

TAX PAK

NEWSLETTER BY
TOLA ASSOCIATES



NOVEMBER
2020



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CONTENTS

Tax Notifications/ Circulars

**Corporate Notification/
Circulars**

**Time Barred Show-Cause
Notice Loses Legal Value, Even
If It Relates To Tax Fraud - SHC**

**Topic of the Month -
Controlled Foreign Company
and Taxation**

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EDITORIAL NOTE

We are back yet again with our monthly issue of “Tax Pak”. This the 37th Edition of this newsletter, and by now we hope we have been able to keep you updated with the recent developments in the Tax system of Pakistan. 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 our tax system.



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. For this month, the Case Law section pertains to a judgment passed by the Sindh High Court. The case was contested on the back of a Show cause notice passed by the department under section 11 of the Sales Tax Act, 1990. 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 “Controlled Foreign Income & its Taxation” which belongs to the International Taxation segment and hence is of importance to person(s) involved in ‘cross border transactions’.

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. AMENDMENTS IN RULES RELATING TO IN ALTERNATIVE DISPUTE RESOLUTION U/S 134A OF ITO

The FBR has issued SRO 1249(I)/2020 dated 23rd November 2020, whereby following amendments are made in Rule 231C to align them with amendments in Section 134A of ITO through Finance Act 2020:

- The definition of dispute “ means any grievance of the applicant pertaining to— (i) the liability of tax against the aggrieved person, or admissibility of refunds, as the case may be; (ii) the extent of waiver of default surcharge and penalty; or (iii) any other specific relief required to resolve the grievance as specified in sub-section (1) of section 134A” is now removed.
- The composition of ADR Committee has been changed to included following:
 - Chief Commissioner Inland Revenue (Chairman of Committee)
 - Two persons from a panel notified by the FBR comprising of chartered accountants, cost and management accountants, advocates, having minimum of ten years’ experience in the field of taxation and reputable businessman. The Rules also prescribe eligibility criteria for these in Schedule.
- The Committee shall decide the dispute through consensus within 120 days.
- The decision of Committee shall be binding on the Commissioner when the applicant has withdrawn the appeal pending before appellate forums and withdrawal has been communicated to Commissioner by applicant within 60 days.
- If the Committee fails to decide within 120 days, the FBR shall dissolve the Committee and matter will again go to the appellate forum where it was pending.
- On receipt of the Committee’s decision the applicant may make the payment of income tax as per Committee decision.

B. SERVICE OF DOCUMENTS ELECTRONICALLY- RULE 74 OF INCOME TAX RULES 2002

Rule 74, read with Section 218 of ITO, prescribe rules for electronic service of documents and orders of FBR to

taxpayers. Now FBR has issued SRO 1250(I)/2020 dated 23rd November 2020 whereby draft amendment in Rule 74 is proposed. Accordingly, where a person is using a mobile phone, document required to be served on that person by the Commissioner or Chief Commissioner shall be considered sufficiently served if sent as SMS on the cell phone registered in the name of such person as per record of the Pakistan Telecommunication Authority.

C. AMENDMENT IN TWELFTH SCHEDULE OF ITO

The rate of advance tax at import stage for goods classified in part II of Twelfth Schedule is 2% of the import value as increased by custom-duty, sales tax and FED. Now FBR has included following goods in part II of Twelfth Schedule through SRO 1240(I)/2020 dated 20th November 2020:

PCT code	Description
3204.1100	Disperse Dyes and Preparation Based thereon
3204.1200	Acid Dyes, whether or not premetallized, and preparations based thereon; mordant dyes and preparations based thereon
3204.1300	Basic dyes and preparation based thereon
3204.1400	Direct Dyes and preparations based thereon
3204.1510	Indigo Blue
3204.1590	Other Vat dyes (including those usable in that state as pigments) and preparations based thereon
3204.1600	Reactive Dyes and Preparations Based thereon
	Pigments and preparations based thereon
3204.1710	(a) Powdered
3204.1720	(b) Liquid
3204.1790	(c) Other
3204.1910	Dyes, Sulphur
32014.1990	Dyes, Synthetic
3204.2000	Synthetic Organic Products of a Kind Used as Fluorescent Brightening Agents
3204.9000	Other Synthetic organic coloring matter
3206.1900	Pigments and preparations based on titanium dioxide
3402.1220	Cationic surface-active agents
3402.1300	Non-ionic surface-active agents

3402.9000	Surface active preparations and cleaning preparations excluding detergents
3409.9090	Other artificial waxes
3506.9110	Hot melt adhesives
3506.9190	
3507.9000	Enzymes
3905.3000	Polymers in vinyl alcohol
3906.9030	Other acrylic polymers
3912.2010	Cellulose Nitrates Nonplasticised
3912.2090	Other cellulose Nitrates
3912.3100	Carboxymethylcellulose and its Salts
4407.1100	Of Pine (Pinus Spp)
4407.1200	Of Fir (Abies Spp) and Spruce (Picea Spp.)
4407.1900	Other- Coniferous
4407.2100	Mahogany (Swietenia Spp.)
4407.2200	Virola, Imbuia and Balsa
4407.2500	Dark Red Meranti, Light Red Meranti and Meranti Bakau
4407.2600	White Launan, White Meranti, White Seraya, Yellow Meranti and Alan
4407.2700	Sapelli
4407.2900	Other- Of tropical wood
4407.9100	Of Oak (Quercus Spp)
4407.9200	Of Beech (Fagus Spp)
4407.9300	Of Maple (Acer Spp.)
4407.9500	Of Ash (Fraxinus Spp.)
4407.9700	Of Popular and Aspen (Populus Spp.)
4407.9900	Wood swan or chipped lengthwise, sliced or peeled, whether or not planned, sanded, or end jointed of thickness exceeding 6mm—other
5403.3100	Viscose Rayon, Untwisted or with a twist not exceeding 120 Turns per Meter
5503.2010	Synthetic staple fibres, not carded, combed, or otherwise

D. NEW INSERTION CHAPTER XVIB IN THE INCOME TAX RULES 2002 REGARDING DRAFT REFUND RULES

FBR has issued draft Rules vide SRO 1239(I)/2020 dated 20th November 2020, for refunds orders issued under Section 170(4) of ITO. The Salient feature are as follows:

- A new Centralized Income Tax Refund Office (CITRO) shall be established by FBR.

- The Commissioner shall transmit a Refund Order u/s 170(4) under his digital signature to the Treasury officer in CITRO through IRIS.
- The treasury officer and a co-signatory shall issue cheque or promissory note to the FBR Refund Settlement Company Limited
- The CITRO shall also prepare a statement of payment advice for the concerned bank on a daily basis, for direct transfer to the taxpayer.

E. SALES TAX EXEMPTION ON COVID RELATED ITEMS

The FBR had issued SRO 555(I)/2020 dated 19th June 2020 to exempt the import and subsequent supplies of 61 COVID related medical items from sales tax for period from 20th June 2020 to 30th September 2020. Now FBR has issued SRO 1257(I)/2020 dated 25th November 2020 to exempt same items from sales tax on import and subsequent supply from 1st October 2020 to 30th June 2021.

F. SALES TAX SPECIAL PROCEDURE FOR ADJUSTMENT OF SUBSIDY AGAINST SALES TAX ON LOCALLY MANUFACTURED TRACTORS RULES, 2020

Section 7 of Sales Tax Act, 1990 laid down rules to determine tax liability to be paid by registered person, whereby a registered person shall be entitled to deduct input tax paid or payable during the tax period for the purpose of taxable supplies made by him from the output tax. As per Sub section 4 of Section 7, the Federal Government is empowered to issue notification to allow a registered person or class of persons to deduct such amount of input tax from the output tax as may be specified in the said notification.

Now in exercise of such powers, FG has issued SRO 1248(I)/2020 dated 23rd November 2020 to prescribe Sales Tax Special Procedure for adjustment of subsidy against sales tax on Locally Manufactured Tractors Rules, 2020 for 3 manufacturers of tractors w.e.f. 28th September 2020 to 30th June 2021 or till Rs 1.5 billion subsidy is exhausted which-ever is earlier.

Salient features of Rules are as follows:

- The Ministry of National Food Security and Research shall apportion the amount of subsidy amongst the specified manufacturers so that same does not exceed the limit of Rs 1.5 billion.
- The specified manufacturers shall submit data of supplies in the Annexure-C of the monthly return of the Sales Tax and Federal Excise by 5th day of the month following the end of the tax period.
- The specified manufacturers shall sell the subsidized tractors only to the farmers and growers after obtaining a valid proof of land holding such as Agriculture Pass Book and copy of record of rights of agricultural land duly verified from Provincial Land Revenue Authorities and shall not charge and collect applicable amount of sales tax from such buyers.
- The whole value of the tractor applicable amount of sales and amount of subsidy shall be mentioned on the sales tax invoice.
- The specified manufacturer shall submit details of the subsidized tractors supplied during the tax period on the format provided in Annexures, along with proper reconciliation, copies of sales tax invoices and proof obtained under sub-rule (3) to the Ministry of National Food Security and Research and FBR cell by 5th of month following the end of the tax period to which these supplies relate.

G. AMENDMENT IN SALES TAX RULES, 2006

The FBR has made following amendments in ST Rules through SRO 1172(I)/2020 dated 04th November 2020, which are discussed as under:

- In Rule 28, all the refund claims under section 10 and 8B of the Act, for the tax period July, 2019 and onwards, the data provided in the monthly return shall be treated as data in support of refund claim and no separate electronic data shall be required. The amount specified in column 29 of the return, as prescribed in the form STR-7, shall be considered as amount claimed for the purposes of claim under section 10 of the Act, once the return has been submitted along with all prescribed annexures thereof. In case of a commercial exporter, the claim shall be filed in the aforesaid manner within 120 days, either after submission of the return without Annex-

H, or after the date of issuance of BCA, whichever is later, which may be extended by Commissioner for further 60 days, thus total 180 days. **Now it is provided that if a claimant is registered as commercial exporter and exporting same state goods, the period of 180 days shall be reckoned from date of filing of return or the date of issuance of BCA, whichever is later.**

- In Rule 39D, the data provided in the monthly return shall be treated as data in support of refund claim and no separate electronic data shall be required to be provided. The amount specified in column 29 of the return, as prescribed in the form STR-7, shall be considered as amount claimed once the return has been submitted along with all prescribed annexes thereof. The claimant will be able to submit his return without Annex-H and the same may be filed separately at any time but not later than one hundred and twenty days of submission of the return without Annex-H. The date of submission of Annex-H shall be considered as the date of filing of refund claim. **Now for commercial exporters the no. of days is extended to 180 days.**

H. CONSTITUTION OF PROVINCIAL COMPLAINT RESOLUTION COMMITTEE FOR SETTLEMENT OF ISSUES RELATING TO SALES TAX REFUND.

The FBR has formed committee vide letter no C. No. 1(5) ST-L&P/Misc/2019/197258-R dated 3rd November 2020 with following Terms of Reference:

- Review the nature of complaints/issue, to present possible solution and to take immediate action for resolution
- Follow up with concerned field formations till issue is resolved
- Maintain complete record of complaints/issues, mechanism adopted for resolution and post resolution action required
- Share data with FBR on monthly basis indicating issues received, issues resolved and issues pending for resolution and reasons for pendency.

I. S.R.O 1261 (I)/2020 - DRAFT SIMPLIFIED INCOME TAX RETURN FOR MANUFACTURERS HAVING TURNOVER LESS THAN RS. 50 MILLION.

The FBR vide SRO 1261 dated 26 November 2020 proposed draft amendments in the Income Tax Rules, 2002 wherein,

format for a “simplified return of income for Manufacturers having turnover less than Rs. 50 million” was added in the Second Schedule.

The abovementioned format is applicable only to Individuals and Association of Persons (“AOP”). The said return of income will be applicable from Tax Year 2020.

J. S.R.O 1262(I)/2020 - AMENDMENT IN CHAPTER-XII FOR RULES 76 TO 760 OF THE INCOME TAX RULES 2002

The FBR vide SRO 1262 dated 26 November 2020 proposed draft amendments in the Income Tax Rules, wherein provisions regarding filing online appeals were added w.e.f. 1st January 2021.

In order to reduce person to person interaction in the wake of COVID-19, the FBR has taken this measure to introduce the process of e-filing of appeal in case of grievances by the taxpayers.

The amendments present draft rules regarding filing of an E-Appeal. And any objection or suggestion regarding the proposed changes can be conveyed to the Federal Board of Revenue (FBR) within seven days of the publication of the draft.

The summarized procedures are as follows:

- The date of filing of appeal u/s 127 shall be the date on which it was electronically filled.
- The appellant shall attach order, notice of demand, CPR of appeal fee, any other supporting documents, and electronic index.
- The appeal shall be electronically transmitted to the respondent through IRIS
- Where a fact, which cannot be borne out by or is contrary to record, is alleged, its shall be clearly stated in affidavit filed electronically and produced originally on date of hearing.
- Any defect in appeal shall be intimated electronically within 3 days to bring it to confirmation to rules.
- Power of attorney by authorized representative shall electronically be attached
- Stay application shall also be filled electronically and hearing shall be fixed as follows:

- For application received before 01:00 pm on a working day, hearing shall be fixed on the next working day,
- For application received after 01:00 pm, the hearing shall be fixed on the day after the next working day.
- Stay application shall be disposed electronically within 7 days of fixation.
- The notice of hearing of main appeal and stay shall be issued electronically
- The respondent department may be required to submit para-wise comments electronically in response to appellate submissions.
- No case pertaining to Tax Year 2014 onwards, shall be filed manually w.e.f. 1st January 2021.
- For case earlier filed manually and remanded back, these shall be processed electronically by CIRA w.e.f. 1st July 2021.

2. CORPORATE NOTIFICATIONS / CIRCULARS

A. S.R.O. 1228 (I)/2020 DRAFT AMENDMENTS TO PUBLIC OFFERING REGULATIONS 2017.

The SECP vide SRO 1228 dated 18 November 2020 made Amendments to Public Offering Regulations, 2017. The changes were made due to the addition of provisions relating to Debt Securities Trustee in the Public Offering Regulations, 2017

B. S.R.O. 1229 (I)/2020 DRAFT AMENDMENTS TO DEBT SECURITIES TRUSTEES REGULATIONS 2017.

The SECP vide SRO 1229 dated 18 November 2020 issued draft amendments to debt securities trustee regulations 2017, wherein the references to Companies Ordinance, 1984 are proposed to be replaced by Companies Act, 2017.

Furthermore, the provisions of Debt Securities Trustees are proposed to be included in the abovementioned regulations.

C. S.R.O. 1208 (I)/2020 – UNDER SECTION 510 READ WITH SECTION 66 OF COMPANIES ACT

The SECP vide SRO 1208 dated 11 November 2020 has now specified persons to whom instrument in the nature of “Redeemable Capital” may be issued.

The persons are as follows:

1. Mutual Funds, Voluntary Pension Schemes and Private fund being managed by NBFC;
2. Insurers registered under the Insurer Ordinance, 2000.
3. A Securities Broker.
4. A Fund and Trust as defined in the Employees Contributory Funds (Investment in Listed Securities) Regulations, 2018.
5. A Company and Body Corporate as defined in the Companies Act, 2017.
6. Individual Investors only in case of Government Debt Securities as defined below and debt securities whose debt servicing is guaranteed by the Government.

The person mentioned in point no 6 namely **Government Debt Securities** is defined in the notification, as under:

“Government Debt Securities means a debt security such as Treasury Bill (T-Bill), Pakistan Investment Bond (PIB), Government of Pakistan (GoP) Ijarah Sukuk and any other debt instrument issued by the Federal Government, Provisional Government, Local Government/Authority, and any other statutory body”.

3. SINDH HIGH COURT (SHC): TIME BARRED SHOW-CAUSE NOTICE LOSES LEGAL VALUE, EVEN IF IT RELATES TO TAX FRAUD

In the instant case several petitions filed with the SHC were merged as the subject matter of each petition was the same.

Subsection (37) of section 2 of the Sales Act, 1990 (STA) provides for definition of fraud and describes it as knowingly and dishonestly acting or omitting to act against the duties and obligations of the STA. In simple words it explains avoiding sales tax willingly coupled with deceit and dishonesty.

Subsection (5) of section 11 of the STA provides that an order cannot be passed under section 11 of the STA unless show cause notice is issued within five years of:

- a) the time of payment of tax or charge as provided under section 6; and
- b) in a case where tax or charge has been erroneously refunded, the date of its refund.

Additionally, the show cause issued must contain the reasons and the person being show caused shall be given an opportunity to clear his position

The above subsection (5) of section 11 of the STA carries two provisos, the first proviso states that after a show cause is issued the order must be passed within 120 days with further maximum extension of 90 days by the Commissioner for reasons to be recorded in writing. The second proviso excludes number of days from the above 120 days for the reason of:

- a) adjournment on account of stay order or Alternative Dispute Resolution proceedings; or
- b) adjournments taken by the petitioner not exceeding sixty days in total.

1. GROUND TAKEN BY THE PETITIONER

The counsel for the petitioners has taken, inter alia following two grounds before the SHC and supported their stand against the department:

1. The impugned show cause notice was issued after the expiry of maximum time limit of 5 years and the short payment and recovery of sales tax after such period is time barred (reliance was made upon 1992 SCMR 1898).
2. The amount of subsidy received from Government of Pakistan cannot be included in value of supply and subject to charge of sales tax, even on merits (i.e. even if the show cause was issued within the time limit of 5 years, reliance was made upon 2006 PTD 537 and 2001 SCMR 838).

2. REBUTTAL BY THE DEPARTMENT

The department contended and sought dismissal of the petition on the basis that since the matter involved is of fraud under subsection (37) of section 2 of the STA, therefore limitation of 5 years as provided in subsection (5) of section 11 of the STA is out of jurisdiction.

3. DECISION OF THE SINDH HIGH COURT

On hearing the arguments and perusing the records put before the Honorable Sindh High Court, the SHC held as following in favour of the Petitioners:

1. Facts of the case give admitted position that the show cause notices are time barred in all petitions and it is cardinal principal of law that all are equal before the law whether a citizen or state. The law has prescribed period of time of recovery of tax therefore after expiration of such period, the recovery of short payment of tax cannot be enforced through courts (1992 SCMR 1898).
2. The contention of department that the Petitioners have committed fraud by not charging sales tax is wrongly construed. Firstly, for the sake of argument if it is accepted tax fraud is involved, even this cannot allow department to issue show cause notice or to recover short payment of tax. Secondly, not charging sales tax on price differential claims received from the Government of Pakistan against supplies of oil products, in no way can be counted as tax fraud.
3. Another critical aspect of the case put forth by the SHC in this judgment is that every short payment cannot ipso facto be plunged into the ambit of subsection 37 of section 2 of the STA.

4. TOPIC OF THE MONTH

- CONTROLLED FOREIGN COMPANY AND TAXATION

➤ PREAMBLE

Now, we conclude our newsletter with the most anticipated and our customary segment i.e. Topic of the month which happens to be “Controlled Foreign Company” for this month. The Topic is carved keeping in mind the concept and importance of globalization and its impact on income being generated by Domestic Person outside Pakistan. We have elaborated the concept of Active Foreign Income and the pros and cons of taxing such income according to the statutes present in Pakistan.

The concept of a CFC in Pakistan law has been introduced through Finance Act, 2018 by inserting Section 109A of ITO. The objective of introducing this new concept is to prevent erosion of domestic tax collections due to avoidance or deferment of tax by residents on income earned from overseas businesses carried out through offshore subsidiaries or affiliates.

A. DEFINITION UNDER ITO

a) Resident Company

As per Section 83 of ITO, 2001, company shall be resident company for tax year if:

- It is incorporated or formed by or under any law in force in Pakistan,
- The control and management of the affairs of the company is situated wholly in Pakistan at any time in the year or
- It is a Provincial Government or Local Government in Pakistan.

b) Asset Move

‘Asset Move’ definition was added in ITO through Finance Act 2019 which means the transfer of an offshore to an unspecified jurisdiction by or on behalf of a person who owns, possesses, controls or is beneficial owner of such offshore asset for the purpose of tax evasion.

c) Control

The concept of Control is indirectly discussed in Section 98, in which control represents 50% or more in the underlying ownership of an entity. Underlying ownership in relation to an entity, means an ownership interest in the entity held, directly or indirectly through an interposed entity or entities, by an individual or by a person not ultimately owned by individual.

d) Foreign Income

Foreign Income is a class of income which is used to constitute the Worldwide Income of a country when merged with domestic income of that country. The investment made by a country’s potential investors or services provided by a domestic person in a foreign land and income generated from such activity is generally known as Foreign income.

e) Direct Control/Indirect Control

The term “Direct Control’ refers to direct ownership of capital or voting rights in the foreign entity. The term ‘indirect control’ includes indirect control by a company through subsidiary companies in which the resident person holds capital or voting rights but also include other

companies in which the resident person exercises control through ownership of capital or voting rights.

f) Total Income

Total income is defined u/s 10 of ITO, means persons' income under all heads of income for the year and person' income exempt from tax under any provisions of ITO.

B. INCOME OF CFC

Income of CFC may be classified as follows:

i. Not Attributable Income

Active income for the purpose of exclusion from CFC regime u/s 109A requires fulfillment of two conditions:

- Cumulative income from dividend, interest, property, capital gains, royalty, annuity payment, supply of goods or services to an associate, sale or licensing of intangibles and management, holding or investment in securities and financial assets is less than 20% of total income of the said company, and
- Principle source of the company is under the head "income from business" in the country or jurisdiction of which it is resident.

ii. Attributable Income

The income not meeting above two conditions will fall in Passive income and rules u/s 109A CFC regime will apply.

C. TAXATION OF PASSIVE INCOME OF CFC

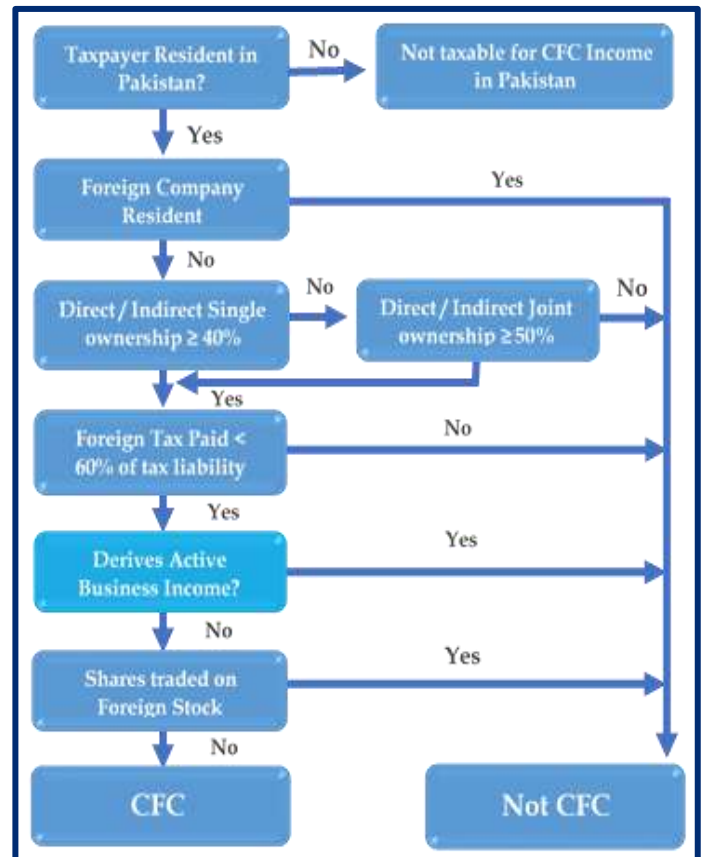
In order to determine that foreign company is a CFC either of two conditions regarding control of the resident over foreign company has to be fulfilled:

- More than 50% of the capital or voting rights of the non-resident company are held, directly or indirectly, by one or more persons resident in Pakistan or
- More than 40% of capital of the or voting rights of the non-resident company are held, directly or in directly, by a single resident person in Pakistan.

However, a foreign entity which fulfills either of the above conditions, cannot be treated as CFC if:

- The shares of the company are traded on any stock exchange
- The non-resident company derives 'active business income'

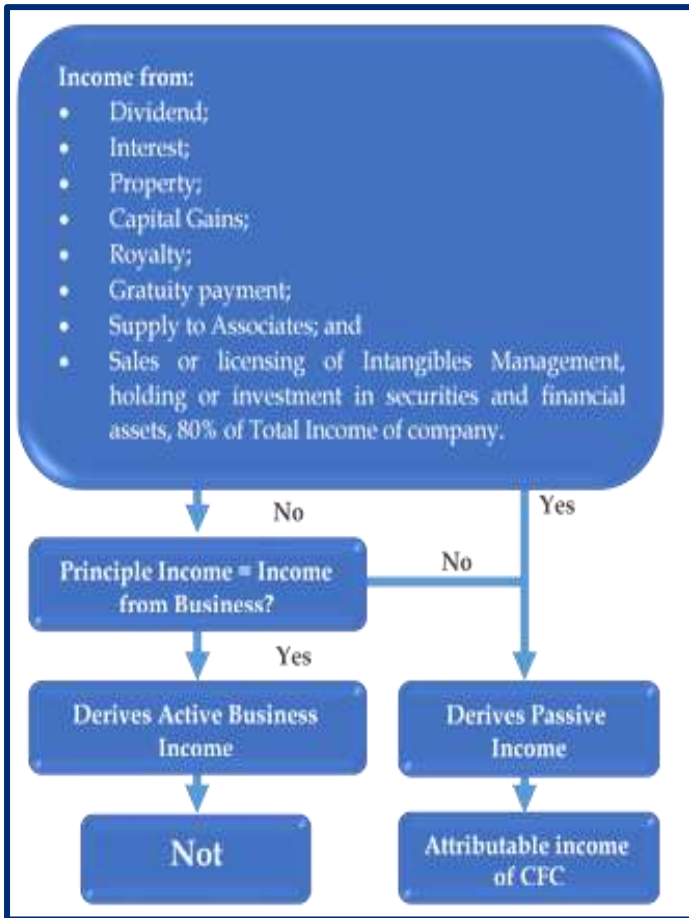
- Tax paid, after taking into account any foreign tax credit available to the non-resident company, on the income derived or accrued, during a foreign tax years, by the non- resident company to any authority outside Pakistan is less than 60% of the tax payable on the said income under ITO.



After determining CFC, the next step is to determine the 'attributable CFC Income' taxable under section 109A of ITO in the hand of resident person. The taxable income is income generated by controlled company that should have been taxed 'when earned' instead of 'when distributed'. The attributable income of the resident shall be determined by comparing the % of control (whether direct or indirect) held by the said person over the CFC.

Certain exclusions have also been prescribed by law from CFC regime:

- Income of a controlled foreign company shall be treated as zero if it is less than 10 million.
- If direct/indirect capital or voting right held by the resident person is less than 10% in the foreign entity.



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Hence, Attributable incomes of CFCs that are retained and not repatriated to Pakistan are subject to tax on the basis of the tax rate applicable to dividends (i.e. 15%). Moreover, no further tax is payable at the time of actual distribution.

D. CONCLUSIONS

So, summarizing above, Pakistan now taxes foreign operations of its corporations on the passive income of their controlled foreign companies (CFCs). Doing so removes the benefit of deferring Pakistan tax on passive income until it is repatriated to the parent company in the form of a dividend or otherwise. In contrast, the active income of a CFC generally enjoys the benefit of tax deferrals and is not taxed to the parent company unless it is repatriated. This new concept lifts the corporate veil and income of company is deemed to be the income of controlling persons. The income is taxed in the year when it is earned not when it is actually received.



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