TAX PAK

NEWSLETTER BY TOLA ASSOCIATES

TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

OCTOBER
2020

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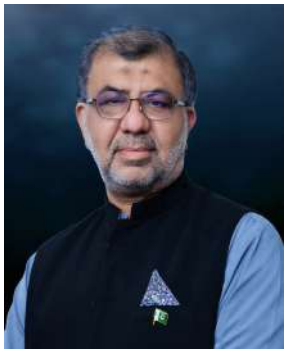

The October 2020 issue of TAX PAK by the grace of Almighty Allah is 36th edition. I, on behalf of my entire team would like to extend our readers good health and a very warm welcome. We are delighted to have compiled this Newsletter to keep all our readers abreast with taxation system and the crucial updates therein.

Following our trend, we have once again discussed a recent advancement in the form of a seminal judgment. The said judgment pertains to the procedure and powers used by the Officer Inland Revenue, to issue a notice under Section 137 of the Income Tax Ordinance, 2001. The notice was served against non-payment of Advance Tax under Section 147 of the Income Tax Ordinance, 2001. The appellant authority in the above was the Lahore High Court. Moreover, we have also embodied certain notifications and circulations issued by the Securities & Exchange Commission of Pakistan (SECP), and the Federal Board of Revenue (FBR).

In the end, we conclude our newsletter with our Topic of the Month "Advance Ruling by FBR" which elaborates, in detail, the circumstantial rulings by FBR in case of taxability of Non-Residential Person's income.

All our readers are requested to visit our website www.tolaassociates.com, or download our mobile application from the links mentioned below, in order to access previously published editions of this monthly issue along with other publications, and to stay updated of future notifications.

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

Lastly, we request our readers 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

1. NOTIFICATIONS/ CIRCULARS

A. DRAFT RULES FOR AGREED ASSESSMENT (PLEA BARGAIN) UNDER SECTION 122D OF THE INCOME TAX ORDINANCE, 2001

Prior to the Finance Act, 2020 there was no mechanism under the Ordinance for negotiated settlement of tax disputes before finalization of an assessment/amended assessment. In order to facilitate taxpayers, reduce burden on formal appeal system and effecting speedy recoveries, a new section 122D enabling agreed assessment has been inserted through the Finance Act, 2020.

If a taxpayer intends to settle his case on or after receipt of a notice for amendment of assessment under section 122(9) of the Ordinance, he shall have the option of filing an offer of settlement in the prescribed form before the Assessment Oversight Committee for resolution of his dispute. In addition, the taxpayer shall also be obliged to file reply in response to notice for amendment of assessment under section 122(9) of the Ordinance before the concerned Commissioner. Cases involving concealment of income or interpretation of question(s) of law having effect on other cases have been covered u/s 122D of ITO.

As per Sub section 7 of Section 122D, FBR may make rules regulating the procedure of the Committee and for any matter connected with, or incidental to the proceedings of the Committee. Now FBR has, through SRO 957(I)/2020 dated 2nd October 2020, issued draft rules for procedures for assessment oversight committee along format of application for Section 122D of ITO.

The Salient procedures for oversight committee are follows:

- A prescribed settlement application shall be made electronically by the applicant in person or by his authorized representatives, under section 122D for agreed assessment to the Committee.
- A settlement application shall be submitted to the Committee after the date of service of the show cause notice issued under section 122(9) of ITO and before issuance of Order.
- The committee shall afford opportunity of being heard to the applicant in writing.
- The committee shall finalize the applications filed under section 122D of ITO within 30 days of receipts of application or maximum 60 days with reasons to be recorded in writing.

B. RESCISSION OF SRO 947(I)/2008 DATED 5TH SEPTEMBER 2008

Through SRO 947, FBR had given exemptions from withholding of income tax at import stage u/s 148 to various persons and industrial undertakings on installation of plant and machinery subject to exemption certificate issued by Commissioner. This SRO has now been rescinded through SRO 1020(I)/2020 dated 7th October 2020.

The SRO has been withdrawn consequent to exemption applications of taxpayers on plea that they are still eligible for exemption under SRO 947 despite amendments in tax deduction rates under section 148 of ITO from person specific to goods specific, as SRO 947 was still in operation.

In our opinion if a taxpayer has already imported plant and machinery and it had arrived before 7th October 2020 on port and Good declaration has also been filed before that date, the taxpayer can still get the benefits of SRO 947(I)/2008 in High Courts on basis of principal of estoppel.

C. RULES IN RESPECT OF PRESCRIBING TIME LIMIT FOR NOTIFYING INCOME TAX RETURN FORMS

Due to delay in notifying form, the FBR has now issued SRO 1041(I)/2020 dated 13th October 2020 to insert rules regarding time limit for notifying income tax return form, to avoid such delay in future.

The Salient features of Rules are as follows:

- The income tax return form shall be notified for suggestions from all persons likely to be affected on or before 1st December following Finance Act to which return relates.
- The Return shall remain available on the portal for suggestions till 7th January following Finance Act to which the return relates.

- The Final Return shall be notified on or before the 31st January following Finance Act to which the return relates.

Within above timeliness the sub timeliness to be observed by various departments for FBR has also been prescribed.

D. SALES TAX (IMPOSITION OF RESTRICTIONS) ON WASTAGE OF INPUT RULES, 2020

Input tax on wastage of raw material is allowed as clarified through Circular 1 of 1989. This input is allowed, and tax liability is determined in accordance with provisions of Section 7 of Sales Tax Act, 1990. The legislature through FA 2020 has given FBR power to impose restrictions on wastage of material on which input tax has been claimed in respect of the goods or class of goods.

Now through SRO 938(I)/2020 dated 1st October 2020, FBR has issued Rules for the purpose of determination of restriction on wastage of material on which input has been claimed. The Salient features of Rules are as follows:

- The action for determination of wastages may be initiated either by the FBR through Sou moto or on a reference received from the Chief Commissioner of Inland Revenue or the Director General of Intelligence and Investigation (Inland Revenue) or on the recommendations of any Government agency or organization or industrial or business association.
- The FBR or Chief Commissioner of Inland Revenue or the Director General of Intelligence and Investigation (Inland Revenue) shall conduct preliminary study or analysis of inputs and outputs before forwarding it to IOCO.
- The IOCO shall perform following:
    - Ascertainment of the exact description and specifications of the inputs and outputs;
    - Details of the manufacturing and production processes and the plant and machinery (including equipment) used in the manufacturing and production processes;
    - Collection of relevant literature required to be consulted before, during or for the assigned work;
    - Identification and availability and engagement of the subject specialists including their payable or likely to be payable financial compensation or remuneration;
    - Identification of industrial units required to be visited to physically examine the manufacturing and production process or processes with a view to ascertain the input-output ratios or wastages;
    - Details of the office bearers (or their nominees) of the concerned industrial or business association likely to be consulted during or for the exercise;
    - Estimate of the financial and other resources required to be made available for the targeted assignment; and
    - Timelines for the completion of the assignment including the preparation of the report of findings.
- Where the extent of wastages has been fixed and notified by the Board under these rules, no registered person shall be entitled to take input tax adjustment in respect of wasted inputs over and above the extent so fixed and notified by the FBR. The FBR or IOCO may also obtain scientific, technical or other opinion from any external expert.
- The FBR may review and revise the wastage restrictions on its own or by representation by any aggrieved person.

E. EXEMPTION OF SALES TAX ON LOCAL SUPPLY OF SUGAR

The Economic Coordination Committee (ECC) had allowed the import of 300,000 metric tons of sugar by Trading Corporation of Pakistan (TCP) without imposition of sales tax at the import stage. The FBR issued SRO 751(I)/2020 dated August 20, 2020 to comply with the decision, although the commodity was allowed exemption from sales tax on import of sugar but there was an ambiguity that subsequent sale of such sugar remained subject to sales tax on supply to the domestic market.

To remove this ambiguity the FBR now issued the SRO 1038(I)/2020 dated October 12, 2020 and has streamlined the supply of sugar to the local market by abolishing sales tax on local supplies of same quantity of sugar being imported by the TCP

F. SRB EXEMPTIONS ON SINDH BASIC EDUCATION PROGRAM (SBEP) PROJECTS AND MUNICIPAL DELIVERY SERVICE PROGRAM SINDH (MSDP)

The SRB has issued Notification no. 3-4/31/2020 and no. 2-4/30/2020 dated 15th October 2020 whereby exemption have been provided on taxable services as are received or procured by the USAID under the Sindh Basic Education Program and Municipal Delivery Service Program Sindh (MSDP) subject to prescribed conditions.

2. CORPORATE NOTIFICATIONS / CIRCULARS

A. DRAFT AMENDMENTS TO THE CODE OF CORPORATE GOVERNANCE FOR INSURERS 2016.

The SECP vide SRO 1085 dated 19 October made draft amendments to the Code of Corporate Governance for Insurers, 2016.

In the proposed amendments, the SECP substituted provisions of Code of Corporate Governance, 2012 with the provisions/conditions mentioned as per "Listed Companies (Code of Corporate Governance) Regulations, 2019.

The presence of Independent director in the Board of Directors of the insurers has been proposed as "mandatory" rather than "preferably".

Another major change proposed are the substitution of provisions of Companies Ordinance. 1980 with Companies Act, 2017.

3. COMMISSIONER IS EMPOWERED TO REJECT OR AMEND ESTIMATES UNDER SECTION 147 AND TAXPAYER HAS REMEDY AVAILABLE UNDER SECTION 127 OF ITO – LAHORE HIGH COURT

The section 147 of the Income Tax Ordinance, 2001 (ITO) provides for a person to pay his tax liability in advance on an estimate basis. A company and association of person (AOP) are mandatorily required to pay advance tax in quarters before the due date, however individual is relieved that is, if his latest assessed taxable income is less than one million rupees he is not required to pay advance tax.

Section 147 of the ITO provides the formula according to which an advance tax liability is calculated on the basis of latest assessed taxable income. The same formula also allows to adjust the tax already paid in the quarter as section 168 permits the tax credit.

Furthermore, the section also binds the taxpayer to estimate the tax payable for the tax year before the end of the second quarter in order ascertain any change in advance tax liability and to pay 50% of the estimated annual tax liability and the balance in remaining two quarters.

The section also prescribes that where before the last instalment is due, the taxpayer estimates that he will pay tax less than as required under this section, he may inform the commissioner regarding the facts and provide the new estimate and deposit the tax accordingly.

The section also provides that the above reduced estimate furnished to the commissioner shall be accompanied with documents and supports and if the commissioner is unsatisfied may reject the estimate and require the taxpayer to pay the tax as per the formula provided in the section.

1. GROUND TAKEN BY THE PETITIONER

The counsel of the petitioner has taken following grounds before the LHC and supported their stand against the department:

1. The Commissioner has no jurisdiction to reject the estimate of the reduced tax liability as provided by the petitioner, under subsection (6) of section 147 of the ITO.
2. No claim for payment of advance tax can be made by the department till the final income tax liability is determined for the relevant tax year.
3. For maintainability of the petition to the LHC the petitioner took plea that they did not have any remedy available under section 127 of the ITO against the rejection orders of estimates provided under section 147.
4. Subsections (4) and (6) of the section 147 of the ITO are independent provisions for the purposes of computation and estimation of advance tax liability.

5. The petitioner pleaded that the recovery notices issued under the section 137 of the ITO with respect of advance tax liability were out of jurisdiction till the conclusive determination of annual tax liability.

2. REBUTTAL BY DEPARTMENT

1. The department contended and sought dismissal of the petition on the basis that the petitioner has remedy available under section 127 of the ITO and referred to precedents as in the reported cases of 1993 SCMR 1810 and PLD 1992 SC 847.
2. The department contended that rejection of estimate given by the petitioner, was in accordance with the provisos provided in the subsection (6) of the section 147 of the ITO.
3. The department contended that the adjustment of tax credit under section 65D, made by the petitioner in the computation of advance tax liability according to subsection (4) of the section 147 of the ITO is illegal because the formula as provided in the said section gives tax credits as available in section 168 of the ITO.

3. DECISION OF THE HIGH COURT

On hearing the arguments and perusing the records put before the Honorable Lahore High Court (LHC), the LHC held as following in favour of the department:

1. The LHC held that the objection raised by petitioner over the exercise of jurisdiction by the Officer Inland Revenue (OIR) with regard to rejection of unsatisfactory estimate was illegal because the insertion of the Proviso through Finance Act, 2018 has given power to the Commissioner to reject an estimate after providing an opportunity of being heard, which was provided as the records showed and also empowered to direct taxpayer to compute advance tax amounts in accordance with the formula of computation provided under subsection (4) of section 147 of Ordinance, 2001, and pay the same within the timeframe prescribed.
2. The LHC held that the subsection (5A) of the section 147 of the ITO provides for time of payment of advance tax and without any doubt default surcharge can be claimed upon default in payment of quarterly advance tax payments, in accordance with due dates mentioned, without waiting for determination of tax liability after the end of relevant tax year.

   Furthermore, the LHC held that, with regard to objection by the petitioner on jurisdiction of recovery notices under section 137 of the ITO, insertion of the Proviso through Finance Act, 2018 have not altered the scope, nature and purpose of the advance tax but countered the harm of evasion of advance tax payments by giving inadequate and wrong estimates. The estimates provided by the taxpayer were subjected to scrutiny in terms of first and second provisos to the subsection (6) of the section 147 of ITO, with fulfillment of the conditions prescribed therein. Therefore, the jurisdictional objection over initiation of recovery of due advance tax is hereby rejected.
3. The LHC held that the petitioner plea that there is no remedy available in the instant case under the section 127 of the ITO, is rejected because turning down of adjustment of certain amounts and ordering of increased payment of the advance tax, were appealable under section 127 of the Ordinance, 2001.

   The words of the section 127 of the ITO *"or an order having the effect of enhancing the assessment or reducing a refund or otherwise increasing the liability of the person"* are of critical importance and cannot be ignored. The petitioner has objected that conditions given for exercise of authority in terms of provisos to subsection (6) of section 147 were not available, which questions along with other ancillary issues can appropriately be raised and may examined by the appellate forum, in case an appeal is filed.

4. TOPIC OF THE MONTH

- ADVANCE RULING OF FBR

➢ PREAMBLE

In the end, we conclude our newsletter with our topic of the month ('TOTM") for the month of October. We have selected "Advance Ruling of FBR" as our TOTM.

In the wake of advancements like "Roshan Digital Pakistan", where the State Bank of Pakistan ("SBP") has provided a lenient platform of investment from Non-Resident Pakistanis (NRPs), we have tried to elaborate

the conceptual basics of Advance Rulings by FBR and its scheme.

1. CONCEPT OF "ADVANCE RULINGS"

Advance Rulings means determination, of question of law specified in the application, by the Committee in relation to the transaction undertaken or proposed to be undertaken by the non-resident.

Where full and true disclosure of the transaction has been made in the application and the transaction has also been conducted in the same manner then ruling is binding on the Commissioner with respect to the application of the law as it stood at the time the ruling was issued.

The advance ruling shall continue to remain in force unless there is a change in facts or in the law on the basis of which the advance ruling was issued. In case of any inconsistency between a circular issued by the FBR and an advance ruling, priority shall be given to advance ruling.

The advance ruling shall cease to be binding in case of any misrepresentation of facts or fraud is subsequently discovered.

2. ADVANCE RULING ELABORATION IN CONTEXT OF SECTION 206A OF INCOME TAX ORDINANCE, 2001 ("ITO") AND 231A OF INCOME TAX RULES, 2002.

On the persistent demand of non-residents and in line with international practices, the concept of advance ruling was introduced through insertion of new section 206A in the Income Tax Ordinance, 2001 through Finance Act 2003.

A Non-Resident person ("NRP") can apply to FBR for the purpose of issuing Advance Rulings for transaction where application of question of law arises from the provisions of ITO.

The FBR upon receiving the application from the NRP is required to form a committee comprising of Chairman FBR, an Inland Revenue Officer and a Nominee of the Law and Justice Division not below the rank of BPS-21.

The Committee may obtain comments from the Commissioner and, if necessary, advice of legal expert regarding application of law over the transaction and decide the issue in a joint sitting or through circulation amongst its members.

The Committee upon verifying that the NRP taxpayer has made full and true disclosure of the transaction and the transaction is complete in all material aspects, will issue advance ruling within 90 days of the application.

The advance ruling is binding on the Commissioner in terms of application of law for the proposed transaction, although application of such advance ruling is restricted on the proposed transaction only.

3. SCOPE OF ADVANCE RULING EXTENDED

Prior to Finance Act, 2017, the scope of Advance Ruling under section 206A of ITO was restricted to a non-resident. In order to facilitate and bring about a certain degree of predictability for non-resident taxpayers having a permanent establishment in Pakistan in respect of decisions regarding their business and investment strategies, the scope of Advance Ruling under section 206A of ITO has been extended to non-resident taxpayers having permanent establishment in Pakistan although they are considered resident.

4. EXAMPLES OF ADVANCE RULINGS ISSUED BY FBR TO DATE

Please note that these advance ruling were applicable only at the time they were issued and may not be relevant in today's scenario as law might have changed.

Q1. Whether the payment of Rs. 50 million received by a non-resident as a result of amalgamation with resident concern is taxable in Pakistan or not?

A. The assessee being non-resident, the income accruing or arising on account of merger and transfer of bank operations with the new entity is revenue receipts in the hands of the applicant, and being Pakistan source income, is liable to tax under the Income Tax Ordinance, 2001.

Q2. Whether the amount to be received by non-resident company for rendering seismic data processing services is chargeable to tax in Pakistan or not?

A. The assessee being non-resident, the amount received against seismic data processing/re-processing services as a result of contract executed in Pakistan is liable to tax in Pakistan under the head "business income" in

view of the provisions of section 6 of the Income Tax Ordinance, 2001.

Q3. Whether the amount of Rs.373 million received from the State Bank of Pakistan by a non-resident on conversion of excess amount of capital account to Pak rupees for setting off against accumulated losses is chargeable to tax?

A. The amount received from the State Bank of Pakistan by a non-resident on conversion of capital account (maintained in Euros) to Pakistan rupees for off-setting accumulated losses is not chargeable to tax.

Q4. Whether the income of non-resident person not having any permanent establishment in Pakistan will be taxable or not?

A. Income of non-resident person is taxable in Pakistan irrespective of the fact whether it is having PE or not. Treatment of tax deducted, in both the situations, will, however, be different accordingly to provisions of section 153 of Income Tax Ordinance, 2001.

Q5. In view of the applicant's statement of interpretation of law and facts of the case, is the income of Overseas Private Investment Corporation arising from the Credit Facility extended to Emerging Markets Consulting (Private) Limited is exempt from Pakistan income tax and accordingly not liable to withholding tax under the Income Tax Ordinance, 2001?

A. Income of OPIC under the credit facility extending to Emerging Markets Consultant (Pvt.) Ltd. would be exempt in Pakistan from Income Tax and accordingly not liable to withholding tax under Section 152 of the Income Tax Ordinance, 2001.
[This is a case-specific Ruling given under an existing investment treaty between Pakistan and the USA.]

Q6. "Whether or not a 'working interest' in a PCA is an 'immovable property"?"

A. The working interest in the PCA belonging to the taxpayer (OPPI) is not an "immoveable property". It is rather an "intangible" asset which is covered under sub-section (11) of section 24 read with sub-section (30) of section 2 of the Income Tax Ordinance, 2001.

Q7. "Whether or not the US Corporation (Media Merchants USA, a Limited Liability Company) would be entitled to protection (being taxable only in the country of residence i.e. USA) under the Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on income between the Government of Pakistan and the United States of America in respect of consideration received by it for providing the 'Basic Television Services' to a Pakistani entity."

A. Consideration received by Media Merchants USA for providing "Basic television Services" to a Pakistani entity is not taxable in Pakistan under the provisions of Article VIII of Pakistan-USA Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

Q8(a). Whether or not M/s Excelerate Energy (Charterer of Vessels on Wet Lease basis) is to be taxed in Pakistan because of the absence of Permanent Establishment in Pakistan?

A. Yes, M/s Excelerate Energy DMCC is to be taxed in Pakistan as absence of Permanent Establishment is not relevant in this case.

Q8(b). If it is to be taxed; whether or not it should be taxed as Shipping Income based on the provisions of the local taxed law i.e. Income Tax Ordinance, 2001 as well as the Double Taxation Treaty between Pakistan and U.A.E?

A. It is not to be taxed as shipping income under the relevant provisions of Income Tax Ordinance, 2001 or Article 8 of the Avoidance of Double Taxation Agreement between Pakistan and U.A.E. since it is not engaged in international traffic. Payments received from the lease of FSRU by M/s Excelerate Energy DMCC are in the nature of royalties, hence taxable in Pakistan under Article 12 of the Avoidance of Double Taxation Agreement between Pakistan and U.A.E.

DISCLAIMER

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