TAX PAK

NEWSLETTER BY TOLA ASSOCIATES

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TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

CONTENTS

Tax Notifications/ Circulars

Corporate Notifications / Circulars

Used Building is Eligible for Initial Allowance – Supreme Court of Pakistan

Topic of the Month - Disposal of Assets outside Pakistan

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EDITORIAL NOTE

Asalam-o-alaikum everyone! Hope this monthly issue of TAXPAK finds you in good spirits and immaculate health! I welocme you to another edition of TAXPAK, our monthy publication the purpose of which is to provide the monthy update on the ongoing legal and administrative development that take place within the world of tax in Pakistan. Alhumdulillah, so far, we have been successful in our mission to educate about, and keep the public-at-large updated of, these developments on a monthly basis.

Moving on to the contents of this letter, I would like to apprise the reader of what information you can expect in this document. This newsletter contains an elaboration of important notifications and circulars issued by the Federal Board of Revenue and its provincial counterparts. Moreover, notifications from the corporate regulatory body i.e. SECP are also discussed. Furthermore, keeping in mind the aforementioned stated purpose of this document, we usually discuss a (relatively) recent judgment passed by the courts of law. In this monthly edition, we have opted to discuss the judgment passed by the Supreme Court of Pakistan stating about the eligibility of used buildings for initial allowance.

Lastly, this newsletter is concluded with our Topic of the month that is titled "DISPOSAL OF ASSETS OUTSIDE PAKISTAN". The said topic discusses about the tax implications and reporting requirements of such disposals.

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. DISCOUNT ON THE STANDARDIZED TAX INVOICE AS PER SRO 1006(I)/2021 – CLARIFICATION ISSUED

The FBR had previously issued a previous clarification on 13th October 2021 on the Standardized format of Sales Tax invoice issued by the captioned SRO. Now, the FBR, after various representations from the taxpayers and Bar Councils seeking a further clarification on the issue of "trade discount", has issued the required clarification through Clarification No. F.No.05/POS/IR/2021/61121-R dated 17th March 2022 ("the Clarification"). The Clarification first cites the definition of "value of supply" as stated in Section 2(46) of the Sales Tax Act 1990 ("STA") Thereafter, through the clarification, the FBR clarifies that the value of supply for sales tax purposes is the actual value received in monetary terms excluding the amount of sales tax and not the gross value. Therefore, per the Clarification, the sales tax will be calculated and charged on the actual or discounted price.

2. PHYSICAL VERIFICATION OF THE BUSINESS PREMISES OF THE TAXPAYERS GETTING REGISTERED ONLINE AS "MANUFACTURER" FOR SALES TAX PURPOSES.

The FBR has issued a circular bearing No. C.No.1(18) ST-L&P/2020/61131-R, dated 18th March 2022 ("the Circular") that pertains to the post-registration physical verification of the taxpayers that have gotten registered as "Manufacturer" from 1st July 2021, under Rules 5 and 6 of the Sales Tax Rules 2006 ("STR"), by the respective field formations. Through the Circular addressed to the Chief Commissioners Inland Revenue, LTOs, MTO, CTOs, and RTOs, the FBR has requested for the post-registration physical verification of the business premises of those taxpayers (except for the ones, the business premises of which have already been physically verified after registration) that have registered themselves online as "Manufacturer" after 1st July 2021 for Sales Tax Purposes under Rule 5 and 6 of the STR. The FBR has further requested the addressees of the Circular to report the physical verifications of the aforesaid taxpayers to the Board by 31.03.2022.

3. FORM STR-7 SUBSTITUTED

The FBR, has through SRO. 407(1)/2022, dated 8th March 2022, has amended the Sales Tax Rules ("STR"). By virtue of the said amendment, the FBR has substituted Form STR-7 of the STR.

4. AMENDMENT OF SRO 57(I)/2016 DATED 29TH JANUARY 2016

The FBR, has vide SRO. 321(I)/2022, dated 1st March 2022, amended the captioned SRO with effect from 1st February 2022, and substituted the sales tax rates on petroleum products as under:

S. No.	Description	PCT Heading	Rate
1.	MS (Petrol)	2710.1210	0.00%
2.	High Speed Diesel Oil	2710.1931	0.00%
3.	Kerosene	2710.1911	0.00%
4.	Light Diesel Oil	2710.1921	0.00%

5. DISALLOWANCE OF 60% OF ADJUSTABLE INPUT TAX FOR NON-INTEGRATED TIER-I RETAILERS [T-IR] – EXPLANATION

The FBR has, vide Circular No. C.No. 01/POS/IR/2021-Part-IV-/58919-R, dated 15th March 2022 ("the Circular") issued an explanation/request as to how a matter regarding the reduction/disallowance of 60% of the adjustable input tax should be interpreted. In the Circular, the FBR has explained that if a taxpayer is included as a non-registered T-IR in any of the STGOs, then 60% of the adjustable input tax will be disallowed for that month. Moreover, where it was mandatory for the taxpayer (T-IR) to be integrated, but got integrated after its name got included in a STGO, the adjustable input tax disallowed shall for the period/months its name was included in the STGO shall remain disallowed and not be reversible under any circumstances.

However, where a taxpayer was never liable for integration and was inadvertently included in a STGO, the taxpayer will be allowed a full credit of the 60% disallowed/reduced adjustable input tax in the month

after the taxpayer's name is excluded from the STGO following the issuance of an exclusion certificate by the CIR. The total of the said disallowed tax will be reversed and will find mention in Row 6c of the following month's sales tax return.

Furthermore, the FBR has also explained that if a taxpayer is included in the STGO and is not issued an exclusion certificate ***for whatever reason,*** the 60% disallowed adjustable input tax will be permanent, and the disallowance shall continue for each successive month.

Comments: We are of the view that the rejection of exclusion certificate must be on the premise of "reasonable grounds" rather than "whatever reasons" as the effect of the said rejection will be disallowance of the previous, current and future 60% of the adjustable input tax, becoming permanent in nature.

6. ADJUSTMENT OF INCOME TAX REFUND AGAINST THE LIABILITY OF WORKERS WELFARE FUND.

The FBR has, vide Letter No. C.No. 1(10)ST-L&PE/2020/64664-R, dated 28th March 2022, rescinded the Captioned Letter Earlier letter allowed adjustment of WWF liability from Income Tax refunds of the taxpayer. The said adjustment will no more be available and WWF liability will be required to be paid irrespective of the refund status.

7. REFUND TO PHARMACEUTICAL SECTOR - CHAPTER V-B OF THE SALES TAX RULES, 2006

The FBR vide its SRO 383 (I)/2022 dated 7th March 2022, issued an amendment to the Sales Tax Rules 2006, regarding the refund of sales tax to the pharmaceutical sector. This refund shall be applicable to refund claims filed from 15th January 2022 onwards and to the following only:

- Registered persons engaged in the import/ supply of zero rated drugs as registered under the Drugs Act 1976; or
- Medicaments as classified under Chapter 30 of the First Schedule to the Customs Act, 1969 except PCT heading 3005.0000

In the notification it has also been specified that the maximum threshold of the refund amount shall be the lower of the amount of:

- input tax actually consumed in goods supplied at zero rate; or
- the amount as per ceiling determined by the Board (if any).

Data provided in the monthly sales tax return shall be treated as support of refund claim and no further electronic data shall be required for submission. However supportive documents shall only be presented if required by the officer-in-charge of post-refund-scrutiny with the approval of the concerned Commissioner. A timeline has also been specified where return has been submitted without Annex-H or where Annexure-H has been filed separately. The timeline is as under:

- Submission of Annex H separately: any time not later than 120 days of return.
- The Commissioner having jurisdiction, shall grant an extension not exceeding 60 days for filing of Annex-H provided reasons have been recorded in writing by the claimant.

**The date Annex-H is submitted shall be considered as the date of refund claim.*

7.1 PROCESSING OF REFUND:

Refund shall be processed after evaluation by a Risk Management System (RMS) in a fully automated processing module namely FASTER Pharma, this shall further scrutinize and verify the refund claim. Upon being found admissible a Refund Payment Order (RPO) will be generated and it shall be electronically communicated directly to the State Bank of Pakistan (SBP) within 72 hours of submission of claim. Upon which it shall be forwarded to the respective bank account of the claimant. Procedures of Chapter V of the Sales Tax Rules, 2006 shall be applicable to refund claims which do not fulfil the RMS parameters.

Refund claims which are not verified or admissible shall be subjected to system validation checks every week and a RPO shall be generated for the amounts which were found valid during each check. Every validation shall generate information or objection which would be communicated to the refund claimant

and concerned IRS field. Once RPO is generated it shall be communicated to the SBP for direct payment. However, if after eight validation checks (including the first) if any amount is still pending, such shall be processed under the STARR module according to Chapter V of the Sales Tax Rules, 2006.

8. VALUATION OF IMMOVABLE PROPERTIES

The FBR vide SRO 328(I)/2022 to SRO 366(I)/2022 had revised the value of immovable property of various cities in Pakistan. These notifications can be accessed via https://fbr.gov.pk/valuation-immovable-properties/51147/131220

Cities which had revision in immovable properties values are:

S No	Cities	S No	Cities
1	Rawalpindi	21	Kasur
2	Rahim Yar Khan	22	Karachi
3	Sahiwal	23	Jhelum
4	Quetta	24	Jhang
5	Sheikhupura	25	Islamabad
6	Peshawar	26	Hyderabad
7	Sialkot	27	Hafizabad
8	Narowal	28	Gawadar
9	Sukkur	29	Gujrat
10	Nankana Sahib	30	Gujranwala
11	Toba Tek Singh	31	Ghotki
12	Mirpurkhas	32	Faisalabad
13	Mardan	33	DG Khan
14	Manshera	34	D.I. Khan
15	Mandi Bahauddin	35	Chakwal
16	Multan	36	Bhawalpur
17	Lasbela	37	Bhawalnagar
18	Larkana	38	Attock
19	Lahore	39	Abbottabad
20	Khushab		

2. CORPORATE NOTIFICATIONS / CIRCULARS

1. DRAFT AMENDMENTS TO THE NBFC REGULATIONS 2008:

The SECP has issued a draft amendment to the NBFC Regulations 2008, vide SRO 435(I)/2022, dated 15th March 2022 which can be accessed at https://www.secp.gov.pk/laws/draft-for-discussion/draft-rules-regulations/ for further details.

2. DRAFT AMENDMENTS TO THE NON-BANKING FINANCE COMPANIES AND NOTIFIED ENTITIES REGULATIONS, 2008 (P2P LENDING):

The SECP has issued a draft amendment to the NBFC Regulations 2008 (P2P Lending), vide SRO 436(I)/2022, dated 25th March 2022 which can be accessed at https://www.secp.gov.pk/laws/draft-for-discussion/draft-rules-regulations/ for further details.

3. INCLUSION OF HOUSING FINANCE COMPANIES (HFCS) IN GOVERNMENT MARKUP SUBSIDY SCHEME (GMSS) FOR HOUSING FINANCE

Vide SECP's Circular No. 5 of 2022 it was approved by the Economic Coordination Committee ("ECC") along with ratification from the Federal Cabinet and State Bank of Pakistan, that Housing Finance Corporations duly licensed by the Commission shall be included in the Executing Agencies (EAs) under the GMSS for Housing Finance subject to the conditions mentioned in the abovementioned circular.

3. USED BUILDING IS ELIGIBLE FOR INITIAL ALLOWANCE – SUPREME COURT OF PAKISTAN

1. FACTS OF THE CASE

Against the judgment dated 16.07.2020 of the Islamabad High Court, Islamabad, passed in ITR No.24 to 27 of 2009, the Commissioner of Income Tax (Legal) filed a petition before the Honourable Supreme Court of Pakistan ("SCP") titled as Civil Petitions No.2597 to 2600 of 2020.

The controversy involved in the case was the interpretation of Section 23 of Income Tax Ordinance, 2001 ("ITO") with respect to the eligibility of a building which is previously used in Pakistan by a person other than the taxpayer.

The question put before the SCP was as under:

Quote

Whether the respondent taxpayer can claim deduction of initial allowance for an eligible depreciable asset (building in this case) being put to use by the taxpayer for the first

time in a tax year, irrespective of the fact that the said building had been in use in the past in the hands of other taxpayers.

Unquote

2. ARGUMENTS BY THE DEPARTMENT

It was argued before the SCP that that the phrase "first time in a tax year" in Section 23 means that the building must have been put to use for the first time in its life. In the present case, as the building has already been put to use earlier by its previous owner or proprietor, the use of the building by the respondent taxpayer is not for the first time, hence the respondent taxpayer is not entitled to deduct initial allowance regarding the said asset.

3. SCP FINDINGS

The SCP held that Section 23 of the ITO provides for initial allowance of eligible assets which have been used in Pakistan for the first time in a tax year. While subsection (5) of section 23 provides a list of assets which are excluded from the definition of eligible asset under section 23.

Moreover, the SCP held that the provisions of Section 23 states that "A person who places an eligible depreciable asset into service in Pakistan for the first time in a tax year." It means that the term "first time in a tax year" relates to the first time use of the building by the taxpayer and has no concern with the history of usage of the building prior to it falling in the hands of the taxpayer. The act of placing the eligible depreciable asset into service or use, for the first time in a tax year, is of the taxpayer and it is inconsequential if the same asset/building was earlier put into service or use while it was in the hands of an earlier owner or proprietor. A taxpayer becomes entitled to deduction of initial allowance if he, through his own act, has placed an eligible depreciable asset into service for the first time in a tax year.

The SCP further stated that the view is fortified from the reading of sub-section (5) of section 23 which defines "eligible depreciable asset" and specifically excludes a 'plant or machinery' which has been used previously in Pakistan from the definition of "eligible depreciable asset". A previously used building has **not** been excluded and is therefore an eligible depreciable asset and if put to use by the taxpayer for the first time in the tax year, irrespective of its previous use, the taxpayer is entitled to deduction of initial allowance.

4. TOPIC OF THE MONTH

DISPOSAL OF ASSETS OUTSIDE PAKISTAN

➢ PREAMBLE

To mitigate Base Erosion and Profit Shifting and to safe guard the due tax revenues of Pakistan, Section 101A (Gain on Disposal of Assets outside Pakistan) was introduced vide Finance Act, 2018. As our topic of the month, we will discuss this provision in detail.

1. TRIGGERING EVENT FOR SECTION 101A

The said section will be invoked in the event of transaction of disposal of shares or interest of a non-resident entity holding assets located in Pakistan. The gain on disposal of such asset, if any, will be treated as **Pakistan source income.**

For example, Company X is a non-resident company which owns immovable property in Pakistan. The shareholders of Company X dispose of all or a portion of the shareholding of Company X. The disposal of such shares will trigger the provisions of Section 101A.

2. RATES OF TAX

The gain on disposal of an asset treated to be located in Pakistan shall be chargeable to tax at the higher of the following rates:

a) 20% of A where, A = Fair Market Value less cost of acquisition of asset; or

b) 10% of fair market value of the asset

For example, Fair Market Value of shares of Company X which are being disposed is Rs. 200 million and cost of acquisition of such shares are Rs. 25 million. Tax chargeable will be Rs. 35 million as under:

a) 20% x (Rs. 200 million – Rs. 25 million) = Rs. 35 million; or

b) 10% x Rs. 200 million = Rs. 20 million

The non-resident entity disposing of the asset will get tax credit for any tax deducted or collected under point 5 below.

3. ASSETS TREATED TO BE LOCATED IN PAKISTAN

Where the asset which is disposed is a share or an interest in a non-resident company, such asset will be treated as to be located in Pakistan if:

a) The share or interest derives, directly or indirectly, its value wholly or principally from the assets located in Pakistan; and

b) Shares or interest representing 10% or more of the share capital of the non-resident company are disposed.

For example, assets of Company X comprise only of a land situated in Pakistan but the shares of Company X being disposed are less than 10%. In such a case, the shares being disposed off will not be treated as being located in Pakistan.

The share or interest shall be treated to derive its value principally from the assets located in Pakistan, if on the last day of the tax year, the value of such assets:

a) exceeds Rs. 100 million; and

b) represent 50% or more of all assets owned by the non-resident company

For example, the assets of Company X comprise of an immovable property valuing Rs. 150 million which accounts for only 40% of the total assets of Company X. In such a case, shares of Company X will not be treated to derive its value principally from assets located in Pakistan.

4. VALUATION OF SHARES OR INTEREST

The shares of the non-resident company falling under Section 101A will be valued at Fair Market Values as prescribed under Rule 19H of Income Tax Rules, 2002 as under:

4.1 SHARES TRADED ON ANY STOCK EXCHANGE

In case the shares or securities are traded on any stock exchange the fair market value of such share or securities shall be determined with reference to the stock exchange in which such share are listed.

4.2 EQUITY SHARES NOT TRADED ON ANY STOCK EXCHANGE

If the shares are not traded on any stock exchange and the shares are equity shares, Fair Market Value of such shares will be determined using following formula:

Fair Market Value = (A + B + C + - D) * E/F

Where,

A	Book value of all assets except assets mentioned in B
B	(i) In case of immovable property, auction price or price notified by FBR, whichever is higher (ii) Fair market value in case of painting, sculpture, drawing, other work of art; jewelry, rare manuscript, folio or book; postage stamp or first day cover; a coin or medallion; or an antique
C	Fair market value of shares or securities held of other companies (computed using this formula)
D	Book value of liabilities except for provisions and contingencies
E	Paid up value of shares
F	Paid up no. of shares

4.3 NON-EQUITY SHARES NOT TRADED ON ANY STOCK EXCHANGE

In case of share or securities not traded on the stock exchange and not equity shares, the value of shares or securities shall be estimated to be the price it would fetch if sold in the open market on the date of transaction.

4.4 INTEREST BY A MEMBER IN AN AOP

In case of disposal of an interest by a member in an AOP, the Fair Market Value shall be the sum of its Capital Contributed in the AOP and his share in the AOP as in excess of his Capital.

In case the transaction value is higher than the value determined under Rule 19H, the transaction value will be the share value.

For example, the transaction value is Rs. 140 million and the value under rule 19H is Rs. 130 million, the share value will be Rs. 140 million.

5. LIABILITY OF TAX COLLECTION AND REPORTING

5.1 **The person acquiring the asset** from the non-resident person shall deduct tax from the gross amount paid as consideration for the asset at the rate of 10% of fair market value of the asset. The tax deducted is required to be credited to the Federal Government within 15 days of the payment to the non-resident entity.

5.2 Where the non-resident entity holds the asset through a resident company, **such resident company** shall furnish to the Commissioner the information prescribed in Form A of the Rule 19H. Such information is required to be furnished within 60 days of the transaction of disposal of shares or interest.

The resident company is also required to collect tax from the non-resident company at higher of following rates:

c) 20% of A where, A = Fair Market Value less cost of acquisition of asset; or

d) 10% of fair market value of the asset

However, if the tax has been deducted by the person acquiring the asset, the resident company will not collect the tax.

6. LIABILITY UNDER OTHER PROVISIONS OF THE ITO

6.1 Where tax has been paid under point 5 above, no tax shall be payable by the non-resident entity as gain on disposal of a business asset. Likewise, the disposal will also not be treated as capital gain tax on disposal of securities or shares.

6.2 Where any gain is taxable under Section 101A and is also taxable under any other provision of the ITO, the said gain shall be taxable under the other provision of ITO.

7. CONCLUSION

In a nutshell, the following are prerequisites to invoke section 101A:

- A non-resident entity (“entity”)
- Entity should own an asset in Pakistan (“property”)
- The share (“asset”) being disposed of the entity should be 10% or more and should derive its interest wholly or principally from Pakistan.
- The property should value more than Rs. 100 million and more than 50% of all assets of the entity.

The valuation of the property will be as prescribed under Rule 19H.

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