TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

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TAXPAK

Newsletter by

Tola Associates

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CONTRIBUTORS

Mr. Muhammad Furqan ACA
Head of Editorial Board

Mr. M.Amayed Ashfaq Tola
Co-Head of Editorial Board

Mr. Rahool Roy
Contributor

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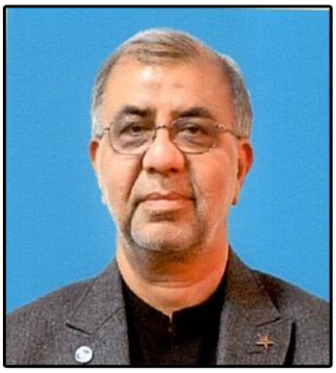

Asalam-o-alaikum everyone! Hope this monthly issue of TaxPak finds you in good spirits and immaculate health! We welcome you to another edition of TaxPak, our monthly publication the purpose of which is to provide a monthly update on the ongoing tax related developments in Pakistan. Alhamdulilah, so 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 two judgments. The first one has been passed by the Hon'ble Appellate Tribunal Inland Revenue-Peshawar regarding recharacterization of transaction and applicability of section 161 of the Income Tax Ordinance 2001 ("ITO"), whilsr the other judgement was passed by the Hon'ble Lahore High Court regarding the applicability of the First Schedule of the ITO for computing tax on profits of Insurance businesses.

Towards the end of the newsletter, we have discussed our Topic of the month titled "Group relief under section 59B of the Income Tax Ordinance, 2001". The said topic provides an insight on the effect and criteria for surrendering tax losses by a subsidiary or holding company.

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.

FBR Notifications:

Income Tax Notifications

1. Notified CA Firms to be certifiers for completion of development projects

The FBR, vide SRO No. 399(I)/2024, dated 14th March 2024, notified that the Chartered Accountant firms, having a valid Quality Control Review (QCR) rating of "satisfactory" from the Institute of Chartered Accountants of Pakistan on and after 30th September 2023, shall be eligible to issue certificates of completion of development projects as provided under section 100D(3)(e)(ii)(B) of ITO.

For further reading: FBR

2. Introduction of SWAPS Rules by amendment in the Income Tax Rules, 2002

The FBR, through SRO No. 419(I)/2024 dated 21st March 2024, has made further amendments to Income Tax Rules, 2002 by inserting SWAPS Rules which shall be applicable to all SWAPS agents. Moreover, we have also issued a brief note on same which can be accessed from Note

For further reading: FBR

3. Amendments in the Income Tax Rules, 2002 regarding Online integration of businesses

The FBR, vide SRO 428(I)/2024, dated 22nd March 2024, made further amendments to the Income Tax Rules, 2002 which had been earlier published vide SRO No. 1845(I)/2023 dated 22nd December 2023, whereby rules regarding licensing and integration of online businesses with FBR's web portal were set out. Furthermore, 14 businesses, subject to certain exclusions, were notified to be registered with the FBR's POS integration, these have been listed herein below:

1) Restaurants;
2) Hotels, motels, guest houses, marriage halls, marquees, clubs, race clubs;
3. Inter-city travel by road;
4. Courier services and cargo services;

5) Services for personal care (beauty parlors, clinics, slimming clinics, massage and pedicure centers);
6) All medical service providers;
7) Pathological laboratories;
8) Private hospitals or medical care centers;
9) Health clubs, gyms, physical centers, swimming pools and clubs operated by any civilian/non civilian administration;
10) Photographers, videographers, and event managers;
11) Chartered Accountants and Cost and Management Accountants;
12) Retailers including manufacturer cum-retailer, wholesaler-cum retailer, importer-cum retailer or such other person who combines the activity of retail sale with another business activity.;
13) Foreign exchange dealers/companies;
14) Private schools, colleges, universities, professionals/ vocational centers.

For further reading: FBR

4. Introduction of Draft Tajir Dost Scheme, 2024

The FBR, vide SRO. 420(I)/2024 dated 21st March 2024, issued a draft special procedure for small traders and shopkeepers and titled the scheme as the "Tajir Dost Scheme". Under this scheme, small traders and shopkeepers were provided with a scheme to have themselves registered by 1st April 2024 and commence paying monthly advance tax from 1st July 2024. We have also issued a brief note in this regard, and can be accessed through Note

For further reading: FBR

5. Tajir Dost (Special) Procedure, 2024

The FBR, vide SRO 457(I)/2024 dated 30th March, prescribed special procedures for small traders and shopkeepers by the title of "Tajir Dost (Special) Procedure, 2024. This was earlier published through SRO 420(I)/2024 dated 21st March 2024.

For further reading: FBR

Sales Tax Notifications

1. INTRODUCTION OF A SINGLE SALES TAX RETURN FOR THE TELECOM SECTOR

The FBR and Provincial Tax Authorities have earlier introduced a Single Sales Tax Return (SSTR) for the telecom sector to simplify business, reduce compliance costs, and facilitate taxpayers. The SSTR was developed after negotiations with the FBR, Provincial Revenue Administrations, and the sector. The FBR is now requesting intimation of any proposed changes to the legislative framework for the SSTR to the Design Development & Implementation Committee.

For further reading: FBR

2. STANDARD OPERATING PROCEDURE FOR DISPOSAL OF CASES OF CONDONATION OF TIME LIMIT UNDER SECTION 74 OF THE SALES TAX ACT. 1990.

The Board vide Circular No.3(I)/ST&FE/MISC/2023/42611-R, dated 04th March 2024, has prescribed a procedure for requesting condonation of time under section 74 of the Sales Tax Act, 1990. The registered person must apply to the Commissioner Inland Revenue, specifying the grounds for delay. If the request is received directly in the board, the matter shall be forwarded to the Commissioner Inland Revenue. After considering the grounds and information, the Commissioner Inland Revenue will send categorical recommendations to the Board. The Board will then examine the request and recommendations, deciding on approval or rejection of the request. This circular superseded Sales Tax Circular No.02 of 2020/IR Operations.
For further reading: FBR

3. IMPOSITION OF 25% SALES TAX ON IMPORT AND SUPPLY OF LUXURY VEHICLES

The FBR, vide SRO No. 370(I)/2024, dated 08th March 2024, has made amendments to the earlier issued S.R.O. 297(I)/2023, dated 8th March 2023, whereby, the following vehicles shall be subject to imposition of 25% sales tax on import and supply:

- Locally manufactured or assembled vehicles having engine capacity of 1400cc and above.
- Locally manufactured or assembled vehicles if invoice price (excluding sales tax) exceeds Rs. 4 million.
- Locally manufactured or assembled double cabin (4x4) pick-up vehicles.

For further reading: FBR

4. Amendments to the Sales Tax Rules, 2006

The FBR, vide SRO No. 350(I)/2024 dated 7th March 2024, issued amendments to the Sales Tax Rules, 2006, wherein rules for registration, temporary registration, and electronic filing of sales tax returns for every individual, member of an AOP, or a Single Member company was made, some have been listed below:

a. Annual Biometric verification/re-verification in July in order to file their monthly sales tax returns;
b. That the monthly sales tax returns would be accompanied with a balance sheet showing assets, bank balances, and amounts attributable to partners with the percentage.

c. Where sales declared is 5 times more than the declared business capital, then the prior authorization of the Commissioner through IRIS is required; and
d. Rules with respect to issuance of debit/credit note and destruction of goods.

For further reading: FBR

Corporate Notifications

1. Amendments to the Companies (Further Issue of shares) Regulation, 2020

The SECP, vide SRO 361(1)/2024 dated 4th March 2024, issued a notification whereby in addition to general conditions, the board of directors before announcing right issue shall comply with additional procedures. For instance, ensuring that the sponsor/promoter/substantial shareholders and directors do not owe any overdue from the Credit Information Bureau, that the sponsors shall retain their entire shareholding for one year or completion of project whichever is later and more detailed procedures.

For further reading: SECP

2. CLARIFICATION REGARDING THE POWERS OF THE COMMISSION TO CALL OVERDUE GENERAL MEETINGS

The SECP, vide Circular No. 07/2024, dated 7th March 2024, clarified that an application intimating the Commission for its powers to call overdue general meetings, will not be entertained if it has been filed by or on behalf of the company and that it should be filed by an aggrieved member/director in his own capacity along with proper justification and documentary evidence.

For further reading: SECP

3. GUIDELINES FOR NBFCs ENGAGED IN DIGITAL LENDING

The SECP, vide Circular No. 08 of 2024, dated 12th March 2024, issued guidelines for NBFCs engaged in digital lending whereby, guidelines with respect to advertisement and call center management were elaborated ensuring that clarity, transparency, and non-discriminatory practices were present in advertisement and respect, courtesy, oversight, and confidentiality were applied for call center management.

For further reading: SECP

4. Notification under section 17 of the Companies Act, 2017

The SECP, vide SRO 464(I)/2024 dated 15th March 2024, notified that all moneys payable by the subscriber to the Memorandum and Articles of Association shall be payable in cash, through banking channels within 30 days from the incorporation, following which the companies shall proceed to issue physical share certificates/ book entry with the central depository. Moreover, the company shall intimate the registrar within 30 days of incorporation of the subscriptions.
For further reading: SECP

5. INTIMATION TO THE REGISTRAR ON TRANSFER OF SHAREHOLDING BELOW 25%

The SECP, vide Circular No. 9/2024, dated 22nd March 2024, issued a circular whereby a company other than a listed company may intimate the registrar about any change of 25% or less in its shareholding/ membership/voting rights through Form 3. This was issued to curb difficulties faced in reporting transfers of shareholding below the stipulated threshold.
For further reading: SECP

Case Law: The Hon'ble ATIR elaborately explained / interpreted Section 161 of the Income Tax Ordinance, 2001 and decided whether recharacterization of transaction could be made based on the circumstances of the case at hand.

Introduction:

The Appellate Tribunal Inland Revenue, Islamabad ("ATIR") was moved by M/s Khyber Pakhtunkhwa Highway Authority (KPKHA) ("Learned Appellant") in ITA Nos. 19/PB/2023 & 20/PB/2023 for the Tax Years 2017 and 2018 against the orders passed by the Commissioner Inland Revenue, RTO, Peshawar ("Learned Respondent"). The Learned Appellant challenged the act of Recharacterization of transaction by the Assessing officer under section 161 of the Income Tax Ordinance, 2001 ("ITO").

Brief Facts of the Case:

The Learned Appellant was a corporate body established in 2001 engaged with the construction of road highways in the KPK Province. The Appellant in partnership with the Frontier Works

Organization (FWO), constructed the Swat Expressway (Phase-I) under the Public Private Partnership Act, 2014 ("PPP"). The assessing officer observed that minor withholding default under section 153 of the ITO had been made, and decided to recharacterize a transaction of investment.

The transaction represented Appellant's shares in Swat Expressway Planning Construction and Operations (Pvt.) Ltd ("SEPCO"), a company separately incorporated under the PPP arrangement. The assessing officer did not accept the explanations of the Appellant and passed orders under sections 161/205 of the ITO for the tax years 2017 and 2018. It also held that the withholding agent was liable in default for the alleged non/short deduction/payment of taxes as required under various provisions of the Ordinance. Furthermore, the Orders accompanied with a levy of default surcharge under section 205 of the ITO. Thereafter, the Appellant filed an appeal against these Orders before the learned Respondent who confirmed the Orders passed at the assessment stage. Being aggrieved and dissatisfied of the said Order, the Appellant preferred an appeal before the Hon'ble ATIR, Islamabad.

Arguments by the Learned Appellant:

The Learned Appellant argued that the Learned Respondents erred in confirming the treatment accorded by the assessing officer for re-characterizing the transaction of investment under section 161 of the ITO, as the entire proceedings were out of the mandate of section 161. It was contended that no specific notice under section 109 of the Ordinance was served upon the Appellant, which was a pre-requisite for the initiation of proceedings. Moreover, it was argued that no independent Order was framed for the re-characterizing transaction of investment under section 109. Furthermore, it was also contended that the assessing officer had ignored the exemption certificates claimed by recipients for payments made to PESCO, PTCL, and others under section 153 of the ITO, and that default surcharge could not be levied in terms of 161(1B) as all the recipients were in fact NTN holders and had been filing their income tax returns, which meant that the primary liability to pay tax deducted was on the person from whom it was being deducted. Moreover, the final determination of liability was governed by various provisions of the ITO thus, the Appellant's liability was only secondary and vicarious, and that the power to take action under section 161 could not be open-ended and without limit, as per section 24-A of the General Clauses Act, 1897.

Arguments by the Learned Respondent:

The Learned Respondent argued that the Appellant was informed of tax avoidance during the release of funds to SEPCO under section 161 of the Ordinance. They also argued that the ITO had an overriding effect on the KPK PPP Act, 2014, and that the transaction could be recharacterized.

under section 109 of the ITO. The learned Respondents relied on minutes of a meeting chaired by the Chief Minister, Chief Secretary, and Secretary of Finance, which pointed out that the revenue department could recharacterize the equity financing transaction. It was further contended that the Appellant had failed to withhold tax under section 161(1B), and therefore, they could not claim the benefit of the section.

Decision of the Hon'ble ATIR:

The Hon'ble ATIR, Islamabad held that the orders of both the authorities below were void and illegal and that the appeal of the Appellant was allowed. Further, the revenue authorities were directed to refund the amounts recovered from the Appellant within 15 days of the Order. The Hon'ble ATIR, while deleting the alleged default, also found that the assessing officer had erred in computing the default surcharge as default surcharge had been charged on those companies as well who already had exemption from section 153(1)(a)/(c).

The findings were broken down into two parts:

(a) Applicability and scope of section 161;

While placing reliance on the judgements 2014 PTD 1939, 395 ITR 734 and various others, the Hon'ble ATIR held that section 161 provided the consequences of failure to collect or deduct taxes and also consequence where tax had not been deposited. Hon'ble ATIR held that:

1) In cases of short deduction, the assessing officer was empowered to collect the appropriate amount from the recipient or payee of income, not from the payer.

2) If the payer did not deduct tax or fails to pay to the Government treasury, then he would be deemed to be a taxpayer in default and provisions of penalty and default surcharge would apply accordingly and would resultantly face consequences as prescribed in the ITO. However, it remains payable by the recipient or payee directly.

3) Where the assessment of the recipient had already been made and tax was accordingly fully paid by him, then in this case, the assessing officer shall lack jurisdiction to demand further tax.

Therefore, the Hon'ble ATIR, while placing reliance on the judgement titled CIT vs Sahara India Commercial Corporation Ltd (395 ITR 734), held that in order to declare that the payer / deductor had failed to deduct tax (that the taxpayer is in default), it should be evident that the payee (recipient of the monies, i.e the service provider) had failed to pay the tax directly. Vice versa, where no tax was deducted but the payee/recipient paid tax on the income earned, then no tax

could be recovered again from the payer / deductor. Nonetheless, default surcharge shall still apply.

(b) Whether recharacterization of the transaction of the investments and tax liability determination invoking section 161 of the ITO were in place under these facts and circumstances.

The ATIR held that recharacterization of the transaction incurs only when assessing the normal income of the taxpayer and determining the tax liability thereon. It also held that companies against which the Appellant allegedly failed to deduct or withhold tax were not questioned and that their returns submitted had been accepted (as no amendment of assessment orders against the submissions had been made), this meant that the department only took action from one party and not from the other (i.e. recharacterization of taxation was applied for the Appellant and not the companies against which default surcharge was applied). Furthermore, the Hon'ble ATIR held that the scope of section 161 was limited and that Chapter VIII of the ITO (Anti-Avoidance) was not applicable on section 161, as such the Appellant could not be treated as a taxpayer in default. Moreover, while placing reliance on the judgement titled Habib Bank Limited vs Federation of Pakistan (2013 PTD 1659), the Hon'ble ATIR held that nature of the transaction could not be ascertained in the proceedings under section 161 as it pertains to recovery in nature and is excercised only when tax recovery arises, and that section 161 was not a charging section (2003 PTD 1167). Furthermore, the Hon'ble ATIR also found that the entire proceedings were weak, as the withholding agent was neither a beneficiary nor granted an incentive for performing on behalf of the withholdee. Therefore, it was held that the recharacterization and imposition of taxation was invalid.

CASE LAW: THE COMPUTATION OF TAX LIABILITY ON INCOME OF INSURANCE BUSINESSES WILL HAVE TO BE MADE ON THE BASIS OF THE GENERAL PROVISION OF FIRST SCHEDULE.

INTRODUCTION:

The Hon'ble High Court of Lahore ("LHC") was moved by the Commissioner Inland Revenue ("Appellant") versus Security General Insurance Company Limited ("Respondent") in respect of applicability of provisions regarding the determination or computation of tax on profits and gains of insurance companies.

BRIEF FACTS OF THE CASE:

The issue involved in this case was that the insurance business companies have a special provision for computation of profits and gains in accordance with section 99 read with Rules in the Fourth Schedule of the Income Tax Ordinance, 2001 ("ITO"). The Learned Respondents challenged that the Fourth Schedule provides for computation of the profits and gains in accordance with terms of Rule 5 of the Fourth Schedule, and does not pertain to computation of tax liability. During the course of the hearings at the 2nd Appellate stage before the Hon'ble Appellate Tribunal Inland Revenue ("ATIR"), it transpired that the members of the Hon'ble ATIR had different opinions. Consequently, the matter was thereafter referred to a full Bench of Hon'ble ATIR, which concurred with the view given by the Supreme Court of Pakistan, reported as ***(1997) 76 Tax 213*** and Messrs. E.F.U. General Insurance Co. Limited v. The Federation of Pakistan and others ***(PLD 1997 SC 700)*** and held that these judgements squarely applied with the facts of the case at hand. Aggrieved of the said Order, the Learned Appellant filed an appeal / reference before the Hon'ble LHC.

ARGUMENTS BY THE LEARNED APPELLANTS:

The Learned Appellant contended that the judgment of the Supreme Court of Pakistan in EFU General Insurance was distinguishable as it was premised on the provisions of Income Tax Ordinance, 1979 and in particular Section 26(a) which provides that:

> ***"The profits and gains of any business of insurance and the tax payable thereon shall be computed in accordance with the rules contained in the Fourth Schedule."***

Moreover, the Learned Appellant contended that the aforesaid provision was in pari materia to Section 99 of the ITO with the only difference that the words ***"and the tax payable thereon"*** had been deleted from Section 99 of the ITO. Hence, the income of the taxpayers in these cases would have to be taken cumulatively and the computation of tax liability will have to be payable on the business of insurance as in accordance with the Fourth Schedule.

ARGUMENTS BY THE LEARNED RESPONDENTS:

The Learned Respondents contended that the Rule 5 of the Fourth Schedule dealt with the computation of profits and gains, and that the computation of tax liability was a completely different concept which was not covered under the Fourth Schedule. Since there were no provisions regarding payment of tax and its determination in the Fourth Schedule, as such, general provisions in the First Schedule would be applicable and that the taxpayers would be entitled to avail benefit regarding dividend income given in the First Schedule.

FINDINGS OF THE HON'BLE LHC:

The Hon'ble LHC, agreeing with the judgment passed by Full bench of the Hon'ble ATIR, held that since there were no provisions in Rule 5 regarding computation of tax on such income, the provisions of First Schedule would be applied and the benefit prescribed therein would be applicable to the case of insurance businesses as contended by the Learned Respondents. Although the current Section 99 did not contain the words ***"and the tax payable thereon"***, it was held that it would have created no difference had these words been mentioned therein, in that, at the relevant time to which these tax references relate there were no provisions regarding the tax payable on the business of insurance in the Fourth Schedule. Hence, insurance businesses would compute their tax liability on the basis of the general provision of First Schedule.

Topic of the Month: Group Relief under section 59B of the Income Tax Ordinance, 2001

Introduction:

Under the group relief option, the tax loss may be surrendered by either a subsidiary or a holding company in favour of the holding company, subsidiary company or another subsidiary of the holding company, as the case may be. This relief is eligible in case the holding company directly holds share capital of the subsidiary company in following manner:

1. If one of the companies in the group is listed in Pakistan – 55% or more shareholding; or
2. If none of the companies are listed – 75% or more shareholding.

Computation of loss:

The loss to be surrendered is computed as under, excluding brought forward losses and capital losses:

$$\frac{\%\ of\ share\ capital\ held\ by\ the\ holding\ company\ of\ its\ subsidiary}{100}\ x\ Assessed\ loss\ of\ the\ subsidiary$$

For example, if the holding company has 83% shares in the subsidiary, then it means that 83% of the assessed loss can be surrendered by that subsidiary.

This loss can be set off under the heading of "Income from Business" in the tax year and subsequent 2 tax years subject to the following conditions:

1. Ownership is continued for 5 years of share capital of the subsidiary company to the extent of 55% for listed and 75% for others;
2. A company within the group, is not engaged in the business of trading;
3. If the holding company is a private limited company, then it will gets itself listed within 3 years from the year in which loss was claimed;
4. The group companies are locally incorporated under the Companies Act, 2017;
5. The loss surrendered and claimed are approved by the Board of Directors of the respective companies;
6. The subsidiary company shall continue the same business during this 3 years period; and
7. All companies within the group shall comply with the corporate governance requirements as specified by the Securities and Exchange Commission of Pakistan ("SECP") from time to time, and are designated as companies entitled to avail group relief.

Furthermore, a subsidiary company shall not be allowed to surrender its assessed losses for set off against income of the holding company for more than 3 tax years. If a subsidiary company does not adjust income of the holding company within these 3 tax years, the subsidiary company shall carry forward the unadjusted losses in accordance with section 57 of the ITO.

Furthermore, the loss claiming company shall, with the approval of the Board of Directors, transfer cash to the loss surrendering company equal to the amount of tax payable on the profits to be set off against the acquired loss at the applicable tax rate. Moreover, transfer of cash would not be an allowable expense for the loss claiming company nor will it be a taxable income for the loss surrendering company.

In case transfer of shares between companies and the shareholders is made in one direction, it would not be taken as a taxable event provided that the transfer is to acquire share capital for formation of the group and approval of the SECP has been obtained in this effect. However, sale and purchase from third parties would be taken as a taxable event.

Situation where the holding company disposes of shares within 5 years:

If shares have been disposed of within or during the 5 year period, resulting to a decrease in the stipulated percentage of holding, the holding company shall, in the year of disposal, offer the amount of profit on which taxes have not been paid due to set off of losses surrendered by the subsidiary company.

Application for group relief:

An application for group relief shall be submitted by the taxpayer in the prescribed form declaring that it meets the criteria set out by the ITO (such as it has the required percentage, or companies within this group are not engaged in the business of trading, the BOD have approved the loss, and the transfer of cash to the loss surrendering company is equal to the amount of tax payable on the profit set off against the acquired loss etc.) and it shall be accompanied by a certificate from the SECP that corporate governance requirements have been met and that it has not violated any provisions of the ITO. It is pertinent to mention that the certificate shall be invalid in case any violation is committed by the companies after the date of issuance of this certificate.

DISCLAIMER