



TAX PAK

NEWSLETTER BY TOLA ASSOCIATES



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EDITORIAL NOTE

Asalam-o-alaikum everyone! Hope this monthly issue of TAXPAK finds you in good spirits and immaculate health! We welcome you to another edition of TAXPAK, our monthly publication the purpose of which is to provide a monthly update on the ongoing tax related developments 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.

Moreover, we would like to apprise the readers 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. This edition of TaxPak discusses the recent judgement passed by the Hon'able Sindh High court dismissing the constitutional petitions that challenged the vires of Section 7E (Deemed Income).

Lastly, we have concluded our newsletter with our Topic of the month titled "Applicability of Capital Value Tax (CVT)". The said topic provides an insight on the taxes levied on Resident Individuals having foreign assets (moveable and immovable), motor vehicles held in Pakistan, or Government notified assets.

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

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.

Warm Regards,

Tola Associates.

1. NOTIFICATIONS/ CIRCULARS

A. INCOME TAX

1. EXEMPTION FROM CVT OF REKO DIQ MINING COMPANY (PRIVATE) LIMITED

The FBR, vide SRO 2200(i)/2022 dated 12th December 2022, has granted exemption on all assets of the Reko Diq Mining Company (Private) Limited (formerly Tethyan Copper Company Pakistan (Private) Limited) from the whole of Capital Value Tax introduced under Section 8 of the Finance Act, 2022.

2. AMENDMENT TO RULE 34 OF THE INCOME TAX RULES, 2002

The FBR, vide SRO 2068(i)/2022, dated 1st December 2022, has issued an amendment in Rule 34 of the Income Tax Rules, 2002 which had been earlier issued vide SRO 2052(i)/2022, dated 22nd November 2022, for public objections and suggestions. A proviso was inserted, whereby, a form shall be submitted by the 31st of December 2022 for those who have filed their returns before the issuance of SRO 189(i)/2022 dated 13th October 2022. This SRO was applicable on persons having capital assets as defined under Section 7E (Deemed Income) which was inserted in the Income Tax Ordinance, 2001 vide the Finance Act 2022.

3. REVALUATION OF PROPERTIES SITUATED IN LAHORE

The FBR, vide SRO 2300(i)/2022, dated 27th December 2022, issued a notification wherein it revised the Fair Market Value (FMV) of immovable properties situated in Lahore. It also directed that these values shall be effective from 01st January 2023 and is in supersession of the earlier Notification No. SRO 348(i)/2022.

B. SALES TAX

1. SINDH BUDGET 2023-24 - INVITATION OF PROPOSALS IN RELATION TO THE SINDH SALES TAX ON SERVICES ACT, 2011 AND RULES AND NOTIFICATIONS ISSUED THEREUNDER

The SRB, vide Notification No. SRB/TP/1/2023/47667 dated 5th December 2022, requested all Chambers,

Associations, Groups, Stakeholders, Taxpayers including Business councils, trade associations, tax bars, Institute of Chartered Accountants, and Institute of Cost & Management Accountants to send their written proposals in a prescribed format on urgent basis by 27th January 2023 in relation to the Budget for 2023-24 for Sindh, on the following:

1. Sindh Sales Tax on Services Act, 2011;
2. Sindh Sales Tax on Services Rules, 2011;
3. Sindh Sales Tax Special Procedures (Withholding) Rules, 2014;
4. Sindh Sales Tax Special Procedure (Transportation or Carriage of Petroleum Oil through Oil Tankers) Rules, 2018;
5. Sindh Sales Tax Special Procedure (Services provided or rendered by cab aggregator and services provided/rendered by owners or drivers of the motor vehicles using the cab aggregator services) Rules, 2019;
6. Sindh Sales Tax Special Procedure (Online Integration of Business) Rules, 2022; and
7. Other various notifications issued under the said Sindh Sales Tax on Services Act, 2011.

2. CORPORATE NOTIFICATIONS / CIRCULARS

1. ASSET BACKED SECURITIZATION REGULATIONS, 2022

The SECP, vide SRO 2135(i)/2022, dated 1st December 2022, issued Asset Backed Securitization Regulation, 2022 which had been previously issued vide SRO 870(i)/2022 dated 23rd June, 2022. The said regulations shall be applicable on companies proposing to commence business as a Special Purpose Vehicle (SPV) having paid-up capital of not less than Rs 1 million.

3. TOPIC OF THE MONTH

APPLICABILITY OF CAPITAL VALUE TAX (CVT)

INTRODUCTION

In this edition of TaxPak, we will discuss the Capital Value Tax introduced through Section 8 of the Finance Act, 2022. The said Tax was given retrospective effect, i.e from Tax Year 2022 and onwards, except in the case of Motor

Vehicles held in Pakistan in which case the tax will be levied prospectively.

A. WHAT IS CAPITAL VALUE TAX?

The Capital Value Tax (CVT) was levied on the following assets:

1. Motor Vehicles held in Pakistan (tax on which has been levied prospectively);
2. Foreign Assets (both movable and immovable); and
3. Assets notified by the Federal Government.

B. COMPUTATION OF CVT

1. MOTOR VEHICLES HELD IN PAKISTAN

MINIMUM CRITERIA:

- (a) Engine capacity exceeds 1300cc or;
(b) For electric vehicles: battery power capacity exceeding 50kwh;

RATE OF TAX: 1% OF THE VALUE

DETERMINATION OF "VALUE"

The value in case of motor vehicles shall be determined on the basis of whether it was imported, or manufactured / assembled locally, or auctioned. If the vehicle was imported, then the value shall be assessed by the Customs authorities and shall include all duties and taxes leviable at import stage. If it was manufactured or assembled locally, then the ex-factory price shall be taken into consideration including all taxes and duties. Where vehicles were auctioned, the auction values inclusive of all duties and taxes shall be considered.

Furthermore, the value shall be reduced by 10% each year from the end of the financial year in which the motor vehicle is acquired. It was further provided that the value shall be treated as "0" after 5 years from the end of financial year in which the motor vehicle is imported/sold by local manufacturer or auctioned

COLLECTION OF TAX:

Mode	Responsibility
Motor vehicle was imported	The Collector of Customs shall collect tax at the time of import wherein provisions of the Customs Act, 1969 (IV of 1969) shall be applicable (as far as relevant)
Motor vehicle was locally manufactured or assembled	The buyer of the motor vehicle, shall deposit the said amount to the Government Treasury/authorized SBP branches/NBP within 7 days of collection.
Motor vehicle was sold by public auction or auction by tender	The person to whom the vehicle was sold and shall deposit the said amount to the Government Treasury/authorized SBP branches/NBP within 7 days of collection.
Where none of the above applies	Every motor vehicle registering authority of Excise and Taxation department at the time of registration of a motor vehicle/ transfer of registration

Furthermore, if tax was collected by the Federal/Provincial/Local government, then the amount shall be paid to the Federal Government on the day the tax is collected.

2. FOREIGN ASSETS

MINIMUM CRITERIA:

The tax is applicable on a resident individual where the value of foreign assets of the resident individual on the last day of the tax year exceeds Rs 100 million in aggregate.

Foreign assets means any movable or immovable assets held outside Pakistan directly or indirectly and includes but not limited to:

- (a) Real estate
- (b) Mortgaged assets
- (c) Stocks and shares
- (d) Bank accounts
- (e) Bullion
- (f) Cash
- (g) Jewels
- (h) Jewelry;
- (i) Paintings;
- (j) Accounts and loan receivables;
- (k) Assets held in dependents' name;
- (l) Beneficial ownership/ beneficial interests;
- (m) Contribution in offshore entities;
- (n) Trusts

RATE OF TAX: 1% OF THE VALUE

DETERMINATION OF "VALUE"

Value of foreign assets shall be determined by the total cost of foreign assets on the last day of the tax year converted into Pakistani Rupees as per exchange rates notified by the State Bank of Pakistan for the said day. However, sometimes the cost cannot be determined with reasonable accuracy due to many reasons then in that case, the fair market value of the asset on the last day of the tax year converted to Pakistani Rupees as notified by the State Bank of Pakistan for the said day shall be accounted for.

For instance, Mr. G (resident) owns a villa in Dubai, and it costed him AED 5million, then the value shall be converted to Rs 55.77 (as per SBP's notified rates as on 30.06.2022) = AED 5 million x PKRS 55.77= PKRS 278.850 million on which 1% would result to Rs 2,788,500/-. If Mr. G was a non-resident in that year, then no such tax shall be levied on him.

COLLECTION OF TAX:

The person holding the foreign assets shall be liable to pay tax at the time the income tax return for the tax year is due.

3. ASSETS NOTIFIED BY THE FEDERAL GOVERNMENT

MINIMUM CRITERIA:

Assets or class of assets as specified by the Federal Government through a notification in the official gazette
RATE OF TAX: 5% of the value wherein the value of the asset and mode of collection shall be specified in the notification

C. THE CVT RULES 2002

The FBR, vide SRO. 1797(I)/2022, on 29th September 2022, issued the Capital Value Rules 2002, through which it provided that persons eligible to CVT having foreign assets or those that fall under the notification issued by the Federal Government shall file an electronic declaration in IRIS, whereas every motor vehicle registration authority/ manufacturer/person selling through auction shall submit a quarterly electronic statement in IRIS along with an annual electronic statement which shall be submitted within 30 days of the end of the tax year (30.07.202X).

The separate declaration has been termed as "Form A", a specimen whereof has also been annexed to the aforesaid Rules. Form A is available on the IRIS Portal as well.

D. THE DECISION OF THE HONOURABLE HIGH COURTS OF SINDH AND LAHORE AND ON CVT

The vires of the CVT had been challenged before the Honourable High Courts of Sindh ("SHC") and Lahore ("LHC"). Both the Honourable High Courts have dismissed the respective Constitutional Petitions filed before it.

Hence, both Courts have held the CVT to be intra vires to the Constitution of Pakistan 1973. It remains to be seen if the Petitioners may prefer an intra-court appeal (in the petitions dismissed by the Hon'ble LHC) or an appeal to the Supreme Court of Pakistan (in the petitions dismissed by the Hon'ble SHC).

4. JUDGEMENT PASSED BY THE HONOURABLE HIGH COURT OF SINDH DISMISSING THE CONSTITUTIONAL PETITIONS CHALLENGING THE VIRES OF SECTION 7E (DEEMED INCOME).

1. BACKGROUND

Section 7E of the Income Tax Ordinance 2001 (“ITO”) was introduced vide the Finance Act 2022. Through this section, a tax of 20% tax on the fair market value of 5% of the entire immovable property held by a resident taxpayer, the fair market value of which in aggregate exceeds PKR 25 million, was introduced, subject to certain exclusions. The said section was also made effective retrospectively (from Tax Year 2022). However, being aggrieved of this tax, Constitutional Petitions were filed challenging the vires of Section 7E before various High Courts all over the country. The Learned Division Bench of the Hon’ble Sindh High Court (“SHC”) heard the matter at length and dismissed the petitions on 26th November 2022 vide a short order, whereafter detailed reasons were authored and released accordingly.

2. ARGUMENTS BY THE PETITIONERS’ COUNSEL

The counsel for the Petitioners challenged the provisions of Section 7E of the ITO on the grounds that, inter-alia, the same was discriminatory, confiscatory, and therefore, ultra vires to the Constitution of Pakistan 1973 (“Constitution”). The Petitioners challenged that the impugned levy should have been levied through the Act of Parliament by following the procedure as laid down under Article 70 of the Constitution. They argued, inter-alia, that tax can only be made when there is an earning potential; which lacked in the present facts and circumstances, that it also failed to pass the twin test regarding discrimination as settled by the Hon’ble Supreme Court of Pakistan (“SC”) and India. It was also argued that it imposes a tax on immovable property and is not a tax on deemed income. Moreover, the said tax has been retrospectively instead of being levied from the next tax year. Furthermore, the said tax is confiscatory as the taxpayers are not generating any

income, notwithstanding holding of immovable properties, so as to pay tax on its deemed income. Furthermore, the Petitioners stated that when the Finance Bill was sent to the Senate of Pakistan, a resolution was passed against this levy and that the advice of the senate must not be ignored. They further contested that deemed income has some nexus with a business activity which is lacking in the present case, and that it amounts to double taxation as property tax is already levied by the provinces. The petitioners also argued that the exclusion and exemptions provided in the Section 7E must have nexus with some policy objectives of the Government. Moreover, an idle property was also being taxed and deemed as generating income, which therefore meant that there was no actual receipt of income / money. In other words, tax was being levied on fictional income.

3. ARGUMENTS BY THE RESPONDENTS’ COUNSEL

The counsel for the Respondents contended that the concept of deemed income was not novel, and claimed that a number of cases passed by the superior courts had validated it. They further argued that the tax imposed was not on property but in fact it was on income which falls within the competence of the Federal Legislature under Entry 47 of the Fourth Schedule of the Constitution. The Respondents, therefore, argued that the said tax did not fall within Entry No. 50. The Respondents, inter-alia, also argued that a tax on rental income (Section 15 of the ITO) is already in field and is being paid by the taxpayers, and so are various other taxes on property under the ITO. Moreover, as far as discrimination is concerned, the Respondents further argued that the exceptions that have been provided under Section 7E relate to different classes of persons that are otherwise enjoying exemptions and exceptions under the ITO. The Respondents also argued that the levy itself is a tax and within the competence of the Federal Legislature to introduce the same under Article 70 of the Constitution by way of a Money Bill. As far as hardship to pay the tax or the inability to pay is concerned, this is not a ground for the tax to be declared ultra vires. The respondents also stated that the levy did not affect any

fundamental rights nor was the property being forcefully acquired. It was also argued that the tax had been levied to fulfil various obligations and functions of the State which required immediate taxation measures. It was not ultra vires as it is the prerogative of the legislature to choose a class of persons on whom the tax may be imposed or not, and that there are provisions of presumptive incomes and presumptive taxes in the ITO therefore it was not necessary to have an actual taxable income for taxation purposes. They also contested that various taxpayer had also availed the benefits of Foreign Assets Declaration Act, 2018 followed by an Ordinance of 2019 when benefits of the said legislation on property was availed. The respondents prayed for dismissal of the petitions.

4. ARGUMENTS BY THE LEARNED ASSISTANT ATTORNEY GENERAL OF PAKISTAN

The Learned Assistant Attorney General appeared on behalf of the Federation and contended that it was within the competence of the Federal legislature to tax any income from property and the provisions in question was not a tax itself on such property, and that the income in this matter is generated through the property, and that it falls within the competence of the Federal Legislature under Entry 47 of the Fourth Schedule to the Constitution. He, therefore, prayed for the dismissal of the Petitions as well.

5. FINDINGS OF THE HON'BLE SINDH HIGH COURT

The SHC announced the judgement, and it is held as follows:

5.1. DISCRIMINATION:

That this argument was not only misconceived, but it also had no force or legs to stand on. It had been held by the SC as well as various judgments by various High Courts that the legislature has the competence to levy tax on different classes of persons and merely for the fact that someone is exempted from tax, it cannot always be pleaded that it is discriminatory in nature and is liable for being struck down.

The SHC also stated that in order to strike down, according to Article 25 of the Constitution, it must be demonstrated that the said law was not based on intelligible criteria and does not have a nexus with the purpose of law. Therefore, the legislature is competent to classify persons or properties into different categories subject to different rates of tax. The SHC further stated that the test of vice of discrimination was less rigorous and if there was uniformity within each group founded in intelligible differentia having a rational nexus with the object sought to be achieved by the law then the constitutional mandate that a law should not be discriminatory is fulfilled.

Furthermore, the classes of persons who have been granted exemptions from such levy are within the competence of the legislature as being classified separately. It further held that the classification was further classified and not generic in nature. For instance, original allottee of the capital assets (duly certified by allotment authorities) were granted exemption where the exception was only provided to the original allotment and not thereafter. Hence, it was held that if the Legislature had classified persons/properties into different rates of taxation with reference to income or property then it would not be an inequality, nor would such classification be deemed to be unequal. The SHC placed reliance on the case of I A Sherwani reported as 1991 SCMR 1041, wherein the SC held that equal protection of law did not envisage that every citizen should be treated alike in all circumstances but in fact contemplates that persons similarly situated or similarly placed should be treated alike. It was further held that reasonable exemption (up to Rs 25 million) has been provided to all taxpayers in respect of properties owned by them therefore of any merits and not tenable.

5.2. CONFISCATORY NATURE OF LEVY:

The SHC held that there is no concept of invalidating a levy or tax merely on the ground that the taxpayer does not have any such capacity to pay tax. The SHC took reliance on the judgment passed by the SC in the case of Elahi Cotton which was decided by a five-member bench and

held that taxing power is unlimited as long as it does not amount to confiscation and such imposition cannot be struck down just because the taxpayer is not in the capacity to pay. It further stated that it is a natural thing that while paying taxes there is always an element of hardship for a taxpayer in discharging the tax liability so created by the statute, but this neither makes it inevitable nor any ground supports it to be struck down. Therefore, it cannot be declared as ultra vires to the Constitution on the ground that it is confiscatory in nature

5.3. LEGISLATIVE COMPETENCE:

The SHC noted that deemed income is an approved concept of taxation and not dependent on the actual money/income received by the taxpayer like in case of rental property, the annual amount of rental property can be deemed irrespective of being rented or not. Moreover, it was held that the argument that this can only be levied by Provincial government is misconceived. The SHC has in effect held that Section 7E levies a tax on the income deemed to arise from the capital asset(s) mentioned in the said Section, subject to certain exceptions. Therefore, as per this judgment, Section 7E is not in pith and substance a tax on the capital value of immovable property. It was further held that holding the property beyond the threshold is deemed to be generating income and should be levied. Deemed income is a fictional income concept and may not always be actual income, therefore, if the mentioned condition in the Act is satisfied then it is considered to be deemed income irrespective of the actual transaction. Whoever holds property is presumed to be having an income even if the owner receives income or possibility of receiving any income or neither exists, as fictions always conflict with reality but presumptions may prove to be true. The argument on technical grounds regarding the inability of FBR to make arrangements regarding the collection mechanisms deserves to be decided by the Government. If this fiscal statute is

beneficial to the country as a whole, then the Individual interests cannot yield higher than the national interest.

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