TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

TAX PAK

NEWSLETTER BY TOLA ASSOCIATES

FEBRUARY

2021

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EDITORIAL NOTE

We are delighted to bring forth our readers yet another edition of our monthly Newsletter. We hope our Newsletter finds our readers in good health. Adding to our rack, this happens to be 40th consecutive edition of our Newsletter. By the grace of Almighty Allah, we enable our readers to access quality content from the tax and corporate world and fulfill our noble duty to educate the masses.

With that being said, getting underway, we commence our newsletter with analysis on the notifications passed by the tax regulatory bodies including FBR and SRB, etc. Advancing to the mid-section of the newsletter, our readers will find brief comments on the corporate notifications issued by the Securities and Exchange Commission of Pakistan and our comments on a recent verdict passed by the Judiciary Body pertaining to tax. For this month, the Case Law section contains a verdict passed by the Appellate Tribunal Inland Revenue on the matter of payment of penalty under section 205(1)(b) of the Income Tax Ordinance, 2001. Lahore High Court on the matter of assessment of initial burden of proof in tax fraud cases with respect to input adjustment of sales tax.

In the end, we finalize our newsletter with our very own Topic of the Month, which for this month comes forth to be "Concept of Advance Pricing Agreement" which will all the more be useful to the people 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. EXEMPTION ON IMPORT-OXYGEN GAS

The FBR has issued SRO 132(I)/2021 dated 3rd Feb 2021 whereby exemption on import u/s 148 is given in case of Cryogenic Tanks (for oxygen gas) [PCT code 7311.0030] to manufacturers, for a period of 3 months starting from 25th December 2020 [Clause 12J, Part IV, Second Schedule].

B. AMENDMENTS IN INCOME TAX REFUND RULES

The FBR has issued amendments vide SRO 214(1)/2021 dated 18th Feb 2021, the changes have been highlighted in **RED**.

RULE	BEFORE PROPOSED AMENDMENT	AFTER PROPOSED AMENDMENT
210IA	This Chapter shall apply for electronic issuance of refunds under sub-section (4) of section 170 of the Ordinance.	This Chapter shall apply for electronic issuance of refunds under sub-section (4) of section 170 of the Ordinance.
210IB	There shall be established a Centralized Income Tax Refund Office (CITRO) under the Federal Board of Revenue for centralized payment of refund amount to such claimants and from such date as the Board may specify	There shall be established a Centralized Income Tax Refund Office (CITRO) under the Federal Board of Revenue for centralized payment of refund amount to such claimants and from such date as the Board may specify
210IC	**Sanction and payment of refund** (1) From such date to be notified by the Board of Commissioner shall transmit an order under sub-section (4) of section 170 of the Ordinance through Iris to the treasury officer in CITRO under his digital signature and retain a copy thereof for record. (2) The treasury officer in CITRO and the co-signatory designated by the Board in this regard shall issue the cheque or a promissory note to the FBR Refund Settlement Company Limited, as the case may be, for the sanctioned amount as mentioned in the refund order or online transfer. (3) The CITRO shall also prepare a statement of payment advice for the concerned bank on a daily basis, for direct transfer to the taxpayer under intimation to the CITRO, the concerned Commissioner as well as the taxpayer. (4) This in-charge of CITRO shall reconcile the refund cheques and payment advices issued during the month with the Bank scrolls received from the State Bank of Pakistan and record the outcome of such reconciliation in the system. (5) Where any cheque is returned back by the State Bank of Pakistan due to any reason, the treasury officer shall cancel such cheque, if required, and attach such cancelled cheque with the respective counterfoil of the cheque-book	(1) From such date to be notified by the Board, after completing all codal formalities the Commissioner shall pass an order under section 170(4) and transmit the order to CITRO. The same shall be reflected in CITRO in real time. (2) The CITRO shall generate electronic advice of approved amount for onwards submission to State Bank of Pakistan (SBP) through dedicated VPN tunnel established between FBR & SBP. The SBP shall credit amount directly to the account of taxpayer. (3) SBP shall confirm the transfer of accounts to the taxpayers account or vice versa electronically to CITRO. (4) The CITRO shall reconcile the payments issued as per instructions during the month with the electronics scrolls received from the SBP and record the outcome of such reconciliation in the system. (5) Where any payment instruction is returned back by the SBP due to any reason, the CITRO shall transmit the same to concerned Commissioner for correction in payment instruction. (6) FBR shall ensure that complete data of refunds issued is made available to

		the concerned Commissioner electronically.

C. EXEMPTION/REDUCED RATES OF TAXES ON IMPORT OF RAW & WHITE SUGAR

The FBR has issued SRO 235(I)/2021 dated 23rd February 2021 and SRO 215(I)/2021 dated 19th February 2021, whereby following amendments were made:

i. Commercial Import

- **Income Tax**

The tax rate on import of white sugar from 26th January 2021 to 30th June 2021 u/s 148 of ITO was reduced to 0.25%. [Clause 9AB, Part II, Second Schedule].

- **Sales Tax**

Minimum value addition tax (VAT) at the rate of 3% as specified under the Twelfth Schedule of the Sales Tax Act, 1990, was exempted on import of white sugar till 30th June 2021.

- **Import by Sugar Mills**

The tax rate on import of raw sugar from 26th January 2021 to 30th June 2021 with maximum limit of 50,000 M. Ton per sugar mill and 300,000 M. Ton for all industry, has been reduced to 0.25% [Clause 9AC, Part II, Second Schedule]

- **Import by Trading Corporation of Pakistan**
  - Exemption from application of section 148 (at the time of import) and section 153 (at the time of subsequent supply) has been provided, subject to a limit of 500,000 M. Ton, for white sugar [Clause 12K, Part IV of Second Schedule].
  - Exemption from sales tax (17%) and minimum value addition tax (3%) have been provided on import and subsequent supply of white sugar during current season subject to limit of 500,000 M. Ton.

D. ELECTRONIC SERVICE OF NOTICES

The FBR had issued a clarification vide No. 1(34) Secy(ITP)/2018-22938-R dated 22.02.2018 wherein it was stated that electronic mode of service may be restored to as an additional means of service for facilitation of the taxpayers and may not be treated as a legal mode of service. However, it was against following provisions of ITO and Rules:

- The notice, order etc. shall be treated as properly served if served on the individual electronically in the prescribed manner. [Section 218(1)(d) and Section 218(2)(d)]
- Where a person has notified the Commissioner in writing of an electronic address for service of documents under the Ordinance or rules, a document required to be served on the person by the Commissioner or Commissioner shall be considered sufficiently served if sent to that address. [Rule 74]

Now to remove anomaly and to bring consistency the above clarification is withdrawn vide C.No. 1(8) Secy(ITC)/2021/17817-R dated 3rd Feb 2021, with effect that electronic means will be sufficient for service of any notice, order etc.

E. Powers of Commissioner Appeal to be used to boost MORAL.

As per Section 128(4) of ITO, the Commissioner (Appeals) may, before disposing of an appeal, call for such particulars as the Commissioner (Appeals) may require with respect to the matters arising in the appeal or cause further enquiry to be made by the Commissioner. Similar powers have been provided in Section 45B (3) of Sales Tax Act, 1990 and Section 33(3) of Federal Excise Act, 2005.

FBR had issued letter no. 3(25) Secy. Appeals/2019 Vol-1 dated 15th Feb 2021 whereby it is noted that **above powers are encouraged to be exercised** and unnecessary annulment of orders with directions may be avoided. The letter also states, “The frequent annulled with directions orders will reflect adversely on the performance of the officers”.

But now through letter no. 3(25) Secy. Appeals/2019 Vol-1 dated 26th February 2021, the above letter has been withdrawn ab initio, whereby the suggestion to CIRA to avoid annulment of Orders has been withdrawn.

F. SETTING ASIDE OF ASSESSMENT ORDERS BY COMMISSIONER – (APPEALS)

The FBR has issued letter no. 2(22) Rev Bud/2020 dated 08 February 2021 whereby it is noted that as per Section 129 of ITO, the CIRA may make an order to confirm, modify or annul the assessment order after examining such evidence as required by him respecting the matters arising in appeal or causing such further enquiries to be made as he deems fit.

However, in contrast to legal position, it has been observed with great concern that the CIRA set aside the assessment orders for de-novo proceedings which is against the principle of Section 129 of ITO. All Chief Commissioners are requested to share cases where CIRA have set aside assessment orders for denovo proceedings for further action at FBR by 15th February 2021.

G. INCLUSION OF 3RD SCHEDULE ITEMS IN MONTHLY SALES TAX RETURN SOFTWARE ALLOWING EXCLUSION FROM SECTION 8B

The FBR has issued letter no. U.O. No. 1 (7) DG (Retails)/2021/16714 dated 02-02-2021, in which reference is made to Serial no. 9 of SRO 1190(I)/2019 dated 02-10-2019 whereby 3rd Schedule items were excluded from applicability of Section 8B to those registered persons supplying goods covered under 3rd Schedule of the Act, provided the value of taxable supplies exceed 80% of all taxable supplies. Subsequently said SRO was partially amended vide SRO 344(I)/2020 dated 29-4-2020 which substituted the word “Retailers” with words “Tier-1 Retailers” entitling them to adjustment of input tax to the extent of 95% of output tax only.

In the light of above, referred SRO. Tier-1 retailers supplying goods under 3rd Schedule items which constitute 80% or more of their total sales are excluded from application of Section 8B of the Sales Tax Act, 1990. However, the Annexure-C of the Sales Tax Returns, automatically fetching the data, does not recognize this description and does not exclude Tier-1 retailers dealing in 3rd Schedule item.

Now PRAL is directed to enable 3rd Sch. Identity row in the software of monthly sales tax return and allow exclusion of items based on serial 9 of SRO 1190.

2. CORPORATE NOTIFICATIONS / CIRCULARS

A. PREAMBLE

The Security & Exchange Commission of Pakistan (“SECP”) is a financial regulator for the corporate sector in Pakistan. The SECP was formed on January 1, 1990, it is the successor to the previously established Corporate Law Authority or CLA. The SECP scope of services includes, asset management services, investment advisory services, investment financial services, venture capital investment, etc. By approach, SECP generally promotes the free market model. The working body of SECP is headed by the CEO who is vested with the operational and executive powers further assisted by four commissioners who in turn manage the various operational units. The SECP head-office is located in Islamabad, the capital territory, while its regional offices also known as Company Registration offices or “CRO(s)” are present in Islamabad, Karachi, Lahore, Multan, Peshawar, Sukkur, Faisalabad, Quetta and Gilgit-Baltistan.

B. SRO 107 (I)/2021 2ND DRAFT AMENDMENTS IN THE NON-BANKING FINANCE COMPANIES AND NOTIFIED ENTITIES REGULATIONS, 2008.

The SECP vide SRO 107 of 2021 dated 27 January 2021, made draft amendments in the Non-Banking Finance Companies and Notified Entities Regulations, 2008, wherein an Assets Management company has been proposed to place a mechanism for regular review and reporting of sales team approved by the management or Board Committee.

Furthermore, the SECP, if it deems fit, can relax the conditions provided under Clause (a) of Schedule IX i.e., Integrity and Track record.

Any person affected by such amendments can report its reservation within fourteen days of publishing of this notification.

C. SRO 131 (I)/2021 AMENDMENTS TO THE ASSOCIATIONS WITH CHARITABLE AND NOT FOR PROFIT OBJECTS REGULATIONS, 2018.

The SECP vide SRO 131 of 2021 dated 1 February 2021 made amendments to the Associations with Charitable and Not for Profit Objects Regulations, 2018 dated 1 February 2021, wherein significant amendments were made regarding meeting fee for attending meetings of board or committee of board.

D. AMENDMENT IN SRO 920(I)2020 ANTI MONEY LAUNDRY ACT, 2010 DATED 28 SEPTEMBER 2020.

The SECP vide SRO 197 of 2021 dated 12 February 2021 made amendments in its earlier notification vide SRO 920 of 2020 dated 28 September 2020, wherein the Annual risk assessment and control/compliance assessment framework based on data and information which previously ended on **30 June** and filed by **31 July** is now required to be ended on **31 March** and filed by **30 April**.

E. SRO 229(I)/2021 – DRAFT AMENDMENTS TO THE COMPANIES (DISTRIBUTION OF DIVIDENDS) REGULATIONS, 2017.

The SECP vide SRO 229 of 2021 dated 18 February 2021 made draft amendments in Distribution of Dividends Regulations, 2017, wherein the time period to make payment of cash dividend has been proposed to be reduced from 15 working days to 03 working days.

Any person affected by such amendments can report its reservation within fourteen days of publishing of this notification.

F. SRO 230(I)/2021 – DRAFT AMENDMENTS TO THE FUTURES BROKERS (LICENSING AND OPERATIONS) REGULATIONS, 2018.

The SECP vide SRO 230 of 2021 dated 19 February 2021 made draft amendments to the Futures Brokers (Licensing and Operations) Regulations, 2018, wherein the provisions related to Educational or other Qualification or Experience are proposed to be omitted.

Any person affected by such amendments can report its reservation within fourteen days of publishing of this notification.

G. SRO 231(I)/2021 – DRAFT AMENDMENTS TO THE CREDIT RATING COMPANIES REGULATIONS, 2016.

The SECP vide SRO 231 of 2021 dated 19 February 2021 made draft amendments to the Credit Rating Companies Regulations, 2016 dated 19 February 2021 wherein changes are proposed to be made in "Assessment of Fitness and Propriety" part of the abovementioned regulations.

Any person affected by such amendments can report its reservation within fourteen days of publishing of this notification.

H. SRO 233(I)/2021 – DRAFT AMENDMENTS TO THE SECURITIES BROKERS (LICENSING AND OPERATIONS) REGULATIONS, 2016.

The SECP vide SRO 233 of 2021 dated 19 February 2021 made draft amendments to the Securities Brokers (Licensing and Operations) Regulations, 2016, wherein an addition has been proposed, providing that independent directors of Trading and Clearing applicant should meet the fit and proper criteria provided in the regulations.

Furthermore, the clause pertaining to Qualification or Experience providing that "*profile of at least one sponsor should have extensive experience of providing financial services in any regulated market within or outside Pakistan*" has been proposed to be omitted.

Any person affected by such amendments can report its reservation within fourteen days of publishing of this notification.

3. NO DEFAULT SURCHARGE U/S 205 IF TAXPAYER HAVE DETERMINED REFUNDS WITH FBR – ATIR

- **LEGAL PROVISIONS INVOLVED**

As per Section 147 of ITO, where a taxpayer, being an AOP or a Company including a banking company, is required to make payment of advance tax, they shall estimate the tax payable for the relevant tax year, at any time before the second installment is due. In case the tax payable is likely to be more than the amount that the taxpayer is required to pay, the taxpayer shall furnish to the Commissioner on

or before the due date of the second quarter an estimate of the amount of tax payable by the taxpayer and thereafter shall pay 50% of such amount by the due date of the second quarter (i.e. 15th day of last month of the second quarter) of the tax year after making adjustment for the amount, already paid. The remaining fifty per cent of the estimate shall be paid after the second quarter in two equal installments payable by the due date of the third and fourth quarter of the tax year, i.e., 15th day of the last month of the quarters.

➢ **As per Section 205 of ITO,**

Where, in respect of any tax year, any taxpayer fails to pay tax under section 147 or the tax so paid is less than ninety per cent of the tax chargeable for the relevant tax year, he shall be liable to pay default surcharge at the rate of 12% per annum on the amount of tax so chargeable or the amount by which the tax paid by him falls short of the 90%, and such default surcharge shall be calculated from the first day of April in that year to the date on which assessment is made or the 30th June of the financial year next following, whichever is the earlier.

➢ **Facts of Case**

In case reported as 102 Tax 443 the taxpayer, a public limited company, was engaged in the business of providing services for investment. The taxpayer filed return for the year showing net income of Rs 51,745,079/-. The tax officer required to file estimate for payment of advance tax for the year under review or to pay amount of instalment of advance tax not less than 90% of the tax chargeable but the taxpayer failed to do so, hence the officer charged default surcharge u/s 205(1)(B). The taxpayer being aggrieved filed an appeal with Commissioner appeals, who vacated the tax officer Order with the observation that when **determined refunds** were available on record, the additional tax i.e., default surcharge was not chargeable. Being aggrieved with CIRA order, the department filed an appeal against CIRA order with ATIR-Islamabad Bench on following ground:

"That the learned CIR(A) was not justified to annul the order with the observation that when determined refunds are available on record, the additional tax u/s 205(1)(B) is not chargeable".

➢ **Findings of ATIR**

The ATIR observed that issue was the levy of additional tax and not payment of advance tax, which was already paid subsequently by taxpayer. Concept of default surcharge is that if taxpayer uses government money then he has to compensate in the form of default surcharge. In this case the Government is collecting tax in advance, and on other hand determined refunds of taxpayer are still to be adjusted. The CIRA order was very clear that at the time of levy of additional tax unadjusted refunds were due from the department, hence when determined refunds are available on record, the additional tax is not chargeable and hence departmental appeal dismissed.

4. TOPIC OF THE MONTH

- CONCEPT OF ADVANCE PRICING AGREEMENT

➢ **PREAMBLE**

Before curtaining our Newsletter, we bring forth to our readers, our customary Topic of the month, which in this month happens to be "Advance Pricing Agreement". The topic yet interesting is not applicable in Pakistan as of now, but we are positive that it will be applicable in the near future as such is happening globally. In order to apprehend, the concept of Advance Pricing Agreements, we will request our readers to go-through our previous topic of the month(s) specifically which are based on Double Taxation Conventions.

A similar concept in our jurisdiction is advance ruling. With a view to remove any confusion and to avoid disputes in respect of determination of the income tax liability of a non-resident person, a procedure of Advance Rulings has been brought on statute by way of incorporating Section 206A into the Income Tax Ordinance, 2001, w.e.f. 1.7.2003. Through this facility non-residents can obtain, in advance, a binding ruling on the issues that could arise in determining their tax liabilities at a later stage. Therefore, time consuming and expensive legal disputes can be avoided. The FBR is empowered to determine any question of law or of fact as specified in the application

made before it in respect of a transaction which has been undertaken or is proposed to be undertaken by a non-resident in Pakistan on its own or in combine with a resident concern.

Similarly, given the transfer pricing cases in disputes, Advance Pricing Agreements are in place to alleviate the uncertainty regarding arm's length pricing of international transactions.

A. HOW BARTER TRADE TAKES PLACE?

i. Arm's Length Transactions

An arm's length transaction means a business transaction in which buyers and sellers act separately without one party influencing the other. These types of sales maintain that both parties act in their own self-regard and are not subject to pressure from the other party. Furthermore, it assures others that there is no connivance between the buyer and seller. In the interest of fairness, both parties usually have equal access to information related to the transaction.

ii. Transfer Pricing

Transfer pricing means establishing arm's length principles on prices charged or paid upon the transfer of physical goods and intangible property or supply of services in transactions undertaken between related enterprises located in the same or different tax jurisdictions.

Both the concept of Transfer Pricing and Arm's Length are interlinked and hence are aggressively utilized in the concept of Advance Pricing Agreement.

B. WHAT IS ADVANCE PRICING AGREEMENT?

Advance Pricing Agreement is a binding agreement between tax administrations and the taxpayer concerned. It is different from Mutual Agreement Procedures mechanisms provided in Avoidance of Double Tax Treaties (ADTT) to ensure that taxation is in accordance with the tax treaty, which can also be invoked when taxpayer suffers or is likely to suffer an adverse action during transfer pricing audit to avoid double taxation. Whereas APA commands the treatment of future tax transactions between associated taxpayers. Upon audit, the Tax authority will not challenge whether transactions between the taxpayer and the related party have been conducted at arm's length.

Primarily, Advance Pricing Agreement makes the tax treatment of relevant transactions clear for both the tax administrations and the taxpayers for the period covered. Advance Pricing Agreement is an agreement between a taxpayer and tax authority determining the transfer pricing procedure for pricing the taxpayer's worldwide transactions for future years. The procedure is to be applied for a definite period of time based on the fulfillment of certain terms and conditions.

The primary advantage of an APA is the approval of the transfer pricing methodology (TPM), which can be not only a traditional methodology, such as compensable profits method or resale price method, but also any other method or a combination of methods. The taxpayer is assured of the outcome of examination of the TPM in advance. No surprises or challenges will arise if the agreement is followed.

C. WHAT IS THE SCOPE OF AN ADVANCE PRICING AGREEMENT?

An Advance Pricing Agreement includes but, is not limited to:

- International transactions;
- Agreed transfer pricing policy;
- Determination of arm's length price; and
- **Critical assumptions** and the conditions, (if any).

D. WHAT ARE CRITICAL ASSUMPTIONS?

Critical assumptions include facts about an enterprise, an affiliate, a third party, an industry or general economic conditions.

Examples of some of the assumptions can be as below:

- assumptions about the relevant domestic tax law and treaty provisions and government regulations;
- assumptions about economic conditions;
- assumptions about the nature of the functions and risks of the enterprises involved in the transactions;
- assumptions about the enterprises that operate in each jurisdiction and the form in which they will do so etc.

An Advance Pricing Agreement defines future critical assumptions, including those not within the control of the enterprise or the tax authorities.

E. TYPES OF ADVANCE PRICING AGREEMENT

An Advance Pricing Agreement can be divided into three categories, i.e. Unilateral agreement, Bilateral agreement and Multilateral Agreement.

i. Unilateral agreement

An agreement that involves only the taxpayer and the tax authority of the country where the taxpayer is located.

ii. Bilateral agreement

An agreement that involves the taxpayer, associated enterprise of the taxpayer in the foreign country, tax authority of the country where the taxpayer is located, and the foreign tax authority.

iii. Multilateral agreement

An agreement that involves the taxpayer, two or more Associated Enterprises of the taxpayer in different foreign countries, tax authority of the country where the taxpayer is located, and the tax authorities of Associated Enterprises.

F. APPLICATION OF MUTUAL AGREEMENT PROCEDURE AND ITS DIFFERENTIATION WITH ADVANCE PRICING AGREEMENT.

Mutual agreement procedure is used to resolve situations arising in double tax transactions or situations in which taxation is non-compliant with a bilateral tax convention and it is independent of any domestic laws, whereas, the advance pricing arrangement is a tax ruling that provides businesses with legal certainty with respect to their future transactions between two related companies.

The advance pricing arrangement is a tax decree that provides businesses with legal certainty with respect to their future intra-group transactions, whereas, the mutual agreement procedure is an out-of-court procedure provided for bilateral tax conventions which aims to eliminate the double taxation of taxpayers. It is independent of any domestic law remedies.

In October 2012, OECD issued initial draft for "Advance Pricing Arrangements, Approaches to Legislation" in which APA and MAP practical application is depicted in following example.

As an example, assume that Taxpayer A in Country A sells goods to an associated enterprise, Taxpayer B, resident in Country B, and that Taxpayer A enters into a unilateral APA with the tax authorities of Country A in respect of the sale of these goods. The APA will specify a transfer pricing approach acceptable to Country A for the duration of the APA. It might specify, for example, that Taxpayer A reports a net profit margin of 4.5% in relation to those sales, for periods 1,2 and 3. Assume also that, subsequently, the tax authorities of Country B examine the transfer pricing between Company A and Company B in the course of an audit of Company B relating to one or more of these periods. As a result of that audit, they may take the view that the transfer pricing agreed in the unilateral APA is not in accordance with the arm's length principle, and propose an adjustment to the transfer pricing – perhaps to a price that results in a net profit margin of 3.5% to Company A. In this case, there will be potential economic double taxation. As a result, Company A may approach Country A and request that it enters into the "Mutual Agreement Procedure" (MAP) with Country B, in respect of the affected transaction. In such a case, and if there is a relevant treaty between Countries A and B, Country A will enter into MAP discussions with Country B, with a view to avoiding double taxation. If necessary, and if the relevant agreement between Countries A and B can be reached, this might require Country A to revisit the terms of the unilateral APA. Of course, such an issue will not arise in respect of a bilateral or multilateral APA, which will contain terms acceptable to both (or all) countries concerned.

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