (extended up to 25.03.2020)	15.04.2020

vi. APPELLATE TRIBUNAL DIRECTIONS AMID CORONA VIRUS SPREAD

The Assistant Registrar of the Appellate Tribunal Inland Revenue (hereafter “ATIR”) has, through a letter bearing no. F.55-ATP/HQ/(Ad)/2020, dated 25.03.2020, instructed the infra, to be followed from 26.03.2020 onwards:

- Only Stay applications etc. will be heard and decided by the respective Benches at Islamabad, Lahore, Karachi and Peshawar. The main appeals of urgent nature, will be fixed and heard, by the concerned Benches upon appropriate application.
- All Officers/officials are directed to avoid marking their attendance through a thumb/finger impression.
- The office has been directed to ensure that no such ‘litigant public’ enters into the premises of the Tribunal, as are not required to attend court proceedings. Furthermore, all litigant public shall be asked to produce a copy of the notice of the hearing to ensure their appearance is mandatory.

vii. EXTENSION FOR E-DEPOSITING OF SINDH SALES TAX, AND E-FILING OF TAX RETURN FOR THE PERIOD FEBRUARY 2020.

The Sindh Revenue Board (hereafter “SRB”), vide Circular No. 01/2020, dated 17th March 2020, had extended the date for making an e-deposit of the amount of Sindh Sales Tax for the tax period of February

2020, up to 24th March 2020. Moreover, the e-filing of tax returns in Form SST-03 or SSTW-03 for the tax period February 2020, was extended up to 27th March 2020.

Now, the SRB, through Circular Letter No. 02/2020, dated 27th March 2020, has extended the date for e-depositing the amount for the tax period Feb 2020, up to 31st March 2020. Moreover, the date for e-filing of tax returns in Form SST-03 for the same period has been extended upto 10th April 2020.

viii. NO ADVERSE ORDER TO BE PASSED BY COMMISSIONER(APPEALS) IN CASE OF PUNJAB SALES TAX ON SERVICES

The Punjab Revenue Authority (hereafter “PRA”), vide its Office Order dated 25th March 2020, has instructed that no adverse orders may be passed due to non-appearance of any party, lawyer or authorized representative(s) in a case fixed for hearing before the Commissioner(Appeals), PRA. The said instructions shall be applicable with immediate effect, and till further orders.

ix. FILLING OF APPEALS WITH COMMISSIONER APPEALS IN CASE OF PUNJAB SALES TAX ON SERVICES

The PRA, through its notification dated 25th March 2020, has directed that appeals before the Commissioner (Appeals) can be filed through email at commissionerappealspra@gmail.com, or can be couriered too.

x. FBR CASE MANAGEMENT PROCEDURE TO AVOID (COVID-19)

The FBR has issued a letter bearing No. C.No 3(25)S/(Appeals)/2019, dated 27th March 2020, in response to a request made by the Pakistan Tax Bar Association, through their letter dated 24.03.2020, to adjourn all hearings already fixed from 26.03.2020 to 24.04.2020 without application or seeking any requests from the authorized representative(s). The FBR, through the said letter, has stated that it will be fair and just if no case will be decided ex-parte due to non-attendance,

and that no new case may be fixed for hearing from 26.03.2020 to 24.04.2020.

xi. OFFICE ORDER (MINISTRY OF LAW) TO AVOID THE CORONAVIRUS

The Ministry, vide its letter no. F.No. 1(27)/2015-A-IV, dated 25th March 2020, has directed that no adverse orders may be passed due to non-appearance of any party, lawyer or authorized representative(s), in any case fixed for hearing before Customs Appellate Tribunal or Appellate Tribunal Inland Revenue (ATIR), with immediate effect.

xii. APPELLATE TRIBUNAL SINDH REVENUE BOARD CIRCULAR TO AVOID CORONA (COVID-19)

The Appellate Tribunal of SRB has issued a letter bearing no. AT/SRB/COVID-19/Circular/2020, dated 24th March 2020, and has directed that:

- The regular work of the Tribunal with respect to hearing of appeals shall remain suspended for fourteen (14) days, with effect from 24.03.2020 to 07.04.2020.
- The appeals shall be received daily, during working days, from 09:00 a.m. to 02:00 p.m.
- The Chairman/Technical Member of the Tribunal would be available in the office for attending urgent work from 10.00 am to 02.00 pm,
- The appeals will be taken up during the above suspended period on the basis of urgent application which would be enclosed with affidavit disclosing the reason for urgency.

2. CORPORATE NOTIFICATIONS/ CIRCULARS

i. SRO 145 (I)/2020 (dated 28th February 2020)

The captioned SRO was issued by the Securities Exchange Commission of Pakistan ("hereafter "SECP"). The said SRO notified certain amendments that were earlier made, to the Association with Charitable and not for Profit Objects Regulations 2018, through SRO 48(I)/2020 dated 27th January 2020.

The crux of the amendment is that each of the

promoters, directors, chief executive officer and members of the association, shall meet the fit and proper criteria as provided in these regulations.

ii. SRO 141 (I)/2020 (dated 28th February 2020).

The SECP, through the captioned SRO, has published the proposed draft amendments in the Auditors (Reporting Obligations) Regulations 2018. By virtue of the said SRO, the SECP has proposed certain changes in the "independent auditor's report" that have to be submitted by companies.

Under the above-mentioned regulation, companies are required to submit the auditor's report on consolidated financial statements.

iii. SRO 173 (I)/2020 (dated 5th March 2020).

The SECP has, through the captioned SRO, issued draft amendments to the Real Estate Investment Trust Regulations 2015.

The SECP has introduced the concept of "Developmental Infrastructure REIT Scheme" which is established for investment, development and construction in infrastructure real estate.

iv. SRO 231(I)/2020 (dated 16th March 2020)

The SECP, through the captioned SRO, has finalized the draft amendments issued through SRO 33 of 2020.

These regulations will be applicable to companies issuing further capital by way of:

1. right shares;
2. other than right shares;
3. bonus shares;
4. employee stock option schemes; and
5. Shares with different rights including preference shares.

The aforesaid regulations, finalized through the captioned SRO, will be termed as the 'Companies (Further Issue of Shares) Regulations 2020'.

3. SUSPENSION OF SALES TAX REGISTRATION WITHOUT PRIOR NOTICE ULTRA VIRES THE CONSTITUTION

The heading pertains to the case **Saleem Ahmed vs. Federation of Pakistan & Others (C.P. No. D-8101 of 2017 and others)**. The facts were such that the sales tax registration of the taxpayer was suspended, and blacklisted, unilaterally by an officer of the FBR. The said officer did this without issuing any show cause notice, or providing an opportunity of being heard, to the taxpayer. Aggrieved by such actions, the taxpayer directly approached the Sindh High Court (hereafter "SHC"), and filed a Constitutional Petition. The said petition was filed on the following grounds; a) That Section 21 of STA read with Rule 12 of STR is in violation of Article 10-A (Right to a fair trial) of the Constitution of Pakistan 1973 (hereafter "the Constitution"), hence, against the principal of natural justice; and b) That the aforesaid Section is hanging sword on the businesses of the taxpayer(s)/petitioners, and coupled with such whimsical acts of the FBR, is violative of Article 18 of the Constitution. It was prayed in the said Petition for Rule 12 to be declared Ultra Vires to the Constitution.

The SHC observed that Section 21 of STA only provides 2 grounds to blacklist or suspend one's registration. These are; (a) if one has issued fake invoices; or (b) he has otherwise committed tax fraud. Rule 12 has added other situations on account of which the taxpayer's Sales Tax Registration Number may be blacklisted or suspended. Hence, Rule 12 exceeds the scope and limit(s) of Section 21(2) of STA against a registered sale tax payer. Moreover, it also observed that where Rules have overstretched powers granted by its parent statute/Act, the courts have given directions in favor of the taxpayer. The SHC further noted that as per Section 21(2), the following must be adhered to:

- The Commissioner, must, before exercising his powers under the said Section, be "satisfied" (i.e must be free

from anxiety, doubt, perplexity, suspense or uncertainty, convinced beyond a reasonable doubt), rather than having an "opinion" (i.e. belief resulting from what one thinks on his own on a particular question), that a registered person is found to have issued fake invoice, or has otherwise committed tax fraud. In other words, Commissioner must, on the basis of material sufficient to prove, conclude that the registered person had issued fake invoices, or has committed tax fraud. Thus, it is imperative that the Commissioner must give a full opportunity to be heard to the other side, before he can be convinced against the taxpayer beyond a reasonable doubt.

- Once the Commissioner reaches the conclusion that, either fake invoices have been issued, or tax fraud has been committed, due process in terms of Article 10-A of the Constitution must be followed.

The SHC, after making the above observations, held Rule 12(a)(i) of STR, to the extent it gives authority to the Commissioner to suspend the sales tax registration of a registered person "without prior notice", to be ultra vires to the Constitution. Moreover, it also held the said Section, in terms of the above, to be violative of the principles of natural justice, and in excess of the authority vested under Section 21(2) of STR. Hence, the Order passed earlier, was done so without recording reasons in writing, and that the show cause notice was not issued within 7 days. Henceforth, the blacklisting order, issued 90 days after the suspension Order, is void ab initio, and Sales Tax Registration was restored accordingly.

4. TOPIC OF THE MONTH

- ARM'S LENGTH PRICING: A SIGNIFICANT ASPECT OF TRANSFER PRICING IN PAKISTAN

In the modern-day landscape of competition, efficiency and management, enterprises now recognize that they have to deal with two types of customers: (i) External; and (ii) Internal. Where a company opts for a

divisionalised structure, some divisions might supply, goods or services, to other divisions within the same company. For the purposes of accounting, these internal transfers of goods or services are given a value. The transfers could be recorded at cost as well. However, when the selling division is a profit center, it is expected to make some profit. A transfer price, is the price at which goods or services are sold by one division to another division within the same company.

The objective of Transfer pricing, should be, to make it possible for a divisionalisation structure to operate successfully within a company, and to give autonomy to the managers of the said profit centers. It should also enable the company to measure the performance of each division in a fair way, and maximize the company's profits. However, there are other objectives which are also aimed for, by companies, through transfer pricing. An example could be where groups of corporations around the world, park their profit in subsidiaries which operate in jurisdictions with low tax rates, and park their losses jurisdictions with high tax rates in order to increase their net benefits. It may be noted, that the scope of transfer pricing problems is not limited to just company-to-company transactions. An example illustrating the same could be where a transaction between an individual and an overseas company is completed, through which controls are manipulated. The Government has been trying to improve/address this issue, in order to improve tax yields.

1. THE ARM'S LENGTH PRINCIPLE.

The most commonly used valuation method by the tax authorities is the Arm's length principle (hereafter "ALP"). The said principle entails that transactions should be valued as if they had been carried out between unrelated parties, each acting in its own interest. This principle is preferred over any other approach because it is very simple and widely accepted. However, there are difficulties in finding concrete standard(s), against which an arm's length price can be determined. In some cases, this may result in an administrative burden for the taxpayer(s) and tax

authorities in evaluating different types of cross-border transactions. Transfer prices may be valued/based on marketing and/or financial policy, or to minimize tax. For effective tax planning, it needs to be ensured that a transfer within a group should be valued approximately at a price similar to that which would have been negotiated between independent entities i.e. the arm's length price.

2. OECD GUIDELINES

The Organization for Economic co-operation and Development (hereafter "OECD") has published certain guidelines for Multinational Enterprises and Tax administration. The said guidelines support the arm's length principle. It stipulates that the means of establishing the pricing, for and under the ALP, will be similar to that in determining what the open market would demand. The OECD provides guidance on how to apply general provisions to complex situations, and improving tax administration procedures.

3. METHODS OF ARRIVING AT ARM'S LENGTH TRANSACTION

The methods *infra*, are generally, and globally, accepted methods of arriving at an Arm's Length Prices:

- **Comparable Uncontrolled Price Method:** This compares prices charged in similar transactions between independent parties. In real life, it may be difficult to find wholly similar transactions, especially in niche situations, an example thereof could be where special purpose products are involved. For example, division A of ABC motors manufactures a specialized battery cell which can only be used by division B of ABC motors to install in their specially built electric vehicles. Over here, there can be no comparable uncontrolled price of such battery cells as no one else makes them. Difficulties can also arise while evaluating prices of general products, as the entities may claim that they are charging more price due to superior quality of their product when compared to similar products.
- **Resale/Resale-Minus Method:** This is the subtraction of a margin, from the end-selling price to an

independent third party. For example, a product is sold at Rs. 12 per piece by the retailer having a 10% margin. In this case, the transaction price between retailer from its associated distributor will be Rs. 10.08 (Rs. 12 minus the margin of Rs. 1.12)

- **Cost-based/Cost plus Method:** This method provides for an addition of a margin to the costs of producing the relevant goods or services. The Cost based method is most useful in case of semi-finished goods being sold to related firms. A cost plus markup earned in comparable transactions by an independent firm may serve as a useful guide in such a situation. For example, if it is a norm in Pakistan that the auto industry has a built-in 5% margin in their prices, division A in the above example may charge 5% of its cost while transferring batteries to division B.

- **Transactional Profit Method:** This consists of the profit-split method, and transactional net margin method. For example, where the net profit margin of a group in a particular year is 4%; the same rate of profit may be incorporated in each transaction between the associates.

4. TRANSFER PRICING TAX LAWS IN PAKISTAN

Countries with Transfer Pricing legislations ordinarily follow the Transfer Pricing Guidelines of Organization for Economic Cooperation Development (“OECD”) for Multinational Entity (“MNE”) groups and tax administrations which provide guidance on the application of the ALP. OECD has also recommended country-by-country reporting to address Base Erosion and Profit Shifting (“BEPS”).

In Pakistan, Section 105 of the ITO deals with the taxation of permanent establishments of a non-resident person in Pakistan, whereby certain principles would apply in determining the income of a permanent establishment of a non-resident company chargeable to tax under the head “income from business”.

Section 108 of the ITO deals with the transactions between associates, whereby the Commissioner, in respect of any transaction between persons, who are

associates, may distribute, apportion or allocate income, deductions or tax credits between the persons, as is necessary to reflect the income that the person would have realized in an arm’s length transaction. In other words, the Commissioner has the power to distribute, apportion or allocate income, expenditure or tax credits between associates in respect of transactions not made in accordance with the ALP. In determining the income from a transaction with an associate, the standard applied by the Commissioner shall be that of a person dealing at arm’s length with a person who is not an associate.

The Income Tax Rules 2002 (hereafter “ITR”) prescribe the methods for determination of an arm’s length price. Rules 20 to 27 of ITR govern transfer pricing assessment/-monitoring in Pakistan between Associates. These rules provide that transactions should be done on an ALP. The ALP may be applied by Commissioner using the following methods:

1. Comparable Uncontrolled Price Method
2. Resale Price Method
3. Cost Plus Method
4. Profit Split Method

Moreover, Rules 27A to 27Q provides for Documentation, and the CbCR requirements between Associates as required to be maintained under Section 108 of ITO. These rules require every taxpayer, who has entered into a transaction with his associates, to maintain a record of documents, information, files, country-by-country reporting, and any other information and documents pertaining to the said transaction.

The purpose of this legislation is to maintain transparency, and to testify, as to whether these companies are paying the right amount of tax to the authorities or not.

5. TRANSFER PRICING AND CORPORATE LAW REQUIREMENTS:

Section 208 of Companies Act 2017 stipulates certain guidance for transactions between related parties. In

case of listed companies, the Code of Corporate Governance Regulations, issued by the SECP, are also applicable. The SECP has issued a guidance that requires companies to maintain records of their related-party transactions. The new recordkeeping rules have been effective 1st January 2019. The guidance, issued through SRO 1194(I)/2018 dated 11th October 2018, under the Companies Act 2017, requires companies to identify related parties, and maintain records of transactions or contracts with these related parties. These rules also apply with respect to arrangements in which a company's director has an interest.

Under these provisions, a company can enter into an arrangement with a related party only if the same is approved or is within a policy approved by the board of directors of the company. These conditions do not apply with respect to related-party transactions if entered into by a company within the ordinary course of its business on an arm's length basis. For example, any director of a fast-moving consumer goods does not need approval while shopping for his company's products over the counter.

» **Resources Used:**

- 1) coursehero.com
- 2) fbr.gov.pk

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