

## WINDFALL TAX | A NON-STARTER

### 1. PROLOGUE:

Section 99D of the Income Tax Ordinance 2001 (“ITO”) provides for additional tax on certain income, profits and gains. The same was introduced by the Finance Act, 2023 and has been levied on companies. The additional windfall income tax has been levied on a company that generated excessive income, profit or gain (i.e. windfall income) due to any economic factor (such as currency fluctuation) during any of the last three tax years preceding the tax year 2023 and onwards. At the time the Finance Act, 2023 was passed, no sectors were specified nor any rate of tax was notified (however a bar of not exceeding the rate from 50% was fixed). Further, Section 99D(2) of the ITO empowers the Federal Government (“FG”) to define windfall income, profit and / or gains, and economic factors due to which such windfall income, profit and / or gains has arisen. Section 99D(3) has mandated the FG to place the aforesaid Notification before the National Assembly within 90 days of its issuance or 30th June of the relevant financial year in which it was issued, whichever is earlier.

The Federal Government has now exercised its powers vested under Section 99D(2) of the ITO, and issued SRO 1588(I)/2023 dated 21<sup>st</sup> November 2023 (“said Notification” or “said SRO”). Through the said SRO, the FG has specified the method to calculate the windfall income and the tax rate at which such windfall income will be charged.

Our brief comments on the introduction of the said SRO and its applicability are as follows:

### 2. COMMENTS:

- The notification shall be applicable to banking companies only.
- The rate of tax applicable on windfall income for the aforesaid sector shall be 40%.
- The due date of payment of tax on windfall income is 30<sup>th</sup> November, 2023, which is extendable upto 15 days by the Commissioner at his discretion on the application by the taxpayer.
- The scope of windfall income, profits and gain shall be for the Calendar years 2021 and 2022 corresponding to Tax years 2022 and 2023, respectively.

### METHODOLOGY FOR COMPUTING WINDFALL INCOME, PROFITS AND GAINS:

- The windfall income has been specified to be the difference of foreign exchange income of subject year and the average foreign exchange incomes for preceding six years for both tax years 2022 and 2023. However, for tax year 2023, windfall income of tax year 2022 has been reduced from the sum of foreign exchange incomes of preceding six tax years for the purpose of calculation of average of preceding six tax years.
- The same is represented through the formulae as under:

**For the tax year 2022 (calendar year 2021):**

$$\text{Foreign Exchange Income for 2021} - \frac{\text{Foreign Exchange income for (2015–2020)}}{6}$$

**For the tax year 2023 (calendar year 2022):**

$$\text{Foreign Exchange Income for 2022} - \frac{\text{Foreign Exchange income for (2016–2021)} - \text{Windfall income of TY 2022}}{6}$$

- Foreign exchange income has been defined to be the income as disclosed in the financial statements or notes to the financial statements for the calendar years relevant to Tax Years 2016-2023.
- It has also been provided that in case windfall income for Tax year 2022 is negative, then the value shall be deemed to be zero for the purpose of calculation of windfall income of tax year 2023.

## WINDFALL TAX | A NON-STARTER

- It has also been provided that in case there is an exchange loss for any of the year, that year will be ignored for the purpose of calculation of average exchange gain along with exclusion of number of years. For instance, if in the tax year 2017 there was a loss, then that amount would not be considered and the denominator would be 5 instead of 6.

### ILLUSTRATIONS:

#### EXAMPLE 1 (FOR TAX YEAR 2022):

A company's foreign exchange income for tax year 2021 was Rs.10 million. Its foreign exchange income for tax years 2015 to 2020 were as follows:

- 2015: Rs. 2 million
- 2016: Rs. 3 million
- 2017: Rs. 4 million
- 2018: Rs. 5 million
- 2019: Rs. 6 million
- 2020: Rs. 5 million

The company's windfall income for 2021 would be calculated as follows:

Windfall Income = Rs.10 million - (Rs.2 million + Rs.3 million + Rs.4 million + Rs.5 million + Rs.6 million + Rs.5 million)/6

Windfall Income = Rs.10 million - Rs. 25 million / 6

Windfall Income = Rs.10 million - Rs. 4.167 million

Windfall Income = Rs. 5.83 million

Therefore, the company's windfall income for tax year 2022 will be Rs.5.83 million and additional tax payable will be Rs. 2.33 million (Rs. 5.83 x 40%)

#### EXAMPLE 2 (FOR TAX YEAR 2023):

A company's foreign exchange income for tax year 2022 was Rs. 12 million. Its windfall income for tax year 2022 was Rs. 5.83 million. Its foreign exchange incomes for 2016 to 2021 were as follows:

- 2016: Rs. 3 million
- 2017: Rs. 4 million
- 2018: Rs. 5 million
- 2019: Rs. 6 million
- 2020: Rs. 5 million
- 2021: Rs. 10 million

The company's windfall income for 2023 would be calculated as follows:

Windfall Income = Rs.12 million - (Rs.3 million + Rs.4 million + Rs.5 million + Rs.6 million + Rs. 5 million + Rs. 10 million – Rs. 5.83 million) / 6

Windfall Income = Rs.12 million - Rs. 27.17 million / 6

Windfall Income = Rs.12 million - Rs. 4.53 million

Windfall Income = Rs. 7.47 million

Therefore, the company's windfall income for tax year 2022 will be Rs.7.47 million and additional tax payable will be Rs. 2.99 million (Rs. 7.47 x 40%)

## WINDFALL TAX | A NON-STARTER

### 3. POINTS TO PONDER:

- As per section 99D(3), the Federal Government is required to place the notification before National Assembly latest by 19th February 2024, whereas, the National assembly is not expected to be constituted by then even if the general elections are carried out as per schedule. The due date of payment seems to be fixed without any critical thinking and in haste. The said Notification would also become invalid if not approved by the National Assembly by 19th February, 2024 as per section 99D(3) and Article 142 of the Constitution of Pakistan 1973 (“the Constitution”).
- Another possible issue that may be subject to litigation is the retrospective application of Section 99D, as it may unlawfully vitiate past and closed transactions and the aggrieved persons may rely upon the judgement of the Hon’ble High Court of Sindh in 2011 PTD 1558.
- The normal tax rate for banking companies is 39% for tax year 2023 (35% for 2022), whereas, the banking companies are also subject to 10% Super tax year for Tax Year 2023 (4% for tax year 2022). This means a banking company will be subjected to 89% tax in case of its forex income in tax year 2023 (79% for tax year 2022). This 89% still does not include the effect of administrative expenses (which may be 20-25% of the income) incurred by the banks, which if accounted for, may make it virtually a confiscatory taxation and it may also lead to litigation by the aggrieved persons.
- To calculate the windfall income, only one factor (i.e. currency fluctuation) has been incorporated, while other factors (such as economic growth and inflation) which may have an adverse impact on the overall income of the banks, have not been incorporated.
- The formula for calculation of average foreign exchange gain for tax year 2023 excludes the windfall income of tax year 2022. This seems counter logical as on the one hand the banks will pay additional tax of 40% on windfall income of tax year 2022, while on the other, the same windfall income will reduce the average foreign exchange income which will in turn increase the windfall income for tax year 2023.

### DISCLAIMER

*This publication is the property of Tola Associates and Tola & Tola and contents of the same may not be used or reproduced for any purpose without prior permission of Tola Associates and Tola & Tola in writing.*

*The contents of this publication may not be exhaustive and are based on the laws as of date unless otherwise specified. Tax laws are subject to changes from time to time and as such any changes may affect the contents.*

*The comments in the publication are a matter of interpretation of law and is based on author's judgments and experience, therefore, it cannot be said with certainty that the author's comments would be accepted or agreed by the tax authorities. Furthermore, this publication does not extend any guarantee, financial or otherwise. Tola Associates and Tola & Tola do not accept nor assume any responsibility, whatsoever, for any purpose.*

*This publication is circulated electronically free of cost for general public to create tax awareness in the country.*