

Overview of Amendments of Certain Sections of The Income Tax Ordinance, 2001 (“ITO”) by Finance Act, 2025

Various sections have been introduced or amended by the Finance Act 2025, which is affecting businesses. We have explained a few of these for your perusal.

1) Disallowance of Business Expenditure - Section 21(s)

The Finance Act, 2025 has inserted a new clause (s) in Section 21 of the Income Tax Ordinance, 2001, which pertains to “Deductions Not Allowed.” The newly inserted clause reads as follows:

Quote

(s) fifty percent of the expenditure claimed in respect of sale where the taxpayer received payment exceeding two hundred thousand rupees otherwise than through a banking channel or digital means against a single invoice containing one or more than one transactions of supply of goods or provisions of services.

Unquote

This amendment disallows 50% of the claimed expenditure related to any sale where payment exceeding Rs. 200,000 is received in cash or through any mode other than banking channel or digital means, in relation to a single invoice, regardless of whether it includes one or multiple transactions for the supply of goods or services.

We understand that the disallowance will apply to expenditure related to sales, such as freight, carriage, commission, and other distribution-related expenses.

Example 1 (Below Threshold – No Disallowance):

A taxpayer sells goods worth Rs. 199,999 through a single invoice and receives the amount in cash. Since the payment does not exceed Rs. 200,000, no disallowance will apply.

Example 2 (Above Threshold – Disallowance Applies):

A taxpayer makes a sale of goods amounting to Rs. 200,001 through a single invoice and receives the payment in cash. Since the transaction exceeds the prescribed threshold of Rs. 200,000 and the payment is not made through a banking channel or digital means, 50% of the claimed expenditure related to such sale shall be disallowed under the relevant provision.

For instance, if the taxpayer has claimed Rs. 30,000 as expenditure directly attributable to such sale, Rs. 15,000 shall be disallowed.

It is important to note, however, that there is no prescribed method, ratio, or formula under the law to determine what portion of expenditure is “directly attributable to such sale.” This creates a significant ambiguity, as the FBR has no mechanism to assess which amount of expenditure

pertains specifically to sales made through invoices exceeding Rs. 200,000 with cash payments. Consequently, due to such ambiguity, taxpayers may argue that a low amount of directly attributable expenditure has been made for such sales to mitigate the impact of disallowance which can defeat the entire purpose of this amendment and may lead in a revenue loss for the exchequer.

Furthermore, individuals are under no statutory obligation to have their accounts audited by an auditor, and similarly, AOPs falling below the prescribed turnover threshold of Rs. 300 million are not legally required to undergo audit. This may lead to significant practical challenges in certifying expenditure attributable to sales.

This measure may prove counterproductive, as it could incentivize businesses to conceal such sales, thereby contributing to the expansion of the informal economy.

2) Disallowance of Business Expenditure - Section 21(q)

The Finance Act, 2025 has substituted clause (q) in Section 21 of the Income Tax Ordinance, 2001, whereby ten percent of the claimed expenditure attributable to purchases made from persons who are not National Tax Number (NTN) holders shall be disallowed. The newly inserted clause reads as follows:

Quote

(q) ten percent of the claimed expenditure made attributable to purchases made from persons who are not National Tax Number holders:

Provided that in case of purchase of agricultural produce this clause shall only apply to the purchase made from middle man:

Provided further that the Board may, by notification in the official Gazette, exempt persons or classes of persons from this clause subject to such conditions and limitations as may be specified therein; and

Unquote

An exception has been carved out for the purchase of agricultural produce, wherein the disallowance shall apply only to purchases made from middlemen, not directly from growers. Furthermore, the FBR is empowered to exempt any person or class of persons from the operation of this clause through a notification in the official Gazette, subject to specified conditions and limitations.

Example: If a textile manufacturer purchases raw cotton from a local grower with no NTN, the abovementioned clause does not apply. However, if the purchase is made from a middleman who is also not an NTN holder, 10% of the claimed expenditure will be disallowed.

The Finance Act, 2025 introduces a positive amendment by restricting the 10% disallowance to purchases from non-NTN holder middlemen of agricultural produce; however, it may be difficult for the FBR to accurately identify and verify such middlemen in practice.

Agricultural produce has not been expressly defined under the Income Tax Ordinance, 2001 or the Sales Tax Act, 1990. However, reference can be made to definitions provided under provincial laws for interpretative guidance.

In Punjab, agricultural produce is defined under Section 2(a) of the Punjab Agricultural Produce Markets Ordinance, 1978, which may be broadly classified into the following categories:

Agricultural Crops and Grains, Fruits and Vegetables, Livestock and Poultry Products, Tobacco and Related Products, Agricultural By-products etc.

For further insight: [Punjab Agricultural Produce Markets Ordinance, 1978](#)

In Sindh, the definition is provided under Section 2(a) of the Agricultural Produce Markets Act, 1939, which states:

“(a) ‘Agricultural Produce’ means agricultural or horticultural produce, livestock or poultry and products and bye-products thereof as specified by notification in the Schedule, provided that Government may, by notification in the official Gazette, add to or omit any agricultural produce or their bye-products specified in the Schedule.”

Therefore, it is evident from the above definitions that the term “*agricultural produce*” encompasses a broad and diverse range of items, including but not limited to grains, pulses, fruits, vegetables, cotton, oilseeds, dairy products, livestock, poultry, and their by-products.

Implications

There is a risk that the FBR may misconstrue purchases as business expenditure for the purposes of this provision. Such an interpretation would be legally flawed, as purchases form part of the cost of sales rather than deductible business expenditure under section 21. Any such misapplication could result in arbitrary disallowances and unwarranted tax exposure for taxpayers.

However, this interpretation has been expressly rejected by the Appellate Tribunal Inland Revenue in the case of *Messrs Quality Home (Pvt.) Ltd., Lahore v. Commissioner of Inland Revenue, R.T.O., Lahore* reported as **2012 PTD (Trib.) 1444**, wherein it was held that the provisions of section 21(1) are only applicable to the expenses made in profit and loss account and that the same cannot be invoked for the purpose of making addition on account of purchases.

Tuesday, July 8, 2025

The relevant excerpt of **2012 PTD (Trib.) 1444** is reproduced hereunder:

Quote

7. In the light of above clear-cut provisions of section 21(1) of the Ordinance as well as verdict given by this Tribunal in the above referred judgment dated 25-10 2010 we are also compelled to hold that the provisions of section 21(1) are only applicable to the expenses made in profit and loss account and that the same cannot be invoked for the purpose of making addition on account of purchases.

Unquote

The abovementioned case establishes that purchases, being part of the cost of sales and not deductible business expenditure, fall outside the scope of section 21.

Although there exists binding case law clarifying that purchases do not fall within the ambit of section 21, the introduction of clause (s) and (q) may still give rise to interpretational issues or arbitrary application by the FBR, particularly in distinguishing between cost of sales and deductible expenditures.

There are certain business models where purchases form the core component of cost of sales rather than business expenditure.

Example: Retail Trading Business (e.g., Electronics or Grocery Retailer).

A retail business engaged in the sale of electronics or grocery items purchases inventory in bulk from various suppliers. These purchases constitute the primary component of the cost of sales.

Suppose the business purchases goods worth Rs. 500,000 from a local supplier but makes the payment in cash, not through a banking channel or digital means. Under clause (s) introduced via the Finance Act, 2025, 50% of the expenditure on such purchases, i.e., Rs. 250,000, would be disallowed, even though it represents direct cost of goods sold rather than a business expense

However, as per the aforementioned judgement, section 21 does not apply on purchases.

3) Tax on Cash Withdrawals by Non-ATL Persons - Section 231AB

The Finance Act, 2025 has amended Section 231AB of the ITO, which pertains to tax on cash withdrawals by persons not appearing on the Active Taxpayers List (“ATL”).

It is important to note that the daily threshold of Rs. 50,000 for such withdrawals remains unchanged, the rate of withholding tax has been increased from **0.6% to 0.8%**.

This amendment applies only to persons not appearing on the ATL and is aimed at encouraging broader tax base.

Example: If an individual who is not on the ATL withdraws Rs. 100,000 in cash from their bank account on a single day, the bank will deduct Rs. 800 (0.8%) as withholding tax instead of the earlier Rs. 600 (0.6%).

Implications

The increased withholding tax rate on cash withdrawals by non-filers from 0.6% to 0.8%, raises the cost of remaining outside the tax net. This amendment may be contradictory to the aim of documentation of the economy as it may discourage use of banking channels altogether, as non-filers may deal in cash to avoid the tax, thereby undermining the goal of economic documentation.

DISCLAIMER

This document is the property of Tola Associates and Tola & Tola ("Authors"), and contents of the same may not be used or reproduced for any purpose without prior permission of the Authors in writing.

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

The comments in the document are a matter of interpretation of law and current economic scenario 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 any authority. Furthermore, this document does not extend any guarantee, financial or otherwise. The Authors do not accept nor assume any responsibility, whatsoever, for any purpose.

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