



TAX PAK

NEWSLETTER BY TOLA ASSOCIATES



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CONTENTS

Tax Notifications/ Circulars

Corporate Notifications / Circulars

Judgement passed by the Hon'able High court of Islamabad discussing the parameters of the records required under notice for audit issued under Section 177 of the Income Tax Ordinance 2001 ("ITO")

Topic of the Month- Minimum Value Addition Sales Tax at import stage

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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 ("FBR") and its provincial counterparts. 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 High court of Islamabad discussing the parameters of the records required under notice for audit issued under Section 177 of the Income Tax Ordinance 2001 ("ITO").

Furthermore, we have discussed in our newsletter our Topic of the month titled "Minimum Value Addition Sales Tax at import stage". The said topic provides an insight on the concept of minimum value addition sales tax in Pakistan.

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. THE FINANCE (SUPPLEMENTARY) ACT, 2023 (NO. X OF 2023)

Through, reference Letter No. F.22(6)/2023-Legis., dated 23rd February 2023, a Finance (Supplementary) Act, 2023 was issued upon the assent of the President on 23rd February, 2023. In the said Act, Advance income tax on functions and gatherings had been imposed at 10% of the value, and treatment of capital gain on disposal of shares (not through SECP/NCCPL) had been introduced. It is pertinent to mention that amendments to the Sales Tax Act, 1990 and the Federal Excise Act, 2005 had also been made. For further reading, please download our comments on the same through the following link: <https://tolaassociates.com/major-developments-2023/>.

2. FURTHER AMENDMENT IN THE SEVENTH SCHEDULE OF THE INCOME TAX ORDINANCE, 2001

The FBR, vide SRO 213(i)/2023, dated 22nd February 2023, granted exemption on Profit on debt, and capital gains derived from debt and debt instruments approved by the Federal Government which are derived by any non-resident banking company approved by the Federal Government. The said had been inserted by amending the Seventh Schedule of the Income Tax Ordinance, 2001.

3. SHARING OF DECLARATION OF ASSETS OF CIVIL SERVANTS RULES, 2023.

The FBR, through SRO 80(i)/2023, dated 1st February 2023, published the rules which had been earlier published as draft vide Notification No. SRO 76(l)/2023 dated 26th January 2023. The said rules shall apply to Civil servants in BS 17-22 and are for the purpose of sharing information with banking companies. Moreover, the said rules contain compliance requirements and responsibilities of the banking companies, procedures and applicability on these

civil servants. The said can be accessed from <https://download1.fbr.gov.pk/SROs/20232119282592SR080.pdf>.

4. DRAFT FOR FURTHER AMENDMENTS TO THE INCOME TAX RULES, 2002- RECORD OF BENEFICIAL OWNERS

The FBR, through SRO 229(l)/2023, dated 28th February 2023, issued draft of certain further amendments ("the draft rules") to the Income Tax Rules 2002, for objection or suggestion within seven days of issuance of the same. The said shall be applied on every company and AOP. However, where a company / AOP are already in existence, then electronic submission of the requisite form should be done on or before December 31st, 2023. Any change should be updated within 30 days from the date of change, and incase there were no changes throughout the tax year, then a "Certificate of Confirmation for Beneficial Owner" shall be submitted. Furthermore, for NPOs under section 2(36) of the Income Tax Ordinance, 2001, it provides that a settlor, trustee, founder, promoter, beneficiary or class of beneficiary shall be the beneficial owner of the NPO, however an exemption from this rule shall be applied if a beneficiary or class of beneficiary is the general public.

The draft rules provides definitions of chain of ownerships, contractual association, direct and indirect means, joint control arrangement, and ultimate effective controls.

The draft also specifies the documents needed to maintain a record of the beneficial owners, however this shall be applicable if the beneficial owner hold 25% or more direct ownership right (through shareholding).

Furthermore, the rule introduces a cascading process containing 3 tests wherein these tests will be applied in succession, and it will only progress if there is doubt in ownership. For instance, test 2 will only be applied if results of test 1 are dubious or uncertain, similarly test 3

will only be performed if results of test 1 and 2 are insufficient.

The draft rules also directs that companies and AOP shall retain records of beneficial owners for 10 years (from the date of cessation of being a beneficial owner) and FBR shall retain for 15 years (from the date when the company or AOP ceases to be registered with the FBR). For further reading:

[https://download1.fbr.gov.pk/SROs/20232281925228758SRO229\(I\)of2023.pdf](https://download1.fbr.gov.pk/SROs/20232281925228758SRO229(I)of2023.pdf).

B. SALES TAX

1. ENHANCEMENT OF STANDARD RATE OF SALES TAX FROM 17% TO 18%

The FBR, vide SRO 179(I)/2023, dated 14th February 2021 increased the rate of sales tax from 17% to 18% for taxable goods falling under section 3(1) of the Sales Tax Act, 1990, i.e., on taxable supplies made by registered persons in the course of any taxable activity carried on by him; and on goods imported into Pakistan. The same can be accessed from [SRO 179 OF 2023 DATED 14.02.2023 -- ENHANCEMENT OF RATE OF SALES TAX FROM 17% TO 18% \(fbr.gov.pk\)](https://download1.fbr.gov.pk/SROs/20232281925228758SRO229(I)of2023.pdf).

2. THE FINANCE (SUPPLEMENTARY) ACT, 2023 (NO. X OF 2023).

Vide Reference Letter No. F.22(6)/2023-Legis., dated 23rd February 2023, a Finance (Supplementary) Act, 2023 was issued upon the assent of the President on 23rd February 2023. In the said Act, general sales tax had been increased from 17% to 18%, while increasing to 25% for CBU import on mobile phones exceeding USD 500 and certain other amendments to the Sales Tax Act, 1990. For further reading, you may download our comments through the following link: <https://tolaassociates.com/major-developments-2023/>.

Furthermore, vide Circular 01 of 2023, dated 28th February 2023, the FBR issued an explanation on the important amendments made to the Sales Tax Act, 1990 and the

Federal Excise Act, 2005. The same can be accessed from <https://download1.fbr.gov.pk/Docs/20232281524459451Circular01-2023SalesTaxFederalExcise.pdf>.

3. SALES TAX GENERAL ORDER NO. 7 OF 2023 – TIER I RETAILERS - INTEGRATION WITH FBR'S POS SYSTEM

The FBR issued a Sales Tax General Order Bearing No. 07 of 2023, dated 09th February 2023, wherein the identified Tier-1 Retailers have been directed to get themselves integrated with the FBR by the 10th of February 2023. It has also been provided that failure to comply would result in disallowance of input tax claim and shall create tax demand of the same amount. The list may be perused through the following link: <https://download1.fbr.gov.pk/Docs/20232101322945345STGO7.pdf>.

4. CONSTITUTION OF A SPECIAL AUDIT CELL

The FBR constituted a Special Audit Cell, vide Office order no. Jud/CIR/Audit-II/CTO/KHI/2022-23/1920 dated 10th February 2023, to streamline internal controls, with immediate effect. It was also communicated that this cell shall perform various functions such as carrying out inquiries for cases referred by FBR/ Chief Commissioner/ Commissioners or to carry out physical verification of taxpayers having abnormal profiles/ dubious activities (with the permission of the Commissioner Inland Revenue).

5. NO MONTHLY SALES TAX RETURN OPTION TO REPORT SALES BY PHARMACEUTICAL INDUSTRY POST FINANCE ACT, 2022

The FBR vide FBR's U.O. No. 1(8)ST-L&P/STR/2022-PT/17670R dated 2nd February 2023, directed PRAL to update Annex-C for Pharmaceutical Industries in order to enable them to post sales as per the amendment in the Fifth schedule of the Finance Act, 2022 ("Act") for the tax periods of January-June 2022, it was also directed that no

option to report exempt sales was available in the Annex-C for the tax period of July 2022.

disallowance of input tax claim and shall create tax demand of the same amount. The list may be perused through the following link: [20231101612054461STGO6-2023.pdf \(fbr.gov.pk\)](https://www.fbr.gov.pk/20231101612054461STGO6-2023.pdf)

2. CORPORATE NOTIFICATIONS / CIRCULARS

1. THE COMPANIES (POSTAL BALLOT) REGULATIONS, 2018

The SECP vide SRO No. 254(I)/2018, dated 27th February, 2023, issued the Companies (Postal Ballot) Regulations, 2018 which had been earlier published vide S.R.O. 3(I)/2018 dated 1st January 2018 for public comments and amendments. The said regulations, shall be applicable to every company and a listed company (for all special businesses and in case of election of directors -only if the number of persons offering for themselves, exceed the number fixed). The said regulation can be accessed through <https://www.secp.gov.pk/laws/regulations/>.

3. RECORD SHALL BE CONFINED TO THE EXTENT OF REASONS MENTIONED IN NOTICE U/S 177 AND ROVING INQUIRIES ARE NOT PERMITTED UNDER THE LAW

1. BACKGROUND

The Hon'ble Islamabad High Court ("IHC") simultaneously issued a single judgement binding on the writ petitions filed by (a) Fairdeal Exchange Company (Private) Limited ("Fairdeal") vs FOP through Ministry of Finance and others and (b) Pakistan Television Corporation Limited ("PTV") vs Commissioner Inland Revenue (Audit-I) and others as they both had raised common grounds.

2. ARGUMENTS BY THE LEARNED PETITIONERS

(A) PTV

PTV being aggrieved of receiving a subsequent notice dated 04.01.2023 intimating them to provide record for

the purpose of audit, despite being selected for audit u/s 177 of the Income Tax Ordinance, 2001 ("ITO") which was issued on 17.12.2021 filed a writ petition with the Hon'ble IHC. PTV contended that the 'Two-step' process for audit was necessary between the two notices, such as the Commissioner Inland Revenue ("CIR") was supposed to provide PTV an opportunity to satisfy the CIR to issue a speaking order to justify the audit which was absent in this case. Secondly, the CIR's jurisdiction under section 177(1) was either abolished under section 214C by implication or in alternative, was subservient to the Board's power for selection of audit under section 214C.

(B) FAIRDEAL

Fairdeal filed a writ petition because it was issued 5 audit selection notices under section 177(1) for the tax years 2016 to 2020 followed by 5 notices to produce records for audit against each year. Therefore, Fairdeal, being aggrieved of the subsequent notices, filed a petition on grounds similar as PTV, except that the CIR, in this case, had provided an opportunity of being heard, but did not pass a speaking order to proceed with summoning financial records. The only ground which stood out from PTV was that section 177(7) precludes simultaneous audit for multiple years and for this, they referred to FBR's circular No. C.4(36)ITP/2002 dated 05.10.2009 ("2009 Circular") wherein the circular had prohibited the officers from issuing multiple tax years' notices as it caused undue harassment to the taxpayers

3. ARGUMENTS BY THE LEARNED RESPONDENTS

(A) PTV

The counsel for the Learned Respondents opposed the stance filed by the Learned Petitioner.

(B) FAIRDEAL

For the third contention, i.e. multiple years' simultaneous audit, the counsel for the learned respondents argued that the 2009 Circular was not in force and that it had been withdrawn. However, the counsel for the Learned

Respondents did not produce any material which proved otherwise. The counsel for the Learned Respondents also argued that the petitions were not maintainable as selection for audit was not an adverse action.

4. FINDINGS OF THE HON'BLE IHC

The Hon'ble IHC addressed the above contentions in its detailed judgement. A summary of the legal principles was discussed and are appended here as follows:

- a. Selection for audit u/s 177(1) by the CIR is not contingent on selection for audit by the Board u/s 214C.
- b. Position regardless of creeping erosion of the deemed assessment status of a tax return u/s 120;
- c. An audit may (not) lead to an amended assessment and an audit report is only to be issued only after obtaining taxpayers explanations;
- d. Yet another opportunity of hearing is afforded before amending the assessment following the hearing on the audit report;
- e. An audit selection u/s 177(1) must list reasons for selection, and reasons must be communicated to the taxpayer;
- f. If reasons given for selection are manifestly inadequate, the notices will be set aside or remanded for the revenue to give proper reasons after hearing the taxpayer; and
- g. Law does not invariably require a 'two-step' progression to audit where proper reasons are given in audit selection notice, the audit can proceed without an intermediate hearing and a speaking order by the Commissioner "preliminary" audit is not required.

The judgement also held that where a well-reasoned audit-selection order is issued under section 177(1) 2nd step of

hearing is not needed and a speaking order by the CIR, compelling the CIR for another order is also not needed. Furthermore, it was also held that, where an audit is conducted into areas beyond the ones stated in the reasons for which the notice had been sent, it leads to roving examination of other tax matters, which is forbidden.

The judgement also provided an example wherein if for instance, a discrepancy between the withholding tax deducted for salary stated in the tax return versus periodic withholding statements had been given as reasons for audit selection then it should remain confined to records relating the withholding taxes and salary alone and should not form basis for a general and expansive audit into other financial records (such as capital expenditure or investments) as it would result to roving inquiry.

Therefore, the reasons given in the audit-selection order should clearly point out the extent of records that is to be summoned and the record summoned should correlate with the reasons given for the audit.

As for the impugned notices, reasons should reflect an objective application of mind with reference to the specific heads that appear discrepant, and once the threshold is crossed, the reasons would meet the standard required.

Conclusion derived for Fairdeal was that the 2009 Circular was deemed enforceable as the counsel for the Learned Respondents did not provide any satisfactory answer for the 2009 Circular. Furthermore, it was directed that the CIR may select any one of the years for which the impugned notices were issued and the notices for the remaining shall stand cancelled upon selection. Lastly, the Hon'ble IHC dismissed the petition for PTV and stated that both PTV and Fairdeal, shall provide records which had been called for audit provided that those records duly correspond with the reasons given in the audit-selection notices.

4. TOPIC OF THE MONTH

MINIMUM VALUE ADDITION SALES TAX AT IMPORT STAGE

INTRODUCTION

The minimum value addition sales tax refers to the minimum amount of sales tax that must be charged on goods and services sold by businesses. Essentially, this type of tax ensures that businesses are paying at least a certain percentage of tax on the value they add to the goods and services they sell.

For example, if the minimum value addition tax is 3%, it implies that the businesses are essentially required to add value of more than 3% so that the amount of sales tax charged on subsequent supplies is sufficient enough to absorb or adjust the tax paid on inputs or raw materials. Another example may be that where minimum value addition tax is 3% or standard rate is 18% and inputs cost Rs. 100, the business should add minimum of Rs. 3 to its subsequent supplies i.e. Rs. 103. This will result in output tax of Rs. 21.54 (Rs. 103 x 18%), which will be more than enough to adjust input of Rs. 21 (Rs. 3 + Rs. 18).

In Pakistan, concept of minimum value addition sales tax is present since July 01, 2004 through sales tax rules and sales tax special procedure rules. These rules were replaced by the Twelfth Schedule to Sales Tax Act, 1990 vide Finance Act, 2019. Provisions of the said schedule are discussed hereunder:

APPLICATION AND RATE

Sales tax on account of minimum value addition tax ("VAT") shall be levied and collected at import stage from the importer on all taxable goods as are chargeable under Section 3 of the STA, i.e. liable to a standard tax rate of 18% on goods imported to Pakistan irrespective of their final destination in Pakistan.

The tax is required to be levied at the rate of 3% on the value of the product being imported.

EXCEPTIONS

Value addition tax shall be levied on all imported goods excluding the following:

1. Raw materials and intermediary goods imported by a manufacturer for in-house consumption, excluding:
 - A. Compressor scrap.
 - B. Motor scrap; and
 - C. Copper cable cutting scrap.

This means VAT will be applicable on Compressor scrap; Motor scrap; and Copper cable cutting scrap even if they are to be used as raw materials or intermediary goods.

2. Petroleum products falling under Chapter 27 of the Pakistan Customs Tariff provided that they are imported by a licensed Oil Marketing Company for sale within the country.
3. Registered service providers importing goods for their in-house business use to enhance their taxable activity and not intend for further supply.
4. Cellular mobile phones or satellite phones;
5. LNG/RLNG;
6. Second hand and worn clothing or footwear.
7. Gold and silver (in unworked conditions)
8. Goods specified in the 3rd Schedule on which tax is paid on retail price basis; (such as shampoos, soaps, cigarettes, aerated beverages).
9. Plant, machinery and equipment falling under Chapters 84 and 85 of the First Schedule to the Customs Act, 1969, as are imported by a manufacturer for in-house installation or use.
10. Electric vehicles:
 - A. 4 wheelers CKD Kits for small cars/SUVs with less than or equal to 50kwh battery and LCVs with less than or equal to 150kwh till 30th June 2026.

- B. 4 wheelers small cars/SUVs with less than or equal to 50kwh battery and LCVs with less than or equal to 150kwh CBU condition till 30th June 2026.
- C. 2-3 wheelers and heavy commercial vehicles in CBU condition till 30th June 2025.

11. Motor cars of cylinder capacity of up to 850cc.

ADJUSTMENT OF VAT

VAT paid at import stage shall form part of the input tax and the importer shall deduct the same from the output tax due for the tax period. The excess shall be carried forward to the next tax period as provided under section 10 of the STA.

NO REFUND OF VAT

Refund of excess input tax over output tax, which is attributed to VAT, shall not be refunded to a registered person in any case and will always be carried forward for adjustment against output tax of next month.

However, if the imported goods are used to make subsequent supplies at zero rate, such VAT will be eligible for refund.

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