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TAX & CORPORATE ADVISORS

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TAXPAK

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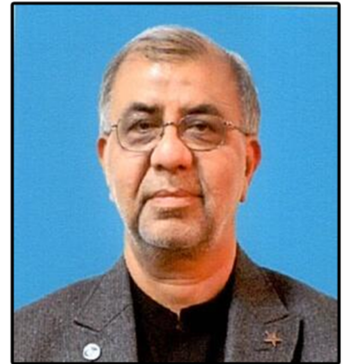
Chairman's Message



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. Alhamdulilah, 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. Moreover, Notifications from the corporate regulatory body i.e., SECP are also discussed. As our main aim is to keep the masses updated regarding the developments in the Pakistani tax law, we usually discuss a (relatively) recent judgement passed by the courts of law. This edition of TaxPak consists a discussion of a judgment issued by the Appellate Tribunal Inland Revenue (Islamabad) in which it was held by the Hon'ble ATIR that the limitation is dependent upon the end of the financial year in which the return is filed irrespective of a special tax year or a normal tax year.

Towards the end of the newsletter, we have discussed our Topic of the month titled "Transfer pricing methods recommended by OECD guidelines and applicable provisions of the Income Tax Ordinance, 2001". The said topic provides an insight on the treatment and applicability of the transfer pricing methods and their legal modalities in Pakistan as per the provisions of th Income Tax Ordinance 2001.

All our readers are requested to visit our website www.tolaassociates.com , or download our mobile application in order to access previous published editions of 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,
Ashfaq Yousuf Tola - FCA,
Chairman
Tola Associates.

Income Tax Notifications:

1. Draft rules for Real Time Access to Information and Databases

The FBR, vide SRO 1771/2023, dated 5th December 2023 ("said Notification"), issued draft amendments to the Income Tax Rules, 2002 ("ITR"). Through the said Notification, a new Chapter is proposed to be inserted namely: "Real Time Access to Information and Databases".

The new rules shall apply to organizations enumerated in the Table of the said Notification who shall provide real time access to information and database directly to the Board through a software called Real-time accessed data analysis repository or RADAR.
For further reading: FBR

2. Amendments to the Income Tax Rules, 2002 with respect of licensing for Online Integration of Tier-1 Retailers

The FBR, vide SRO 1845(I)/2023, dated 22nd December 2023, issued draft amendments to the Income Tax Rules, 2002 whereby rules and procedures with respect to integration of Electronic Fiscal Devices were made. Furthermore, methodology of application for grant of license was also laid down such as the FBR shall determine accreditation of the brand, model and specification of the electronic fiscal device, which means a system composed of one sale data controller and at least one Point of Sale connected together.
For further reading: FBR

3. Further amendments to the Income Tax Rules, 2002 regarding rules pertaining to Synchronized Withholding Administration and Payment Software (SWAPS)

The FBR, vide SRO 1846(I)/2023, dated 22nd December 2023, issued draft rules pertaining to "SWAPS" which included rules regarding registration, obligations, payment receipts and consequences of non-compliance.
For further reading: FBR

Sales Tax Notifications:

1. Amendments in the Sales Tax Rules, 2006 for online integration of tier-1 retailers

The FBR, vide SRO No. 1775(I)/2023, dated 7th December 2023, issued further amendments to the Sales Tax Rules, 2006 whereby, the integrated suppliers are required to notify FBR through the computerized system in real time the name, address, branch name, registration date, NTN and other information. The said SRO also requires the suppliers to make sure that the POS system does not issue temporary or draft invoices through the POS system and a proper debit/credit note is issued by the system.

For further reading: FBR

2. Specification of the persons who shall mandatorily issue electronic sales tax invoices

The FBR vide SRO No. 1525-DI/2023 dated 12th December 2023, notified the following registered persons to comply with the issuance of electronic sales tax invoices between buyers and sellers:

a. All importers and manufacturers of fast moving consumer goods;
b. All wholesalers (including dealers), distributors of fast moving consumer goods;
c. All wholesaler-cum-retailers engaged in bulk import and supply of fast moving consumer goods on wholesale basis to the retailers.

Furthermore, the Notification also explained the meaning of a fast-moving consumer goods.

For further reading: FBR

3. Further amendments to the Sales Tax Rules, 2006 for the integration and licensing of Tier-1 Retailers:

The FBR, vide SRO 1788(I)/2023, dated 11th December 2023, made amendments to the Sales Tax Rules, 2006 whereby it has been mandated that the integration of the software of registered persons will be done through licensed software providers only. The said Notification also provides that every payment counter will be integrated with the FBR through the licensed system. Furthermore, documentations for registration have also been enumerated for this purpose.

For further reading: FBR

4. Threshold for 236G/236H retailers to be treated as Tier-I retailers set at Rs 100,000/-

The FBR, vide SRO No. 1842(I)/2023, dated 21st December 2023, issued amendments to the Online Integration of Tier-I Retailers whereby a retailer whose deductible withholding under sections 236G or 236H during the last 12 consecutive months exceeds Rs 100,000/- shall be subject to the provisions and rules as applicable to Tier-I Retailer.

For further reading: FBR

5. Positive list of input, goods &services for each sector for Input Adjustment

The FBR, vide Circular No. C.NO. 1(98)ST-L&P/2023/188987-R, dated 14th December 2023, issued a positive list of input, goods and services which would be allowed to claim for input tax on raw materials from the following sectors:

- **a. Weaving;**
- **b. Dyeing and printing;**
- **c. Steel melters/ rerollers;**
- **d. Oil and ghee**
- **e. Chemicals;**
- **f. Cement;**
- **g. Lead & batteries; and**
- **h. Paper and paper board.**

It is pertinent to mention that the circular was issued as a draft for 7 days before attaining finality, but since it is no more available on FBR's website, the link could not be inserted.

Corporate Notifications:

1. Amendments to the Futures Brokers (Licensing and Operations) Regulations, 2018

The SECP, vide SRO No. 1819(I)/2023, dated 13th December 2023, issued amendments to the Futures Brokers (Licensing and Operations) Regulations, 2018 which had earlier been published vide SRO No. 1350 (I)/2023 dated 19th September 2023, whereby, requirements and eligibility of Agri-only category of futures brokers and minimum net worth requirements for each category was established.

For further reading: SECP

2. Categorization of Open-End Collective Investment Schemes (CIS)

The SECP, vide Direction No. 17 of 2023, dated 06th December 2023, allowed Money Market Schemes to invest in Government Debt Securities with a maturity exceeding 6 months and up to 1 year for a period of 12 months form the date of publication subject to certain conditions.

For further reading: SECP

3. FAQs on Category-wise voting for the election of directors

The SECP issued FAQs on category-wise voting for the election of directors whereby the concept of election, protection of minority shareholders rights, disclosures were explained.

For further reading: SECP

CASE LAW: THE LIMITATION IS DEPENDENT UPON THE END OF THE FINANCIAL YEAR IN WHICH THE RETURN IS FILED IRRESPECTIVE OF A SPECIAL TAX YEAR OR A NORMAL TAX YEAR

INTRODUCTION:

The Appellate Tribunal Inland Revenue-Islamabad ("ATIR") was moved by M/s. Sprint Oil and Gas Services Islamabad ("Appellant") against The Commissioner Inland Revenue LTO, Islamabad ("Respondent") in respect of limitation for passing an order in terms of section 122 (2) and (4) of the Income Tax Ordinance, 2001 ("ITO"), and claim of initial depreciation allowance under section 23 of the ITO

BRIEF FACTS OF THE CASE:

The Appellant, engaged in the business of oil field services in Pakistan, had filed return of income for the tax year 2015 which constituted a deemed assessment order in terms of section 120 (1) of the ITO. Subsequently, it was observed that such deemed assessment was erroneous as well as prejudicial to the interest of revenue necessitating amendment under section 122(5A) of the ITO. Resultantly, the deemed assessment was amended under section 122(5A) of the ITO. However, further examination revealed that such an amended assessment was still erroneous as well as prejudicial to the interest of revenue. In light of the above, a show-cause notice was issued on 29.04.2022. Following which, the appellant filed a reply/rebuttal where in the legality of the proposed invocation of section 122(5A) of the ITO was challenged on the basis of exhaustive arguments. However, despite the contention, the proceeding was finalized and the order was passed under section 122(5A) of the ITO against the Appellant resulting in a tax demand.

Following which, an appeal before the Commissioner Inland Revenue (Appeals), Islamabad, ("CIRA") was filed which, was again unsuccessful. Thereby, being aggrieved of the decisions passed by the earlier authorities, the Appellant approached the ATIR for adjudication against the matter in question.

ARGUMENTS BY THE APPELLANT:

The Appellant contended that the original amended order passed under section 122(5A) was illegal and void ab-initio as the order of delegation of powers to the assessing officer issued by the concerned Commissioner IR under the provision of section 210 of the ITO was neither notified in the official gazette nor was it available on the web portal of the FBR. They further contended that the limitation provided in clause (b) of sub-section (4) of section 122 of the ITO had become barred by time. In addition, thereto, the Appellant argued that in aggregate five-year period had been provided for amendment of deemed/amended assessment from the end of the financial year in which the deemed order was passed or amended order was issued by the Commissioner. The Appellant stressed that the words "within the later of" was used implying that the limitation was for five years only and not more than that. On merits, the Appellant stated that both the authorities had erred in law by disallowing initial depreciation.

ARGUMENTS BY THE RESPONDENT:

The Respondent contended that the present action taken by the assessing officer was very much within the limitation period. He further submitted that the department had the authority to amend an assessment within a period of five years plus one year, which was exactly what the department did and thus the action of the department was in accordance with the law.

The respondent also stated that the issue confronted to the Appellant was raised for the first time and that the legislature had given full powers to the department to amend the assessments, within the limitation period, as many times as deemed necessary and the impugned amended order had been issued within the limitation provided under the law, therefore, the submission of the Appellant was incorrect and that the CIR(A) had passed a speaking order and there was no infirmity in the impugned order.

FINDINGS OF THE ATIR:

The Hon'ble ATIR while considering the arguments submitted by both parties, determined the following questions raised during the course of hearing, which are as follows:

i. Whether the recent judgment delivered by the Hon'ble Supreme Court in the case titled Ajmal Ali Sheraz, M/s Sheraz Restaurant, Peshawar and another Vs CIR, Zone-1, RTO, Peshawar bearing CA No.51 of 2020 dated 03.10.2020 read with review petition filed by the department in the said appeal reported in 2023 SCP 299 would apply in pending cases with retrospective effect?

The ATIR found that this contention was without force because firstly, the Supreme Court did not give any such ***direction as it was merely an expectation and a good practice*** if followed for future purposes without stating any penal consequence. The ATIR also held that words "direct" and "expect" were neither interchangeable nor cut from the same cloth. Secondly, the delegation was declared invalid by the Supreme Court for the reason that there was no delegation of power by CIR to DCIR with respect to the amendment of assessments under section 122 of the ITO, which was not applicable in the instant case. In the case of PMDC v. Muhammad Fahad Malik, (2018 SCMR 1956), it was held that the judgment of the Supreme Court operated prospectively unless expressly declared to be retrospective. There was no direction given by the Supreme Court with retrospective effect. Based on this expectation, if order and proceedings are annulled, it would lead to large-scale evasion of tax for instance, various cases would become time-barred if show-cause notices are annulled on this score. Such a consequence is neither stated n o r intended in the judgment of the Supreme Court. It is a well-settled principle of law that any interpretation that leads to large-scale evasion of tax has to be avoided. Hence, the ATIR held that the contention is without force and the ratio decidendi of the above case does not apply to the facts and circumstances of this instant case.

ii. Whether under the facts and in the circumstances of the case, the period of limitation prescribed in subsections (2) and (4) of section 122 of the ITO would start separately in respect of the taxpayers having a special tax year or normal tax year, as the case may be?

In response to the above query, the Appellant submitted that the taxpayer followed a special tax year commencing on 1st January and ending on 31st December, therefore, it was submitted by the counsel for the Appellant that the time limitation for passing an order would be considered according to Special Tax Year or transactional year commencing during the financial year. It was further submitted that the order passed by the Respondent in this instant case followed by normal tax year, which was time barred. The ATIR also held that they were not impressed with the submissions of the appellant. Moreover, the ATIR observed that the expression "Financial Year" had not been defined in the ITO. However, as per the scheme of the ITO the "Financial Year" meant that the year beginning on the 1st July and ending on the 30th June of the next following year (which is the financial year in common parlance). A similar definition of the "Financial Year" had been given in section 2(19) of the General Clauses Act, 1897. Thus, the starting point of the limitation is the end of the tax year or the income year to which it related. Hence, the limitations stated under the said section was dependent on the tax year or income year. In subsections (2) and (4) of section 122 ibid the period begins from the end of the financial year in which the Commissioner had issued or had treated as having issued the original assessment order to the taxpayer while in sub-section (4)(b) the period of one year begins from the end of the financial year in which the Commissioner issues or is treated as have issued an amended assessment order. Thus, the starting point of the limitation in the said provision was the end of the financial year in which the taxpayer filed the return of income. Therefore, it was held that the limitation is dependent on the end of the financial year in which the return is filed irrespective of the fact whether the taxpayer follows a special tax year or a normal tax year. The ATIR further held that it was a settled law that a definition in a statute is declaratory through the definitions provided for in the definition clauses are to be read into the provisions of the ITO while interpreting the defined terms/words, if the contents of the provisions of the ITO indicate otherwise, the definition clause cannot override the main provision of the statute. Thus, the limitations prescribed in subsections (2) and (4) of section 122 have no concern with the tax year whether the taxpayer follows a special tax year or a normal tax year.

iii. Whether under the facts and in the circumstances of the case, the impugned order passed by the assessing officer on 24.06.2022 is barred by limitation as provided under subsection (4) of section 122 of the ITO?

Regarding the question raised above, the ATIR held that the contention of the Appellant was misconceived inasmuch as Section 122(4) ibid provides for two different situations i.e., in respect of amendment of an original assessment order, and further amendment of an amended assessment order, with a further rider by using the word "within the later of". Hence, the limitation of (6) six years in aggregate for making amendments to the assessment order and further amendments as many times as may be necessary, and the period of six years was to be counted from the end of the financial year in which a return had been filed and in this case the return is for the tax year 2015, therefore, the five year period would start from 01.07.2016 to 30.06.2021 and thereafter, from 01.07.2021 to 30.06.2022 and therefore, the impugned amended order dated 24.06.2022 is well within the period of limitation. Thus, the impugned amended order was passed well within the time. Section 122(4) (a) and (b) are distinct and separate and apply to two different sets of situations i.e., amendment of the original assessment order and amendment of an amended assessment order. The argument of the learned counsel for the appellant taxpayer is misconceived and is a result of a misreading of the legal provision. The language of section 122(4)(a) and (b) is clear and unambiguous. Both timelines deal with different periods of limitation for amendment(s) in assessment orders. The only difference is that both timelines have a different reference/starting point for calculating the period of limitation. In subsection (a) the period begins from the end of the financial year in which the Commissioner has issued or has treated as having been issued the original assessment order to the taxpayer while in sub-section (b) the period of one year begins from the end of the financial year in which the Commissioner has issued or has treated as having been issued amended assessment order. The importance of the term "later of" needs to be underlined. This term indicates that both the timelines under subsections (a) and (b) are available to the revenue department and the department has the option to place reliance on the timeline which expires later in time. It is settled that while interpreting the law, a specific provision of any statute, which is independent in nature, cannot and should not ordinarily be held to be redundant, especially on the touchstone of another independent provision of the same statute; rather all possible efforts should be made to apply and adhere to the rules of purposive and harmonious construction so that the allegedly conflicting provisions should be reconciled and saved.

iv. Whether the appellant was entitled to claim initial depreciation allowance under section 23 of the ITO?

In this regard, the ATIR held that the provision of section 23(1) was used to determine when an asset becomes eligible for deduction of initial allowance. It established that the starting point for calculating the initial allowance was with the use of the asset in business activities as defined in section 2(10) of the ITO. The intention of the legislature was to ensure that businesses could account for the tax impact of their investments in assets when those assets were actively contributing to the operation of the business or production. The initial allowance was an incentive to encourage the taxpayer but if the interpretation of the department were applied for section 23 of the ITO, it would deprive the investors from the incentive of initial allowance on investment in the IT assets for the purposes of a business in Pakistan and use it for the first time after it was purchased. Moreover, section 23(5) of the ITO provided only the assets for exclusion from the definition of the term "eligible depreciable assets". Thus, the computer hardware/allied items were included in the definition of the term "eligible depreciable assets", therefore, the appellant was entitled to claim an initial allowance under section 23 of the ITO. In accordance with the principles of interpretation of fiscal statutes, as established by the Supreme Court of Pakistan as well as the High Courts. The ATIR was of the opinion that the plain language of section 23 of the ITO, when read in its entirety and in conjunction with the words/phrases used therein, the provision, of section 23 did not exclude from its preview, the plant & machinery, computer hardware/equipment if purchased by the person in a tax year in Pakistan for business purposes and place into service for the first time in a tax year. It is also well settled that if the provision resulted to two or more interpretations, then the one which favors the taxpayer would be adopted. Resultantly the ATIR held that both the authorities below had erred in law in disallowing the initial allowance under section 23 of the ITO. Therefore, the answer to the above question is in the affirmative in favor of the appellant.

Topic of the Month: Transfer pricing methods recommended by OECD guidelines and applicable provisions of the Income Tax Ordinance, 2001

INTRODUCTION:

This month's edition brings a brief insight on the issue of transfer pricing methods that are recommended by OECD guidelines and their application under the ITO. There are many methods of transfer pricing out of which some have been recommended by the Organization for Economic Co-operation and Development ("OECD"). However, we will primarily discuss about those methods which are acceptable to the tax authorities in Pakistan.

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Transfer pricing in case of intra-group transactions includes payments for intra-group services by one and intra-group transfers of technology by the other. For instance, in multinational groups, receipts from end-sales of the Group products are directed to provide a contribution to the other members in exchange for the contributions made by their activities to sell the product to 3rd parties, for instance offsetting sales with research and development of the other.

Where two or more countries are involved, problems of double taxation may also arise or tax authorities may consider the transfer price unreasonable. To curb these issues, the OECD has issued guidelines which provide a comprehensive framework on the relevant issues and adjustment of profits in controlled transactions.

ARM'S LENGTH PRINCIPLE:

A transaction made at Arm's length means that the business transaction is conducted in a formal manner without doubting the other's fairness or integrity, and without being subject to the other's control. It is difficult to apply this method in multinationals carrying business in specialized nature, such as unique ornaments, pharmaceuticals products, chemicals etc.

In these scenarios, it is exceedingly difficult to assess the value which would be treated as arm's length therefore, a flexible approach is required to be implemented. However, for others, there are many methods used to establish whether arm's length principle was applied or not. Out of the many options set out, the most common OECD and Tax authorities' approved practices have been elaborately discussed below.

METHODS ESTABLISHED BY THE OECD AND TAX AUTHORITIES FOR ARRIVING AT ARM'S LENGTH PRICES

1. Comparable uncontrolled price method ("CUP"):

The method compares the prices charged in comparable transactions between independent parties. In simpler words, "controlled transaction" means a transaction between associates while an uncontrolled transaction means a transaction between persons who are not

a. None of the differences between the transactions being compared or between firms undertaking the transactions could materially effect the price in the open market; or
b. Reasonably accurate adjustments to eliminate the material effects of such differences can be established.

This method determines whether the amount charged in a controlled transaction gives rise to an arm's length result by reference to the amount charged in a comparable uncontrolled transactions.:

2. Resale or resale-minus method:

This method subtracts a margin from the price charged to an end consumer by an independent third party.

Procedure:

- Price of the product is established by assuming that the product was purchased from an associate and is now sold to a person who is not an associate;
- From this end consumer price, a gross margin is then subtracted which would represent the amount that covers the person's selling and other operating expenses while taking into account the assets used and risks assumed resulting to an appropriate profit;
- Then, any other costs associated to it is subtracted and the residual amount is treated as an arm's length purchase price.

3. Cost-based method including cost-plus method:

This method identifies whether the amount charged in a controlled transaction gives rise to an arm's length result by reference to the cost plus markup realized in a comparable uncontrolled transaction.

Procedure:

- Cost incurred in the controlled transaction is determined;
- A markup is applied consistent with the market fluctuations and conditions;
- Both of the above values are then added up to derive the amount of value which would be considered as arm's length.

In easier terms, it means an addition of margin to the costs of producing the relevant goods or services.
The cost plus mark up of a person in a controlled transaction may be determined by comparing it with either:-

- The cost plus markup that the person earns in a comparable uncontrolled transaction; or
- The cost plus markup that an independent person earns in comparison to an uncontrolled transaction.

4. Transactional Profit Methods: (Profit split method and transactional net margin method)

This method is only applied where transactions are interrelated to the extent that the arm's length result cannot be determined on a separate basis. Basically, the purpose of this method is to look at how two companies would share profits if they were separate and independent, just to ensure that the transactions between them are fair and unbiased. While looking at the taxability of this method, the Commissioner may determine the division of profits on the basis of a contribution analysis, a residual analysis or on any other basis as appropriate having regard to the facts and circumstances. Under a contribution analysis, the total profits from controlled transactions are divided on basis of the relative value of the functions performed by each person participating in the controlled transactions, while under a residual analysis, the total profits from controlled transactions are divided in the following manner:

- Each person is allocated sufficient profit to provide the person with a basic return (figured out by looking at how other independent persons are doing with similar transactions) appropriate for the type of transactions in which the person is engaged; and
- The profit remaining after this allocation is then allotted between the number of persons.

Transfer pricing in Pakistan

If business transactions between a resident and non-resident person are not on arm's length basis and such transactions result in diversion of business profits to the non-resident, then as per the Income Tax Ordinance, 2001 ("ITO"), the tax authorities are empowered to recompute the profits in a manner that these reflect the correct profits due to the resident person. For example, to establish that the transaction was not based on arm's length, in the CUP method, the tax officer shall compare the relevant financial and commercial transactions before attaining finality that the transactions between the two associates was not at arm's length. In Pakistan, under the ITO, the tax authorities prefer the following methods based on the opinion of the Commissioner:

a. CUP method;
b. Resale price method;
c. Cost plus method;
d. Profit split method.

However, it should be noted that the profit split method would only be applied if the first three could not be applied.

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