

A sunset over the ocean with birds flying in the sky and on the beach. The sky is filled with orange and yellow clouds, and the sun is low on the horizon. The ocean is dark blue with white foam from the waves. The beach is sandy and reflects the sunset colors. Several birds are visible in flight and on the ground.

**COMMENTS ON
AMENDMENTS VIDE
FINANCE ACT, 2016**

**“Pakistan - An emerging economy
to be reckoned with”**

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Prologue:

Amended FB-16 i.e. Finance Act, 2016 (“FA-16”) has been presented in the National Assembly of Pakistan for its approval. Consequent to its passage, budget making process is concluded. *Needless to scribe*, recommendations enlarged by the Senate, being recommendatory forum, have also been considered.

These comments have been prepared by using:

- FB-16; and
- Comments on FB-16 by our firm’s Tax Memorandum dated June 3, 2016.

AMENDMENTS VIDE FA-16 VIS-À-VIS FB-16

A. Sales Tax Act, 1990 (“STA”)

Following Amendments have been incorporated in FB-16 vide FA-16 in STA.

1. Alternate Dispute Resolution – Section 47A:

- The committee appointed by the Board consists of an Inland Revenue Officer along with two other persons from notified panel. Previously there was restriction for Inland Revenue officer to be not below Additional Commissioner. This restriction has been changed to Commissioner.
- The time limit for passing of orders on recommendations by the Board has also been extended from 45 days to 90 days. In case of failure of passing of order by the Board within 90 days, recommendations by the committee shall be treated to be an order passed by the Board.
- The same recommendations were put forward by Tax Reform Commission (“TRC”).

2. Exemption to PIA:

- Exemption of sales tax on import or acquisition of Air Craft on wet or dry lease by Pakistan International Airlines Corporation shall be available with effect from 19th March, 2015. This amendment has been incorporated to Synchronize Taxation Regime and Aviation Policy introduced in March 2015 and to plug the gap from March 19, 2015 to June 30, 2015.

3. Agricultural Tractors – Sch. VIII, Table I, Serial 25:

- Sales Tax on agricultural Tractors has been further reduced from 10% to 5%. Vide SRO 79(I)/2012, different rates of sales tax were charged during different periods as follows:
 - 02-02-2012 to 31-12-2012 – 5%
 - 01-01-2013 to 31-12-2013 – 10%
 - 01-01-2014 to 25-06-2014 – 16%

- The rate of sales tax was again reduced to 10% vide SRO 572(I)/2014 for period 26-06-2014 to 30-06-2015. Agricultural Tractors were then made part of 8th schedule vide FA 2015, to be charged sales tax at unchanged rate of 10%.
- Further reduction in sales tax rate from 10% to 5% vide FA 2016 will result in huge refunds for the manufacturers as the output of 5% will not be sufficient enough to absorb the input taxes. Consequently, it will be appropriate if major inputs on respective raw material of agricultural tractors is also made zero rated.

4. Laser Land Levelers – Sch. VIII, Table I, Serial 26:

- Reduced Sales Tax rate of 7% has been introduced on Laser Land Levelers by adding the same in 8th Schedule to the STA.

5. TV Set Top Boxes – Sch. VIII, Table I, Serial 34:

- Reduced Sales Tax rate of 5% has been introduced on TV/Internet Set top Boxes or satellite receivers by adding the same in 8th Schedule to the STA, upto 30th June, 2017, subject to approval of type by PEMRA.

6. Dairy Machinery and Equipment - Sch. VIII, Table II, Serial 8:

- Reduced rate of 5% on import of milk chillers, Tabular heat exchanger, Milk Processing plant, milk spray drying plant, milk UHT plant, milk filters and any other machinery and equipment for manufacturing of dairy products, has been introduced, subject to condition that the importer is registered with Pakistan Dairy Association.

7. Pharmaceutical Active Ingredients – Sch. VI, Table I, Serial 105:

- Sales Tax Exemption on Raw material for basic manufacture of Pharmaceutical Active Ingredients was subject to condition that such raw materials are liable to custom duty not exceeding 10% advalorem. This condition has been changed to 11% advalorem custom duty.

8. Energy Saver Lamps etc. - Sch. VI, Table I, Serial 110:

- Sales Tax on following lighting devices has been exempted by adding same in Sixth Schedule:
 - Tabular Day Lighting Devices
 - Energy Saver Lamps and Tube Lights
 - Renewable energy Inverters

B. Federal Excise Act, 2005 (“FEA”):

1. Alternate Dispute Resolution – Section 38:

- The committee appointed by the Board consists of an Inland Revenue Officer along with two other persons from notified panel. Previously there was restriction for Inland Revenue Officer to be not below Additional Commissioner. This restriction has been changed to Commissioner.
- The time limit for passing of orders on recommendations by the Board has also been extended from 45 days to 90 days. In case of failure of passing of order by the Board within 90 days, recommendations by the committee shall be treated to be an order passed by the Board. This recommendation was put forward by TRC.

2. Chartered Flight Services – Sch. III, Table II, Serial 13

- FED on chartered flight services used by or for armed forces to move troops or equipment has been exempted.

C. Income Tax Ordinance, 2001 (“ITO”):

1. Super Tax – Income Definition – Section 4B:

- A super tax was levied, for tax year 2016; vide Finance Act 2015 (“FA-15”) for every banking company and every other company whose taxable profits exceeded Rs.500 million. The super tax was charged in the backdrop of Military operation ‘Zarb-e-Azb’ for rehabilitation of Temporarily Displaced Persons (“TDPs”). The tax was levied at 4% for Banking Companies and at 2% for others.

Amendment vide FB 16:

- FB-16 proposed to continue the super tax for tax year 2017. Furthermore, the definition of income was also proposed to be changed to abstain adjustment of unabsorbed depreciation and brought forward losses. However, drafting of the law was not clear.

Amendment vide FA 16:

- Necessary changes in the language has been made to exclude the adjustment of unabsorbed depreciation and brought forward losses from income.

2. Relaxation in requirement of 100% Owned Equity for Tax Credit for Establishing new Industry – S. 65D:

- The tax credit, for establishing new Industry, was first allowed vide FA 2011 by insertion of section 65D. Section 65D provides that Tax credit @ 100% of tax payable (including on account of minimum tax and final tax) is allowed for a period of 5 years if a company invests (with 100% equity owned by it) to establish a new industrial undertaking for manufacturing in Pakistan. Vide FA 2012, corporate dairy farming was also made part of industrial undertaking. It was also explained that 100% equity owned means issuance of 100% shares for cash consideration, and
- One of the conditions, to avail above credit, is that the company is incorporated and industrial undertaking is setup between 1.7.2011 and 30.6.2016.

Amendment vide FB 16:

- FB-16 proposes to relax the above condition of 100% owned equity and proposes that the limit of new equity investment be reduced to 70%. However, in case of equity investment less than 100%, the percentage tax credit allowed will also be reduced in proportion to ratio of equity investment,
- For example if an industrial undertaking is set up in Equity to Debt ratio of 80:20, the tax credit allowed under this section will also be reduced to 80% of tax payable instead of 100%, and
- Furthermore, the above time limit for incorporation of company and setting up of industrial undertaking is also proposed to be extended to 30-06-2019 from existing 30-06-2016.
- It has also been proposed that in the event of discontinuation of business within five years of availing credit, the tax credit will be deemed to have been wrongly allowed.

Amendment vide FA 16:

- The formula proposed for prorated tax credit was not correct and needed correction. The same has been corrected vide FA 2016.

3. Tax Credit for Equity Investment on Expansion of Machinery or a New Project – S. 65E:

- The tax credit, for equity investment on expansion of machinery or a new project, was first allowed vide FA 2011 by insertion of section 65E. Section 65DE provides that where a company, set up in Pakistan before 1.7.2011, invests with 100% new equity in the purchase and installation of plant and machinery for an industrial undertaking for the purposes of:
 - (i) expansion of the plant and machinery already installed therein; or
 - (ii) undertaking a new project.
- A 100% tax credit shall be allowed against the tax payable for a period of five years beginning from the date of setting up or commencement of commercial production from the new plant or expansion project, whichever is later,

- Vide FA 2012, corporate dairy farming was also made part of industrial undertaking. It was also explained that 100% equity owned means issuance of 100% shares for cash consideration, and
- One of the conditions, to avail above credit, is that the company is incorporated and industrial undertaking is setup between 1.7.2011 and 30.6.2016.

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- Furthermore, the above time limit for incorporation of company and setting up of industrial undertaking is also proposed to be extended to 30-06-2019 from existing 30-06-2016.
- It has also been proposed that in the event of discontinuation of business within five years of availing credit, the tax credit will be deemed to have been wrongly allowed.

Amendment vide FA 16:

- The formula proposed for prorated tax credit was not correct and needed correction. The same has been corrected vide FA 2016.

4. Fair Market Value – Section 68:

- It was proposed vide FB 2016 that fair market value of any property shall be determined without taking into consideration the value fixed or notified by any provincial authority.

Amendment vide FA 16:

- FA 2016 has withdrawn the above proposed amendment and, instead, has barred Commissioner from determining Fair Market Value of Immoveable Property. The same will be determined on the basis of valuation made by a panel of approved valuers of the State Bank of Pakistan (“SBP”).

- The above amendment by FA 2016 may create practical hindrance as currently there is no such panel maintained by SBP. Pakistan Banks Association (“PBA”) has a panel of approved valuers and their list comprises of more than 150 valuers. SBP may adopt PBA list to avert any legal adversities.

5. Definition of Company – Section 80:

- FB 2016 proposed to add a foreign trust in the definition of company under section 80, however, the proposal has been withdrawn vide FA 2016. This amendment was widely viewed as a Political Amendment.

6. Notice to file return - Section 114(5):

- FA 2016 has added a proviso to subsection (5) of section 114, enabling commissioner to issue notice in respect of any of last 10 years if the taxpayer has not filed return of any of the last 5 years.
- Prior to FA 2016, the notice for any tax year prior to five years could not be sent under section 114 for filing of return. We believe retrospective application of this amendment may cause legal complications.

7. Alternate Dispute Resolution – Section 134A

- The committee appointed by the Board consists of an Inland Revenue Officer along with two other persons from notified panel. FA 2016 has introduced restriction on Inland Revenue Officer to be not below Commissioner level.
- The time limit for passing of orders on recommendations by the Board has also been extended from 45 days to 90 days. In case of failure of passing of order by the Board within 90 days, recommendations by the committee shall be treated to be an order passed by the Board. This recommendation was put forward by TRC.

8. Recovery from persons holding money for taxpayers – Section 140:

- FA 2016 has added a proviso to subsection (1) of section 140, restricting commissioner from issuance of recovery notice in case an appeal before Commissioner Appeals is pending provided that 25% of the demand has been paid. The amendment is in consonant with the settled proposition of law that a taxpayer shall not be forced to pay the demand created by an order unless he has gone through an appellate forum, however, condition of payment of 25% of the demand is against the spirit of such principle of law.

9. Payment to Non –Resident/Permanent Establishment (“PE”) – Section 152

- FA 2016 has amended subsection (2A) of section 152, excluding goods sold by importer (who has paid income tax under section 148 and has sold the goods in the same condition as imported) from purview of section 152. This means that advance tax under section 152 shall not be deducted while making payment to PE of a non-resident person if such PE is the importer as described above.
- Furthermore, Income Tax withholding rate on payments to non-residents on account of contracts has been amended to be 7% for filer and 12% for non-filer. Prior to enactment of FA 2016, these rates were in the range of 6% to 10% depending upon the status (company and others) of the non-resident person.

10. Adjustability of Final Tax Excess Charged on Non-Filer – Section 169

- It was proposed in FB 2016 that excess tax collected or deducted on account of higher rate of non-filer shall be adjustable.
- FA 2016 has restricted the above adjustment to the return filed for relevant tax year only.

11. Advance Tax on Foreign Produced TV Plays and Serials – Section 236E

- The explanation of foreign plays was proposed, vide FB 2016, to be amended as plays dubbed in ‘any language other than English’ instead of ‘dubed in urdu or any other regional language’.
- However, FA 2016 has altogether omitted section 236E and its corresponding division XII, Part I of First schedule, having effect that no advance tax shall be collected from foreign produced TV Plays and Films. (also refer point 12 below)

12. Advance tax on cable television operators – Div. XIII, Part IV, Sch, I

- FA 2016 has reduced advance taxes to be collected from cable TV operators on the basis of license category.
- Furthermore, an additional advance tax has also been imposed to be collected by PEMRA at 50% of permission fee or renewal fee, from every TV channel on which a foreign TV drama serial is screened.

13. Advance Tax on Banking Transactions – Section 236P:

- FB 2016 proposed an explanation to section 236P to calculate the limit of Rs. 50,000 to be aggregate withdrawals from all the bank accounts in a single day.
- FA 2016 has further refined the above explanation that the limit of Rs. 50,000 will be calculated on the basis of aggregate transactions, instead of aggregate withdrawals, from all bank accounts in a single day.
- The amendment vide FA 2016 has the effect that limit of cash withdrawals will still be calculated on a single account single day basis.

14. Capital Gain Tax on Immovable Property – S. 37, Sch. I, Div. VIII, Part I:

- FA 2012 for the first time brought capital gain arising out of disposal of immovable property to tax subsequent to 18th constitutional amendment, wherein, entry number 50 in Federal Legislative List empowers the Federal Government to levy this tax. However, chargeability of capital gain on immovable property has been controversial, as Honourable Supreme Court of Pakistan has held in their judgment 1992 PTD 1 that “immovable property” is not a capital asset for the purpose of chargeability under the head capital gain. Consequent to 18th Amendment in Constitution, legal gurus says right of Federal Government has no more power to tax such transactions.

Amendment vide FB 2016:

- FB 2016 proposed to levy a tax at 10% on capital gain on disposal of immovable property where holding period does not exceed 5 Years. In case the holding period is more than 5 years, the gain shall be exempt. A comparison of tax rate with last year is provided below:

Holding Period	2015-16	2016-17
Upto one Year	10%	10%
More than one year but less than two years	5%	
More than two years but less than five years	Nil	Nil
More than five years	Nil	

Amendment vide FA 2016:

- FA 2016 has seconded the above amendment with a variation that Capital gain from sale of immovable property to Rental REIT Scheme shall be taxed at 5% upto 30th June, 2019, irrespective of holding period.

15. Gratuity – Div. 13, Part I, Sch. II:

- Prior to FA 2016, income from gratuity from an Approved Gratuity Scheme is exempt upto an amount of Rs. 200,000.
- FA 2016 has extended the above limit of Rs. 200,000 to Rs. 300,000.

16. Exemptions for Gwader Port – Div. 126A, 126AB, 126AC, 126AD, Sch. II:

- FB 2016 proposed that total income of the Companies associated with the development of Gwader Port, as specified in above clauses, may be exempted from charging of Income Tax. However no exemption period was mentioned.
- FA 2016 has upheld the proposals of FB 2016 and has specified period of exemption for 23 years from July 01, 2016.

17. Reduction in Tax Rate for Shariah Compliant Company – Div. 18B, Part II, Sch. II:

- FA 2016 has introduced a 2% reduction of tax rate (i.e. 30% for TY 2016, 29% for TY 2017 and 28% for TY 2018 and onwards) on income of a listed Company if:
 - The company is Shariah Compliant as per criteria of SBP, SECP and Board;
 - The company derives income from manufacturing only;
 - The company has declared taxable income for last 3 consecutive tax years; and
 - The company has issued dividend for last 5 consecutive tax years.

18. Import of Ships – Div. 98, Part IV, Sch. II

- FA 2016 has added a new clause in part IV of Second Schedule, whereby, import of ships and other floating crafts including tugs, survey vessels and other specialized crafts purchased or bare-boat chartered by a Pakistani entity and flying Pakistani flag has been exempted from payment of advance tax under section 148 upto year 2020 subject to condition that ships etc. are used for the purpose for which these are procured. This amendment will enlarge a big boost to shipping sector specially National Carrier PNSC.

19. Imports by PIA - Div. 99, Part IV, Sch. II

- FA 2016 has added a new clause in part IV of Second Schedule, whereby, import or acquisition of aircraft on wet or dry lease by PIA has been exempted from payment of advance tax under section 148, with effect from March 19, 2015. This amendment has been incorporated to Synchronize Taxation Regime and Aviation Policy introduced in March 2015 and to plug the gap from March 19, 2015 to June 30, 2015.

20. Allowance of Any Expenditure subject to Collection/Deduction of Tax – S. 21(c)

- Currently, expenditures are specified, which are disallowed in case collection/deduction of tax at the time of their payment is not made. Furthermore, expenses are not allowed even if demand raised, as a result of proceedings under section 161 and 162, is paid.

Amendment vide FB 2016:

- FB-16 proposed that all expenditures, instead of certain expenditures, are disallowed in the aforesaid case. However, in the event of subsequent payment of demand raised by order, the same expenses may be allowed in respective tax years.
- FB 2016 further proposed that disallowance of expense may not be more than 20% of the purchases of raw material and finished goods.

Amendment vide FA 2016:

- FA 2016 has further clarified the above limit of 20%. FA 2016 has clarified that disallowance of expenses with respect to raw material and finished goods only, instead of all expenses, will be restricted to 20% of purchases raw materials and finished goods.

- For example, if a tax payer has claimed Rs. 40,000 for expenses relating to consumption of raw material and finished goods and Rs. 70,000 for administrative expenses, then the above limit of disallowance will be Rs. 78,000 (20% of Rs. 40,000 plus Rs. 70,000) because limit is only for expenses with respect to raw materials and finished goods.

21. Tax Credit on Health Insurance – S. 62

- Currently, a resident person other than a company is allowed tax credit in respect of life insurance premium paid. The limit of credit is lower of actual payment of premium, Rs. 1,500,000 or 20% of taxable income.

Amendment vide FB 2016:

- FB-16 proposes to also allow tax credit for premium paid on health Insurance policy as well. The proposed credit will be lower of actual payment of premium, 5% of Taxable income or Rs. 100,000.

Amendment vide FA 2016:

- The above tax credit has been extended to only resident persons being filer, vide amendment through FA 2016, i.e. tax credit will only be allowed to resident filers.

Disclaimer:

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