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Brief on Amendments in the Finance Bill, 2016



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**BRIEF ON AMENDMENTS
IN THE FINANCE BILL, 2016**

The Finance Bill, 2016 (hereinafter referred to as 'Bill') was presented in the National Assembly on June 3, 2016, proposing amendments in various statutes relating to Federal taxes. Subsequently, after the debate in the National Assembly and Senate, the Finance Minister presented Amendments in Finance Bill, 2016 (hereinafter referred to as 'Act') on June 22, 2016, which have been passed by the National Assembly and assented by the President of Pakistan.

This memorandum summarizes the effect of changes in the Bill through the Act and our views on certain matters not addressed in the Act.

These notes as well as our memorandum dated June 4, 2016 on amendments proposed through the Finance Bill, 2016, read with the relevant law at present, exhibit the revised status of the respective fiscal statute.

This Brief can also be accessed on our website www.pwc.com/pk

June 25, 2016



IMPORTANT AMENDMENTS NOT ADDRESSED IN THE ACT

Some amendments proposed through the Bill laid before the National Assembly on June 3, 2016 were expected to be either withdrawn or appropriately amended in the Act.

In this regard, concerns with valid reasons were also raised at the appropriate forums, however, the same have not been corrected in the Act. It is suggested, as a last resort, to include the following two matters in the proposed Amendment Act, 2016 which is expected to be introduced in the Parliament, as announced by the Finance Minister in his concluding speech on the Finance Bill:

INTER-CORPORATE DIVIDEND IN HOLDING COMPANY STRUCTURE

The primary issue in this matter relates to tax on inter-corporate dividend in the case of a Holding Company (other than 100% owned) structures, which are formed after the approval by the Securities & Exchange Commission of Pakistan. After deliberations at various forums, it was expected that this matter was to be corrected in the Finance Act, 2016. However, the correction has not been made and after July 1, 2016 inter-corporate dividend in the case of a Holding Company structure (other than 100% owned) will be taxed.

This is not a desirable course especially for internal investment perspective and it is highly recommended to reinstate the position as existed prior to the Bill. This has disturbed the investment strategies for almost all the major industrial groups of the country.

INADMISSIBILITY OF PROVINCIAL SALES TAX AGAINST FEDERAL SALES TAX LIABILITY

Through the Bill, fundamental departure was proposed in the sales tax regime which is governed under the VAT principles. The definition of input tax was proposed to be amended to exclude the Sales tax paid under respective Provincial laws.

This proposal simply exhibited the absence of harmony between federal and provincial governments. It was therefore proposed by various trade bodies, professional firms as well as the provincial revenue authorities to withdraw this amendment since in economic sense, this would imply dual indirect taxation in the country as the indirect taxes paid to Provinces shall not reduce the incidence of sales tax paid to Federation.

The Federal Government has proceeded to withdraw the taxpayers' right to claim input tax adjustment on provincial sales tax. The provincial authorities have been conveyed by FBR that they may also review corresponding provisions in their respective laws in response to the amendment to disallow cross-adjustment of input tax against provincial services.

BRIEF ON CHANGES THROUGH THE ACT

INCOME TAX

SUPER TAX

Through the Bill, the Federal Government whilst extending the levy of super tax to tax year 2016 also proposed to amend the definition of 'income' for the purpose of computing Super Tax to exclude the impact of depreciation and business losses. The language of proposed amendment was ambiguous as regards the treatment of current year's depreciation.

Through the Act, the aforesaid ambiguity has been removed and it has been clarified that only brought forward depreciation losses (and not current year's depreciation) will be excluded along with brought forward business losses for computing income for the purposes of levying super tax.

DISALLOWANCE OF BUSINESS EXPENSES DUE TO NON-WITHHOLDING OF TAX

Through the Bill, the provision regarding disallowance of expenditure on account of non-deduction of tax was clarified that if tax under section 161 or 162 has been collected, the same will be considered as taxes paid for the purposes of the said provision, and the disallowance would not be made. It was also proposed through the Bill to restrict the limit of disallowance to 20% of purchases of raw material and finished goods which was ambiguous.

There had been a circular in the past where disallowance in respect of purchases was not allowed, inter alia in certain mode, despite non-compliance of certain provisions. This amendment appears to be an extension of that concept that purchases of raw materials and finished goods cannot be disallowed for any non-compliance of withholding provision over and above the percentage prescribed in the law. At present, this percentage as per the proviso is 20% of the amount of total purchases of raw materials and finished goods. This would mean that if the compliance exceeds 20% on transaction-wise basis, there will not be a disallowance of expenses beyond 20% of total purchases.

TAX CREDITS UNDER SECTIONS 65D AND 65E

Under sections 65D and 65E of the Ordinance, tax credits for investments are presently available to companies making 100% equity based investments for industrial undertaking and corporate dairy farm upto June 30, 2106. It was proposed through the Bill to not only increase the time period of investments to June 30, 2019 but also the credit was allowed (on proportionate basis) where the equity investment is 70% or more. However, the formula proposed for that purpose had a mathematical error which has now been corrected. The credit is now allowable as per the following formula:

$$A \times (B/C)$$

where –

- A** is the amount of tax assessed for the tax year before allowance of any tax credit for the tax year;
- B** is the equity raised through issuance of new shares for cash consideration; and
- C** is the total amount invested in setting up the new industrial undertaking / plant and machinery, as the case may be.

FAIR MARKET VALUE OF IMMOVABLE PROPERTY

Through the Bill, it has now been provided that the fair market value of immovable property will be determined on the basis of valuation made by a panel of approved valuers of the State Bank of Pakistan. The proposal through the Bill that the value fixed or notified by any Provincial authority for the stamp duty or any other purpose shall not be taken into consideration for determining the fair market value of an asset for the purpose of the Ordinance, has not been finally adopted.

This is a major deviation as deemed / practical acceptance of single value has been dispensed with and the possibility of different valuation by various persons within the panel cannot be overruled.

FOREIGN TRUST

The explanation proposed to be inserted through the Bill for clarifying that a foreign trust is also covered by the definition of company has been deleted. Effectively, deletion of this amendment has made no change in the law and even under the existing provisions, a 'foreign trust' is a company.

NOTICE FOR FILING OF RETURN

Through the Act, a new proviso has been added to section 114 empowering the FBR to issue a notice for filing of return of income for one or more of the last ten completed tax years in case of a person who has not filed return for any of the last five completed years. The retrospective impact of this amendment to past and closed years requires examination.

ALTERNATE DISPUTE RESOLUTION

With a view to improve the Alternate Dispute Resolution mechanism, following amendments have been introduced:

- Alternate Dispute Resolution committee would include a Commissioner Inland Revenue instead of Additional Commissioner Inland Revenue;
- Board is required to pass an order on the recommendation of the Committee within ninety days instead of forty five days; and
- In case order is not passed by the Board within ninety days, the recommendation of the committee shall be treated as an order passed by the Board.

Similar amendments have been made in the Sales Tax and Federal Excise Laws.

RECOVERY OF TAX BY WAY OF FREEZING BANK ACCOUNT

In order to curb the practice of taking coercive measures including freezing of bank accounts even in those cases where the matter is subjudice in appeals, an amendment is made to section 140 whereby no action under the said provision will be taken if the appeal filed by the taxpayer relating to such tax is pending before the Commissioner – Appeals subject to the condition that 25% of the said tax is paid by the taxpayer. This also means that if 25% of demand has been paid, there cannot be recovery by way of freezing of bank accounts.

In cases where the taxpayer would not be willing to pay 25% of the said tax, he will remain entitled to approach the Commissioner – Appeals / High Court for stay of full demand.

ADVANCE TAX FROM PROVINCIAL SALES TAX REGISTERED PERSON

The Bill proposed insertion of a new section 236W whereby every provincial revenue authority was made liable to collect adjustable advance tax at the rate of 3% of the turnover from a 'non-filer' who is otherwise registered with Provincial authority.

The above amendment has been adopted in the Act in different form. Now, Provincial Revenue Authorities have been absolved from this responsibility. Tax collection from such non-filers has now been substituted by a new section 147A. Under the new mechanism, monthly adjustable advance tax at 3% of turnover will be payable by the non-filer of FBR, who is registered with provincial revenue authority. Advance tax paid under section 147A will be payable at the time when provincial sales tax return is filed, and the tax so paid will be taken into account while working out advance tax payable under section 147 of the Ordinance. The requirement to pay advance tax will not be applicable on a person who was filer on 30th June of the previous tax year. Practical application of this provision would have to be prescribed.

CAPITAL GAINS ON REDEMPTION OF SECURITIES

Through Bill, gain on redemption of units of open ended mutual funds was subjected to collection of tax under the mechanism as laid down in the Eighth Schedule.

For that purpose, it has now been clarified that a mutual fund or collective investment scheme shall continue to collect capital gains tax at the prescribed rates on redemption of securities. It has been noted that separate rates which were earlier prescribed for such collection of tax on capital gains have been omitted due to substitution of the relevant Division.

ADVANCE TAX ON FOREIGN PRODUCED TV PLAYS AND SERIALS

Section 236E inserted through Finance Act 2013 whereby adjustable advance tax was required to be collected by the licensing authority from foreign produced TV plays has now been deleted. However, PEMRA will now be required to collect adjustable advance tax under section 236F at the rate of 50% of the permission fee or renewal fee from every TV Channel on which foreign TV drama serial or a play in any language, other than English, is screened or viewed. Modalities and effects of the same need to be examined.

GAIN ON DISPOSAL OF IMMOVABLE PROPERTY TO RENTAL REIT

Gain arising on the disposal of immovable property by a person in a tax year to the Rental REIT Scheme will be taxed at the rate of 5% upto June 30, 2019 irrespective of holding period. The general rate of tax on gain on disposal of immovable property is 10%, whereas no tax is payable where holding period of immovable property is more than 5 years. It may be noted that gain on disposal of immovable property to developmental REIT is exempt from tax upto June 30, 2020 under Clause (99A) of Part I of the second schedule.

WITHHOLDING TAX FROM PAYMENTS TO NON-RESIDENTS FOR CONTRACTS AND ADVERTISEMENT SERVICES

The rate of withholding tax on payments to non-residents for execution of certain contracts and advertisement services rendered by TV Satellite channels is presently prescribed at 6% irrespective of the filer status. Now, separate rates of 7% and 12% are prescribed for filers and non-filers respectively. Similarly, payments to Permanent Establishments of non-residents for execution of contracts, sale of goods and services rendered will also be subject to withholding tax of 7% and 12% for filers and non-filers respectively.

REDUCED TAX RATES FOR CERTAIN LISTED COMPANIES

A new clause (18B) is now inserted in Part II of the Second Schedule whereby the corporate rate of tax specified in First schedule will be reduced by 2% in case of listed companies subject to following conditions:

- (a) it fulfils prescribed *shari'ah* compliant criteria approved by State Bank of Pakistan, Securities and Exchange Commission of Pakistan and the Board;
- (b) derives income from manufacturing activities only;
- (c) has declared taxable income for the last three consecutive tax years; and
- (d) has issued dividend for the last five consecutive tax years.

It appears that *shari'ah* compliant criteria is being developed jointly by the regulators.

EXEMPTION FROM COLLECTION OF TAX ON IMPORT OF SHIPS AND AIRCRAFTS

Collection of withholding tax at import stage will not be applicable in the following cases:

- (a) 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 upto the year 2020 subject to the condition that imports ships, etc. are used for the purpose for which they were imported. In case of ships and crafts used for demolition purposes, the import tax will be applicable.
- (b) Import or acquisition of aircraft on wet or dry lease by PIA with effect from March 19, 2015.

Corresponding concessions have also been provided in Sales Tax and Customs Law, wherever applicable.

WITHHOLDING TAX FROM NON-RESIDENT IMPORTERS

In order to remove the ambiguity, section 152 has been amended (in line with section 153) to exclude the payments for sale of imported goods of non-residents from the purview of withholding tax deduction subject to the collection of tax at import stage and supply of goods in similar state. This is a corrective measure.

ADJUSTABILITY OF FINAL TAX COLLECTED IN EXCESS FROM A NON-FILER

In the Bill, it was proposed that where the tax collected or deducted is final tax and separate rates are prescribed for filer and non-filer, the final tax shall be the tax rate for a filer and the excess tax deducted or collected on account of higher rate of a non-filer shall be adjustable.

While accepting this proposal, a clarificatory amendment has been made by adding in the relevant section that such excess collection of tax will be adjustable only in the tax return filed for the relevant tax year.

INCREASE IN EXEMPTION LIMIT FOR GRATUITY INCOME

Any payment received by an employee on his retirement, or by his heirs in the event of his death, by way of gratuity from an Approved Unfunded Gratuity Scheme is presently exempt upto Rs. 200,000. Through the Act, this limit has been increased to Rs. 300,000.

SALES TAX

SIXTH SCHEDULE – EXEMPTIONS

- (a) Import and supply of ships with gross tonnage of over 15 LDT have also been extended exemption from sales tax.
- (b) Imports of raw materials for the basic manufacture of pharmaceutical active ingredients and for manufacture of pharmaceutical products have been extended exemption which are liable to customs duty not exceeding 11%, instead of the earlier limit of 10%.
- (c) Following further items with dedicated use for renewable source of energy subject to certification by Alternative Energy Development Board (AEDB) have been included in the lists of exemption:
 - Tubular day light device
 - Energy saver lamps and tube lights of varying voltages (operating on AC or DC)
 - Specified invertors
- (d) Exemption to import or acquisition of aircrafts on wet or dry lease by PIA has been made effective from March 19, 2015.

EIGHTH SCHEDULE

- (a) Sales tax rate on agricultural tractors has been reduced from 10% to 5%.
- (b) Laser land leveler has been extended reduced sales tax of 7%.
- (c) Set top boxes for gaining access to internet, TV broadcast transmitter, reception apparatus for receiving satellite signals used for television and other set top boxes have been extended reduced sales tax of 5%.
- (d) Milk chillers, Tubular heat exchanger (for pasteurization), milk processing plant, milk spray drying plant, milk UHT plant, milk filters and other machinery and equipment for manufacturing of dairy products have also been extended reduced sales tax of 5%.

ISLAMABAD CAPITAL TERRITORY (TAX ON SERVICES) ORDINANCE, 2001 (ICTO)

Education testing services provided or rendered under a bilateral or multilateral agreement signed by the Government of Pakistan are excluded from the levy of Federal Sales Tax.