



TAX PAK

NEWSLETTER BY
TOLA ASSOCIATES

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EDITORIAL NOTE

A very warm welcome to our readers to yet another edition of our newsletter “Tax Pak” for the month of July 2021. As our newsletter serves as medium of communication, we would like to wish health and prosperity amid the 4th wave or Delta variant of Corona Virus to our readers. By the blessing of Almighty Allah, we have compiled comprehensive yet cardinal sets of information to keep our readers abreast of the current situation of tax and corporate world. Moving ahead, as



per our custom we would like to apprise our readers regarding the scheme of things which they should expect while transcending to our newsletter. First of all, we begin our newsletter with important updates from the Tax regulatory authorities including, but not limited to Federal Board of Revenue [FBR] and Sindh Revenue Board [SRB]. Secondly, the mid part of our newsletter consists of updates from the Securities and Exchange Commission of Pakistan [SECP] which can be of due importance to the entities from the corporate compliance point of view and, a judgment passed by an adjudicating authority on the subject of taxation. In this month, the judgment belongs to a verdict passed by Supreme Court of Pakistan on the matter of Section 122 “Amendment of assessments” and Section 111 “Unexplained income or assets”.

In the end, we finalize our Newsletter, with our customary Topic of the month segment. In this month, the topic selected for discussion is “Treatment of Foreign Currency Exchange Gain / Loss in Income Tax Ordinance, 2001 and Generally Accepted Accounting Principles” which can be of immense importance to 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

1. CHANGE IN SALES TAX ON PETROLEUM PRODUCTS

The FBR had issued SRO 860(I)/2021 dated 6th July 2021 whereby following rates of sales tax are applicable with effect from 1st July 2021

S.No.	Description	PCT Heading	Current Rate	Previous Rate
1	MS (Petrol)	2710.1210	16.40 % ad valorem	17.00 % ad valorem
2	High Speed Diesel Oil	2710.1931	17.00% ad valorem	17.00% ad valorem
3	Kerosene	2710.1911	06.70% ad valorem	06.70% ad valorem
4	Light Diesel Oil	2710.1921	00.20% ad valorem	00.20% ad valorem

The FBR has further issued SRO 937(I)/2021 dated 26th July 2021 whereby following rates of sales tax are applicable with effect from 16st July 2021

S.No.	Description	PCT Heading	Current Rate	Previous Rate
1	MS (Petrol)	2710.1210	10.77 % ad valorem	16.40 % ad valorem
2	High Speed Diesel Oil	2710.1931	17.00% ad valorem	17.00% ad valorem
3	Kerosene	2710.1911	06.70% ad valorem	06.70% ad valorem
4	Light Diesel Oil	2710.1921	00.20% ad valorem	00.20% ad valorem

It can be noted that tax paid as input on reduce rate below standard rate cannot be allowed against output in provincial sales taxes.

2. FIXATION OF VALUE OF WHITE CRYSTALLINE SUGAR

The FBR had earlier issued SRO 812(I)/2016 dated 02.09.2016 whereby it had fixed values for domestically produced white crystalline sugar @ Rs 60 per kg and imported white crystalline sugar @ US\$ 725 per MT for purpose of assessment of sales tax liability.

However, the value was considerably lower than actual market price, therefore in order to address this the sugar was included in Third Schedule of Sales Tax Act, so that sales tax is charged and collected on actual retail price of the product at the manufacturing stage. Now as a technical correction FBR through SRO 895(I)/2021 dated 8th July 2021 has withdrawn SRO 812(I)/2016 dated 02.09.2016.

3. EXTENSION IN RETURN FILLING DATE-PRA

The Punjab Revenue Authority vide letter no. PRA/Orders.06/2021/76 dated 16th July 2021 has extended due date of payment of Punjab Sales Tax and filling of Sales Tax returns/withholding statements for the tax period June, 2021 upto 26th July 2021 for all registered persons including withholding agents.

4. EXEMPTION OF WHOLE OF SALES TAX ON IMPORT OF THIRTY MILLION ADULT 3PLY KNIT FACE MASKS AS DONATION BY M/S HANES BRANDS, USA TO GOVERNMENT OF PUNJAB

The FBR has issued SRO 952(I)/2021 dated 28th July 2021 whereby the Federal Government as per its decision in case no. 648/Rule-19/2021 dated 19th July 2021 has exempted the whole of one time sales tax on import of thirty million adult 3ply knit face masks which are imported as donation by M/s Hanes Brands Inc. North Carolina, USA to Government of Punjab.

5. EXTENSION IN RETURN FILLING DATE-KPRA

The KPK Revenue Authority vide letter no. F.No. 7(2)/KPRA/ADC(HQ)/CIRCULAR/2019/689 dated 19th July 2021 has extended due date of payment of Sales Tax upto 27th July 2021 and filling of Sales Tax returns for the tax period June, 2021 upto 30th July 2021.

6. EXTENSION IN RETURN FILLING DATE-SRB

The Sindh Revenue Board vide circular letter no. 02/2021 dated 19th July 2021 has extended due date of payment of Sales Tax upto 27th July 2021 and filling of Sales Tax returns/withholding statements for the tax period June, 2021 upto 30th July 2021.

2. CORPORATE NOTIFICATIONS / CIRCULARS

1. AMENDMENTS TO REITS REGULATIONS 2015

The SECP vide SRO 724/2021 dated 7 June 2021, placed on the website on 30 July 2021 made amendments to the Real Estate Investment Trust Regulations 2015 [REIT].

The amendments brought forward changes, substitutions as well as additions in the above-mentioned regulations with aim of easing of conditions for investment schemes to boost growth in documented real estate sector.

The changes can be accessed through the link given as below;

[REIT Regulations, 2015.](#)

3. THE PROCEEDINGS UNDER SECTION 111 AND 122(5) OF INCOME TAX ORDINANCE, 2001 SHOULD FOLLOW A PROPER SEQUENCE TO BE HELD LEGAL – SC [CIVIL APPEAL NO. 1125 OF 2020]

1. BACKGROUND

As per Section 122(5) of ITO, an assessment order shall only be further amended where on the basis of audit or on the basis of definite information the Commissioner is satisfied that

- i. any income chargeable to tax has escaped assessment; or
- ii. total income has been under-assessed, or assessed at too low a rate, or has been the subject of excessive relief or refund; or
- iii. any amount under a head of income has been misclassified.

Whereas, as per Section 111, if a taxpayer offers no explanation about the nature and source of the amount credited or the investment was made or the explanation offered by the person is not satisfactory in the Commissioner's opinion, the amount credited, value of the

investment, money, value of the article or amount of expenditure shall be included in the person's income chargeable to tax under head "Income from Other Sources" to the extent it is not adequately explained.

In the case reported as Commissioner Inland Revenue, Zone-Bahawalpur, Regional Tax Office, Bahawalpur vs M/s Bashir Ahmed, (deceased through LRs.) Prop: Sarfaraz Hussain & Brothers Commission Agent, Grain Market, Fort Abbas (Civil Appeal no. 1125 of 2020), the taxpayer had declared only agriculture income of Rs 500,000 for tax year 2010, whereas department claimed to have definite information about acquisition of property of Rs 5,600,000/- by taxpayer on 10.02.2010. On the basis of this information, SCN was issued u/s 122(9) read with section 122(5) along with a separate notice u/s 111 of ITO. The Department proceeded with ex-parte order however the taxpayer contested the case and got relief from Appellate Tribunal on basis that there was procedural defect as separate notice was required to be issued under section 122(9) and section 122(5). Further it was noted by Tribunal that the notice u/s 122(9) did not specify which clause of sub-section (5) of section 122 was sought to be applied. It was also held that there was no definite information available with department and tax officer was merely trying to fish out the material from taxpayer and this observation of Tribunal was also upheld by the Honorable High Court.

The Department filed a tax reference with Supreme Court of Pakistan to consider the findings and conclusions as regard to "definite information" by the Tribunal and High Court.

2. ARGUMENTS FROM FBR

The FBR filed appeal on basis of law laid down by SCP in case reported as Commissioner of Inland Revenue-Zone I v. Khan CNG Filling Station 2017 SCMR 1717 ("Khan CNG") in which SCP held that a formula for natural gas consumption developed by OGRA, and the results obtained from an application of that formula constitute definite information with the meaning of law, however, SCP held that law laid down in Khan CNG do not apply to current case.

3. DECISION OF SCP

The SCP noted that notice u/s 122(9) states that the department was in the possession of definite information regarding investment allegedly made in immovable property and this claim was also repeated in notice u/s 111. As per Section 111, it is mandatorily required that the taxpayer be given opportunity to explain the source of funds by which the immovable property was acquired. However, the department from inception and throughout proceeded on the basis that it already had definite information and it was sufficient enough for amendment of assessment u/s 122. Hence the proceedings under Section 111 made defective altogether since the department began with the premise that it already had definite information available with it, and officer proceeded accordingly.

The SCP further noted that in case the proceedings u/s 111 are conducted in proper manner and order is passed accordingly, the order could constitute as definite information and would allow the amendment u/s 122.

➤ CONCLUSION

The SCP on basis of above observations, held that there was no definite information available as per requirement of law and upheld the findings of Tribunal and High Court.

4. TOPIC OF THE MONTH

TREATMENT OF FOREIGN CURRENCY EXCHANGE GAIN/LOSS IN INCOME TAX ORDINANCE, 2001 ["ITO"] AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ["GAAP"]

➤ PREAMBLE

As we indulge in broader aspects of the Taxation curriculum, in this month our focus lies on a topic which comprises of foreign exchange and its evaluation under the current Pakistani Laws as well as the Generally Accepted Accounting Principles worldwide.

As our topic is constructed under taxation point of view, by Pakistani laws, we would take into consideration the Income Tax Ordinance, 2001 ("ITO") for the purpose of defining and explaining the treatment of Foreign Currency Exchange Gain/Loss

1. FOREIGN CURRENCY EXCHANGE GAIN/LOSS UNDER INCOME TAX ORDINANCE, 2001 [ITO]

1.1 REALISED AND UNREALISED GAINS

The concept of realized and unrealized exchange gain/loss is important to understand the implications in tax assessments. According to Section 32 of ITO "Method of Accounting" a company shall account for income chargeable to tax under the head "Income from Business" on an accrual basis, while other persons may account for such income on a cash or accrual basis. Hence the concept of unrealized gains only relevant to companies that follows accrual basis of accounting.

Section 71 of the ITO provides that every amount utilized for tax purposes under the ITO should be accounted for in Pakistani Rupees.

In cases, where the amount present is in any other foreign currency, the amount should be converted into Pakistani Rupees, in order to be considered under the ITO. The rate taken for the purpose of exchange should be rate present at the time the amount is accounted for the purposes of the ITO.

The main purpose of evaluating the foreign exchange under the ITO is to remove any confusion which arises while accounting for any transaction or assets which are being dealt in terms of foreign currency, as any uncertainty between the ITO and the Generally Accepted Accounting Principles (**GAAP**) can result in confusion while recording any transaction or asset for the purpose of Taxability under the ITO in Pakistan.

As per accounting principles, in case of companies following accrual basis of accounting, asset and liabilities in foreign currency are translated into Pak Rupee at the rates prevailing on the balance sheet date and (unrealized) exchange difference, if any, are taken to profit and loss account. The exchange gains or loss recorded at year end date on conversion of foreign currency liability or asset is reworked at the time of actual payment in the next year. This in effect result in recording of actual loss is two steps, once at the year end rate and the balance amount at the time of actual payment in the subsequent year.

However, as per the provisions of ITO and judgments of Courts of Law, the unrealized gain/loss recorded at year

end is disallowed and only allowed when realized i.e. the asset is sold or liability is paid.

Here it is also worthwhile to mention the principle from which the above rule is derived and that is the provisions of Section 34(3) in case of liabilities in foreign currency. As per Section 34(3), an amount shall be payable by a person when all the events that determine liability have occurred, and the amount of the liability can be determined with reasonable accuracy. Since the exchange gain or loss cannot be determined with reasonable accuracy until realized, therefore unrealized gain or loss being notional is not allowed as income or deduction, respectively.

1.2 COST OF ASSET

In contrast to above principles, the unrealized exchange differences are allowed to be incorporated when calculating cost of assets and resulting depreciation.

Section 76 establishes the formulation of cost of an asset for the purpose of the ITO. As our topic revolves around the concept of foreign exchange, sub section 5 of Section 76 provides for the accountability of an asset which is acquired by a person in majority through debt in foreign currency. This sub section clarifies that in cases of fluctuation in the currency exchanges in Pak rupees, any increase of liability is to be added to the cost of the asset whereas any reduction of liability would reduce the cost of the asset for the purpose of consideration of that asset for taxability under the ITO.

The change in cost of asset in accordance with increase and decrease of liability due to currency fluctuation is sought after to calculate tax depreciation on such assets an explanation was also added through Finance Act, 2009 whereby it was clarified that for the purpose of depreciation, the difference if any on account of foreign currency fluctuation is now to be taken into account only in year of occurrence of such fluctuation and WDV adopted in previous year will not be altered.

2. FOREIGN CURRENCY EXCHANGE UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES.

Generally Accepted Accounting Principles or “GAAP” contain guidelines for the accounting of foreign currency transactions. Correct reporting of transactions in foreign currency is important specifically for companies that

import or export goods to calculate accurate taxable gains and losses as problems may arise due to change in currency value in day-to-day business transactions.

The concept of “**Functional Currency**” is of importance in the GAAP as it establishes the principle of converting the foreign currency into the functional currency which in Pakistan’s case is PKR.

According to GAAP, any Gain or Loss arising from the currency exchange should be realized in the accounts and is taxable unless the loss or gain arises through an intercompany transaction or futures exchange contract. Correct reporting of transactions under foreign currency exchanges are important as the revenue department such as the Federal Board of Revenue or “FBR” can scrutinize such transactions in cases of selection in audit.

3. FOREIGN CURRENCY EXCHANGE UNDER INTERNATIONAL ACCOUNTING STANDARDS.

International Accounting Standards or “IAS 21” discuss “The Effects of Changes in Foreign Exchange Rates”. It establishes as to how the foreign currency transactions and operations are to be accounted for in the financial statements.

The IAS 21 also adopts the terminology of functional currency for the purpose of recording operations and transactions in foreign currency in the financial statements.

IAS 21 also establishes the tax effects of exchange differences between functional currency and foreign currency.

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