

**GOVERNMENT OF PAKISTAN  
REVENUE DIVISION  
FEDERAL BOARD OF REVENUE**

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Islamabad, the 27<sup>th</sup> July, 2012

**Circular No. 02 of 2012**  
**Income Tax**

Subject: **FINANCE ACT, 2012 – EXPLANATION REGARDING  
IMPORTANT AMENDMENTS MADE IN THE INCOME TAX  
ORDINANCE, 2001.**

Salient features of the amendments made in the Income Tax Ordinance, 2001 through Finance Act, 2012 are explained as under:-

1. **SALARY RATE STRUCTURE.**

Tax in the case of a salaried taxpayer shall be computed in accordance with sections 12, 13 and 14 of Income Tax Ordinance 2001, read with rules 3, 4, and 5 of Income Tax Rules 2002. A salaried taxpayer means where salary constitutes more than 50% of the total income. All perquisites, allowances or benefits, [excepting those covered under Part-I of the Second Schedule to the Ordinance], are to be included in the salary and rate of tax prescribed in Part-I of the First Schedule shall be applied for the tax year 2013. For withholding purposes, these shall apply to salary paid on or after 1<sup>st</sup> day of July, 2012. The taxation of salaried taxpayer is explained as under:

(a) **INCREASE IN BASIC THRESHOLD.**

The basic exemption for tax year 2012 is rupees 3,50,000/-. This has been enhanced to Rs. 400,000/- for the tax year 2013.

(b) **REVISION IN TAX SLABS.**

The tax slabs have also been revised through Finance Act, 2012. The existing tax rate slabs have been reduced from 17 to 6. These slabs shall be applicable for tax year 2013. For withholding purposes, these shall

apply to salary paid on or after 1<sup>st</sup> day of July, 2012. The revised slabs are as under:-

<u>S.No.</u>	<u>Taxable Income</u>	<u>Rate of tax</u>
1	0 to 400,000/-	0%
2	400,000 to 750,000	5% of the amount exceeding Rs.400,000/-
3	750,000 to 1,500,000	Rs.17,500+10% of the amount exceeding Rs.750,000/-
4	1,500,000 to 2,000,000	Rs.95,000+15% of the amount exceeding Rs.1,500,000/-
5	2,000,000 to 2,500,000	Rs.175,000+17.5% of the amount exceeding Rs.2,000,000/-
6	2,500,000 and above	Rs.420,000+20% of the amount exceeding Rs,2,500,000/

(c) **COMPUTATION.**

Computation of tax on salary shall be as per above table. Instead of applying tax rate on gross amount of salary, computation of tax is to be made through progressive tax rates. However, maximum relief has been provided to low salary income and the relief gradually decreases with the increase in salary. For taxpayers in highest tax rate slab only basic exemption of Rs. 400,000 is provided and the benefit of lower rates of the intermediate slabs has not been passed on to taxpayers in this slab. This is apparent from the fact that for this slab, the rate is 20% plus Rs. 420,000 (instead of Rs. 255,000 which would have been the case if benefit of lower rate of previous slabs was provided to taxpayers in this slab). Similarly, relief in other slabs also decreases with increase in salary. In slab (5), tax rate is 17.5% plus 175,000 (instead of 167,500) and in slab (4), the rate is 15% plus 95,000 (instead of 92,500). However, for first three slabs, benefit of the previous slab rate has been passed on.

2. **CAPITAL GAINS ON IMMOVABLE PROPERTY [Section 37 and 236C].**

Prior to the 18<sup>th</sup> Constitutional Amendments effective from 19<sup>th</sup> April 2010 Entry 50 of the Federal Legislative List contained in Part-I of the Fourth Schedule to the Constitution of Islamic Republic of Pakistan empowered the Federal Legislature to levy taxes on the capital value of the assets, not including taxes on capital gains on

immoveable property. The words “on capital gains” were omitted by the 18<sup>th</sup> Constitutional amendment. The effect of omission of these words is that the Federal Legislature cannot impose taxes on capital value of immoveable property but can levy tax on capital gains on disposal of immoveable property.

In view of the aforesaid modified constitutional position exemption to capital gains on the disposal of immoveable property held for a period upto two years was withdrawn by making amendments in section 37 of the Income Tax Ordinance, 2001 through the Finance Act, 2012. Simultaneously, a new Division was added in the First Schedule to the Income Tax Ordinance, 2001 giving the following rates of tax to be paid on capital gains from disposal of immoveable property:-

<u>S.No</u>	<u>Period</u>	<u>Rate of Tax</u>
1.	Where holding period of Immovable property is up to one year.	10%
2.	Where holding period of Immovable property is more than one year but not more than two years.	5%

To overcome the administrative problems in respect of collection of CGT on disposal of immoveable property and to keep a track of the transactions of immoveable property adjustable advance withholding tax @ 0.5% of the consideration received on sale/transfer of immoveable property was levied on sellers/transfersors of immoveable property under section 236C of the Income Tax Ordinance, 2001.

It is clarified that the advance tax to be collected under section 236C has been introduced for the purposes of providing a mechanism for collection of capital gain tax on disposal of immoveable property. The actual quantum of capital gain and tax payable thereon is to be computed at the time of filing of return of income. Section 236C is not an independent provision and does not operate in isolation. Since Capital Gain Tax has been imposed only on disposal of properties held for a period up to two years therefore, advance tax is also to be collected from sellers who held the immoveable properties for a period upto two years.

### 3. **TOTAL INCOME [Section 10]**

The definition of total income has been redefined to include a person’s income exempt from tax. However “Taxable Income” as per section 9 shall continues to be a person’s income from all heads of income for the year except the exempt income for the year. As a consequence, sub-section (1A) of Section 53 has also been deleted.

4. **EMPLOYEE LOANS AND BENCHMARK RATE [Section 13]**

To facilitate low income employees who seek loans for their social obligations, the threshold of Rs.500,000/- has been earmarked and henceforth notional interest on loans below this amount shall not be considered as a perquisite within the meaning of section 13 of the Income Tax Ordinance, 2001.

Difference between the interest, if any, payable by an employee on a loan from employer and interest computed on such loan at the “benchmark rate” is considered as “perquisite” taxable in the hands of the said employee. Benchmark rate is defined as 5% plus 1% for every successive tax year after tax year 2001, which means that benchmark rate for tax year 2012 is 15% and will continue to increase by 1% after every tax year. Finance Act 2012 has fixed an upper limit of “benchmark rate” and is now restricted to a maximum of 10 per cent.

5. **NORMAL TAX REGIME OPTION FOR COMMERCIAL IMPORTERS, TRADERS AND EXPORTERS**

Prior to Finance Act, 2012 commercial imports, export of goods, indenting commission, sale of goods to an exporter or to an indirect exporter and trading of goods are subject to Presumptive Tax Regime and taxes collected or deducted at source are treated as a final tax liability. Persons under this regime are not allowed to be taxed on net income basis i.e. under normal law. Through, Finance Act 2012, clauses (41A), (41AA) and (41AAA) have been inserted in Part IV of the Second Schedule, and now such persons have been provided an option to be taxed on net income basis. However, that option will be subject to a condition that minimum tax liability in respect of such income shall not be less than;

- (i) 60% of tax collected at the import stage;
- (ii) 70% of tax deducted at source on sale of goods.
- (iii) 50% of the tax collected at the time of realization of export proceeds and indenting commission.

6. **PAYMENTS TO TRADERS AND DISTRIBUTORS.**

Through Finance Act, 2012, all manufacturers are required to collect tax at 0.5% of the gross amount of sales to distributors, dealers and wholesalers. The said tax is to be collected from all such persons irrespective of amount of sale and status of the distributor, dealer and wholesaler. The tax so collected at the time of sale shall be adjustable by the distributors, dealers and wholesalers against their tax liability.

It is also clarified that in case of commission agents, since the sale is being made to a third party and commission agent is only receiving some amount on account of facilitating two other parties, the said section will not be applicable to them. However, this section shall apply to the party to whom sales are being made through commission agent, if that party is a distributor, a dealer or a wholesaler.

7. **ADDITIONAL PAYMENT FOR DELAYED REFUNDS.**

A new clause has been inserted in Section 39 by which additional payments received on delayed issuance of refunds under any tax law have been included in the definition of “Income from other Source”.

8. **SECTION 59A.**

Section 93 of the Income Tax Ordinance, 2001 was omitted by Finance Act, 2007. However, its reference in section 59A was overlooked and it continued to find mention in Section 59A. Finance Act, 2012 has redeemed this anomaly and omitted mentioning of the already omitted Section 93 of the Income Tax Ordinance, 2001.

9. **TAX CREDIT FOR INVESTMENT IN SHARES AND INSURANCE [Section 62].**

To encourage investment in the Capital and Insurance Sectors by the non-corporate sector certain substitutions have been introduced in Section 62 that aims to enhance the tax credit that a person shall be allowed for a tax year.

10. **TAX CREDIT FOR INVESTMENTS**

(a) **SECTION 65B.**

To facilitate industrialization in the country and to encourage modernization of the already existing manufacturing concerns, tax credit under this section has also been extended for extension and expansion of an industrial undertaking. Furthermore, the ambit of tax credit has been extended to include minimum tax and final taxes payable under any provision of the Ordinance.

The substituted sub-section (4) incentivizes Industrial Undertakings already set up before July 01, 2011 to make 100% equity investment through issuance of new shares for cash consideration. In balancing, modernization and replacement of their plant & machinery by providing a tax credit of 20% of the amount invested in the tax year the machinery is installed. The limitation of availing tax credit for investments by Industrial Undertakings already set up before July 01, 2011 and making 100% equity investments during the period July 01, 2011 to June 30, 2016 has been extended to five years. However, the tax credit allowable under this section shall not exceed the limits as specified in subsections (1) & (4) of this section.

(b) **SECTION 65D.**

Certain substitutions have been made that clarify the mode of 100% equity to be raised through issuance of new shares for cash consideration. Corporate Dairy farming has also been included in the ambit of this section to encourage this important sector of our economy. The domain of tax credit to be availed in this section has been extended to minimum tax and final taxes payable under any provision of the Income Tax Ordinance, 2001. It has also been clarified that short term financing obtained from banking companies or non banking financial institutions for meeting the working capital requirements shall not disqualify the taxpayer from claiming tax credit under this section.

It has further been elaborated that an industrial undertaking shall be considered to have been set up when it starts its production whether trial or commercial.

(c) **SECTION 65E.**

The ambit of Section 65E has been expanded to facilitate existing industrial undertakings to undertake new projects for claim of a tax credit under this section. The period of tax credit has been enhanced to five years instead of the previous four years.

To ensure proper documentation, taxpayers have been encouraged to maintain separate books of accounts for an expansion project or a new project. An incentive of 100% tax credit equal to hundred percent tax payable including minimum & final taxes payable under any provisions of the Income Tax Ordinance, 2001 has been offered.

Furthermore the proportionate formula for tax credit has been elaborated and it will be as under:-

(New Equity/Total Equity including new equity) X tax payable

‘New equity’ has been explained to include equity raised through issuance of fresh shares by the company against cash and shall not include loans obtained from shareholders or directors. It has been elaborated that short term loans and finances obtained by the company for meeting working capital requirements shall not disqualify it from claiming credit under this section.

11. **SECTION 100B.**

A new sub-section has been inserted in section 37A that lays down the method of calculating the capital gain arising on the disposal of a security as under:-

A – B

Where-

‘A’ Consideration received on disposal of the security,

‘B’ Cost of acquisition of security.

Special provisions relating to Capital Gain arising from the disposal of securities of listed companies and tax thereon have also been enacted. It also stipulates that the rules for computing capital gain tax have been laid down in the Eight Schedule. These special provisions were introduced through insertion of section 100B and a new Eighth Schedule through Presidential Ordinance dated April 24, 2012. The Ordinance has now been incorporated in the Finance Act, 2012.

Under these new provisions, National Clearing Company of Pakistan Limited (‘NCCPL’), licensed as “Clearing House” by the Securities and Exchange Commission of Pakistan, will be responsible to compute and collect the capital gains tax on disposal of securities on the basis of information collected from Central Depository Company.

Furthermore, enquiries shall not be made for the nature and source of the amount invested in companies listed on stock exchanges till June 30, 2014 subject to the conditions that amounts remain invested for 120 days, tax on capital gains has been duly discharged in the manner prescribed and a statement of investments is filed with the return of total income/ wealth Statement.

A mutual fund, banking company, non-banking finance company and insurance company subject to tax under the Fourth Schedule to the Ordinance, modaraba, foreign institutional investor being a person registered with NCCPL as a foreign institutional investor and any other person or class of persons notified by the FBR have been excluded from the ambit of these provisions.

Moreover, a person can opt out from payment of tax under Eighth Schedule by obtaining prior approval of Commissioner Inland Revenue and filing of an irrevocable option with NCCPL to this effect and the person shall be subject to scheme of taxation provided for in section 37A of the Ordinance.

12. **EXEMPTION FROM WITHHOLDING TAX IN CASE OF INTER-CORPORATE DIVIDEND AND INTEREST**

Currently, inter-corporate dividend within the group companies, entitled to group taxation under section 59AA or section 59B is exempt from levy of tax. However, the recipient undergoes withholding tax on dividend. Finance Act 2012 grants exemption from collection of withholding tax on dividends. The Act also exempts from collection of withholding tax of inter-corporate profit on debt within the group companies entitled to group taxation under above referred sections.

13. **MINIMUM TAX U/S 113.**

Minimum tax u/s 113 at a rate of 1% has been reduced to 0.5%. Moreover, the controversy as to whether or not 'tax payable or paid' includes the taxes under FTR, while determining the applicability of section 113 has also been resolved by adding an explanation inserted in section 113(1) to the effect that "tax payable or paid" does not include tax paid under FTR. Accordingly, consequent to this amendment, while determining the applicability of section 113, tax under FTR would not be considered as part of 'tax payable or paid' for the year.



14. **WITHHOLDING TAX PROVISIONS APPLICABLE TO NON-RESIDENTS**

- (i) Withholding tax provisions applicable on payments to Permanent Establishment of a non-resident person on account of sale of goods, rendering of or providing services or execution of a contract, have been consolidated with other payments to non-residents covered under section 152.

Withholding tax provisions regarding payments made to non-residents, such as royalty payments, technical assistance fee payments, insurance payments etc. are dealt with in section 152 of Income Tax Ordinance, 2001. However, withholding tax provisions regarding payments in respect of contracts, supply of goods, or services to Permanent establishment of a non-resident, were placed in section 153 which mostly deals with residents. This resulted in complications, particularly, when treatment of withholding tax rates for resident companies were changed, for example, treating them as final tax or minimum tax, the rates for PEs of non-resident companies also changed automatically, which otherwise are protected by double taxation agreements between Pakistan and other countries. So frequent changes in law were made through circulars etc. To remove this problem, these payments, through Finance Act, 2012, have been omitted from section 153 and are made part of section 152.

- (ii) Withholding tax provisions applicable on payments to a non-resident media person relaying advertisement from outside Pakistan have also been consolidated in section 152. The withholding tax shall remain final discharge of tax on the income of the non-resident media person. This was previously covered under section 153A which has now been replaced.
- (iii) Further, tax deduction from payment of insurance premium or re-insurance premium to a non-resident shall not apply in case of written approval of the Commissioner to the effect that such amount is taxable to a permanent establishment of the non-resident in Pakistan.

15. **TAX LIABILITY UNDER PTR.**

Under Presumptive Tax Regime (PTR), the tax liability is equal to the tax required to be deducted at source on certain transactions including contracts,

supplies etc., irrespective of net income arising from such transactions. For example, income from contracts is taxed at 6% of the value of the contract and not actual income earned from such contract. The said 6% tax is required to be deducted by the person at the time of making the payment, from the gross amount payable to the person for execution of contract.

Currently, in the Income Tax Ordinance, 2001, it is written that the tax deducted shall be the final tax on such income, which means that if 6% tax was to be deducted, and the person deducts, say, 5%, the said deducted tax of 5% will be final tax according to the language of the statute, which, of course, is not the intention of the Legislature. To remove this ambiguity the word 'deducted', is substituted with the word 'deductible', which means that tax required to be deducted should be treated as final tax and not the tax that has actually been deducted. If it is more than what is to be deducted, the excess shall be refunded, whereas, if it is short deducted, the same is to be recovered.

16. **REVISED RETURN OF INCOME.**

An additional requirement for a revised return of income has been added and now revised return of a taxpayer declaring taxable income/loss which is less/more than income/loss, as the case may be, determined by an order issued under section 121, 122, 122A, 122C, 129, 132, 133 or 221, shall be treated as an invalid return.

17. **TIME LIMITATION OF ASSESSMENT U/S 120.**

Time limitation within which Commissioner can issue notice for incomplete return of income filed by the taxpayer has been extended by 180 days. Previously, if a taxpayer filed an incomplete return on the last day of financial year no such notice could be issued, since no such notice can be issued after the end of the financial year in which the said return of income was filed by the taxpayer.

18. **PAKISTAN SOURCE DIVIDEND INCOME.**

Through Finance Act, 2012, scope of Pakistan source dividend income is extended to include remittances of after tax profit by a branch of a foreign company operating in Pakistan. Previously, the definition of dividend given in section 2(19)(f) had been amended through Finance Act, 2008 to include such remittances.

19. **DEFAULT SURCHARGE.**

Prior to Finance Act, 2012, default surcharge under section 205 was payable at KIBOR plus 3 per cent per quarter. Through Finance Act, 2012, the same has been changed to 18 per cent per annum. Further no default surcharge shall be payable for the period the demand remained unpaid, beginning from the due date given in the demand notice issued at the time of giving appeal effect, if the taxpayer makes the payment in consequence to an appellate order passed by the Commissioner (Appeals) and does not file a further appeal to the Appellate Tribunal.

20. **AMMENDMENT OF ASSESSMENT U/S 122.**

The power of the Commissioner to amend assessment of taxable income under section 122(1) has been extended to amend provisional assessment under section 122C. The revisional power of the Commissioner under section 122(5A) has also been extended to allow him to make or cause to make such enquiries as he may deem necessary.

21. **DISPOSAL OF APPEAL BY COMMISSIONER (APPEALS).**

After insertion of a proviso in sub-section (4) of section 129, through Finance Act 2009, two separate time limitations for disposal of appeals by CIR(A) were available in the statute. One under the aforesaid proviso and second under sub-sections (5), (6) and (7). To remove this anomaly, sub-sections (5), (6) and (7) have been omitted.

22. **STAY OF DEMAND BY COMMISSIONER(APPEALS)**

Commissioner (Appeals), previously, did not have any power to stay recovery of demand in an order under appeal. By inserting a new sub-section (1A) in section 128, CIR (A) has been empowered to grant stay against recovery for a period or periods not exceeding 30 days in aggregate.

23. **STAY OF DEMAND BY APPELLATE TRIBUNAL**

The provisions regarding grant of stay by Appellate Tribunal have been substituted to remove ambiguities and bring clarity. Tribunal can now grant stay for a period not exceeding one hundred and eighty days after providing an opportunity of being heard to the relevant Commissioner. However, while

computing the above period of 180 days the period for which the recovery was stayed by the High Court shall be excluded.

24. **COST AND CONSIDERATION RECEIVED.**

Through Finance Act, 2012, Federal Board of Revenue has been empowered through section 75 and 76 to prescribe rules for the determination of cost and consideration received for any asset.

25. **CASH WITHDRAWAL FROM A BANK.**

Through Finance Act, 2012, aggregate daily cash withdrawal limit without subjecting it to withholding tax has been enhanced to Rs 50,000 from Rs 25,000. The rate of withholding remains at 0.2 per cent of cash withdrawn.

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