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TAXATION PRINCIPLES AND COMPLIANCE



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Note: All practical/scenario-based questions have been dealt with in accordance with the laws applicable for tax year 2026.

SYSTEM OF TAXATION IN PAKISTAN

IN THIS CHAPTER:

- 1 Objectives of tax laws
- 2 Basics of taxation laws
- 3 Introduction to different taxation laws of Pakistan
- 4 History of tax laws in Pakistan

1 OBJECTIVES OF TAX LAWS

1.1 Definition of taxation

Taxation is defined in many ways, common definition is as under:

- It is the process by which the sovereign, through its law making body, raises revenues in order to use it for expenses of government.
- It is a means for the government in increasing its revenue under the authority of the law, purposely used to promote welfare and protection of its citizenry.
- It is the collection of the share of individual and organizational income by a government under the authority of the law.

1.2 Revenue & Non-revenue objectives

Taxes are primary revenue yielding tools of the Government of modern ages. The government levies taxes in order to achieve following objectives:

- For collection of revenue to run and administer the Government;
- To use as a tool for implementation of its policies; and
- For fair distribution of wealth.

Aside from purely financing government operational expenditures, taxation is also utilized as a tool to carry out the national objective of social and economic development.

- To strengthen anaemic enterprises by granting them tax exemptions or other conditions or incentives for growth;
- To protect local industries against foreign competition by increasing local import taxes;
- As a bargaining tool in trade negotiations with other countries;
- To counter the effects of inflation or depression;
- To reduce inequalities in the distribution of wealth;
- To promote science and invention, finance educational activities or maintain and improve the efficiency of local forces;
- To implement laws which eliminate discrimination among various elements in the markets/businesses.
- To discourage certain undesirable sectors and activities.

► Illustration: Objectives of Taxation Laws

Explain what are the objectives of following tax laws:

Tax Law	Objective
Tax on salary income	Revenue Collection
Any amount transferred otherwise than banking channel will be deemed as income	Documentation of economy
Tax on moveable assets of the taxpayers	Fair distribution of wealth
Higher taxes on import of luxury goods	Reduction in imports of unnecessary goods and create good balance of trade
Allowability of expenditure of research & developments	Promotion of research & developments

Tax Law	Objective
Zero rating on Exports	Promotion of Exports
Tax credit on Donations to approved institutions	To promote culture of payment of donation to only organised and regulated institutions
Tax credit on investments	Promote investments in listed companies
Tax exemptions to software exports	Promote software industry
Higher taxes on import of luxury goods	Reduction in imports of unnecessary goods and create good balance of trade
Allowability of expenditure of research & developments	Promotion of research & developments
Zero rating on Exports	Promotion of Exports
Tax credit on Donations to approved institutions	To promote culture of payment of donation to only organised and regulated institutions
Tax credit on investments	Promote investments in listed companies
Tax exemptions to software exports	Promote software industry

1.3 Taxes as mean for development

Taxes are one of the main sources for development. This is not because revenue collected by the state is used on developmental projects. Rather, taxes can be used in many different ways for development of the country. Some examples are as under:

- The Government can declare some areas as free zone, industrial zone, and economic zone and provide tax incentives to such areas. Such incentives could attract businessman/industrialist who may opt to establish business concerns/industrial units that would bring employment, opportunities and overall prosperity in these under developed areas.
- Taxing the rich at higher rates while taxing the low income groups at lower tax rates.
- Imposition of high custom duty rates on luxury items. This promotes local manufacturing industry.
- Tax credits on charitable donations to promote welfare activities.
- Tax exemptions to charity organisation/educational institutions to promote these activities.
- Exemption of tax to Agriculture sector to promote agriculture.

2 BASICS OF TAXATION LAWS

2.1 Basics of tax laws

Adam Smith's in his famous book "Wealth of Nations" has elaborated following canons of Taxation:

- Equality
Tax payments should be proportional to income and applied equally to all concerned areas
- Certainty
Tax liabilities should be clear and certain
- Convenience of payment
Taxes should be collected at a time and in a manner convenient for taxpayer
- Economy of collection
Taxes should not be expensive to collect and should not discourage business.

Principles for levy of tax

Following are some broad principles for levy of taxes:

- The Benefit Principle
This principle holds that the individuals should be taxed in proportion to the benefits they receive from the governments and that taxes should be paid by those people who receive the direct benefit of government programs and projects out of the taxes paid.
- The Ability-to-Pay Principle
This principle holds that taxes should relate with the person's income or the ability to pay, that is, those with greater income or wealth who can afford to pay should be taxed. Similarly, even rate of tax could increase with higher income.
- The Equal-Distribution Principle
Income, wealth and transaction may be taxed at a fixed percentage; that is, people who earn more and spend more should pay more taxes, but not pay a higher rate of tax.

Kinds of taxes

- Proportional tax/Flat Tax
A tax system that requires the same percentage of income from all taxpayers regardless of their earnings. A proportional tax applies the same tax rate across low, middle and high-income taxpayers. The proportional tax is in contrast to a progressive tax, where taxpayers with higher incomes pay higher tax rates than taxpayers with lower incomes. A proportional tax is also called a flat tax.
- Regressive tax
A tax that takes a larger percentage from a person's low-income than from another person's high-income. A regressive tax is generally a tax that is applied uniformly. This means that it hits lower-income individuals harder.
- Progressive tax
A tax that takes a larger percentage from high-income earners than it does from low-income earners. In other words, the more one earns, the more tax he would have to pay. The tax amount is proportionately equal to someone's status in the society. A rich man should pay more than a poor man.

Characteristics of tax laws

Following are major characteristics of a taxation system:

- Tax is an enforced contribution
Tax payment is not voluntary in nature and the imposition is not dependent upon the will of the person taxed.
- Tax is generally payable in cash (bank)
This means that payment by cheques, promissory notes, or in kind is not accepted.
- Tax is proportionate in character
Payment of taxes should be based on the ability to pay principle; higher income of the tax payer, the bigger amount of the tax paid.
- Tax is levied (to impose; collect) on income, transactions or property
There are taxes that are imposed or levied on acts, rights or privileges.
- Tax is levied by the state which has jurisdiction over the person or property
As a general rule, only persons, properties, acts, right or transaction within the jurisdiction of the taxing state are subjects for taxation.
- Tax is levied by the law making body of the state
This means that law must be enacted first by the Parliament in Pakistan.
- Tax is levied for public purposes
Taxes are imposed to support the government in implementation of projects and programs.

The principles of a sound tax system

- **Fiscal adequacy**
The sources of revenue taken as a whole should be sufficient to meet the expenditures of the government, regardless of business, export taxes, trade balances and problems of economic adjustments. Revenues should be capable of expanding or contracting annually in response to variations in public expenditures.
- **Equality or Theoretical Justice**
Taxes levied must be based upon the ability of the citizen to pay.
- **Administrative Feasibility**
In a successful tax system, tax should be clear and plain to taxpayers, capable of enforcement by the adequate and well-trained public officials, convenient as to the time and manner of payment and not unduly burdensome to discourage business activity.
- **Consistency or Compatibility with Economic Goals**
Tax laws should be consistent with economic goals or programs of the government which pertain to basic services intended for the masses.

3 INTRODUCTION TO DIFFERENT TAXATION LAWS OF PAKISTAN

3.1 Brief overview of different direct and indirect taxes

Federal taxes in Pakistan like most of the taxation systems in the world are classified into two broad categories, viz., direct and indirect taxes. A broad description regarding the nature of administration of these taxes is explained below:

DIRECT TAXES

Direct taxes are those that are levied directly on the income or wealth of individuals or organizations and are paid directly to the government by the taxpayer. The burden of a direct tax cannot be shifted to another person or entity.

Income Tax

Direct taxes primarily comprise of Income Tax. In the Income Tax Ordinance, 2001, tax is levied generally on the net income of a taxpayer earned during a tax year computed by applying the specified tax rates as applicable to respective taxpayer.

For the purpose of the charge of tax and the computation of total income, all income is classified under the following heads:

- Salary
- Income from property
- Income from business
- Capital gains; and
- Income from other sources

Capital Value Tax

Capital value tax on different transaction such as transfer of immoveable property, transfer of rights etc.

INDIRECT TAXES

Indirect taxes are imposed on the sale or consumption of goods and services. The indirect tax is transferred from the supplier or seller to the end consumer, who pays the tax as part of the purchase price.

Example: In the case of sales tax, the importer pays the tax to the customs department and then recovers it from the manufacturer. The manufacturer, in turn, recovers it from the distributor, who passes it on to the wholesaler. The wholesaler then recovers the tax from the retailer, and ultimately, the retailer recovers the tax from the consumer.

Following are the indirect taxes under the Pakistani Taxation System.

Custom Duty

Goods imported and exported from Pakistan are liable to rates of customs duties as prescribed in Pakistan Customs Tariff. Customs duties in the form of import duties and export duties constitute a major part of the total tax receipts. The rate structure of customs duty is determined by a large number of socio-economic factors. However, the general scheme envisages higher rates on luxury items as well as on less essential goods. The import tariff has been given an industrial bias by keeping the duties on industrial plants and machinery and raw material lower than those on consumer goods.

Federal Excise Duty

Federal Excise duties are levied on a limited number of goods produced or manufactured, and services provided or rendered in Pakistan. On most of the items Federal Excise duty is charged on the basis of value or retail price. Some items are, however, chargeable to duty on the basis of weight or quantity. Classification of goods is done in accordance with the Harmonized Commodity Description and Coding system which is being used all over the world. All exports are subject to a zero percent Federal Excise Duty. Additionally, any duty paid on these goods is refundable from the tax department in accordance with the applicable rules. Examples include duty on tobacco, cigarettes, and cigarette substitutes.

Sales Tax

Sales tax is levied at various stages of economic activity:

- All taxable goods imported into Pakistan, payable by the importers;
- All taxable supplies made in Pakistan by a registered person in the course of furtherance of any business carried on by him; and
- All taxable services provided in Pakistan.

There is an in-built system of input tax adjustment and a registered person can make adjustment of tax paid at earlier stages against the tax payable by him on his supplies. Thus, the tax paid at any stage does not exceed 18% of the total sales price of the supplies. In Pakistan, the government has the flexibility to levy sales taxes at varying rates, which may be higher or lower than 18%.

4 HISTORY OF TAX LAWS IN PAKISTAN

4.1 History of tax laws in Pakistan

In Pakistan, Federal Government is empowered to levy and collect tax on the income of a person. The history of modern income taxation dates back to the year 1860. The British Empire introduced first formal Income Tax Act of 1860 in an effort to end the budgetary deficit faced due to the war of independence of 1857. The tax was not intended to be permanent and was repealed in 1865.

The Income Tax Act of 1886 was a general income tax that had been imposed on traders by some of the provinces. This Act of 1886 was a great improvement on earlier enactments. Its basic scheme, by and large, survives till today. It introduced the definition of “agricultural income” which is almost the same as in the Income Tax Ordinance 2001. This Act continued in force for 32 years.

The 1918 Act consolidated a number of wartime amendments. A graduated super tax on income over Rs.50,000 and on the undistributed profits of the corporation and other entities was introduced by the Super Tax Act of 1917 and continued in force through modifications by the Super Tax Act of 1920. The Income Tax Act and the Super Tax Act were later on consolidated in another act i.e. the Income Tax Act of 1922, which remained in force in Pakistan till 30th June 1979; when the new law was promulgated i.e. the Income Tax Ordinance, 1979 with effect from 1st July 1979.

Income Tax Ordinance 1979 was amended through innumerable presidential ordinances, annual finance acts/ordinances and statutory regulatory orders (SROs) and most of its lacunas were removed over a long period of time. On 13th September 2001, a new ordinance (i.e.) Income Tax Ordinance, 2001 was promulgated.

CONSTITUTIONAL PROVISIONS ON TAXES

IN THIS CHAPTER:

1. Federal financial procedures
2. Provincial financial procedures
3. Distribution of revenues between federation and provinces
4. Federal legislative list

1 FEDERAL FINANCIAL PROCEDURES

1.1 Introduction

Constitution of Pakistan is the prime source for all legislations in Pakistan. It provides that tax shall only be levied by or under the authority of Act of (Majlis-e-Shoora) Parliament (Article 77). The Constitution distributes powers among Federation and Provinces. It provides procedures for levy and collection of taxes as well as procedures for use of funds received from taxes or by the Federation from any other source. This chapter is divided into three main areas which are as follows:

- Federal Financial Procedures
- Provincial Financial Procedures
- Distribution of Revenues between Federation & Provinces

These areas are now explained in detail in the upcoming paragraphs.

1.2 Federal consolidated fund and public account and expenditure to be charged to Federal constitutional fund

1.2.1 Federal consolidated fund and public account [Article 78]

- All revenues received by the Federal Government, all loans raised by that Government and all monies received by it in repayment of any loan, shall form part of a consolidated fund, to be known as the Federal Consolidated Fund.
- All other monies:
 - received by or on behalf of the Federal Government; or
 - received by or deposited with the Supreme Court or any other court established under the authority of the Federation;shall be credited to the Public Account of the Federation.

1.2.2 Custody of federal consolidated fund and public account [Article 79]

The custody of the Federal Consolidated Fund, the payment or monies into that Fund, the withdrawal of monies there from, the custody of other monies received by or on behalf of the Federal Government, their payment into, and withdrawal from, the Public Account of the Federation, and all matters connected with or ancillary to the matters aforesaid shall be regulated by Act of Majlis-e-Shoora (Parliament) or, until provision in that behalf is so made, by rules made by the President.

1.2.3 Annual budget statement [Article 80]

- The Federal Government shall, in respect of every financial year, cause to be laid before the National Assembly a statement of the estimated receipts and expenditure of the Federal Government for that year, in this Part, referred to as the annual budget statement.
- The annual budget statement shall show separately:
 - the sums required to meet expenditure described by the Constitution as expenditure charged upon the Federal Consolidated Fund; and
 - the sums required to meet other expenditure proposed to be made from the Federal Consolidated Fund; and
- The annual budget statement shall distinguish expenditure on revenue account from other expenditure.

1.2.4 Expenditure charged upon federal consolidated fund [Article 81]

The following expenditure shall be expenditure charged upon the Federal Consolidated Fund:-

- the remuneration payable to the President and other expenditure relating to his office, and the remuneration payable to-
 - the Judges of the Supreme Court and the Islamabad High Court
 - the Chief Election Commissioner;
 - the Chairman and the Deputy Chairman;
 - the Speaker and the Deputy Speaker of the National Assembly;
 - the Auditor-General;
- The administrative expenses, including the remuneration payable to officers and servants, of the Supreme Court, the Islamabad High Court, the department of the Auditor-General, the Office of the Chief Election Commissioner and of the Election Commission and the Secretariats of the Senate and the National Assembly;
- All debt charges for which the Federal Government is liable, including interest, sinking fund charges, the repayment or amortisation of capital, and other expenditure in connection with the raising of loans, and the service and redemption of debt on the security of the Federal Consolidated Fund;
- Any sums required to satisfy any judgment, decree or award against Pakistan by any court or tribunal; and
- Any other sums declared by the Constitution or by Act of Majlis-e-Shoora (Parliament) to be so charged.

1.2.5 Procedure relating to Annual Budget Statement [Article 82]

- So much of the Annual Budget Statement as relates to expenditure charged upon the Federal Consolidated Fund may be discussed in, but shall not be submitted to the vote of, the National Assembly.
- So much of the Annual Budget Statement as relates to other expenditure shall be submitted to the National Assembly in the form of demands for grants, and the Assembly shall have power to assent to, or to refuse to assent to, any demand, or to assent to any demand subject to a reduction of the amount specified therein;

However, for a period of ten years from the commencing day or the holding of the second general election to the National Assembly, whichever occurs later, a demand shall be deemed to have been assented to without any reduction of the amount specified therein, unless, by the votes of a majority of the total membership of the Assembly, it is refused or assented to subject to a reduction of the amount specified therein.

- No demand for a grant shall be made except on the recommendation of the Federal Government.

1.2.6 Authentication of schedule of authorised expenditure [Article 83]

1. The Prime Minister shall authenticate by his signature a schedule specifying:
 - a) the grants made or deemed to have been made by the National Assembly under Article 82, and
 - b) the several sums required to meet the expenditure charged upon the Federal Consolidated Fund but not exceeding, in the case of any sum, the sum shown in the statement previously laid before the National Assembly.
2. The schedule so authenticated shall be laid before the National Assembly, but shall not be open to discussion or vote thereon.
3. Subject to the Constitution, no expenditure from the Federal Consolidated Fund shall be deemed to be duly authorised unless it is specified in the schedule so authenticated and such schedule is laid before the National Assembly as stated above.

1.2.7 Supplementary and excess grants [Article 84]

If in respect of any financial year it is found that:

- a) the amount authorized to be expended for a particular service for the current financial year is insufficient, or that a need has arisen for expenditure upon some new service not included in the Annual Budget Statement for that year; or
- b) any money has been spent on any service during a financial year in excess of the amount granted for that service for that year;

the Federal Government shall have power to authorize expenditure from the Federal Consolidated Fund, whether the expenditure is charged by the Constitution upon that Fund or not, and shall cause to be laid before the National Assembly a Supplementary Budget Statement or, as the case may be, an Excess Budget Statement, setting out the amount of that expenditure, and the provisions of Articles 80 to 83 shall apply to those statements as they apply to the annual budget statement.

1.2.8 Votes on account [Article 85]

Notwithstanding anything contained in the foregoing provisions relating to financial matters, the National Assembly shall have power to make any grant in advance in respect of the estimated expenditure for a part of any financial year, not exceeding four months, pending completion of the procedure prescribed in Article 82 for the voting of such grant and the authentication of the schedule of authorized expenditure in accordance with the provisions of Article 83 in relation to the expenditure.

1.2.9 Power to authorise expenditure when assembly stands dissolved [Article 86]

Notwithstanding anything contained in the foregoing provisions relating to financial matters, at any time when the National Assembly stands dissolved, the Federal Government may authorize expenditure from the Federal Consolidated Fund in respect of the estimated expenditure for a period not exceeding four months in any financial year, pending completion of the procedure prescribed in Article 82 for the voting of grants and the authentication of the schedule of authorized expenditure in accordance with the provisions of Article 83 in relation to the expenditure

1.2.10 Secretariats of Majlis-e-Shoora (Parliament) [Article 87]

- Each House shall have a separate Secretariat:
- Provided that nothing in this clause shall be construed as preventing the creation of posts common to both Houses.
- Majlis-e-Shoora (Parliament) may by law regulate the recruitment and the conditions of service of persons appointed to the Secretarial staff of either House.
- Until provision is made by Majlis-e-Shoora (Parliament) under clause (2), the Speaker or, as the case may be, the Chairman may, with the approval of the President, make rules regulating the recruitment and the conditions of service, of persons appointed to the secretarial staff of the National Assembly or the Senate.

1.2.11 Finance committees [Article 88]

- The expenditure of the National Assembly and the Senate within authorised appropriations shall be controlled by the National Assembly or, as the case may be, the Senate acting on the advice of its Finance Committee.
- The Finance Committee shall consist of the Speaker or, as the case may be, the Chairman, the Minister of Finance and such other members as may be elected thereto by the National Assembly or, as the case may be, the Senate.
- The Finance Committee may make rules for regulating its procedure.

2 PROVINCIAL FINANCIAL PROCEDURES

2.1 Introduction

Provincial Financial Procedures are almost the same as Federal Financial Procedures. However, these are discussed in detail for clarity on the issue

2.2 Provincial consolidated fund and public account and expenditure to be charged to Provincial consolidated fund

2.2.1 Provincial consolidated fund and public account [Article 118]

- All revenues received by the Provincial Government, all loans raised by that Government, and all monies received by it in repayment of any loan, shall form part of a consolidated fund, to be known as the Provincial Consolidated Fund.
- All other monies:
 - received by or on behalf of the Provincial Government; or
 - received by or deposited with the High Court or any other court established under the authority of the Province;

Shall be credited to the Public Account of the Province.

2.2.2 Custody of provincial consolidated fund and public account [Article 119]

The custody of the Provincial Consolidated Fund, the payment of moneys into that Fund, the withdrawal of monies therefrom, the custody of other monies received by or on behalf of the Provincial Government, their payment into, and withdrawal from, the Public Account of the Province, and all matters connected with or ancillary to the matters aforesaid, shall be regulated by Act of the Provincial Assembly or, until provision in that behalf is so made, by rules made by the Governor.

2.2.3 Annual budget statement [Article 120]

- The Provincial Government shall, in respect of every financial year, cause to be laid before the Provincial Assembly a statement of the estimated receipts and expenditure of the Provincial Government for that year, in this Chapter referred to as the Annual Budget Statement.
- The annual budget statement shall show separately:
 - The sums required to meet expenditure described by the Constitution as expenditure charged upon the Provincial Consolidated Fund; and
 - The sums required to meet other expenditure proposed to be made from the Provincial Consolidated Fund;

and shall distinguish expenditure on revenue account from other expenditure.

2.2.4 Expenditure charged upon provincial consolidated fund [Article 121]

- The following expenditure shall be expenditure charged upon the Provincial Consolidated Fund:
 - The remuneration payable to the Governor and other expenditure relating to his office, and the remuneration payable to:
 - the Judges of the High Court; and
 - the Speaker and Deputy Speaker of the Provincial Assembly;
 - the administrative expenses, including the remuneration payable to officers and servants, of the High Court and the Secretariat of the Provincial Assembly;

- All debt charges for which the Provincial Government is liable, including interest, sinking fund charges, the repayment or amortization of capital, and other expenditure in connection with the raising of loans, and the service and redemption of debt on the security of the Provincial Consolidation Fund;
- Any sums required to satisfy any judgment, decree or award against the Province by any court or tribunal; and
- Any other sums declared by the Constitution or by Act of the Provincial Assembly to be so charged.

2.2.5 Procedure relating to annual budget statement [Article 122]

- So much of the Annual Budget Statement as relates to expenditure charged upon the Provincial Consolidated Fund may be discussed in, but shall not be submitted to the vote of, the Provincial Assembly.
- So much of the Annual Budget Statement as relates to other expenditure shall be submitted to the Provincial Assembly in the form of demands for grants, and that Assembly shall have power to assent to, or to refuse to assent to, any demand, or to assent to any demand subject to a reduction of the amount specified therein:
- No demand for a grant shall be made except on the recommendation of the Provincial Government.

2.2.6 Authentication of schedule of authorised expenditure [Article 123]

- The Chief Minister shall authenticate by his signature a schedule specifying:
 - The grants made or deemed to have been made by the Provincial Assembly under Article, 122 and
 - The several sums required to meet the expenditure charged upon the Provincial Consolidated Fund but not exceeding, in the case of any sum, the sum shown in the statement previously laid before the Assembly.
- The schedule so authenticated shall be laid before the Provincial Assembly, but shall not be open to discussion or vote thereon.
- Subject to the Constitution, no expenditure from the Provincial Consolidated Fund shall be deemed to be duly authorized unless it is specified in the schedule so authenticated and such schedule is laid before the Provincial Assembly as stated above.

2.2.7 Supplementary and excess grants [Article 124]

If in respect of any financial year it is found that:

- the amount authorized to be expended for a particular service for the current financial year is insufficient, or that a need has arisen for expenditure upon some new service not included in the annual budget statement for that year; or
- any money has been spent on any service during a financial year in excess of the amount granted for that service for that year;

the Provincial Government shall have power to authorize expenditure from the Provincial Consolidated Fund, whether the expenditure is charged by the Constitution upon that Fund or not, and shall cause to be laid before the Provincial Assembly a Supplementary Budget Statement or, as the case may be, an Excess Budget Statement, setting out the amount of that expenditure, and the provisions of Article 120 to 123 shall apply to those statements as they apply to the annual budget statement.

2.2.8 Votes on account [Article 125]

Notwithstanding anything contained in the foregoing provisions relating to financial matters, the Provincial Assembly shall have power to make any grant in advance in respect of the estimated expenditure for a part of any financial year, not exceeding three months, pending completion of the procedure prescribed in Article 122 for the voting of such grant and the authentication of the schedule of expenditure in accordance with the provisions of Article 123 in relation to the expenditure.

2.2.9 Power to authorise expenditure when assembly stands dissolved [Article 126]

Notwithstanding anything contained in the foregoing provisions relating to financial matters, at any time when the Provincial Assembly stands dissolved, the Provincial Government may authorize expenditure from the Provincial Consolidated Fund in respect of the estimated expenditure for a period not exceeding four months in any financial year, pending completion of the procedure prescribed in Article 122 for the voting of grants and the authentication of the schedule of authorized expenditure in accordance with the provisions of Article 123 in relation to the expenditure.

2.2.10 Provisions relating to Provincial Assembly, etc., to apply to provincial assembly, etc. [Article 127]

- Subject to the Constitution, the provisions of clauses (2) to (8) of Article 53, clauses (2) and (3) of Article 54, Article 55, Articles 63 to 67, Article 69, Article 77, Article 87 and Article 88 shall apply to and in relation to a Provincial Assembly or a committee or members thereof or the Provincial Government, but so that:
 - any reference in those provisions to Majlis-e-Shoora (Parliament), a House or the National Assembly shall be read as a reference to the Provincial Assembly;
 - any reference in those provisions to the President shall be read as a reference to the Governor of the Province;
 - any reference in those provisions to the Federal Government shall be, read as a reference to the Provincial Government;
 - any reference in those provisions to the Prime Minister shall be read as a reference to the Chief Minister.
 - any reference in those provisions to a Federal Minister shall be read as a reference to a Provincial Minister.
 - any reference in those provisions to the National Assembly of Pakistan shall be read as a reference to the Provincial Assembly in existence immediately before the commencing day.

3 DISTRIBUTION OF REVENUES BETWEEN FEDERATION AND PROVINCES

3.1 Introduction

It is essential to know who authorises which revenues. Federation can only tax to the extent the Constitution authorises it to legislate for collection of revenues. Similarly, Provinces can only legislate for levy of taxes to the extent authorised in the Constitution of Pakistan. This part of the chapter describes the mechanism for determination of distribution of revenue among Federation and Provinces.

3.2 National Finance Commission [Article 160]

1. Within six months of the commencing day and thereafter at intervals not exceeding five years, the President shall constitute a National Finance Commission consisting of the Minister of Finance of the Federal Government, the Ministers of Finance of the Provincial Governments, and such other persons as may be appointed by the President after consultation with the Governors of the Provinces
2. It shall be the duty of the National Finance Commission to make recommendations to the President as to:
 - a) the distribution between the Federation and the Provinces of the net proceeds of the taxes;
 - b) the making of grants-in-aid by the Federal Government to the Provincial Governments;
 - c) the exercise by the Federal Government and the Provincial Governments of the borrowing powers conferred by the Constitution; and
 - d) any other matter relating to finance referred to the Commission by the President.
3. The taxes referred above are the following taxes raised under the authority of Majlis-e-Shoora (Parliament), namely:
 - i. taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund;
 - ii. taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed;
 - iii. export duties on cotton, and such other export duties as may be specified by the President;
 - iv. such duties of exercise as may be specified by the President; and
 - v. such other taxes as may be specified by the President.

(3A) The share of the Provinces, in each Award of National Finance Commission shall not be less than the share given to the Provinces in the previous Award.

(3B) The Federal Finance Minister and Provincial Finance Ministers shall monitor the implementation of the Award biannually and lay their reports before both Houses of Majlis-e-Shoora (Parliament) and the Provincial Assemblies.

4. As soon as may be after receiving the recommendation, of the National Finance Commission, the President shall, by Order, specify, in accordance with the recommendations of the Commission, the share of the net proceeds of the taxes mentioned above which is to be allocated to each Province, and that share shall be paid to the Government of the Province concerned, and, notwithstanding the provision of Article 78 shall not form part of the Federal Consolidated Fund.
5. The recommendations of the National Finance Commission, together with an explanatory memorandum as to the action taken thereon, shall be laid before both Houses and the Provincial Assemblies.
6. At any time before the above Order is made, the President may, by Order, make such amendments or modifications in the law relating to the distribution of revenues between the Federal Government and the Provincial Governments as he may deem necessary or expedient.
7. The President may, by Order, make grants-in-aid of the revenues of the Provinces in need of assistance and such grants shall be charged upon the Federal Consolidated Fund.

3.3 Natural gas and hydro-electric power [Article 161]

Notwithstanding the provisions of Article 78:

- the net proceeds of the Federal duty of excise on natural gas levied at well-head and collected by the Federal Government, and of the royalty collected by the Federal Government, shall not form part of the Federal Consolidated Fund and shall be paid to the Province in which the well-head of natural gas is situated.
- the net proceeds of the Federal duty of excise on oil levied at well-head and collected by the Federal Government, shall not form part of the Federal Consolidated Fund and shall be paid to the Province in which the well-head of oil is situated.
- the net profits earned by the Federal Government, or any undertaking established or administered by the Federal Government from the bulk generation of power at a hydro-electric station shall be paid to the Province in which the hydro-electric station is situated.

Explanation: for the purposes of this clause "net profits" shall be computed by deducting from the revenues accruing from the bulk supply of power from the bus-bars of a hydro-electric station at a rate to be determined by the Council of Common Interests, the operating expenses of the station, which shall include any sums payable as taxes, duties, interest or return on investment, and depreciations and element of obsolescence, and overheads, and provision for reserves.

3.4 Prior sanction of President required to Bills affecting taxation in which provinces are interested [Article 162]

No Bill or amendment which imposes or varies a tax or duty the whole or part of the net proceeds whereof is assigned to any province, or which varies the meaning of the expression "agricultural income" as defined for the purposes of the enactments relating to income-tax, or which affects the principles on which under any of the foregoing provisions of this chapter monies are or may be distributable to provinces, shall be introduced or moved in the National Assembly except with the previous sanction of the President

3.5 Provincial taxes in respect of professions, etc. [Article 163]

A Provincial Assembly may by Act impose taxes, not exceeding such limits as may from time to time be fixed by Act of Majlis-e-Shoora (Parliament), on persons engaged in professions, trades, callings or employments, and no such Act of the Assembly shall be regarded as imposing a tax on income.

3.6 Grants out of consolidated fund [Article 164]

The Federation or a Province may make grants for any purpose, notwithstanding that the purpose is not one with respect to which Majlis-e-Shoora (Parliament) or, as the case may be, a Provincial Assembly may make laws.

3.7 Exemption of certain public property from taxation [Article 165]

- The Federal Government shall not, in respect of its property or income, be liable to taxation under any Act of Provincial Assembly and, subject to clause (2), a Provincial Government shall not, in respect of its property or income, be liable to taxation under Act of Majlis-e-Shoora (Parliament) or under Act of the Provincial Assembly of any other Province.
- If a trade or business of any kind is carried on by or on behalf of the Government of a Province outside that Province, that Government may, in respect of any property used in connection with that trade or business or any income arising from that trade or business, be taxed under Act of Majlis-e-Shoora (Parliament) or under Act of the Provincial Assembly of the Province in which that trade or business is carried on.
- Nothing in this Article shall prevent the imposition of fees for services rendered.

3.8 Power of Majlis-e-Shoora (Parliament) to impose tax on the income of certain corporations, etc. [Article 165A]

- For the removal of doubt, it is hereby declared that Majlis-e-Shoora (Parliament) has, and shall be deemed always to have had, the power to make a law to provide for the levy and recovery of a tax on the income of a corporation, company or other body or institution established by or under a Federal law or a provincial law or an existing law or a corporation, company or other body or institution owned or controlled, either directly or indirectly, by the Federal Government or a Provincial Government, regardless of the ultimate destination of such income.
- All orders made, proceedings taken and acts done by any authority or person, which were made, taken or done, or purported to have been made, taken or done, before the commencement of the Constitution (Amendment) Order 1985, in exercise of the powers derived from any law referred to in above paragraph, or in execution of any orders made by any authority in the exercise or purported exercise of powers as aforesaid, shall, notwithstanding any judgment of any court or tribunal, including the Supreme Court and a High Court, be deemed to be and always to have been validly made, taken or done and shall not be called in question in any court, including the Supreme Court and a High Court, on any ground whatsoever.
- Every judgment or order of any court or tribunal, including the Supreme Court and a High Court, which is repugnant to the provisions stated above shall be, and shall be deemed always to have been, void and of no effect whatsoever.

4 FEDERAL LEGISLATIVE LIST

4.1 Introduction

Federal Legislative List defines the areas whereby Federal Government can legislate to collect revenue. This is a long list, however, we herein discuss the areas which relate to taxation.

4.2 Powers of the Federation to legislate on taxes

Following entries in the Federal legislative list as contained in the Constitution of Pakistan relates to taxes:

Entry No	Taxes which can be imposed by the Federation
43.	Duties of customs, including export duties.
44.	Duties of excise, including salt, but not including alcoholic liquors, opium or other narcotics;
47.	Taxes on income other than agricultural income;
48.	Taxes on corporations.
49.	Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services.
50.	Taxes on the capital value of the assets, not including taxes on immovable property.
51.	Taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy.
52.	Taxes and duties on the production capacity of any plant, machinery, undertaking, establishment or installation in lieu of any one or more of them.
53.	Terminal taxes on goods or passengers carried by railway, sea or air; taxes on their fares and freights.

Keeping in view the above provisions, following laws are enacted by the Federal Government:

Legislative powers of Federation	Laws enacted thereunder
Taxes on income other than agricultural income; Taxes on corporations. Taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy.	Income Tax Ordinance, 2001
Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services Taxes and duties on the production capacity of any plant, machinery, undertaking, establishment or installation in lieu of any one or more of them.	Sales Tax Act, 1990, Federal Excise Act, 2005, Customs Act, 1969
Taxes on the capital value of the assets, not including taxes on immovable property.	Capital Value Tax levied through Finance Act, 1989

4.3 Powers of the Provinces to legislate on taxes

All taxes other than the mentioned in above list of Federal legislative list as contained in the Constitution of Pakistan are covered in the scope of legislation of Provinces. Accordingly, various types of taxes are introduced by the Provinces:

- Sales tax on services
- Taxes on transfer of immoveable property
- Professional tax
- Tax on luxury houses
- Tax on registration of luxury vehicles etc.
- Property tax

IN THIS CHAPTER:

1. Ethics
2. Deductions allowed
3. Ethics for tax administrators
4. Ethics for tax practitioners
5. Ethics for taxpayers
6. Code of Ethics for Chartered Accountants as applicable to Tax Services

1 ETHICS

1.1 Ethics – meanings and application

The word *ethics* is derived from the Greek word *ethos*, which means "character," and from the Latin word *mores*, which means "customs." Aristotle was one of the first great philosophers to study ethics. To him, ethics was more than a moral, religious, or legal concept. He believed that the most important element in ethical behaviour is knowledge that actions are accomplished for the betterment of the common good. He asked whether actions performed by individuals or groups are good both for an individual or a group and for society. To determine what is ethically good for the individual and for society, Aristotle said, it is necessary to possess three virtues of practical wisdom:

- i. temperance,
- ii. courage, and
- iii. justice.

2 ETHICS FOR TAX LEGISLATORS

2.1 Ethics for tax legislators

"Legislative office is a public trust, and every effort to realise personal gain through official conduct is a violation of that trust"

The constitution mandates the legislature to enact a code of ethics prohibiting conflicts between the public duty and private interests of members of the legislature, disclosure of prohibited conduct and financial interest (if any) and post-service restrictions. In addition, the constitution requires that the legislature enact a code of ethics for all officials and employees of the state and its political subdivisions

2.2 Canons of taxation

They are the basic principles (i.e.) rules set to build a 'Good Tax System'. Canons of Taxation were first originally laid down by economist Adam in his famous book "The Wealth of Nations". These canons of taxation were discussed in Chapter 1 in a summary. In this book, Adam Smith only gave four canons of taxation, which are now known as the "Original or Main Canons of Taxation". These are as follows:

1. Canon of Equity

The principle aims at providing economic and social justice to the people. According to this principle, every person should pay to the government depending upon his ability to pay. Rich people should pay higher taxes to the government, because without the protection of the government authorities (Police, Defence, etc.) they would not have earned and enjoyed their income. Adam Smith argued that the taxes should be proportional to income, i.e., citizens should pay taxes in proportion to the revenue which they respectively enjoy under protection of the State.

2. Canon of Certainty

According to Adam Smith, the tax which an individual has to pay should be certain, not arbitrary. The taxpayer should know in advance how much tax he has to pay, at what time he has to pay the tax, and in what form the tax is to be paid to the government. In other words, every tax should satisfy the canon of certainty. At the same time a good tax system also ensures that the government is also certain about the amount that would be collected by way of tax.

3. Canon of Convenience

The mode and timing of tax payment should be as far as possible, convenient to the taxpayers. For example, land revenue is collected at time of harvest and income tax is deducted at source. Convenient tax system encourages people to pay tax and increases tax revenue.

4. Canon of Economy

This principle states that there should be economy in tax administration. The cost of tax collection should be lower than the amount of tax collected. It may not serve any purpose, if the taxes imposed are widespread but are difficult to administer. Therefore, it would make no sense to impose certain taxes, if they are difficult to administer.

Additional Canons of Taxation Activities and functions of the government have increased significantly since Adam Smith's time. Governments are expected to maintain economic stability, full employment, reduce income inequality and promote growth and development. Tax system should be such that it meets the requirements of growing state activities. Accordingly, modern economists gave following additional canons of taxation.

5. **Canon of Productivity:** It is also known as the canon of fiscal adequacy. According to this principle, the tax system should be able to yield enough revenue for the treasury and the government should have no need to resort to deficit financing. This is a good principle to follow in a developing economy.
6. **Canon of Elasticity:** According to this canon, every tax imposed by the government should be elastic in nature. In other words, the income from tax should be capable of increasing or decreasing according to the country's requirement. For example, if the government needs more income at a time of crisis, the tax should be capable of yielding more income through increase in its rate.

7. **Canon of Flexibility:** It should be easily possible for the authorities to revise the tax structure both with respect to its coverage and rates, to suit the changing requirements of the economy. With changing time and conditions, the tax system needs to be changed without much difficulty. The tax system must be flexible and not rigid.
8. **Canon of Simplicity:** The tax system should not be complicated. That makes it difficult to understand and administer and results in problems of interpretation and disputes. In Pakistan, efforts of the government in recent years have been to make the system simple.
9. **Canon of Diversity:** This principle states that the government should collect taxes from different sources rather than concentrating on a single source of tax. It is not advisable for the government to depend upon a single source of tax, it may result in inequity for a certain section of the society and uncertainty for the government to raise funds. If the tax revenue comes from diversified sources, then any reduction in tax revenue from one source for any reason is bound to be small.

3 ETHICS FOR TAX ADMINISTRATORS

3.1 Powers of tax administrators

The tax administration is not responsible for tax policy and tax legislation but deals with current tax system. Federal Board of Revenue is empowered under the law to monitor, assess, levy and collect taxes as provided in the tax statutes. There are a number of occasions whereby they possess any of the following powers:

- Assess taxes (including best judgment);
- Collect Revenue;
- Seize Property;
- Attach bank accounts;
- Commence legal (criminal/civil) proceedings against taxpayer

Such powers may be misused and can become abusive powers as exercise of that power can result in the following against the taxpayer:

- Loss of property and income;
- Imprisonment

So, these powers can result in the loss of some of the fundamental human rights of the taxpayer. Ethics tend to bring these powers within the principles of goodness and morality.

► *Illustration:*

Mr. Zahid is running a textile unit and tax amounting to Rs. 5M is assessed against him. His bank accounts balance is Rs. 10M. However, he has to fulfil his exports orders. In case he fails to fulfil his orders, he would lose his customers and that orders. Considering his present critical financial position, Zahid believes that tax recovery proceedings by recovery from bank account (Attachment of bank account) would entail an irreparable loss to his organisation. So he files a request to FBR for allowing him to pay the tax dues in instalments.

FBR staff has the power to allow him relief or recover this tax directly from his bank account. Justice and equity demands that his request should be entertained so that his continuation and prosperity of business would eventually result in payment of better taxes in future whereas recovery of tax could jeopardise his business operations.

► *Illustration:*

Income Tax Ordinance, sales tax law, Federal excise law empower tax authorities to select cases for audit. This power can be misused by selecting some cases while leaving many unaudited. Thus, despite the fact that law provides unfettered powers, these should be exercised on some ethical and rational basis.

3.2 Pillars of tax administration

In order to safeguard the interest of taxpayers and avoid abuse of powers by the tax administration, following four pillars of Tax administration are defined:

1. **Fairness**

Strive to be impartial, fair, neutral and consistent in administering the law without regard to race, social or economic circumstances.

2. **Transparency**

All Proceedings must be transparent and must be seen as transparent.

3. **Equity**

Best tax administration is not that which collects most revenue. Rather it depends on how this revenue generation is actually accomplished. Whether all stakeholders are taxed fairly or tax is collected from the poor/salaried class after failing to collect taxes from entrepreneurs/businesses. Thus, equity demands that tax administrators should not achieve their objectives in an irrational manner.

4. Accountability

There must be a strong system of accountability for wrong doers which should curb corruption, nepotism and maladministration.

Under the four pillars, some of the ethical issues facing tax administration are:

1. Acceptance of gifts
2. Conflict of Interest
3. Selective application of the law/ or inconsistency in applying the law
4. Political influence
5. Confidentiality/secretcy
6. Discretion
7. Corruption
8. Lack of Autonomy

In order to avoid pitfalls of the abusive use of discretion, seven principles for structuring discretion are defined which are as under:

- Open plans
- Open policy statements
- Open rules
- Open findings
- Open reasons
- Open precedents
- Fair informal procedure

3.3 Responsibilities of the tax implementing authorities

A concise code which can enlist responsibilities of Tax Administrators can be as under:

1. Obey all laws relating to taxation and grant no exemptions, credit or advantage to any taxpayer that is not provided by the law;
2. Be dedicated to the highest ideals of honesty and integrity in all matters in order to maintain the respect and confidence of the government and taxpayers;
3. Strive to be impartial, fair, neutral and consistent in administering the law without regard to race, social status or economic circumstances;
4. Provide prompt, efficient and quality service to all stakeholders in an effort to exceed their expectations;
5. Refrain from actively participating in partisan political activities;
6. Accurately record proceedings and maintain taxpayer information in the strictest confidence and highest level of security;
7. Refrain from soliciting gifts for actions and non-actions;
8. Make reasonable effort to collect the proper amount of tax revenue due at the lowest possible cost to the state, and in a manner that warrants the highest degree of confidence in our integrity, efficiency, effectiveness and fairness;
9. Respond to valid taxpayer refund claims with the same diligence as employed in collection of taxes;
10. Educate taxpayers on their rights and responsibilities to ensure the highest possible levels of voluntary compliance to the laws.

4 ETHICS FOR TAX PRACTITIONERS

4.1 Moral and Ethical principles governing tax practitioners

There are five fundamental principles of ethics for tax practitioners. These are set out below:

1. **Integrity**

Tax Practitioners should be straightforward and honest in all professional and business relationships. Integrity implies not just honesty but also fair dealing and truthfulness.

2. **Objectivity**

Tax practitioners should not allow bias, conflicts of interest or undue influence of others to override their professional or business judgments.

3. **Professional competence and due care**

Tax Practitioners have a duty to maintain their professional knowledge and skill at such a level that a client or employer receives competent service, based on current developments in practice, legislation and techniques. Tax practitioners should act diligently and in accordance with applicable technical and professional standards.

4. **Confidentiality**

Tax Practitioners should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose such information to third parties without authority or unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of tax practitioners or third parties.

5. **Professional behaviour**

Tax practitioners should comply with relevant laws and regulations and should avoid any action which discredits the profession.

They should behave with courtesy and consideration towards all with whom they come into contact in their professional capacity.

5 ETHICS FOR TAXPAYERS

5.1 Morality behind tax compliance

There are three approaches to ethics for tax compliance which are as under:

1. **Utilitarianism**, which tells us to aim for the greatest total happiness across the population. In the economic sphere, we can interpret 'happiness' as the satisfaction of our desires; and so utilitarianism as aiming for maximum satisfaction of desires.
2. **Deontology**, which bases ethics on the idea of duty.
3. **Virtue ethics**, which focus on the virtues we should have, and on what constitutes a virtuous life. A broad conception of the virtues must be used here, encompassing not only virtues such as honesty, but also virtues such as using one's talents and leading a fulfilled life.

5.2 Ethics and morality for tax payers regarding taxation compliance

- For Taxpayers following utilitarian approach, the most important economic goals are to ensure that goods and services are available to allow everyone to have a decent life, and to ensure that these resources are distributed widely enough for all or most people to enjoy them. Motivating citizens to pay taxes even at the highest rate. Moreover, their compliance level would also be better as there is dire need for availability of resources for the vast majority of masses and the country.
- Taxpayers preferring the deontologist ethical approach lay down absolute duties. Such duty includes respect for other people's property rights. This could be interpreted to mean that there should be no tax at all, because tax is the forcible transfer of property from taxpayers. On the other hand, the duty to respect property rights could be used to argue that any social resources one uses should be paid for, even if one did not ask for those resources to be provided. Thus in order not to be a thief, anyone who uses a public hospital, or even a public road, should make sure that he or she pays tax to cover their use. So this approach envisages that taxes are paid as a matter of obligation by the taxpayer for use of public facilities.
- Virtue ethics can be a bit more helpful on the question of the fairness of taxation. One should use one's talents to the full. Financial incentives can encourage people to use their talents, but very high taxation dampens those incentives by reducing take-home pay. Another virtue is charity, either in the form of cash or time. The more take-home cash people have, the more likely it is that they would be able to afford charitable donations; and also find time from paid employment to perform charity work or other forms of civic service, as school trustees or Mutawali of Masjid for example. A third virtue is independence. It is good to earn what one needs rather than to depend on subsidies from others. Lower rates of taxation make independence more easily achievable.
- Tax can be used for all sorts of purposes, and it is often clear what ethicists of any particular kind would say about these purposes. We can start with the provision of law and order and the more extensive public services such as healthcare and education.
- Utilitarians will approve of taxation for these purposes because they allow more goods and services to be produced, and they also allow more non-materialistic desires to be satisfied. Virtue ethicists will approve because these services enhance people's opportunities to use their talents and to lead prosperous lives.
- When we turn to aid the poor, utilitarians would be prone to approve because it means increased transfer of resources from the rich to the poor rendering them in a happier position. Virtue ethicists will approve because with redistribution the poor can be helped to flourish and develop virtues, and because looking after the less fortunate is itself a virtue (although voluntary charity may be a greater virtue than forced payment). Deontologists can recognize a duty to care for the poor.
- Taxation addressing the needs of all these ethical thoughts can attract better compliance. Morality for citizens to pay taxes is justified as the State is responsible for providing a proper infrastructure for a decent life. The State is also obliged to provide endow with a level playing field to all the concerned so that talent on merit can be best explored and utilized. It therefore becomes necessary that taxes be paid to the State in return for basic needs benefits peace & prosperity, infrastructural development and economic growth etc.

5.3 Tax avoidance and evasion

In recent years, tax avoidance has been the subject of considerable public concern. It is compliance with the law, though aggressive or abusive avoidance, as opposed to simple tax planning, will seek to comply with the letter of the law, but to subvert its purpose.

Tax evasion occurs when someone acts against the law.

- Tax avoidance is generally the legal exploitation of the tax regime to one's own advantage, to attempt to reduce the amount of tax that is payable by means that are within the law whilst making a full disclosure of the material information to the tax authorities. Examples of tax avoidance involve using tax deductions, changing one's business structure through incorporation or establishing an offshore company in a tax haven.
- By contrast tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade the payment of taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting (such as under declaring income, profits or gains; or overstating deductions).

Difference between 'Tax Avoidance' & 'Tax Evasion'

TAX AVOIDANCE	TAX EVASION
Where the payment of tax is avoided though by complying with the provisions of law but defeating the intension of the law.	Where the payment of tax is avoided through illegal means or fraud.
Tax Avoidance is undertaken by taking advantage of loop holes in the law	Tax evasion is undertaken by employing unfair means & practices
Tax Avoidance is done through not malafied intention but complying the provision of law.	Tax Evasion is an unlawful way of paying lower taxes and defaulter may be punished.
Tax Avoidance looks like a tax planning and is done before the tax liability arises.	Tax evasion is blatant fraud and is done after the tax liability has arisen.
Example of tax avoidance is making use of donating to approved charity recognized by the FBR, to claim a tax credit in future when computing the tax liability.	Falsifying income tax return

► Illustration:

Tax Law	Objective
Mr.A earned Turnover of Rs. 10 M. However, he kept it as cash in his bank locker and hid it from tax authorities. He paid all related expenses from this cash.	Tax evasion , Criminal Act, he cannot buy any asset or settle liabilities unless he declares this income and also pays tax due on it
Mr. B earned income of Rs, 10 M. However, he declared only so much of income which is verifiable from the banks i.e. 6M, remaining amount he has hidden in a separate bank account	This too is tax evasion, a understatement is also an offence
Mr. C earned Rs. 10 M. However, he recorded 7M expenses employing legal tactics to reduce his net income and offering the remaining income of Rs. 3 Million for Taxes.	Tax avoidance, which is legally permissible.

The Impact of Tax Avoidance on Aggregate Welfare: A Utilitarian View

Utilitarianism is a moral philosophy that emphasizes the greatest overall happiness and well-being. According to utilitarian principles, actions are considered morally right if they result in the greatest amount of happiness or pleasure for the greatest number of people, and morally wrong if they produce the opposite

A utilitarian, focused on overall well-being, might not worry much about tax avoidance. This is because avoiding tax doesn't destroy wealth; it just keeps it in the private sector instead of moving it to the government. However, a key concern for utilitarians would be the unfair distribution of tax burdens. When the rich avoid taxes using smart lawyers, the tax burden shifts to people with lower incomes who can't afford such lawyers. This shift decreases the happiness of those with modest incomes more than it increases the happiness of the wealthier people who avoid taxes.

► *Examples 1:*

A wealthy business owner hires a tax lawyer to find legal ways to reduce their tax bill. As a result, they pay significantly less tax.

This means that lower-income individuals, who can't afford such legal services, end up bearing a larger share of the tax burden.

► *Example 2:*

A high-income individual transfers their money to an offshore account to avoid paying taxes in their home country.

Consequently, the government collects less revenue from wealthy individuals, leading to higher taxes or reduced services for ordinary citizens.

A virtue ethicist would perhaps dislike tax avoidance. It is, after all, hardly virtuous to exploit rules knowing that one is exploiting them in unintended ways to redistribute the disadvantage away from oneself. A deontologist would not positively favour tax avoidance, but might not condemn it either. Deontologists can easily argue for a duty to obey the law: yet obeying the law is something the tax planner takes care to do, in his own peculiar way.

Virtue Ethicist's View:

A wealthy individual uses complex financial strategies to pay less tax. A virtue ethicist would disapprove because this behavior isn't morally right and harms others by shifting the tax burden onto them.

Deontologist's View:

A business owner finds legal loopholes to minimize their tax bill. A deontologist might not condemn this behavior since it follows the law, even if the intention is to avoid paying taxes.

6 CODE OF ETHICS FOR CHARTERED ACCOUNTANTS AS APPLICABLE TO TAX SERVICES

The 'Code of Ethics for Chartered Accountants (Revised 2024)' is based on the Handbook of the International Code of Ethics for Professional Accountants (including International Independence Standards), 2023 Edition of the International Ethics Standards Board for Accountants, published by the International Federation of Accountants (IFAC) in September 2023 and is used with permission of IFAC

6.1 Tax Services

Providing tax services to an audit client might create a self-review or advocacy threat. This includes requirements that prohibit firms and network firms from providing certain tax services to audit clients in some circumstances because the threats created cannot be addressed by applying safeguards.

Factors that are relevant in evaluating the level of threats created by providing any tax service to an audit client include:

- The particular characteristics of the engagement.
- The level of tax expertise of the client's employees.
- The system by which the tax authorities assess and administer the tax in question and the role of the firm or network firm in that process.
- The complexity of the relevant tax regime and the degree of judgment necessary in applying it.

6.2 Tax return preparation

Providing tax return preparation services does not usually create a threat. Tax return preparation services involve:

- Assisting clients with their tax reporting obligations by drafting and compiling information, including the amount of tax due (usually on standardized forms) required to be submitted to the applicable tax authorities.
- Advising on the tax return treatment of past transactions and responding on behalf of the audit client to the tax authorities' requests for additional information and analysis (for example, providing explanations of and technical support for the approach being taken).

Tax return preparation services are usually based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice. Further, the tax returns are subject to whatever review or approval process the tax authority considers appropriate

6.3 Tax calculations for the purpose of preparing accounting entries

All Audit Clients

Preparing calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of preparing accounting entries that will be subsequently audited by the firm creates a self-review threat.

In addition to the factors in paragraph 6.1 above, a factor that is relevant in evaluating the level of the threat created when preparing such calculations for an audit client is whether the calculation might have a material effect on the financial statements on which the firm will express an opinion.

Audit Clients that are Not Public Interest Entities

Examples of actions that might be safeguards to address such a self-review threat when the audit client is not a public interest entity include:

- Using professionals who are not audit team members to perform the service.
- Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed.

Audit Clients that are Public Interest Entities

A firm or a network firm shall not prepare tax calculations of current and deferred tax liabilities (or assets) for an audit client that is a public interest entity for the purpose of preparing accounting entries that are material to the financial statements on which the firm will express an opinion.

The examples of actions that might be safeguards in (to all audit clients) to address self-review threats are also applicable when preparing tax calculations of current and deferred tax liabilities (or assets) to an audit client that is a public interest entity that are immaterial to the financial statements on which the firm will express an opinion.

► *Example:*

A Pakistani audit firm is faced with the following situations:

Situation 1

ABC limited an audit client has requested your firm to prepare current and deferred tax working for the purpose of preparing accounting entries that will be reviewed by your firm at the time of Audit. ABC Ltd is not a public interest entity.

Situation 2

ABC limited an audit client has requested your firm to prepare current and deferred tax working for the purpose of preparing accounting entries that will be reviewed by your firm at the time of Audit. ABC Ltd is public interest entity.

Required:

With reference to the ICAP Code of Ethics, what are the threats presented by the events described above. Also comment upon the safeguards to be taken to reduce the said threat (if any)

► *Answer*

Situation 1

Preparing calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of preparing accounting entries that will be subsequently audited by the firm creates a self-review threat. The significance of the threat will depend on:

- The complexity of the relevant tax law and regulation and the degree of judgment necessary in applying them;
- The level of tax expertise of the client's personnel; and
- The materiality of the amounts to the financial statements.

Safeguards

Safeguards shall be applied, when necessary, to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Using professionals who are not members of the audit team to perform the service;
- If the service is performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the tax calculations; or
- Obtaining advice on the service from an external tax professional.

Situation 2

Except in emergency situations, in the case of an audit client that is a public interest entity, a firm shall not prepare tax calculations of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the financial statements on which the firm will express an opinion.

The preparation of calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of the preparation of accounting entries, which would otherwise not be permitted under this section, may be provided to audit clients in emergency or other unusual situations when it is impractical for the audit client to make other arrangements. This may be the case when:

- only the firm has the resources and necessary knowledge of the client's business to assist the client in the timely preparation of its calculations of current and deferred tax liabilities (or assets), and
- a restriction on the firm's ability to provide the services would result in significant difficulties for the client (for example, as might result from a failure to meet regulatory reporting requirements).

Safeguards

- Those who provide the services are not members of the audit team;
- The services are provided for only a short period of time and are not expected to recur; and
- The situation is discussed with those charged with governance.

► Example:

Mr. XYZ, ACA is Manager Taxation at a large tax consultancy firm and reports to Mr. ABC, FCA who is one of the partners of the firm.

Mr. XYZ is presently engaged in the preparation of the income tax return of Digital Systems Limited (DSL), an IT company. During the review of the tax workings, he discovers that DSL has charged certain expenses against which no supporting documents are available. He brings this matter to the attention of Mr. ABC who has responded him that since this is not an audit engagement, it is not our responsibility to highlight such matters.

Required:

Briefly discuss how Mr. ABC may be in breach of the fundamental principles of ICAP's Code of Ethics. Also, state the potential threats that XYZ may face in the above circumstances and how he should respond.

► Answer

In the given situation, Mr. ABC may be in breach of the following fundamental principles of Code of Ethics for Chartered Accountants:

Professional behaviour

This principle imposes an obligation on all chartered accountants to comply with relevant laws and regulations and avoid any action that discredits the profession. Bader has breached the fundamental principle of professional behavior as his proposed suggestion in respect of ignoring the appropriate adjustments to the income tax return would affect the good reputation of the profession.

Integrity

The principle of integrity imposes an obligation on all chartered accountants to be straightforward and honest in all professional and business relationships. Bader has breached the fundamental principle of integrity as he has knowingly ignored the required adjustments to be made in the income tax return which may render it materially false.

Potential threats:

Bilal may face intimidation threat from Bader as refusal to obey instruction may risk his job.

Safeguards

Identified threats are significant as Bilal is being instructed from the highest level of management. In order to reduce the threat to an acceptable level, one or more of the following safeguards should be applied:

- Discuss the matter with Bader and persuade him to follow code of ethics/contact the tax client to make necessary adjustments.
- Consider informing appropriate authorities like a senior partner in the firm.
- Refuse to implement the given proposals.
- Seek legal advice.
- In case threat could not be reduced consider resigning from the job.

BASIC CONCEPTS OF TAXATION

IN THIS CHAPTER:

1. Scope of tax Deductions allowed
2. Tax year
3. Computation of taxable income
4. Person
5. Residential status
6. Determination of tax liability
7. Different types of tax regimes
8. Women enterprises
9. Income tax authorities
10. Common rules

1 SCOPE OF TAX

1.1 Scope of tax

Income tax law deals with the levy of tax on the income of a person. The scope of income tax law is defined in section 4 of the Income Tax Ordinance, 2001 in the following manner:

“Income tax shall be imposed for each tax year on every person who has taxable income, as per the applicable tax rates”

Perusal of the aforesaid provision of law rises following questions in our minds:

- i. What is a tax year?
- ii. What is taxable income and how it is computed?
- iii. Who is person?
- iv. What are applicable rates of tax?
- v. What is the procedure for levy of tax?

These primary questions are answered in the upcoming paragraphs.

2 TAX YEAR

2.1 Tax year (Sec 74)

There are three kinds of tax years as stipulated in Section 74 of the Income Tax Ordinance, 2001:

- Normal tax year
- Special tax year
- Transitional tax year

Normal tax year

Normal tax year is a period of twelve months ending on the 30th day of June and is denoted by the calendar year in which the said date falls.

Special tax year

Where a person's income year is different from the normal tax year, or where, by an order, a person has been allowed by the Commissioner to use a twelve months' period different from normal tax year, such income year or such period shall be that person's special tax year and shall be denoted by the calendar year relevant to normal tax year in which the closing date of the special tax year falls.

The Board has authority to prescribe any special tax year in respect of any particular class of taxpayer. For example, in respect of certain classes of assesses following special tax years are specified by the Board.

Classes of persons	Special tax year
Companies manufacturing sugar	1 st October to 30 th September
All persons exporting rice	1 st January to 31 st December
All banks & insurance companies	1 st January to 31 st December

A person using a special tax year may apply in writing to the Commissioner to allow him to use normal tax year and the Commissioner may by an order, allow him to use normal tax year

The Commissioner shall grant permission only if the person has shown a **compelling need** to use special tax year or normal tax year, as the case may be, and the permission shall be subject to such conditions, if any, as the Commissioner may impose.

A change of tax year from normal to special or vice versa, granted by the Commissioner is subject to withdrawal if in his opinion it is no longer feasible but not unless the person has been provided an opportunity of being heard.

An order of the Commissioner for change of tax year shall take effect from such date, being the first day of the special tax year or the normal tax year, as the case may be, as may be specified in the order.

A person dissatisfied with the order may file a review application with the Board against the decision of the Commissioner at the time of granting permission for a special tax year or withdrawal of the same and the decision by the Board on such application shall be final.

► Example

The normal tax year of ABC Limited was the period from 01 July 2025 to 30 June 2026. On an application by ABC Limited, Commissioner granted approval to adopt special tax year of 30 September each year. The period from October 01, 2025 to September 30, 2026 shall be treated as Special Tax year.

Transitional tax year

Where the tax year of a person changes as a result of an order by the Commissioner of Income tax either from the normal tax year to special tax year or vice versa, the period between the end of the last tax year prior to change and the date on which the changed tax year commences shall be treated as a 'transitional tax year'.

► *Example*

The normal tax year of ABC Limited was the period from 01 July 2025 to 30 June 2026. On an application by ABC Limited, Commissioner granted approval to adopt special tax year of 30 September each year. The period from 01 July 2026 to 30 September 2026 will be treated as transitional tax year.

► *Exercise:*

Determine the tax year for each accounting period mentioned below and also determine whether it is a normal or special tax year.

- a) 1.09.2025 to 31.08.2026
- b) 1.01.2026 to 31.12.2026
- c) 1.04.2025 to 31.03.2026
- d) 1.05.2025 to 30.04.2026
- e) 1.07.2025 to 30.06.2026

► *Answer*

To determine the tax year, identify the calendar year relevant to the normal tax year in which the closing date of the special year falls. Simply check the year in which the next 30th of June occurs after the end of the financial year.

- a) 01.09.2025 to 31.08.2026 (Special, Tax year is 2027)
- b) 01.01.2026 to 31.12.2026 (Special, Tax year is 2027)
- c) 01.04.2025 to 31.03.2026 (Special, Tax year is 2026)
- d) 01.05.2025 to 30.04.2026 (Special, Tax year is 2026)
- e) 01.07.2025 to 30.06.2026 (Normal, Tax year is 2026)

In each case, the tax year is determined by identifying the year in which the subsequent 30th of June occurs.

3 COMPUTATION OF TAXABLE INCOME

3.1 Income [Sec 2(29)]

The definition of term “income” uses the word “includes” therefore, it is inclusive definition and not exhaustive. An inclusive definition is that which not only extends to those things which are included in it, but also covers all such things which the term signifies according to its general and natural meaning.

► **Definitions:**

Sec 2(29), Income includes;

Any amount chargeable to tax under the Income Tax Ordinance, 2001 (e.g. income from salary);

Any amount subject to collection or deduction of tax under final tax regime (e.g. dividend and, bonus shares etc.);

Any amount treated as income under any provision of the Ordinance (e.g. royalty, and profit on debt etc.); and

Any loss of income

Sec 2(63), “Tax” means any tax imposed under Chapter II (i-e. Charge of Tax), and includes any penalty, fee or other charge or any sum or amount leviable or payable under this Ordinance.

Note: Surcharge payable @ 9% of gross liability for salaried individuals and @ 10% of gross liability in case of other than salaried individual and AOP having income of greater than 10 million, will be included in definition of tax.

3.2 Heads of income (Sec 11)

For the purposes of the imposition of tax and the computation of total income, all incomes shall be classified under the following heads, namely:

1. Salary;
2. Income from property;
3. Income from business;
4. Capital gains; and
5. Income from other sources

The income of a person under a head of income for a tax year shall be the total of the amounts derived by the person in that tax year that are chargeable to tax under the head as reduced by the total deductions, if any, allowed under the Ordinance to the person for that year under that head.

► **Illustration:**

Sum of amounts chargeable to tax under any particular head	xxx
Less:	
Deductions (expenses) allowed in relevant head of income	(xx)
Income under a particular head of income	xxx

If the total deductions allowed to a person for a tax year under a head of income exceed the total amounts derived by the person in that tax year chargeable under that head, the person shall be treated as sustaining a loss under that head for that tax year of an amount equal to the excess.

A loss for a head of income for a tax year shall be dealt with in accordance with Part VIII of Chapter III of the Income Tax Ordinance, 2001 (Chapter 11 of this study text).

The income of a **resident person** is computed by taking into account amounts that are his **Pakistan-source income** and amounts that are his **foreign-source income**.

On the other hand, income of a **non-resident person** is computed by taking into account only the amounts that are his **Pakistan-source income**.

In view of aforesaid provisions of law, the equation to determine the taxable income is as under:

Tabulation

Source of Income	Resident	Non-Resident
Pakistan source	Chargeable	Chargeable
Foreign source	Chargeable	Not Chargeable

► Exercise:

Mr. Junaid has following incomes from different heads of income:

	Amount
Salary	1,075,000
Income from Property	335,000
Income from Business	1,025,000
Capital Gains on Immovable Property	237,900
Income from other sources	90,000
Compute his taxable income.	

► Answer

Taxable income under normal tax regime of Mr. Junaid is the sum of all above sources of income which is computed at Rs. 2,762,900.

3.3 Total income (Sec 10)

The total income of a person for a tax year shall be the sum of the

- Person's income under all heads of income for that tax year; and
- Person's income exempt from tax for that tax year under any of the provisions of Income Tax Ordinance, 2001.

3.4 Taxable income (Sec 9)

The taxable income of a person for a tax year shall be the total income other than exempt income of the person for the year reduced (but not below zero) by the sum of any deductible allowances of the person for that tax year.

Total Income other than exempt	xxx
Less: Deductible Allowances (Discussed below)	(xxx)
Taxable Income	xxx

3.5 Deductible allowances (Sec 60, 60A, 60B & 60D)

► Definition:

Sec 2(16), "deductible allowance" means an allowance that is deductible from total income under Part IX (i-e. deductible allowances) of Chapter III (i-e. Tax on taxable income);

Zakat (Sec 60)

A person is entitled to a deductible allowance for the amount of any Zakat paid by the person in a tax year under the Zakat and Ushr Ordinance, 1980.

Where the Zakat has been deducted out of the profit on debt (which is chargeable under the head “income from other sources”), such Zakat shall not be deducted out of the total income, rather, it shall be allowed as a deduction while computing income from other sources.

Where the amount of Zakat is more than total income, the excess amount shall not be refunded or carried forward or carried back.

► **Exercises:**

- Mr Z has received dividend Rs.100,000 which is subject to deduction of Zakat Rs.10,000 and tax @15%. You are requested to compute amount of tax for Mr Z?
- Mr. K has received a dividend of Rs. 160,000, which is net of Zakat Rs. 10,000 and tax at 15%. You are requested to compute the amount of taxable dividend and the tax for Mr. K?

► **Answer:****(a) Mr Z**

Dividend		100,000
Tax @15%	-	15,000
		85,000
Zakat	-	10,000
		75,000

(b) Mr K

Taxable Dividend $(160000 + 10000)/85\% =$	Rs 200000
Tax $(200000 \times 15\%) =$	Rs 30000

Worker's welfare fund (Sec 60A)

A person shall be entitled to a deductible allowance for the amount of any Workers' Welfare Fund (WWF) paid by the person in the tax year under Workers' Welfare Fund Ordinance, 1971 or under any law relating to the Workers' Welfare Fund enacted by Provinces after the Eighteenth Constitutional Amendment Act, 2010. However, no deductible allowance will be allowed where any amount is paid to provinces by trans-provincial organizations (a person having operations in more than one province).

Worker's participation fund (Sec 60B)

A person shall be entitled to a deductible allowance for the amount of any Workers' Participation Fund paid by the person in a tax year in accordance with the provisions of the Companies Profit (Workers' Participation) Act, 1968 under any law relating to the Workers' profit participation Fund enacted by Provinces after the eighteenth Constitutional Amendment Act, 2010. However, no deductible allowance will be allowed where any amount is paid to provinces by trans-provincial organizations (a company having operations in more than one province).

Deductible allowance for education expenses (Sec 60D)

- Every individual shall be entitled to a deductible allowance in respect of tuition fee paid by the individual in a tax year provided that the taxable income of the individual is less than Rs.1,500,000.
- The amount of an individual's deductible allowance allowed for a tax year shall not exceed the lesser of —
 - a) 5% of the total tuition fee paid by the individual in the year;
 - b) 25% of the person's taxable income for the year; and
 - c) an amount computed by multiplying 60,000 with number of children of the individual.
- Any allowance or part of an allowance for a tax year that is not able to be deducted for the year shall not be carried forward to a subsequent tax year.
- Allowance shall be allowed against the tax liability of either of the parents making payment of the fee on furnishing national tax number (NTN) or name of the educational institution.
- Allowance shall not be taken into account for computation of tax deduction from Salary under section 149.

► *Exercise:*

Compute Total and Taxable Income of XYZ (Pvt.) Limited considering following data:

Aggregate income from all heads of income	1,000,000
Aggregate exempt income under 2 nd Schedule of the Income Tax Ordinance, 2001	500,000
Workers Participation Fund paid under Companies Profit (Workers' Participation) Act, 1968	100,000

► *Answer*

Total income	
Aggregate income from all heads	1,000,000
Exempt Income under second schedule	500,000
	1,500,000
Taxable income	
Aggregate income from all heads	1,000,000
Less: WPPF as per Workers' Participation Act, 1968	(100,000)
	900,000

4 PERSON

4.1 Person [Sec 80]

We learnt from the preceding discussion that tax is chargeable on the taxable income of a person. As per sub-section (1) of section 80, following are treated as person:

► *Definition: Person*

- an individual;
- a company or association of persons incorporated, formed, organised or established in Pakistan or elsewhere;
- the Federal Government, a foreign government, a political subdivision of a foreign government, or public international organisation.

Definitions of person includes different entities so these are defined and discussed hereunder:

► *Definition: Association of Persons*

“Association of persons” includes a firm, a Hindu undivided family, any artificial juridical person and anybody of persons formed under a foreign law, but does not include a company;

“Firm” means the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

► *Definitions:*

Sec 2(8) “Board” means

- the Central Board of Revenue established under the Central Board of Revenue Act, 1924 (IV of 1924), and
- on the commencement of Federal Board of Revenue Act, 2007, the Federal Board of Revenue established under section 3 thereof;

“Company” means:

- a company as defined in the Companies Act, 2017
- a Small company as defined in section 2 of the Income Tax Ordinance, 2001
- a body corporate formed by or under any law in force in Pakistan;
- a modaraba;
- a body incorporated by or under the law of a country outside Pakistan relating to incorporation of companies;
- a foreign association, whether incorporated or not, which the Board has, by general or special order, declared to be a company for the purposes of this Ordinance;
- a Provincial Government; or
- a Local Government in Pakistan; or
- a co-operative society, a finance society or any other society
- a non-profit organisation
- a trust, an equity or a body of persons established or constituted by or under any law for the time being in force
- and includes a Member of the Federal Board of Revenue to whom powers of the Board have been delegated under section 8 of the Federal Board of Revenue Act, 2007

► *Definition: Company (continued)*

“trust” means an obligation annexed to the ownership of property and arising out of the confidence reposed in and accepted by the owner, or declared and accepted by the owner for the benefit of another, or of another and the owner, and includes a unit trust; and

Sec 2(47) “Public company” means —

- a) a company in which not less than 50% of the shares are held by the Federal Government or Provincial Government;
- b) a company in which not less than 50% of the shares are held by a foreign Government, or a foreign company owned by a foreign Government;
- c) a company whose shares were traded on a registered stock exchange in Pakistan at any time in the tax year and which remained listed on that exchange at the end of that year; or
- d) a unit trust whose units are widely available to the public and any other trust as defined in the Trusts Act, 1882 (II of 1882);

“Unit trust” means any trust under which beneficial interests are divided into units such that the entitlements of the beneficiaries to income or capital are determined by the number of units held.

Sec 2(45) “Private company” means a company that is not a public company

Sec 2(36) “Non-profit organization” means any person other than an individual which is

- i. established for religious, educational, charitable, welfare purpose for general public or development purposes, or for the promotion of an amateur sport, excluding recreational clubs where the joining fee for membership exceeds one million for any class of new members;
- ii. formed and registered under any law as a non- profit organization;
- iii. approved by the Commissioner for specified period, on an application made by such person in the prescribed form and manner, accompanied by the prescribed documents and, on requisition, such other documents as may be required by the Commissioner;

and none of the assets of such person are available for private benefit to any other person.

Sec 2(11A) “charitable purpose” includes;

- relief of the poor, education, medical relief and
- the advancement of any other object of general public utility

Sec 2(30AE), IT enabled services, include but not limited to inbound or outbound call centres, medical transcription, remote monitoring, graphics design, accounting services, Human Resource (HR) services, telemedicine centers, data entry operations, cloud computing services, data storage services, locally produced television programs and insurance claims processing

Sec 2(41) “permanent establishment” in relation to a person, means a place of business through which the business of the person is wholly or partly carried on, and includes –

- a) a place of management, branch, office, factory or workshop, [premises for soliciting orders, warehouse, permanent sales exhibition or sales outlet,] other than a liaison office except where the office engages in the negotiation of contracts (other than contracts of purchase);
- b) a mine, oil or gas well, quarry or any other place of extraction of natural resources;
 [(ba) an agricultural, pastoral or forestry property;]
 (bb) Where transactions are conducted through internet or any other electronic medium, with or without having any physical presence
- c) a building site, a construction, assembly or installation project or supervisory activities connected with such site or project but only where such site, project and its connected supervisory activities continue for a period or periods aggregating more than ninety days within any twelve-months period;

- d) the furnishing of services, including consultancy services, by any person or entity through employees or other personnel engaged by the person for such purpose;
- e) a person acting in Pakistan on behalf of the person (hereinafter referred to as the “agent other than an agent of independent status acting in the ordinary course of business as such, if the agent –
 - i. has and habitually exercises an authority to conclude contracts on behalf of the other person or habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the person and these contracts are—
 - a) in the name of the person; or
 - b) for the transfer of the ownership of or for the granting of the right to use property owned by that enterprise or that the enterprise has the right to use; or
 - c) for the provision of services by that person; or
 - ii. has no such authority, but habitually maintains a stock-in-trade or other merchandise from which the agent regularly delivers goods or merchandise on behalf of the other person; or
- f) any substantial equipment installed, or other asset or property capable of activity giving rise to income;
- g) a place of business that is used or maintained by a person if the person or an associate of a person carries on business at that place or at another place in Pakistan and— (i) that place or other place constitutes a permanent establishment of the person or an associate of the person under this sub-clause; or (ii) business carried on by the person or an associate of the person at the same place or at more than one place constitute complementary functions that are part of a cohesive business operation.

Sec 2(44A) “principal officer” used with reference to a company or association of persons includes;

- a) a director, a manager, secretary, agent, accountant or any similar officer; and
- b) any person connected with the management or administration of the company or association of persons upon whom the Commissioner has served a notice of treating him as the principal officer thereof

► **Exercise**

- a) Briefly state, with reasons, whether or not you consider the below mentioned companies to be a public company for tax purpose.
 - i. PPL is a company incorporated under the Companies Act, 2017 and is not listed on any stock exchange in Pakistan. 59 per cent of the shares in PPL are held by BBC Ltd, a company incorporated in United Kingdom. United Kingdom holds 97% of the shares in BBC Ltd.
 - ii. XYZ Limited is a public company incorporated under the Companies Act, 2017 whose shares were traded on the Pakistan Stock Exchange from 01 August 2025 until 29 June 2026 on which date the company was delisted on the exchange.
 - iii. The Provincial Government of NWFP holds 50% of the shares in ABC Ltd, a public company under the Companies Act, 2017. ABC Ltd is not listed on any stock exchange in Pakistan.
 - iv. BRR is a public company under the Companies Act, 2017. 41% of the shares are held by the Federal Government, 50% by the Government of Saudi Arabia and 9% by the individuals and group companies. BRR is not listed on any stock exchange in Pakistan.
- b) Anderson Inc, a public company incorporated under the law of the United Kingdom relating to the incorporation of companies, has been operating in Pakistan for over 50 years. The control and management of the Pakistan branch for the accounting year ended 31 December 2025 was situated wholly outside Pakistan.

Required:

Briefly state, with reasons whether Anderson Inc. will be assessed as a company for Pakistan tax purposes for the relevant tax year.

► *Answer*

a)

- i. A public company for Pakistan tax purposes, inter alia includes a company in which not less than 50% of the shares are held by a foreign government or a foreign company owned by a foreign government. 59% of the shares in PPL are owned by BBC Ltd, which is a foreign company but BBC Ltd is not wholly owned by the United Kingdom (foreign government). Therefore, PPL is not a public company for Pakistan tax purpose.
 - ii. A company whose shares are traded on a registered stock exchange in Pakistan at any time in the tax year and which remained listed on that exchange at the end of that year is a public company for tax purpose.
 - iii. Although the shares of XYZ Limited were traded on the Pakistan stock exchange during the tax year 2026, XYZ Ltd did not meet the test of being a public company for tax purpose since its shares were not listed on the Lahore stock exchange on 30 June 2026. XYZ Ltd is therefore not a public company for tax purpose.
 - iv. A company in which not less than 50% of the shares are held by the Federal Government or Provincial Government is a public company for tax purpose. Since the Provincial Government of NWFP holds 50% of the shares in ABC Ltd, ABC Ltd is a public company for tax purpose.
 - v. A public company for Pakistan tax purposes, inter alia means a company in which not less than 50% of the shares are held by a foreign government, therefore, BRR is a public company as 50% of the shares are held by Government of Saudi Arabia.
- b) As per section 80, a company means a body incorporated by or under the law of a country outside Pakistan relating to incorporation of companies. Therefore, Anderson Inc. will be treated as company for Pakistan tax purpose.

4.2 Taxpayer [Sec 2(66)]

► *Definition:*

Taxpayer means any person who:

- derives an amount chargeable to tax under the Income Tax Ordinance, 2001;
- may be a representative of a person who derives an amount chargeable to tax;
- is required to deduct or collect tax under the Ordinance; or
- is required to furnish a return of income or pay tax under the Ordinance;

5 RESIDENTIAL STATUS

5.1 Resident and non-resident persons (Sec 81)

The determination of residential status of a person is necessary as the law explicitly provides that a resident is taxable in respect of its worldwide income whereas the non-resident is taxable only in respect of its Pakistan source income. The Ordinance lays down the method for determination of residential status of a person in the following manner:

- A person shall be a resident in Pakistan for a tax year if the person is:
 - i. a resident individual, resident company or resident association of persons for the year; or
 - ii. the Federal Government.
- A person shall be non-resident person for a tax year if the person is not a resident person for that year.

A very important point to note from the above discussion is that residential and non-residential status of any person is to be determined in respect of each tax year as it may vary from year to year. A person can be resident in tax year 2025 (01 July 2024 to 30 June 2025) but may be a non-resident in tax year 2026 (01 July 2025 to 30 June 2026).

5.2 Resident individual (Sec 82)

- An individual shall be a resident individual for a tax year if the individual:
 - a) is present in Pakistan for a period of, or periods amounting in aggregate to, 183 days or more in the tax year;
 - b) is an employee or official of the Federal Government or a Provincial Government posted abroad in the tax year.
 - c) A citizen of Pakistan who is not present in any other country for more than 182 days during the tax year or he is not a resident taxpayer of any other country.

Note: The amendment is made basically for those Pakistani citizens who do not stay in one country for 182 days and remain non-resident for all the countries they reside during the year.

Rule 14 of the Income Tax Rules, 2002 states the method for computing the number of days of stay of an individual in Pakistan. The said rule reads as under:

- The following rules apply for the purposes of section 82, which provides for the determination of a person as resident individual.
 - Part of a day that an individual is present in Pakistan (including the day of arrival in, and the day of departure from, Pakistan) counts as a whole day of such presence;
 - the following days in which an individual is wholly or partly present in Pakistan count as a whole day of such presence, namely:
 - i. a public holiday;
 - ii. a day of leave, including sick leave;
 - iii. a day that the individual's activity in Pakistan is interrupted because of a strike, lock-out or delay in receipt of supplies; or
 - iv. a holiday spent by the individual in Pakistan before, during or after any activity in Pakistan; and
 - A day or part of a day where an individual is in Pakistan solely by reason of being in transit between two different places outside Pakistan does not count as a day present in Pakistan.

5.3 Resident company (Sec 83)

A company shall be a resident company in Pakistan for a tax year if:

- i. it is incorporated or formed by or under any law in force in Pakistan
- ii. the control and management of its affairs is situated wholly in Pakistan at any time in the year; or
- iii. it's a Provincial Government or Local Government in Pakistan.

5.4 Resident association of persons (Sec 84)

An association of persons shall be a resident association of persons for a tax year if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year.

► **Exercise:**

Explain the residential status of the following persons for the tax year 2026:

- Mr. Raza is working as Director Operations in the Ministry of Tourism. On 15 July 2025 he was posted to Pakistan Embassy in Italy for two years.
- Anderson LLC was incorporated as limited liability Company in UK. The control and management of its affairs was situated wholly in Pakistan. However, with effect from 01 November 2025, the entire management and control was shifted to UK.
- On 01 February 2026, Mr. Sameel a citizen of Pakistan was sent to Pakistan by his UK based company to work on a special project. He left Pakistan on 23 August 2026.
- BBL is a non-listed public company incorporated under the Companies Act, 2017. All the shareholders of the company are individuals. The control and management of affairs of the company during the year was outside Pakistan.
- Mr. Salman a property dealer in USA came to Pakistan on 01 February 2025. During his stay upto 02 August 2025 in Pakistan, he remained in Peshawar upto 30 June 2025 and thereafter till his departure from Pakistan, in Quetta. Assume that Commissioner has granted him permission to use calendar year as special tax year.

► **Answer**

- Being an employee of Federal Government, Mr. Raza would be treated as resident irrespective of number of days he stays in Pakistan.
- A company shall be resident if control and management of the affairs of the company is situated wholly in Pakistan at any time in the year. Therefore, company is resident irrespective of the fact that it was incorporated in UK.
- The stay of Mr. Sameel for the purpose of tax year 2026 is 150 days (28+31+30+31+30). Since his stay in Pakistan is less than 183 days in tax year 2026, he is non-resident for tax purposes. However, if he is not present in any other country for more than 182 days during the tax year or he is not a resident taxpayer of any other country then he will be treated as resident of Pakistan.
- If a company is incorporated or formed by or under any law in force in Pakistan, it is treated as a resident company. Such company cannot be treated as non-resident merely on the basis that the control and management of the affairs of the company were situated abroad. Therefore, BBL is a resident company.
- It is immaterial where he stayed in Pakistan. Number of days shall be counted from the day of his arrival in Pakistan to the day of his departure in the following manner:

Accounting period 01 January 2025 to 31 December 2025 (Tax year 2026)

Month	No. of Days
February 2025	29
March 2025	31
April 2025	30
May 2025	31
June 2025	30
July 2025	31
August 2025	2
Total	184

Since he was present in Pakistan for 184 days, therefore, he is a resident individual.

6 DETERMINATION OF TAX LIABILITY

6.1 Computation of tax liability and tax rates (Sec 4 read with First Schedule)

► *Definition: Sec 2(63)*

Tax means any tax imposed under the Ordinance and includes any penalty, fee or other charge or any sum or amount leviable or payable under the Income Tax Ordinance, 2001.

- Income tax shall be imposed on every person having taxable income for each tax year at the applicable rates as mentioned in the first schedule to the Income Tax Ordinance, 2001.
- First Schedule of the Income Tax Ordinance, 2001 prescribes different tax rates for different classes of persons in the following manner:

Tax rates for salaried individual

Where the income of an individual chargeable under the head “salary” exceeds 75% of his taxable income, the rates of tax to be applied shall be as set out in the following table, namely:

Sr. No.	Taxable Income	Rate of Tax
1.	Where the taxable income does not exceed Rs. 600,000	0%
2.	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	1% of the amount exceeding Rs. 600,000
3.	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 2,200,000	Rs. 6,000 plus 11% of the amount exceeding Rs. 1,200,000
4.	Where taxable income exceeds Rs. 2,200,000 but does not exceed Rs. 3,200,000	Rs. 116,000 plus 23% of the amount exceeding Rs. 2,200,000
5.	Where taxable income exceeds Rs. 3,200,000 but does not exceed Rs. 4,100,000	Rs. 346,000 plus 30% of the amount exceeding Rs. 3,200,000
6.	Where taxable income exceeds Rs. 4,100,000	Rs. 616,000 plus 35% of the amount exceeding Rs. 4,100,000

A surcharge shall also be payable by every salaried individual @ 9% of the Gross tax liability where taxable income exceeds Rs.10 million.

Tax rates for non-salaried individuals and Association of Persons

Sr. No.	Taxable Income (Rs.)	Rate of Tax
1.	Where the taxable income does not exceed Rs.600,000	0%
2.	Where the taxable income exceeds Rs.600,000 but does not exceed Rs. 1,200,000	15% of the amount exceeding Rs.600,000
3.	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,600,000	Rs. 90,000 plus 20% of the amount exceeding Rs. 1,200,000
4.	Where taxable income exceeds Rs. 1,600,000 but does not exceed Rs. 3,200,000	Rs. 170,000 plus 30% of the amount exceeding Rs. 1,600,000
5.	Where taxable income exceeds Rs. 3,200,000 but does not exceed Rs. 5,600,000	Rs. 650,000 plus 40% of the amount exceeding Rs. 3,200,000
6.	Where taxable income exceeds Rs. 5,600,000	Rs. 1,610,000 plus 45% of the amount exceeding Rs.5,600,000

Tax Rate for a Professional Firm:

If an association of persons is a professional firm that cannot incorporate due to legal or regulatory rules, the tax rate of 45% listed under serial number 6 of the Table will be reduced to 40%.

Surcharge for High Earners: 10% on Gross Tax Liability for Income Exceeding Rs. 10 Million

A surcharge at the rate of 10% of the gross tax liability shall be payable by all non-salaried individuals and Associations of Persons (AOPs) whose taxable income exceeds Rs. 10 million.

Computation of income tax payable

The income tax payable shall be computed as under:

- Tax liability – Withholding (advance tax)
- Tax Liability = (Taxable Income x Rate of Tax) – Tax Credits / Tax reduction

If a taxpayer is allowed more than one tax credit for a year, the credits shall be applied in the following order:

- a) Any foreign tax credit; then
- b) Any tax credit allowed for,
 - i. Charitable donations (Sec 61)
 - ii. Contribution to approved pension fund (Sec 63)
 - iii. Interest paid on low cost housing loan (Sec 63A)
 - iv. Point of sale machine (Sec 64D)
 - v. Certain person (Sec 65F)
 - vi. Specified industrial undertakings (Sec 65G)

Any such amount which is taxable as a separate block or under final tax regime (FTR) shall not be included in the computation of taxable income under Normal tax regime (NTR) according to the provisions of the Income Tax Ordinance, 2001.

The computation of income under each head of income and tax credits is discussed in detail in the ensuing chapters. However, the method for determination of tax liability and tax payable (refundable) on taxable income is given hereunder:

Computation of tax	
Gross tax (Including surcharge @ 10%/9% in case income is > 10 million)	XXX
Less: Tax reductions & credits	(XX)
Net Tax	XXX
Tax already paid including adjustments	(XX)
Balance	XXX
(a) Tax Refundable	
(b) Tax Payable or	
(c) Tax nil	

Tax rebates and reductions available to a person are elaborated in respective chapters.

7 DIFFERENT TYPES OF TAX REGIMES

In the foregoing paragraphs, we learnt about the computation of taxable income and tax liability, however, certain incomes are excluded from the normal method of taxation as explained above and are subject to tax separately under various provisions of the Income Tax Ordinance, 2001. The mechanism for determination of taxable income is categorised under three regimes as under:

7.1 Normal tax regime (Net income basis)

Under the normal tax regime, certain rate of taxation on net income (income minus expenses) applied to taxpayers. Tax is applied to taxable income as per 1st Schedule of the Income Tax Ordinance, 2001 which shall be reduced by the amount of tax credits.

7.2 Separate Block of Income

Definition: This regime applies to certain types of income, where specific tax rates are applied and various expenses related to earning that income can be deducted.

Expense Deductibility: Under this regime, taxpayers are allowed to deduct relevant expenses from their income. For example, if you have income from the disposal of securities or immovable assets (capital assets), you can subtract related expenses to determine your net taxable income.

Losses: Losses can arise and are generally considered under this regime. For instance, if you incur a loss from the sale of securities or capital assets, this loss can be carried forward or adjusted against future gains from similar sources.

Examples: Income from the gain on disposal of securities, gain on disposal of immovable assets (capital assets), etc.

- Following rules apply to income subject to separate charge:
 - i. Tax imposed is a final tax
 - ii. The amount of such income is not reduced by:
 - a) Any deductible allowance
 - b) The set off of any loss
 - iii. The final tax payable is not reduced by any tax credit allowed (foreign tax credit or tax credits on donations, investments etc.)
 - iv. The liability of the recipient of such income is discharged to the extent that:
 - a) In the case of shipping and air transport income, the tax is paid in accordance with relevant sections of the Ordinance; or
 - b) In any other case, the final tax payable has been deducted at source.

7.3 Final Tax Regime (Gross income basis)

Definition: This regime applies to certain types of income where the tax paid is considered final, and no further deductions or adjustments are allowed.

Expense Deductibility: Under FTR, expenses related to earning the income cannot be deducted.

Tax Credits: Tax credits are also not allowed under this regime. This means that even if you qualify for tax credits, they cannot be applied to reduce the tax liability for income falling under FTR.

Income Classification: Income under FTR does not fall under any specific heads of income. Instead, it is included in the total income solely to calculate the total income. After calculating the total income, the amount of FTR income is then subtracted from the total income to apply separate tax rates.

Losses: Losses are not considered under FTR. If losses are incurred from sources of income taxed under FTR, they cannot be used to offset other income or be carried forward.

Refunds: There is no refund of non-adjustable tax collected or deducted at source unless such tax exceeds the amount of final tax for which the taxpayer is chargeable.

Assessment: An assessment is deemed to have been made, and the taxpayer is required to furnish a return of income in respect of such income.

Examples: Examples include dividends, lottery winnings, and prize bond winnings.

Taxation of dividend, royalty and fee for technical services

Dividend

- Concept of accumulated profit in section 2(1) and taxation of dividend income is governed by section 2(19), 5 and 8 of the Income Tax Ordinance, 2001 as below.

► Definitions:

Sec 2(1) "Accumulated profits" in relation to distribution or payment of, a dividend, include;

- any reserve made up wholly or partly of any allowance, deduction, or exemption admissible under this Ordinance;- .
- for the purposes of sub-clauses (a), (b) and (e) of clause (19)", all profits of the company including income and gains of a trust up to the date of such distribution or such payment, as the case may be; and
- for the purposes of sub-clause (c) of clause (19), includes all profits of the company including income and gains of a trust up to the date of its liquidation.

Section 2(19) "Dividend"

- any distribution by a company of accumulated profits to its shareholders, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets including money of the company;
- any distribution by a company, to its shareholders of debentures, debenture-stock or deposit certificate in any form, whether with or without profit, to the extent to which the company possesses accumulated profits whether capitalised or not;
- any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not;
- any distribution by a company to its shareholders on the reduction of its capital, to the extent to which the company possesses accumulated profits, whether such accumulated profits have been capitalised or not;
- any payment by a private company [as defined in the Companies Act, 2017]] or trust of any sum (whether as representing a part of the assets of the company or trust, or otherwise) by way of advance or loan to a shareholder or any payment by any such company or trust on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company or trust, in either case, possesses accumulated profits; or
- remittance of after tax profit of a branch of a foreign company operating in Pakistan;
- but does not include —
 - a distribution made in accordance with [sub-clause] (c) or (d) in respect of any share for full cash consideration, or redemption of debentures or debenture stock, where the holder of the share or debenture is not entitled in the event of liquidation to participate in the surplus assets;

- ii. any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company;
- iii. any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e) to the extent to which it is so set off; and]
- iv. remittance of after tax profit by a branch of Petroleum Exploration and Production (E&P) foreign company, operating in Pakistan.
- Tax rates on gross amount of dividend received from a Company;
 - 7.5% in case of dividend paid by Independent Power Producers where such dividend is a pass through item under an Implementation Agreement or Power Purchase Agreement or Energy Purchase Agreement and is required to be reimbursed by Central Power Purchasing Agency (CPPA-G) or its predecessor or successor entity
 - 15% in case of individuals, AOPs, Real Estate Investment Trusts and any other person not covered by 7.5% and 25% categories.
 - 25% in case of a person receiving dividend from a company where no tax payable by such company, due to exemption of income or carry forward of business losses or claim of tax credits

For investments in mutual funds, dividend will be taxed as per following rates:

Particulars	Fixed income funds	Equity and Asset allocation funds	
		Dividend out of income from equity	Dividend out of income from debt securities
Individual and AOP's	25%	15%	25%
Companies	29%	15%	29%

- Dividend received is subject to deduction of tax at source by the person making the payment of dividend.
- Tax deductible at source is treated final tax liability of the person receiving the dividend.
- Where any advance or loan is repaid by the shareholder of a private company, he shall be entitled to a refund of the tax paid by him as a result of such loan or advance having been treated as dividend.

► **Exercise:**

- a) Omega (Pvt.) Limited is engaged in the business of trading and sale of fertilizers. The company has extended loan of Rs. 2.5 million to one of its shareholders on 30 June 2026 when the accumulated profits of the company were Rs. 1.8 million.

Required:

Determine the amount to be treated as dividend.

- b) Robin Petroleum International (RPI), a company incorporated in Netherlands, is operating in Pakistan as a branch. RPI has entered into an agreement with the Government of Pakistan under which RPI has been given the right to explore and produce crude oil and natural gas in specified areas of Sindh and Baluchistan.

Required:

Explain the tax implications on RPI's branch in Pakistan of the remittance of the after tax profits of the branch to its head office in the Netherlands.

- c) Mr Z has received dividend Rs.75,000 net of Zakat Rs.10,000 and tax @15%.

Required:

Determine the amount to be treated as dividend.

► *Answer*

- a) The amount of loan to the extent of accumulated profits will be treated as dividend i.e. Rs. 1,800,000 [Ref: Sec 2(19)(e)]
- b) Remittance of after tax profit of a branch of a foreign company operating in Pakistan is considered as dividend as per section 2(19)(f) of the Income Tax Ordinance, 2001.

However, remittance of after tax profit by a branch of Petroleum Exploration and Production (E&P) foreign company operating in Pakistan is excluded from the definition of dividend.

As the Pakistan branch of RPI is a branch of an E & P foreign company operating in Pakistan, the remittance of the after tax profits of RPI's branch in Pakistan would not be considered to be dividend income.

- c) Total taxable dividend is Rs.100,000 i.e. $(75,000 + 10,000) / 85\%$

Royalty

- Concept of royalty is governed by section 2(54), of the Income Tax Ordinance, 2001.

► *Definition: Sec 2(54) Royalty*

"royalty" means any amount paid or payable, however described or computed, whether periodical or a lump sum, as consideration for;

- a) the use of, or right to use any patent, invention, design or model, secret formula or process, trademark or other like property or right;
- b) the use of, or right to use any copyright of a literary, artistic or scientific work, including films or video tapes for use in connection with television or tapes in connection with radio broadcasting, but shall not include consideration for the sale, distribution or exhibition of cinematograph films;
- c) the receipt of, or right to receive, any visual images or sounds, or both, transmitted by satellite, cable, optic fibre or similar technology in connection with television, radio or internet broadcasting;
- d) the supply of any technical, industrial, commercial or scientific knowledge, experience or skill;
- e) the use of or right to use any industrial, commercial or scientific equipment;
- f) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as mentioned in sub-clauses (a) through (e); and
- g) the disposal of any property or right referred to in sub-clauses (a) through (e);

Fee for technical services

- Concept of fee for technical services is governed by section 2(23), of the Income Tax Ordinance, 2001.

► *Definition: Sec 2(23) Fee for technical services*

Any consideration, whether periodical or lump sum, for the rendering of any managerial, technical or consultancy services including the services of technical or other personnel, but does not include:

Consideration for services rendered in relation to a construction, assembly, or like project undertaken by the recipient; or

Consideration which would be the income of the recipient chargeable under the head "salary"

7.4 Minimum Tax Regime

- Under the minimum tax regime, tax already deducted at source is treated as minimum tax which is then compared with liability under the normal tax regime. In case liability under normal tax regime is greater than tax already deducted, the person is required to pay liability under normal tax regime. In case tax already deducted is greater than liability under normal tax regime, then same is treated as final tax.

- Certain types of incomes are subject to minimum tax under the Income Tax Ordinance, 2001 to assure that certain portion of tax is paid by the taxpayer irrespective of quantum of income.
- Various incomes which are treated as minimum tax under the Income Tax Ordinance, 2001 are:
 - i. Minimum tax under section 113 on turnover.
 - ii. Commercial importer under section 148(7).
 - iii. Tax deduction at source @ 15% from gross amount of service rendered under section 153 for all persons.
 - iv. Minimum tax under section 154 on export of goods.
 - v. Tax collected upto the electricity bill amount of Rs.360,000 per annum for a person other than company under section 235.

7.5 Minimum tax on the income of certain persons [Sec 113]

1. This section applies to:
 - i. A resident company,
 - ii. An individual with a turnover of 100 million rupees or more in tax year 2017 or any later year, and
 - iii. An Association of Persons (AOP) with a turnover of 100 million rupees or more in tax year 2017 or any later year.

The **reason for paying less than 1.25% of turnover as tax** may be any of the following:

- a) The person has a loss for the year;
- b) A loss from a previous year is adjusted;
- c) The person is exempt from tax;
- d) The person uses tax credits or rebates; or
- e) The person claims deductions or allowances (such as depreciation or amortization).

Explanation: For the purpose of this sub-section, the expression tax payable or paid does not include tax already paid or payable in respect of deemed income which is assessed as final discharge of the tax liability under section 169 or under any other provision of this Ordinance; and

2. Where this section applies:
 - a) the aggregate of the person's turnover for the tax year shall be treated as the income of the person for the year chargeable to tax;
 - b) the person shall pay tax @ 1.25% of turnover as income tax for the tax year (instead of the actual tax payable under this Ordinance).

where minimum tax paid @ 1.25% of turnover exceeds the actual tax payable as per applicable slabs, the excess amount of tax paid shall be carried forward for adjustment against tax liability of the subsequent tax year.

Provided that the amount under this clause shall be carried forward and adjusted against tax liability for **two tax years** immediately succeeding the tax year for which the amount was paid.

Provided that if minimum tax is paid due to the fact that no tax is payable or paid for the year (due to taxable loss etc.), the entire amount of minimum tax paid shall be carried forward for two tax years.

3. turnover means,-
 - a) the gross sales or gross receipts, exclusive of Sales Tax and Federal Excise duty or any trade discounts shown on invoices, or bills, derived from the sale of goods, and also excluding any amount taken as deemed income and is assessed as final discharge of the tax liability for which tax is already paid or payable;

- b) the gross fees for the rendering of services for giving benefits including commissions; except covered by final discharge of tax liability for which tax is separately paid or payable;
- c) the gross receipts from the execution of contracts; except covered by final discharge of tax liability for which tax is separately paid or payable; and
- d) the company's share of the amounts stated above of any association of persons of which the company is a member.

Explanation: For the removal of doubt, it is clarified that the definition of turnover covers receipts from all business activities in line with expression "turnover from all sources" including but not limited to receipts from sale of immoveable property where such receipt is taxable under the head Income from Business.

► *Exercise:*

ABC & Co. is an AOP with annual turnover under normal tax regime of Rs. 116,000,000 during the tax year 2026. If the taxable profit of the AOP is Rs. 1,570,000. Compute the tax liability of the AOP for the tax year 2026.

► *Answer*

Turnover tax u/s 113 @ 1.25% on Rs. 116,000,000	1,450,000
Income tax under normal tax regime	
Taxable Income	
Tax on Taxable Income (Rs. 90,000 + 20% x [1,570,000 – 1,200,000])	1,570,000
	164,000

The AOP has to pay higher of minimum tax under section 113 or income tax as computed above under normal tax regime. As the turnover tax is higher than tax computed under normal tax regime therefore the same is to be paid by the AOP (i. e.) Rs. 1,450,000.

The difference Rs1,286,000 (1,450,000-164,000) shall be carried forward for next 2 years.

8 TAXATION OF WOMEN ENTERPRISES

8.1 Women enterprise and its taxation (Clause 19 Part III of Second Schedule)

Woman enterprise” refers to a startup launched on or after 1 July 2021 that is:

- a sole proprietorship owned by a woman, or
- an AOP composed entirely of women, or
- a company fully owned by women,

and meets all of the following Section 65F criteria for start-up tax credit:

- Certified by PSEB;
- Timely filed income tax returns;
- Filed sales tax returns (if liable); and
- Filed withholding tax statement (if liable).

If all conditions are fulfilled, the enterprise may claim a 100% tax credit on income tax for the year of certification plus the next two years. Failure to maintain compliance may result in losing eligibility for the credit.

25% Tax Reduction for Woman Enterprises (If 100% Credit Not Available)

The tax payable by a woman enterprise on profits and gains chargeable under the head ‘Income from Business’ shall be reduced by 25% if the enterprise is unable to claim the 100% tax credit available under Section 65F. This 25% reduction shall not apply to any business formed through the transfer, reconstitution, or splitting up of an existing business

9 INCOME TAX AUTHORITIES

9.1 Income tax authorities

The income tax law provides a complete organisational set up for levy and recovery of income tax which are described in section 207 as under:

- a) Federal Board of Revenue;
- b) Chief Commissioner Inland Revenue;
- c) Commissioner Inland Revenue;
- d) Commissioner Inland Revenue (Appeals);
- e) Officer of Inland Revenue i.e.
 - i. Additional Commissioner Inland Revenue;
 - ii. Deputy Commissioner Inland Revenue;
 - iii. Assistant Commissioner Inland Revenue;
 - iv. Special audit panel;
 - v. Inland Revenue Officer;
 - vi. Inland Revenue Audit Officer or any other Officer;
- f) District Taxation officer;
- g) Assistant Director Audit
- h) Superintendent Inland Revenue;
- i) Inspector Inland Revenue; and
- j) Auditor Inland Revenue.

This section is out of syllabus and is not examinable. This organizational setup is being given to provide better understanding while students studying other examinable sections of the Ordinance where these authorities have been mentioned.

10 COMMON RULES

In addition to foregoing basic concepts, understanding of common rules is necessary for determination and computation of taxable income and tax liability.

10.1 Apportionment of deductions (Sec 67)

- This concept implies that an expenditure, deduction and allowance which relates to the following, shall be apportioned on any reasonable basis taking into account the relative nature and size of the activities to which the amount relates:
 - i. the derivation of more than one head of income; or
 - ii. derivation of taxable income and any class of income subject to Final Tax Regime.
 - iii. the derivation of income chargeable to tax under any head of income and to some other purpose

Rules for apportionment of expenditures, deductions and allowances (Rule 13)

Common expenditure, deductions and allowances means any expenditure, deductions and allowances that is not clearly allocable to any particular class or classes of incomes. Rules regarding apportionment of such expenses, deductions and allowances are given as follows:

- Any expenditure, deduction or allowance that is incurred for particular class of income (chargeable income, FTR income or exempt income) shall be allocated/apportioned to that class only.
- Any common expenditure shall be apportioned amongst each class of income according to the following formula:
- Amount of expense x $\frac{\text{Gross receipts for the class of income}}{\text{Gross receipts for all class of income}}$

Note: Gross receipts means net off receipts or turnover of sales tax of FED paid.

- While allocating common expenditure, deductions and allowances (particularly selling expenses) the nature and source of each class of income must be taken into account.
- The basis determined for allocation of expenditure, deductions and allowances should be certified by a Chartered Accountant or a Cost and Management Accountant. This certificate shall be accepted by CIR unless there is significant variations ($10\% \pm$ beyond the limits) from allocation under the rules.
- Where in case of certain transaction the net gain, brokerage, commission and other income is taken as turnover, then the gross profit from business shall be taken as gross receipts for the purpose of apportionment of expenditures.
- For the purpose of these rules a person may have following classes of incomes:

Pakistan source incomes as well as Foreign source income further classified as:

- i. Salary
- ii. Income from property
- iii. Income from business – Non-speculation
- iv. Income from business - speculation
- v. Capital gains
- vi. Income from other source
- vii. Income chargeable to tax as separate block
- viii. Income exempt from tax e.g. agriculture income
- ix. Income chargeable to tax under final tax regime.

10.2 Fair market value (Sec 68)

- Fair market value (FMV) of any property, or rent, asset, service, benefit or perquisite at a particular time shall be the price which the property, or rent, asset, service, benefit or perquisite would ordinarily fetch on sale or supply in the open market at that time.
- The fair market value of any property, or rent, asset, service, benefit or perquisite shall be determined without having regard to any restriction on transfer or to the fact that it is not otherwise convertible to cash.
- Where the price referred above is not ordinarily ascertainable, the Board may, from time to time, by notification in the official gazette determine the fair market value of the immoveable property of the area and areas as may be specified in the notification.
- Where the fair market value of any immoveable property of an area or areas has not been determined by the board in the notification referred as above, the fair market of such immoveable property shall be deemed to be the value fixed by the district officer (revenue) or provincial or any other authority authorize in this behalf for the purposes of stamp duty.

► *Exercise:*

XYZ purchased a second hand car from M/s ABC Ltd, an associated company. The cost of that car is Rs.500,000 in the books of ABC Ltd whereas written down value of the said car is Rs.350,000. One of the car dealers told the company that the value of the said car in the market is Rs. 250,000.

Required

What is the value of the car as per the Income Tax Ordinance, 2001?

► *Answer*

Value of the Car as per the Income Tax Ordinance, 2001 is its fair market value i-e Rs.250,000.

10.3 Receipt of income (Sec 69)

Method for recognition of receipt of income is elaborated in section 69 of the Ordinance in the following way:

A person shall be treated as having received an amount, benefit, or perquisite if it is:

- actually received by the person;
- applied on behalf of the person, at the instruction of the person or under any law; or
- made available to the person.

► *Exercise:*

Mr. Bashir, an employee of M/s HAs Motors Limited visited different clients for recovery of its bills and he received following response:

- M/s. HA Forts Ltd one of the clients paid him a sum of Rs. 96,500 after deducting a tax of Rs.3,500.
- Modern Motors has stated that it already paid a sum of Rs.35,000 being the bills of M/s HA to M/s Sarhad Motors at the instructions of M/s HA.
- City Flyers (Pvt.) Limited has adjusted a sum of Rs. 55,000 against the travelling tickets purchased by M/s HA Motors Limited from their office and paid the balance amount of Rs. 45,000.
- Hameed Sons said that they recorded their sum payable in its financial records, however, its settlement will be made in due course.

M/s. HA Motors Limited is interested to know the amount of receipts which are liable to be added to the taxable income.

► *Answer*

M/s HA MOTORS LIMITED

Name of client	Receipts to be included in income	Remarks
HA Forts limited	100,000	Sum actually received
Modern Motors	35,000	Paid on the instructions of the person
City Flyers (Private) Ltd	100,000	<i>Sum actually received Rs 45,000 and sum of Rs.55,000 applied on behalf of the recipient</i>
Hameed sons	0	No sum received
Total	235,000	

10.4 Recouped expenditure (Sec 70)

Any amount received subsequently in respect of deduction previously allowed as deduction will be added in the income in the year of receipt, as provided in section 70 below:

Where a person has been allowed a deduction for any expenditure or loss incurred in a tax year in the computation of the person's income chargeable to tax under a head of income and, subsequently, the person has received, in cash or in kind, any amount in respect of such expenditure or loss, the amount so received shall be included in the income chargeable under that head for the tax year in which it is received.

► *Exercise:*

M/s ABC claimed deduction of following finance charges against the income of preceding years:

Year	Amount of finance charges
200W	150,000
200X	75,000
200Y	85,000

The aforesaid mark-up remained payable to the bank and could not be paid due to adverse liquidity position of ABC. On 15 May 2026, the bank agreed to waive off mark up to the extent of Rs.250,000 under a rescheduling agreement. M/s ABC interested to know that what is the tax exposure on such waiver of mark up and in case said amount is taxable then how the said sum is added to preceding years income.

► *Answer*

The aforesaid amount of Rs. 250,000 is taxable in the hands of ABC in the year of Waiver i.e. tax year 2026 and it will not be included in the preceding years.

10.5 Currency conversion (Sec 71)

Every amount taken into account under the Income Tax Ordinance, 2001 shall be in Rupees.

If an amount is in a currency other than rupees, the amount shall be converted to the rupee at the State Bank of Pakistan rate applying between the foreign currency and the Rupee on the date the amount is taken into account for the purposes of the Income Tax Ordinance, 2001.

► *Exercise:*

Mr. XYZ received a sum of US Dollars 500 from his client on 14 April 200X and he paid a sum of Euro 250 for expenses incurred in respect of the said assignment on 15 April 2026. The exchange rate prescribed by the State bank of Pakistan on the dates of transactions are as under:

Date	Currency	Dollar/ Euro	Pak Rs. Conversion
14 April, 2026	Dollar	1	Rs. 290
15 April, 2026	Euro	1	Rs. 300/Euro

► *Answer*

MR. XYZ

COMPUTATION OF TAXABLE INCOME

TAX YEAR 2026

Description	Amount in Rs.
Receipt \$ 500 x Rs.290/Dollar	145,000
Expenses Euro 250 x Rs.300/Euro	(75,000)
Income	70,000

10.6 Cessation of source of income (Sec 72)

- This section applies where any income is derived by a person in a tax year from any business, activity, investment or other source that has ceased either before the commencement of the year or during the year.
- In such a case the income derived before the business, activity, investment or other source ceased, shall be chargeable to tax as if the source of such income had not ceased.

10.6 A Notice of discontinued business (Sec-117)

- Any person discontinuing a business shall give the Commissioner a notice in writing to that effect within fifteen days of the discontinuance and furnish a return of income from start of year till date of discontinuance.

Where notice of discontinuance is not filed by a person, and the Commissioner has reasons to believe that such person has discontinued or is likely to discontinue his business, he may require such person, through a notice, to file a return of income for a specified period within the time specified in the notice.

► *Exercise:*

Explain the tax treatment in respect of the following:

On 21 March 2024, there was a fire in the shop of Mr. Imran and the entire stock of honey valued at Rs.100,000 (at cost) was destroyed. Imran's insurance company refused to entertain the claim for Rs. 100,000 for the loss of the stock-in-trade. Imran ceased doing business as and from 30 June 2024. In the return of income furnished for the tax year 2024, Imran claimed the Rs. 100,000 as a deductible business loss in computing his income under the head 'Income from business'. The loss was allowed as a deductible charge in that tax year. During the tax year 2026, the insurance company, on receiving a legal notice from Imran, made a payment of Rs.75,000 against the claim for the loss of stock-in-trade which Imran accepted in full settlement.

► *Answer*

Law specifically provides that if there is any income that has been derived by a person in a tax year from a business, activity, investment or other source that has either ceased before the commencement of that year or during the year and if that income would have been taxable had there been no cessation, then the provision of the tax statute would apply as if there was no cessation (Ref: Sec 72)

In other words, section 72 deems the business activity, investment or other source to have been carried on by the person in the tax year in which the income was derived despite the cessation of the business activity, investment or other source. The above amount shall be offered for tax in the return under the head "Income from business".

10.7 Rules to prevent double derivation and double deductions (Sec 73)

- If any amount is chargeable to tax on the basis that it is receivable, the amount shall not be chargeable again on the basis that it is received.
- If any amount is chargeable to tax on the basis that it is received, the amount shall not be chargeable again on the basis that it is receivable.
- If any expenditure is allowable as deduction on the basis that it is payable, the expenditure shall not be allowed as deduction again on the basis that it is paid.

If any expenditure is allowable as deduction on the basis that it is paid, the expenditure shall not be allowed as deduction again on the basis that it is payable.

IN THIS CHAPTER:

1. Salary and its components
Deductions allowed
2. Determination/computation
of value of perquisites
3. Determination/computation
of other components of salary
4. Employee share scheme
5. Computation of income
chargeable under the head
'salary'

1 SALARY AND ITS COMPONENTS

1.1 Definition and scope of salary [Sec 12(2)]

- Salary means any amount received by an employee from any employment, whether of a revenue or capital nature, and includes:
 - i. any pay, wages or other remuneration including leave pay, overtime, bonus, commission, fees, gratuity, work condition supplements (such as for the unpleasant or dangerous working conditions);
 - ii. any perquisite whether convertible into money or not;
 - iii. any allowance provided to employee including cost of living, rent, utilities, education, entertainment, travelling, etc. excluding allowance solely expended in the performance of duties of employment;

Note: Any allowance solely expended in the performance of employee's duty does not include:

- a) allowance which is paid in monthly salary on fixed basis or percentage of salary; or
- b) allowance which is not wholly, exclusively, necessarily or actually spent on behalf of the employer
- iv. any expenditure reimbursed by employer other than expenditure incurred solely in the performance of duties of employment
- v. profits in lieu of, or in addition to, salary including:
 - a) consideration received for entering into an employment agreement or for agreement to any condition of employment or changes to the employment conditions or to a restrictive covenant to any past, present or future employment.
 - b) amount received on the termination of employment, including golden handshake payments.
 - c) amount received from provident fund except for a contribution made by the employee in respect of which the employee was not entitled to a deduction.
- vi. any pension or annuity or any supplement to a pension or annuity received / receivable from employer;
- vii. any amount of gain earned under "Employee Share Scheme";
- viii. amount of tax chargeable on employee's salary and borne by employer.

► **Definitions:**

Sec 2(20), "Employee" means any individual engaged in employment.

Sec 2(21), "Employer" means any person who engages and remunerates an employee

Sec 2(22), "Employment" includes:

- a directorship or any other office involved in the management of a company;
- a position entitling the holder to a fixed or ascertainable remuneration; or
- the holding or acting in any public office;

Pakistan Source Salary

An employee's salary income, wherever received is taxed in Pakistan to the extent it relates to employment exercised in Pakistan (Pakistan Source Income). However, salary received by Pakistan Government employee is taxable in Pakistan whether employment is exercised in Pakistan or abroad.

► **Examples:**

Private Sector Employee:

- Ali works for a private company in Pakistan but receives his salary in Dubai.
- Ali's salary is taxed in Pakistan because his work is done in Pakistan.

Pakistan Government Employee:

- Sara works for the Pakistan Government and is posted in Canada.
- Sara's salary is taxed in Pakistan, even though she works in Canada.

1.2 Basis of chargeability

Taxable on receipt basis [Section 12(1)]

- Salary is taxable on receipt basis i.e. any salary received by an employee in a tax year shall be chargeable to tax.
- A person shall be treated as having received an amount, benefit, or perquisite if it is
 - i. actually received by the person
 - ii. applied on behalf of the person, at the instruction of the person or under any law
 - iii. made available to the person. [Section 69]

► **Exercise**

Mr. Bilal, a citizen of Pakistan, is working with PMX (Pvt.) Limited as their head of treasury for the last 15 years. He has provided you with the following information for the year ended June 30, 2026.

- i. His salary was Rs. 300,000 per month (inclusive of all allowances) till June 30, 2025, which was increased to Rs. 400,000 per month effective from 1 July 2025.
- ii. Salary and allowances are deposited into each employee's bank account on the 8th working day of the following month.
- iii. On 31 December 2025, Bilal opted for early retirement and final settlement was made on 8 January 2026.

Required:

Compute Mr. Bilal's taxable income for the tax year 2026.

► *Answer*

Mr. BILAL	
COMPUTATION OF TAXABLE INCOME	
INCOME YEAR ENDED ON 30-06-2026	
Rs.	
TAX YEAR 2026	
Salary for month of June received on 8 July	300,000
Six month salary from July 2025 to	
December 2025 (400,000 x 6)	2,400,000
Total taxable salary	2,700,000

Note:

Salary is taxed on receipt basis. As salary is transferred on the 8th working day following the end of the month, salary for the month of June 2025 will be taxable in the tax year 2026.

Who is salaried person for the purposes of tax rate?

A salaried taxpayer means a taxpayer whose salary income constitutes more than 75% of his taxable income.

1.3 Deductions not allowed [Sec 12(4)]

In computing the income under the head salary, no deduction shall be allowed for expenses incurred by the employee in earning such income.

1.4 Termination of employment [Sec 12(6)]

- If an employee has received compensation on the termination of employment, the employee may, by notice to Commissioner, elect for the amount to be taxed at the rate computed as:

$$\frac{\text{Total tax paid or payable for three preceding tax years}}{\text{Total taxable income for three preceding tax years}} \times 100$$

- The option should be exercised by the due date of furnishing return of income.

► *Exercise:*

MFD Ltd paid a sum of Rs. 500,000 under the Golden Hand shake scheme to Mr. X in addition to the taxable salary of Rs. 1,600,000 in the tax year 2026. The past three years assessed tax results of his assessment are as under:

Tax Year	Taxable Income	Tax Liability (Assumed)
2025	1,450,000	159,500
2024	1,200,000	120,000
2023	800,000	60,000
Total	3,450,000	339,500

Mr. X is interested to know the options available to him for taxation of Golden Hand shake scheme for the tax year 2026.

► *Answer1*

Taxation under Normal Manner (Option 1)

Particulars	Amount is Rs.
Taxable Salary	1,600,000
Sum received under Golden Hand shake Scheme	500,000
Taxable income	2,100,000
Total Tax liability of Rs 2,100,000 [$\text{Rs.}6,000 + 11\% \times (2,100,000 - 1,200,000)$]	105,000

Taxation under section 12(6) (Option II)

Particulars	Amount in Rs.
Taxable income as computed aforesaid	1,600,000
Tax on salary exceeding Rs. 1,200,000 but does not exceed Rs. 2,200,000 [$6,000 + 11\% \times (1,600,000 - 1,200,000)$]	50,000
Tax on Rs. 500,000 $\times 339,500/3,450,000$	49,203
Total Tax liability	99,203

Note: Since the tax under Option II is lower than the tax under Option I, it is more beneficial for Mr. X (the taxpayer) to choose Option II.

1.5 Relief where salary is received in arrears [Sec 12(7) & (8)]

- In case of receipt of amount under salary which is paid in arrears and is expected to be charged at rate higher than the rate which would have been charged if the amount was received in its relevant tax year, the employee may by a notice to the Commissioner elect for tax rate applicable in the tax year in which such salary was earned.
- The above option shall be exercised by the due date for furnishing employee's return of income for the tax year in which the amount was received or such later date as may be extended by the Commissioner.

1.6 Tax free salary to employee [Sec 12(3)]

► *Exercise*

The employer of Mr. Usman has undertaken to bear the amount of tax on his salary income of Rs. 2,000,000. Compute tax liability of Mr. Usman for the year. For the sake of simplicity assume that he is liable to pay tax @ 15% of his taxable income instead of rate mentioned in the first schedule.

Where an employer agrees to pay the tax chargeable on an employee's salary, then the amount so paid shall be treated as an additional benefit to the employee. The salary income of the employee shall be grossed up by the amount of tax payable by the employer.

► *Answer*

Salary income	2,000,000
Add tax paid by employer ($2,000,000 \times 15\%$)	300,000
Taxable salary	2,300,000
Tax liability for the year @ 15%	345,000
Less tax already paid by employer on Usman's behalf	(300,000)
Net tax payable	45,000

In the above example employee is still paying tax of Rs. 45,000. The question that arises is that whether the extra tax of Rs. 45,000 is recoverable by the employee from the employer.

It will be a question of fact in each case to determine whether the extra tax, being the difference of the tax paid by the employer and that calculated on the gross salary, is recovered or recoverable by the employee from his employer. If it is not so recoverable, the matter is simple, as the gross income of the employee in that case will consist of the salary plus the amount paid by the employer as tax, and will be assessed in the hands of the employee, the extra tax, if any being borne by the employee himself. (As illustrated in the above exercise).

However, if the extra tax is also borne by the employer, the gross salary and the rate applicable have to be worked out again by making addition in two or three or four steps. This is illustrated in the following exercise:

► **Illustration:**

Mr. Qasim earned an annual taxable salary of Rs. 1,550,000 from Kahjoor Marka Ltd, with the condition that the entire tax on this salary will be borne by the company.

Required:

You are required to compute his taxable salary and show the working for how the tax borne by the employer is calculated?

Particulars	Gross taxable Income	Tax	Difference
Salary Taxable Income	1,550,000		
Tax on the Income [6,000+ 11% of amount exceeding Rs. 1,200,000]		44,500	44,500
Salary income after addition u/s 12(3) (1,550,000 + 44,500)	1,594,500		
Tax on the Revised income		49,395	4,895
Salary income after addition u/s 12(3) [1,594,500 + 4,895]	1,599,395		
Tax on the Revised income		49,933	538
Tax on revised income of Rs. 1,599,333 (1,599,395 + 538)	1,599,933	49,993	60
Tax on revised income of Rs. 1,599,993 (1,599,933+60)	1,599,993	49,999	6
Tax on revised income of Rs. 1,599,999(1,599,993+6)	1,599,999	50,000	1
Tax on revised income of Rs. 1,600,000 (1,599,999+1)	1,600,000	50,000	0
Short cut formula: (Rs.44,500/0.89)=50,000			

This shortcut formula will be applicable only if by adding tax liability at the first step, tax slab does not change. Shortcut formula will not be applicable if slab changes at first step.

1.7 Amount or Perquisite when treated received [Sec 12(5)]

An amount or perquisite shall be treated as received by an employee from any employment regardless of whether the amount or perquisite is paid or provided:

- By the employee's employer, an associate of the employer, or by a third party under an arrangement with the employer or an associate of the employer;
- By a past employer or a prospective employer; or
- To the employee or to an associate of the employee or to a third party under an agreement with the employee or an associate of the employee.

2 DETERMINATION/COMPUTATION OF VALUE OF PERQUISITES

2.1 Introduction to valuation of perquisites

The term 'perquisites' may be defined as the casual emolument, fee or profit attached to an office or position in addition to salary or wages. Perquisite may be cash (such as utility) or in kind (such as accommodation or motor vehicle provided by the employer to an employee).

Section 13 of the Ordinance contains provisions relating to determination of value of perquisites. The said provisions describe the methods for determination of value of perquisites which are detailed below.

2.2 Conveyance [Sec 13(3) and Rule 5]

In case where motor vehicle is provided by an employer to an employee (including director), the amount chargeable to tax under the head salary shall be determined as follows:

Partly for personal and official use	If owned: 5% of the cost of vehicle to the employer; or If leased: 5% of fair market value (FMV) of motor vehicle at the commencement of lease
For personal use only	If owned: 10% of the cost of vehicle to the employer; or If leased: 10% of FMV of motor vehicle at the commencement of lease
For office use only	No addition

Provision of a motor vehicle and its running and maintenance are two different perquisites and dealt with under different rules.

2.3 Accommodation [Sec 13(12) and Rule 4]

If accommodation or housing is provided by an employer to an employee (including director), the amount chargeable to tax under the head salary shall include higher of the following:

- Amount that would have been paid in case if such accommodation was not provided; and
- 45% of the minimum of time scale (MTS) of the basic salary or the basic salary if there is no MTS.
- Where house rent allowance is admissible @ 30%, the value taken for the purpose shall be an amount not less than 30% of minimum of the time scale of basic salary or the basic salary where there is no time scale

Minimum of time scale is the amount from where the salary scale of a particular employee starts e.g. (4,900-800-8,500) means salary of the employee starts with Rs. 4,900 with increment of Rs. 800 per annum etc. subject to maximum increased salary upto Rs. 8,500.

► Exercise:

Case No 1

(1)	Minimum time scale	250,000-25,000-450,000
(2)	Basic salary	140,000 Per month
(3)	Bonus	1,000,000

Free accommodation whose rental value is Rs 1,000,000

Determine the taxable Income?

► *Solution*

Value under Rule 4	
= 1,350,000 [i.e. 250,000 x 12 x 45%] or Rs. 1,000,000 whichever is higher.	
His taxable income will be:	
Basic salary	1,680,000
Bonus	1,000,000
Addition under rule 4	1,350,000
Taxable income	4,030,000

Case No 2

(i)	Basic Salary	160,000 PM
(ii)	Accommodation [annual rental value Rs. 1,200,000]	
(iii)	Bonus	1,200,000
(iv)	Dearness allowance	30,000 PM

Determine taxable income

► *Solution*

Value of perquisite under Rule 4

= Rs.864,000 [i.e. 160,000 x 12 x 45%]

Total income chargeable

Basic salary	1,920,000
Accommodation under Rule 4 [higher of Rs.1,200,000 or Rs.864,000]	1,200,000
Bonus	1,200,000
Dearness allowance	360,000
Taxable income	4,680,000

Case No 3

Mr X, an employee of ABC Ltd. was residing in a rented house at monthly rent of Rs. 50,000/-. On 1st July 2025 his employer agreed to pay Rs. 25,000/- for his rent and converted it into an accommodation. All his other emoluments remained same which are as under:

Basic salary	200,000 PM
Bonus	300,000
Conveyance allowance	30,000 PM

What will be his taxable salary?

► **Solution**

Value of accommodation	
Basic Salary (200,000 x 12) Rs. 2,400,000	
Rent of the house (50,000 x 12) Rs. 600,000 [Rs.2,400,000 x 45% = 1,080,000 or Rs.600,000 whichever is higher]	
His taxable salary would be as under	
Basic salary (200,000 x 12)	2,400,000
Bonus	300,000
Value of accommodation (1,080,000 – 300,000)	1,080,000
Conveyance allowance (30,000 x 12)	360,000
Taxable salary	3,840,000

Note:

It is assumed in all above cases that annual rental value is equal to the amount that would have been paid by employer if such accommodation is not provided.

2.4 Utilities and services of domestic servants [Sec 13(5) & (6)]► **Definition: Utilities**

“Utilities” includes electricity, gas, water and telephone. [(Section 13(14)(c)]

The amount chargeable to tax under the head salary shall include the FMV of utilities as reduced by any payment made to the employer for such utilities.

Domestic servants [Section 13(5)]

In case services of housekeeper, gardener, driver, or other domestic assistant is provided by an employer to the employee, the amount chargeable to tax under the head salary shall include the amount of total salary paid to housekeeper, gardener, driver, or other domestic assistant as reduced by any payment made by the employee to the employer for such services.

2.5 Interest Free / Concessional Loan [Sec 13(7), (8) & (14)]

- Where a loan is given to an employee on or after 1.7.2002 (i.e. tax year 2003), then the amount to be included in salary income of the employee in the following manner:
 - If no interest is payable by the employee - the amount of interest computed at the benchmark rate,
 - If interest is payable at less than benchmark rate - the interest amount computed at the benchmark rate less the actual amount of interest paid by the employee,
- The above provision shall not apply
 - Loans of Rs. 1,000,000 or less.

Where such benefit is extended by the employer due to waiver of interest by such employee on his accounts maintained with the employer e.g. Provident Fund etc.

- Benchmark rate of interest is 10% per annum.
- Where an amount has been included in salary of an employee in connection with above loan, and the employee uses the loan wholly or partly for acquiring any asset or property producing income chargeable to tax under any head of income, the amount of interest on such loan shall be allowed as deduction against income from such asset. In this regard, an amount equal to benchmark rate shall be allowed as deduction. However, where interest charged by the employer is higher than the benchmark rate, the whole amount paid by the employee shall be allowed as deduction.

► *Exercise*

Mr. A is granted a loan of Rs. 1,500,000 by his employer ABC Ltd on 1 July 2024. The loan is subject to interest rate of 2% per annum. Compute the amount of perquisite relevant to the interest for the tax year 2026.

► *Answer*

	Rs.
Interest chargeable at Benchmark Rate => $1,500,000 \times 10\%$	150,000
Less: Interest charged to the loan by ABC Ltd => $1,500,000 \times 2\%$	(30,000)
Balance perquisite to be added in the income of Mr. A	120,000

2.6 Obligations waiver / settlement [Sec 13(9), (10)]

- Any obligation waived of which an employee owed to the employer shall be included in the salary income of the employee, equal to the amount waived.
- Any repayment by the employer to another person on account of an obligation of the employee shall be included in the salary income of the employee equal to the amount repaid.

2.7 Self-hiring of property [Sec 15(5)]

- Where an employee or his spouse is the owner of any such building that is given on rent to the employer and the employer has provided the same building to the employee against his entitlement for a rent free accommodation, then it will have following effect
 - Receipt of rent of building is chargeable to tax under the head income from property. Any rent received by the employee or his spouse shall be property income of the recipient and be treated accordingly.
 - The building is provided by the employer to his employee as a rent free accommodation. It will be a perquisite and added in the salary income of the employee as per the rule stated in paragraph 2.3 above.

► *Exercise*

An employer owns a residential house and has provided the same to one of its employees for no rent. Explain the tax implications in respect of this transaction.

► *Answer*

The fair market rent or 45% of minimum of time scale / basic salary whichever is higher will be added to employee's taxable salary. The employer will not be considered to have earned any rental income from this property and accordingly there will be no tax consequences for him. [Ref: S 15(5) and Rule 4]

2.8 Transfer of property or provision of services to employees [Sec 13(11)]

If any property is transferred or any services are rendered by an employer to an employee, the amount chargeable to tax to the employee under the head salary for that year shall include the fair market value of the property or services determined at the time the property is transferred or the services are provided, less any payment made by the employee for the property or services.

2.9 Any other perquisite [Sec 13(13)]

The amount calculated as below shall be included in the income of the employee;

Fair market value of the perquisite	xxx
Less: Payment made by the employee if any	(xx)
Amount to be included in salary income	xxx

3 DETERMINATION/COMPUTATION OF OTHER COMPONENTS OF SALARY

3.1 Retirement benefits schemes

Retirement benefits generally include payments on account of gratuity, provident fund and pension. In some cases, employees are encouraged to retire voluntarily and are offered payments under the Golden handshake schemes.

Gratuity

► Definition:

Section 2(3), “approved gratuity fund” means a gratuity fund approved by the Commissioner in accordance with Part III of the Sixth Schedule;

- Gratuity received from approved gratuity fund is fully exempt. Gratuity received from approved scheme and unapproved fund or scheme is exempt upto the following limits:

Gratuity type	Tax treatment
Government employees	Fully exempt
Gratuity Fund approved by the Commissioner Inland Revenue	Fully exempt
Gratuity Scheme approved by the Board	Exempt upto Rs. 300,000
Unapproved gratuity scheme/fund	Exempt upto 75,000 or 50% of the amount receivable whichever is lower To be taxed at average rate of last 3 years

- Exemption in respect of unapproved gratuity shall not apply in the following cases:
 - Any payment not received in Pakistan
 - Any payment received by a director of a company who is not a regular employee of such company
 - Any payment received by a non-resident
 - Any gratuity received by an employee who has already received any gratuity from the same or other employer.

Pension

Through the Finance Act, 2025, the exemption previously available on pension income received by citizens of Pakistan has been withdrawn. As a result, any pension received in respect of employment will now be taxable under the head 'Salary'. Consequently, the following tax rates will apply:

Pension taxable under FTR

Description	Rate of tax
Where the amount of pension received does not exceed Rs.10 million	0% of the amount
Where the amount of pension received exceeds Rs.10 million and age is less than 70 years	5% of the amount exceeding Rs.10 million
Recipient is over 70 years old	Fully Exempt

Pension taxable under NTR as per applicable slabs

Where the individual continues to work for the former employer or its associate and derives pension, such pension received from the former employer will be taxed at the applicable slab rates, salaried or other than salaried, as the case may be, in the hands of the recipient.

Corresponding changes have also been brought about in the withholding tax provisions relating to salary payments whereby the person making payment of pension is now obligated to withhold tax at the rate of 5% from the amount of pension exceeding Rs.10 million paid to an employee below the age of seventy years.

Provident Fund (PF)

Provident fund is categorized into the following three categories:

- i. Government provident fund
- ii. Recognized provident fund
- iii. Unrecognized provident fund

Provisions regarding taxability in respect of employer/employee contribution, interest credited and accumulated balance thereon is as follows:

Event	Government PF	Recognized PF	Unrecognized PF
Employee's Contribution	No treatment	No treatment	No treatment
Employer's Contribution	Exempt	Limit on employer's yearly contribution is Rs.150,000 or 1/10th of (basic salary + dearness allowance) whichever is lower	No treatment
Interest credited during the year	Exempt	Yearly interest is exempt higher of: • 16% interest rate on accumulated balance; or • 1/3rd of (basics salary + dearness allowance).	No treatment
Payment of accumulated balances	Exempt	Exempt	Only the employer's contribution and interest on accumulated balance is taxable in the year of receipt.

- Salary for the purpose of provident fund includes basic salary + dearness allowance. All other allowances are excluded.
- There is no treatment of employee contribution as the amount is paid from salary and the same is already included in his salary.

Benevolent fund

Any benevolent grant paid from a Benevolent Fund to employees or members of their families in accordance with the provisions of the Central Employee Benevolent Fund and Group Insurance Act, 1969 is exempt from tax. **(Clause 24 Part I of the Second Schedule)**

3.2 Other benefits

Certain Perquisites without by virtue of employment (Clause 53A Part I of 2nd Sch.)

The following perquisites received by an employee by virtue of his employment are exempt from tax.

- i. Free or subsidized food provided by hotels and restaurants to its employees during duty hours
- ii. Free or subsidized education provided by an educational institution to the children of employees
- iii. Free or subsidized medical treatment provided by a hospital or clinic to its employees
- iv. Any other perquisite for which the employer does not have to bear any marginal cost, as notified by the Board

Medical allowance and reimbursement (Clause 139 Part I of 2nd Sch.)

- Medical facility or the reimbursement received by an employee is exempt where such provision or reimbursement is in accordance with the terms of employment provided that the NTN of the hospital or clinic is provided and employer also certifies and attests the medical bills.
- Medical allowance is exempt upto 10% of basic salary (The same is fully taxable if it is provided in addition to the exempt medical facility provided by the employer, whether availed by the employee or not)

Leave Encashment (Clause 19 Part I of 2nd Sch.)

Any amount received on encashment of leave preparatory to retirement is exempt, if it is received by a Government employee & member of Armed Forces of Pakistan).

Worker's Profit Participation Fund (WPPF) (Clause 26 Part I of 2nd Sch.)

Amount received from WPPF as worker is fully exempt.

Commutation of pension (Clause 12 Part I of 2nd Sch.)

Commutation of pension received from government or any pension scheme approved by the Board is fully exempt.

3.3 Reduction in tax liability (Clause 2 Part III of 2nd Schedule)

Full time teacher or researcher

Full time teacher/researcher allowance through reduction in tax liability @ 25% has been discontinued from Tax Year 2026 onwards, and will no longer be applicable for income earned on or after July 1, 2025.

3.4 Salary earned outside Pakistan by citizen of Pakistan [Sec 51(2)]

Where a citizen of Pakistan leaves the country during a tax year and remains abroad for the remainder of that year, any salary income earned outside Pakistan during that period shall be exempt from tax. However, this exemption applies exclusively to salary income; all other foreign-source or Pakistan-source income shall remain taxable as per applicable tax laws.

3.5 Foreign source salary (Sec 102)

Foreign-source salary received by a resident shall be exempt from tax in Pakistan if the individual has paid foreign income tax on that salary—either through employer withholding or by direct payment to the revenue authority of the foreign country where the employment was exercised. This exemption shall not apply where no tax has been paid or is not payable in the foreign jurisdiction.

► *Exercise*

Being a tax consultant, you are required to explain the tax implications/taxable income under the appropriate head in respect of each of the following independent situations for tax year 2026:

- i. As part of remuneration package, a company provides for reimbursement of telephone costs on actual basis to its employees.
- ii. Actual expenditure incurred by an employee in relation to travelling and daily allowances is less than the amount of allowances paid by the employer.
- iii. Mr. Hamid, a citizen of Pakistan was working with Zee (Pvt.) Ltd for last 15 years when he opted for early retirement on 31 October 2025. He was due Rs. 5 million as a gratuity under the gratuity scheme of Zee (Pvt.) Limited. The scheme was not approved by the FBR. Due to cash constraints, the gratuity though due to Hamid on 31 October 2025 was not paid to Hamid. On 30 April 2026 at the request of Zee (Pvt.) Limited, Zee (Pvt.) Ltd- an associated company of Zee (Pvt.) Ltd transferred the equivalent of Rs. 5 million in US Dollars into Hamid's US dollar account in UAE in lieu of gratuity due from Zee (Pvt.) Limited.
- iv. A company has taken health insurance cover for its employees. The insurance company reimburses employees for actual cost of medical services for themselves and their dependents.
- v. ABC Ltd has provided scholarship to one of his employees for higher studies abroad.
- vi. Mr. A has leased a car and pays for its lease rentals from his own sources. He uses the car for business purpose. What will be the treatment of lease rentals paid and expenditure incurred on vehicle running and maintenance?
- vii. A partner in a firm is entitled to a fixed remuneration each month. Would this constitute his salary income?
- viii. Mr. Aslam is 67 years old and employed as research scholar in a recognized non-profit institution. His taxable salary for the tax year is Rs. 654,000. Azhar is of the view that he is entitled to both reductions i.e. in respect of senior citizen allowance as well as for full time teacher allowance.
- ix. Mr. Sarmad has purchased a generator amounting to Rs. 1,000,000 from an interest free loan taken from his employer. He rented the generator at an annual rental value of Rs. 250,000. Total expense of Rs. 25,000 was expended on repair, transport and maintenance of the generator.

► *Answer*

- i. Reimbursements of telephone expenses by the company will be treated as taxable benefits of employees in case the facility is used for private purposes. There will be no tax consequences to the extent the facility is used for official purpose. [Ref: Sec 13]
- ii. Travelling and daily allowance spent to the extent for performance of duty will be exempt provided it is not paid with monthly salary or on fixed basis. Any amount given in excess of actual spending will be fully taxable.
- iii. Since gratuity scheme is not approved, amount exempt from tax should be 50% of the amount received or Rs. 75,000, whichever is lower. However, since the payment is received outside Pakistan, the said exemption is not available. The whole amount is chargeable to tax. (Ref. Proviso to Clause 13(iv) of part 1)
- iv. Reimbursement of actual medical expenditure by an employer is tax exempt. (Clause 139 Part I of 2nd Schedule). On a similar basis, there will be no tax implications on reimbursement by the insurance company on behalf of the employer, or any tax consequences for the employees on payment of health insurance premium by the employer.
- v. Scholarship granted to the employee will be exempt from tax provided the employer and the employee are not associates (Ref: Sec 47, discussed in chapter 11 as well)

- vi. Expenditure incurred by an employee to earn salary income including travelling expenses and lease rental payments is not tax deductible. (Ref: Sec 12(4))
- vii. The remuneration paid by a firm to a partner is considered his share in the firm's profit as partner is not an employee of the firm.
- viii. No, full time teacher or researcher allowance and the tax reduction for senior citizen is no more available for tax year 2026.

Annual rental	250,000
Repair, transport and maintenance	(25,000)
Taxable income from other source	225,000

Note

N-1 Loan amount is Rs.1,000,000, so no amount will be added in salary for interest on loan received from employer. However mark up at not less than benchmark rate of 10% as deduction shall be allowed against income as such.

4 EMPLOYEE SHARE SCHEME

4.1 Definition

Employee share scheme means any agreement under which a company may issue shares to:

- i. an employee of the company; or
- ii. an employee of an associated company; or
- iii. the trustee of a trust and under the trust deed the trustee may transfer the shares to an employee of the company or employee of an associated company

4.2 Taxability at grant of right or option

When an employee is granted an option or right to acquire shares under an employee share scheme, no amount is chargeable to tax. It is so for the reason that no benefit is derived by the employee by a mere grant of option.

4.3 Taxability at issue of shares

When an employee is issued with shares as a result of exercise of option under an employee share scheme, the amount chargeable to tax to the employee under the head salary shall be computed in the following manner:

i.	Fair market value of shares	xxx
ii.	Consideration paid for the grant of right or option to acquire shares	(xxx)
iii.	Consideration paid for the purchase of shares	(xxx)
	Taxable salary	xxx

4.4 Taxability at issue of shares subject to restriction on transfer

- If the shares issued to an employee under an employee share scheme, are subject to a restriction on transfer, no amount shall be chargeable to tax until the earlier of the time the employee:
 - i. has free right to transfer the shares; or
 - ii. disposes off the shares; and
- The amount chargeable to tax shall be computed as follows:

Fair market value of shares at the time the employee has free right to transfer or dispose of the shares	XXX
Less: Any consideration paid for shares	(XXX)
Less: Any consideration paid for grant of right or option to acquire the shares	(XXX)
Taxable salary	XXX

4.5 Taxability at disposal of right or option

As stated in paragraph 4.2 above, when an employee is granted an option or right to acquire shares under an employee share scheme, no amount is chargeable to tax. However if, instead of exercising, such right or option is disposed off by the employee, amount chargeable to tax under the head salary shall be worked out as under:-

Consideration received for the disposal of right or option	xxx
Less: Employees cost in respect of the right or option	(xxx)
Taxable salary	xxx

4.6 Cost of shares

After an amount has been charged to tax under the head salary as a result of situations mentioned in paragraph 4.3 and 4.4 above, the cost of shares acquired under the employees share scheme, shall be computed in the following manner:

Consideration paid for shares	xxx
Consideration paid for the grant of any right or option	xxx
Taxable amount representing gain calculated on the	
Issue of shares by company to employee under	
Employees share scheme (paragraph 4.3 / 4.4)	xxx
Cost of shares (generally for the purpose of computing	xxx

► Exercise

Mr. Ahsan has been the Chief Financial Officer of XYZ Limited for the last 5 years. He was offered 5,000 shares on 1 June 2024 by XYZ Limited at a price of \$ 1 per share. The market value on that date was \$5 per share. The shares were transferrable on completion of one year of service, from the date of issue of shares.

The market price of the shares as on 1 June 2024 was \$8 per share. On 17 September 2025, Mr. Ahsan sold all shares at \$9. He also paid a commission of \$10 to the brokerage house.

The relevant exchange rates are as follows:

01 June 2024	\$1=100
01 June 2025	\$1=101
17 September 2025	\$1=102

Required:

Calculate the amount to be included in the taxable income of Mr. Ahsan for tax years 2024, 2025 and 2026. Also specify the head of income under which the income would be classified.

► Answer

Tax Year 2024

As Mr. Ahsan did not have any right to transfer the shares in tax year 2024, therefore, nothing will be included in the taxable income:

Tax Year 2025:

Following will be included in the income of the Mr. Ahsan under the head Salary in tax year 2025.

Market value on removal of restriction on transfer of shares (5000x8x101)	4,040,000
Less cost of shares: amount paid by Mr. Ahsan (5,000x1x100)	500,000
Amount to be included under the head salary	3,540,000
Tax Year 2026: [Capital Gains]	
Following will be included in the income of Mr. Ahsan under the head capital gain	
Consideration received on sale of shares (5,000x102x9)	4,590,000
Less cost of shares (500,000 + 3,540,000)	(4,040,000)
Less commission (10x102)	(1,020)
Capital gain	548,980

5 COMPUTATION OF INCOME CHARGEABLE UNDER THE HEAD ‘SALARY’

The method for determination of taxable income under the head “Salary” is exemplified in the following exercise:

► *Exercise:*

Mr. Mobeen is a chartered accountant and working as finance manager of XYZ (PVT) Limited. During the financial year ending on 30th June 2026, his emolument package includes followings:

- Basic Pay Rs. 100,000 per month .
- Bonus Rs. 100,000.
- Leave encashment Rs. 50,000.
- Mr. Mobeen is provided with a car of 1,300cc. The said car was purchased in the last year for a consideration of Rs.1,000,000. Running and maintenance cost of the said vehicle is borne by employer. The said vehicle is being used partly for the private and partly for business use.
- Mr. Mobeen is provided with a furnished accommodation of 1000 square yards in Lahore and company bears rent of Rs. 60,000 p.m. of the said accommodation.
- The company also bears the cost of utility bills of Mr. Mobeen home. The sum of total bills of electricity, gas and water aggregates to Rs. 200,000.
- The salary paid in respect of the cook and guard appointed on the residence of Mr. Mobeen aggregates to Rs. 10,000 p.m.
- According to the terms of employment, the company bears all the medical expenses of Mr. Mobeen. Total expenses incurred on this account aggregates to Rs. 75,000.
- The company also provided air tickets and other expenses worth Rs. 85,000 for Mr. Mobeen and his family trip to UAE for summer leaves.
- During the year, Mr. Mobeen was deputed to Islamabad for the month of December, 2025 in order to resolve certain administrative issues. He was paid a fixed relocation allowance of Rs. 35,000 in addition to his normal salary.
- The company granted Mr. Mobeen an interest free loan for a sum of Rs.1,500,000 on 1 January, 2026.
- In July 2021, Mr. Mobeen was granted an option to acquire 1000 shares of Alpa (Pvt.) Limited (Parent Company of his employer). The option was exercisable on completion of three years’ employment with the Company. He paid an amount equivalent of Rs. 100,000 to acquire the option whereas the fair market value of such option at that time was Rs. 150,000. On July 4, 2025 he paid a sum equivalent of Rs. 200,000 to acquire the said shares which were issued to him on July 21, 2025 when the market value of the shares was equivalent of Rs. 350 per share. Mr. Mobeen disposed off the shares on June 21, 2026. The sales proceeds received amounted to Rs. 375,000.
- Mr. Mobeen tendered his resignation to the company on June 29, 2026 and he was paid a sum of Rs. 120,000 on account of gratuity from the unapproved gratuity fund on the said date.
- Mr. Mobeen accepted the offer of M/S ABC (Pvt.) Limited to join that organisation and he received a sum of Rs. 75,000 as inducement allowance on account of leaving the past employer.

Required:

Compute the taxable income and tax liability of Mr. Mobeen for the tax year 2026?

► Answer

MR. MOBEEN

COMPUTATION OF TAXABLE INCOME & TAX LIABILITY

Resident Individual

Tax year 2026

Particulars	Gross	Exempt	Taxable	Remarks
Pay	1,200,000	0	1,200,000	
Bonus	100,000	0	100,000	
Leave encashment	50,000	0	50,000	
Car 1,300cc	50,000	0	50,000	5% of 1,000,000
Accommodation	720,000	0	720,000	720,000 or 45% of the basic salary whichever is higher
Utilities	200,000	0	200,000	
Cook and Guard	120,000	0	120,000	
Medical	75,000	75,000	0	Exempt up to 10% of the basic Salary
Leave fare assistance	85,000	0	85,000	
Relocation Allowance	35,000		35,000	Fixed allowance fully taxable
Mark up on interest free loan	75,000	0	75,000	$10\% \times 6/12 \times 1,500,000$
Employee share scheme	50,000	0	50,000	$350,000 - 200,000 - 100,000$
Gratuity	120,000	60,000	60,000	Lesser of 75,000 or 50% is exempt
Inducement Allowance	75,000	0	75,000	
Taxable Salary income	2,955,000	170,000	2,820,000	
Capital gain	25,000 (Rs.375,000-350,000)		25,000	
Total taxable income			2,845,000	
Taxon Rs.2,845,000 (Rs.116,000 + 23% of (Rs.2,845,000 – 2,200,000))			264,350	

Please note that the remarks are provided for guidance purposes only and are not part of the exam requirements.

► *Exercise*

Mr. Arshad is an employee of a public listed company. He submitted the following data for computation of his taxable income for the tax year 2026:

Basic pay per annum	480,000
Bonus	240,000
Dearness allowance	50,000
Rent Free unfurnished accommodation	75,000
Watchman wages paid by employer	36,000
Gardner wages paid by employer	24,000
Sweeper wages paid by employer	6,000
Employer's contribution towards recognised provident fund	24,000
Interest on Provident fund balance @ 18%	18,000
Company maintained car for official and private use 1300CC. The said car was acquired three years earlier. The cost of acquisition of vehicle was Rs. 850,000.	
Reimbursement of medical expenditure	50,000
Utilities bills paid by the company	
Telephone	12,000
Electricity bills paid by employer	15,000
Gas Bills paid by employer	6,000
Water bills paid by employer	9,000
Leave fare assistance (for the first time)	50,000
Commission income for securing a contract paid by the employer	30,000

Due to some health issue, he resigned from the job and following further sums were paid to him:

Provident Fund recognised	150,000
Gratuity Fund unrecognised	70,000

Mr. Arshad bought another car from a relative for a consideration of Rs.285,000 whereas the book value of the said car was Rs. 435,200. He immediately sold the car at Rs. 600,000.

Required:

Compute the taxable income of Mr.Arshad for the tax year 2026?

► Answer

MR ARSHAD**COMPUTATION OF TAXABLE INCOME****TAX YEAR 2026**

Nature of Receipt	Gross amount	Exempt/Not taxable	Taxable
Basic Pay	480,000	0	480,000
Bonus	240,000	0	240,000
Dearness allowance	50,000	0	50,000
Rent Free unfurnished Accommodation [actual rent is lower than 45% of basic so higher value of 45% of basic is adopted]	216,000	0	216,000
Watchman salary	36,000	0	36,000
Gardner salary	24,000	0	24,000
Sweeper salary	6,000	0	6,000
Employer contribution to PF	24,000	24,000	0
Interest on PF Higher of: 1/3 rd of salary or income up to 16% (1/3 x 480,000 = 160,000) or 16% x (18,000/.18) = 16,000	18,000	18,000	0
Company maintained car (850,000 x 5%)	42,500	0	42,500
Re-imbursement of medical expenses	50,000	50,000	0
Utilities bills [electricity, gas and water]	30,000		30,000
Telephone bills	12,000		12,000
Leave fare assistance	50,000	0	50,000
Commission	30,000	0	30,000
Provident fund Recognised	150,000	150,000	0
Gratuity fund	70,000	35,000	35,000
Sale of car (600,000-285,000)	315,000	315,000	Exempt
Taxable income = 1,251,500			

INCOME FROM PROPERTY

IN THIS CHAPTER:

1. Income from property
2. Deductions allowed

1 INCOME FROM PROPERTY

1.1 Principles of taxation

The chargeability of income under the head “Income from Property” is elaborated in section 15 of the Ordinance. The said section states that:

The rent received or receivable by a person for a tax year, other than rent exempt from tax shall be chargeable to tax in that year under the head “Income from Property”.

► *Definition: Sec 2(49); 15, Rent*

“Rent” means any amount received or receivable by the owner of land or a building as consideration for the use or occupation of, or the right to use or occupy, the land or building, and includes any forfeited deposit paid under a contract for the sale of land or a building.

- Where rent received or receivable is less than fair market rent for the property, the person shall be treated as having received the fair market rent for the period the property is let on rent in the tax year. However, this shall not apply in the case of self-hiring where fair market rent is already included in the income of the lessee, chargeable to tax under the head “Salary”.
- Where any amount is included in rent received or receivable by any person for the lease of a building together with plant and machinery or provision of amenities, utilities or any other service connected with the renting of the building, such amount shall be chargeable to tax under Income from Other Sources.

► *Exercise:*

In respect of each of the independent situations mentioned below, Calculate the amount which will be treated as rent chargeable to tax under the head “Income from Property” for the tax year 2026.

- i. Mr. Bilal received rent of Rs. 50,000 per month during the tax year 2026 when the fair market rent of the property was Rs. 60,000 per month.
- ii. On August 2025 Mr. Islam received Rs. 345,000 as rent for leasing out factory, land, building and machinery
- iii. ABC Limited owns a residential house and has provided the same to one of its employees for no rent. Fair market value of the rent was Rs. 1,000,000.
- iv. On 1 July 2025 Mr. Hamza received two years advance rent of Rs. 1,500,000
- v. Mr. Usman owns 75 acres of agriculture land in Mirpur. He did not cultivate the land himself and during the tax year 2026 received annual rent of Rs. 2,500,000 from the tenant cultivating the land.

► *Answer*

- i. Where rent received or receivable is less than fair market rent for the property, the person shall be treated as having received the fair market rent (FMR) for the period the property is let on rent in the tax year. Therefore, income from property will be (Rs. 60,000 x 12 months)
- ii. It will be chargeable to tax under the head “income from other source”
- iii. Employee
 - a) The fair market rent or 45% of basic salary whichever is higher will be added to employee’s taxable salary.
 - b) Employer (ABC Ltd)
 - c) The employer will not be considered to have earned any rental income from this property and accordingly there will be no tax consequences for him.
- iv. Rent relating to a tax year, whether received or receivable, is chargeable to tax in that tax year. Therefore, rent received in advance amounting to Rs. 750,000 (Rs. 1,500,000/2) will be charged to tax in the tax year (TY 2026) to which it relates.

- v. Land is used for agriculture purpose. Any rent received by the owner of such land is treated as agriculture income and exempt from tax. To claim the exemption, it is not essential that the land should be used for agriculture purpose by the owner himself.

Income of joint owners (Section 66)

Multiple ownership with shares individually ascertainable

Where any property chargeable under section 15 is owned by two or more persons and their respective shares in that property are definite and ascertainable, net rental income will be proportionately allocated to each owner. Each owner will pay tax on such income as per their applicable rates.

► *Example:*

Assume that Mr. F (a father) owns a building which is generating a taxable rental income of Rs 1,200,000. He gifted this building to his two sons, Mr. A and Mr. B. Now, the taxable rent for each son will be Rs 600,000 (Rs 1,200,000 x 50%).

Multiple ownership with shares not individually ascertainable

Where any property chargeable under section 15 is owned by two or more persons and their respective shares in that property are not definite and ascertainable, the property will be considered as being jointly owned by an association of persons (AOP) and taxable income and tax payable thereon will be computed as per the principles of taxation for AOP.

Note: Same concept will be applicable in all other heads except income from business.

2 DEDUCTIONS ALLOWED

2.1 Deductions chargeable under the head “Income from Property (Sec 15A)”

- Income from property is chargeable to tax under the Normal Tax Regime (NTR) in case of individual and AOP.

In computing the income of a person chargeable to tax under the head “Income from Property” for a tax year, a deduction shall be allowed for the following expenditures or allowances, namely:-

- In respect of repairs to a building, an allowance equal to one-fifth of the rent chargeable to tax in respect of the building for the year, computed before any deduction allowed under this section;
- any premium paid or payable by the person in the year to insure the building against the risk of damage or destruction;
- any local rate, tax, charge or cess in respect of the property or the rent from the property paid or payable by the person to any local authority or government in the year, not being any tax payable under this Ordinance;
- any ground rent paid or payable by the person in the year in respect of the property;
- any profit paid or payable by the person in the year on any money borrowed including by way of mortgage, to acquire, construct, renovate, extend or reconstruct the property;
- where the property has been acquired, constructed, renovated, extended, or reconstructed by the person with capital contributed by the House Building Finance Corporation or a scheduled bank under a scheme of investment in property on the basis of sharing the rent made by the Corporation or bank, the share in rent and share towards appreciation in the value of property (excluding the return of capital, if any) from the property paid or payable by the person to the said Corporation or the bank in the year under that scheme;
- where the property is subject to mortgage or other capital charge, the amount of profit or interest paid on such mortgage or charge;
- any expenditure, not exceeding FOUR per cent of the rent chargeable to tax in respect of the property for the year computed before any deduction allowed under this section, paid or payable by the person in the year wholly and exclusively for the purpose of deriving rent chargeable to tax under the head, “Income from Property” including administration and collection charges;
- any expenditure paid or payable by the person in the tax year for legal services acquired to defend the person’s title to the property or any suit connected with the property in a court; and
- where there are reasonable grounds for believing that any unpaid rent in respect of the property is irrecoverable, an allowance equal to the unpaid rent where—
 - the tenancy was bona fide, the defaulting tenant has vacated the property or steps have been taken to compel the tenant to vacate the property and the defaulting tenant is not in occupation of any other property of the person;
 - the person has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or has reasonable grounds to believe that legal proceedings would be useless; and
 - the unpaid rent has been included in the income of the person chargeable to tax under the head “Income from Property” for the tax year in which the rent was due and tax has been duly paid on such income.
 - Where any unpaid rent allowed as a deduction is wholly or partly recovered, the amount recovered shall be chargeable to tax in the tax year in which it is recovered.

- Where a person has been allowed a deduction for any expenditure incurred in deriving rent chargeable to tax under the head "Income from Property" and the person has not paid the liability or a part of the liability to which the deduction relates within three years of the end of the tax year in which the deduction was allowed, the unpaid amount of the liability shall be chargeable to tax under the head "Income from Property" in the first tax year following the end of the three years.
- Where an unpaid liability is chargeable to tax as a result of the application of above point and the person subsequently pays the liability or a part of the liability, the person shall be allowed a deduction for the amount paid in the tax year in which the payment is made.
- Any expenditure allowed to a person under this section as a deduction shall not be allowed as a deduction in computing the income of the person chargeable to tax under any other head of income.

The provisions of Income from business relating to deduction allowed shall apply in the same manner as they apply in determining the deductions allowed in computing the income of a person chargeable to tax under the head "Income from Business".

2.2 The treatment of non-adjustable amounts

- The treatment of non-adjustable advances received in relation to buildings is explained in section 16 of the Ordinance in the following manner:
- Where the owner of building receives an advance which is not adjustable against rent, the whole of advance shall be treated as rent chargeable to tax under the head income from property in the year of receipt and following nine tax years in equal proportion i.e. 1/10th of such un-adjustable advance shall be included in the income of the taxpayer under the head "income from property" commencing from the tax year in which the advance is received.

Note: No treatment is required in case of adjustable advance against rent because the same will be automatically included in the computation of rent.

- If advance is refunded in any year before the expiry of 10 years such advance shall not be included in the income from the tax year in which it is refunded or thereafter.
- After vacancy, if the property is let out again against another non-adjustable advance, new advance less the portion of previous advance already charged to tax shall be chargeable equally in 10 tax years, commencing from the tax year in which the advance is received from the succeeding tenant.

► Exercise:

Mr A had let out the property to Mr. B for a sum of Rs.150,000 per month in July 2024. Mr B has paid a sum of Rs. 500,000 as non-adjustable advance. After the expiry of two years, Mr B vacated the premises and Mr A returned the advance to Mr B. Thereafter, Mr C acquired the possession on the same rental amount. However, the amount of non-adjustable advance was increased to Rs.600,000.

Required:

Compute the gross income from the said property for the years 2025 and 2026 before allowing the admissible deductions.

► Answer

Income from Property for tax year 2025

Particulars		Amount
Rent	150,000 x 12	1,800,000
Add: 1/10 of Un adjustable Advance	500,000/10	50,000
Total Gross rental Income without deductions		1,850,000

Income from Property for the year 2026

Particulars		Amount
Rent	150,000 x 12	1,800,000
Add: Un-adjustable Advance	600,000	
Less: Already recognised income in the last two years (Rs. 500,000/10 x 2 years)	(100,000)	
Balance advance chargeable in 10 years	500,000/10	50,000
Total Gross rental Income without deductions		1,850,000

► **Exercise:**

Mr. Mobeen owns a property at Gulberg, Lahore. The said property was rented out to Mr. Asad at a rent of Rs. 175,000 per month. Mr. Asad left the premises on 31 January 2026. Mr. Asad had paid a sum of Rs. 300,000 as un-adjustable advance in tax year 2023. Mr. Mobeen returned the said advance on his departure. The said property remained vacant in the month of February, 2026. Thereafter Mr. Gulzar has taken the possession of the said property at a monthly rent of Rs. 220,000. New tenant has paid a sum of Rs. 350,000 as security. Mr. Mobeen incurred following expenses in connection with the said rented property.

Description	Amount in Rs.
Insurance premium payable	180,000
Property tax paid	80,000
Salary of employee appointed for collection of rent	60,000
Bank charges in connection with collection of rent	20,000
Fee to lawyer for the execution of rent agreements	50,000

His income from salary is Rs 500,000 and from business is Rs. 100,000. He paid Zakat of Rs. 45,000 during the year under Zakat and Ushr Ordinance.

Required:

You are required to compute the taxable income and tax liability of Mr. Mobeen for tax year 2026?

► **Answer**

MR. MOBEEN

COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY

TAX YEAR 2026

Particulars	Rupees
Income from salary	500,000
Income from property (Note-1)	1,359,560
Income from Business	100,000
Total Income	600,000
Less: Deductible Allowance Zakat (paid from income cover under NTR)	(45,000)
Taxable Income	2,514,560
Tax on taxable Income (as a non-salaried individual)	
Rs. 170,000 + 30% x (Rs. 2,514,560-1,600,000)	444,368

Note-1

Income from property:

Particulars		Rupees	Remarks (for student help)
Rent (175,000 x 7) + (220,000 x 4)		2,105,000	
Un-adjustable amount Amount received from New Tenant Rs	350,000		The un-adjustable amount received from the new tenant is reduced by the previously taxed amount. U/S 16 (3)
Less: Already taxed (300,000/10 x 3 years) =	(90,000)		
	260,000/10	26,000	
Chargeable Rent		2,131,000	
Less: admissible deductions			Under section 15A
Repair & maintenance allowance		(426,200)	1/5 th of Rent chargeable to tax U/S 15A(a)
Insurance premium payable		(180,000)	U/S 15A(b)
Property tax paid		(80,000)	U/S 15A(c)
Collection and admin expenses		(85,240)	The salary of the employee, bank charges for rent collection, and lawyer's fees for executing rent agreements will be eligible for deduction under U/S 15A(h), whichever is lower: the actual expenditure incurred or 4% of the rent chargeable to tax. Actual Expenditures Rs. 60,000 + 20,000 + 50,000 = Rs.130,000 OR Rs. 85,240 (4% x 2,131,000)
Taxable Income from Property		1,359,560	

Note for Students:

Please note that the remarks are provided to help you understand the concept. During the examination, do not include remarks unless specifically required. Only the solution is needed.

INCOME FROM BUSINESS – PART ONE

IN THIS CHAPTER:

1. Income from business
2. Deductions against business income
3. Tax accounting
4. Taxation of digital transactions

1 INCOME FROM BUSINESS

1.1 Distinction of business with the employment

Business denotes an activity with the objective of producing / earning profits. Income from illegal business is also taxable under the income tax law. There is a clear distinction between the income from business and employment. Following tests were used to decide whether activity was business or employment.

- a) Whether an individual is doing their own work or working for others, i.e., for remuneration.
- b) Whether the individual works part-time or full-time. If the individual works for multiple persons, it indicates that the individual is carrying on a business. However, working for only one person does not necessarily imply that the relationship between them is that of employer and employee.
- c) If the work is done by a company or a firm, that would also indicate that it is a business.
- d) Another test might be the capacity in which the work is being done. Whether the individual is dealing with their own goods/services (independently) or with goods/services belonging to someone else (dependently).

1.2 Income from business

► Definitions “Business” [Sec 2(10)]

Includes any trade, commerce, manufacture, profession, vocation or adventure or concern in the nature of trade, commerce, manufacture, profession or vocation, but does not include employment;

Section 18 of the Income Tax Ordinance, 2001 outlines the scope of income under this head in the following manner: Income from business

The following incomes of a person for a tax year shall be chargeable to tax under the head “Income from Business”, excluding incomes covered under Final Tax Regime:

- The profits and gains of any business carried on by a person at any time in the year;
- Any income derived by any trade, professional or similar association from the sale of goods or provision of services to its members;

Note: For the removal of doubt, it is clarified that income derived by co-operative societies including recreational club from the sale of goods, immovable property or provision of services to its members is and has always been chargeable to tax under the provisions of this Ordinance

- Any income from the hire or lease of tangible movable property;
- The fair market value of any benefit or perquisite, whether convertible into money or not, derived by a person in the course of, or by virtue of, a past, present, or prospective business relationship. The word benefit includes any benefit derived by way of waiver of profit on debt or the debt itself under circular/scheme issued by the State Bank of Pakistan.
- Any management fee derived by a management company (including a modaraba management company).
- Profit on debt where the person’s business is to derive such income (e.g. banks and financial institutions). In other cases, it will be chargeable to tax under the head “Income from other sources”)
- Lease rentals derived by a scheduled bank, investment bank, development finance institution, modaraba or a leasing company.
- Any amount distributed by a mutual fund or a private equity and venture capital fund, out of its income from profit on debt, to a banking company or a non-banking finance company shall be chargeable to tax under the head income from business and not under the head income from other source.

1.3 Important aspects of income from business

General principles relating to taxation of business income are summarized below:

- A resident person is taxed on his worldwide business income whereas a non-resident person is liable to tax in respect of his income to the extent it is Pakistan-sourced.
- Income may be recorded using the cash or accrual basis of accounting. Companies are, however, required to follow the accrual system of accounting for its business income.
- Expenditure incurred wholly and exclusively for the purpose of business is generally allowable in tax except for certain specific provisions of law which are discussed later in the chapter.
- The profits which are taxed under section 18 are the real profits and not notional profits. Therefore, gain arising from revaluation/impairment of fixed assets / investments or unrealized gain or loss arising from revaluation of foreign currency related debtors and creditors is not taxable as these are not real profits and can only be taxed when these are actually realised.
- Profits can arise only out of the trading (revenue) receipts. Capital receipts are not taxable unless expressly made taxable under the Income Tax Ordinance, 2001.
- Those profits and gains of a business are chargeable to tax which are carried on by the taxpayer at any time during the tax year. However, following receipts are taxable even if the taxpayer does not carry on business during the tax year:
 - Recovery in cash or kind against a deduction/loss allowed previously against business income [section 70]
 - Gain on sale of depreciable assets [Section 22(8)]
 - Recovery made out of bad debts allowed in preceding years [Section 29(3)]
 - Trading liabilities or any portion thereof which is found not to have been paid within the expiration of three years of the end of the tax year in which it was allowed [Section 34(5)]
 - Sum received after discontinuance of a business [Section 72(a) & (b)]

1.4 Speculation business

Speculation business is defined in section 19(2) of the Ordinance in the following manner:

- Speculation business” means any business in which a contract for the purchase and sale of any commodity (including stocks and shares) is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity, **but does not include** a business in which:
 - a contract in respect of raw materials or merchandise is entered into by a person in the course of a manufacturing or mercantile business to guard against loss through future price fluctuations for the purpose of fulfilling the person’s other contracts for the actual delivery of the goods to be manufactured or merchandise to be sold;
 - a contract in respect of stocks and shares is entered into by a dealer or investor therein to guard against loss in the person’s holding of stocks and shares through price fluctuations; or
 - a contract is entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing (arbitrage) to guard against any loss which may arise in the ordinary course of the person’s business as such member.

Tax implications for speculation business

Where a person carries on a speculation business:

- that business shall be treated as distinct and separate from any other business carried on by the person;
- this part shall apply separately to the speculation business and the other business of the person;
- Apportionment of deductions shall apply as if the profits and gains arising from a speculation business were a separate head of income (Sec 67);
- any profits and gains arising from the speculation business for a tax year computed in accordance with this part shall be included in the person's income chargeable to tax under the heading "Income from Business"
- any loss of the person arising from the speculation business sustained for a tax year shall be set off only against the income of the person from any other speculation business of the person chargeable to tax for that year;
- if a speculation loss sustained by a person for a tax year is not wholly set off, then the amount of the loss not set off shall be carried forward to the following tax year and applied against the income of any speculation business of the person in that year and so on, but no speculation loss shall be carried forward to more than six tax years immediately succeeding the tax year for which the loss was first computed.

► Exercise: Speculation Business

M/s XYZ Enterprises deals in cloth trading. Total revenue from cloth trading was Rs. 10,000,000 during the year 20YY. The gross profit from the trading business was amounting to Rs. 2,000,000.

During the year, the price fluctuations were very high in cloth market. Considering this trend, M/s XYZ Enterprises also made forward purchasing of cloth to reap the benefit of price fluctuations. In April 20YY, The enterprises agreed to purchase Bengali cloth of 20,000 bundles at the rate of 100 per bundle, the delivery of which was expected in June 20YY. The seller agreed to purchase the same goods at the rate ruling at the date of sale. In June the price of Bengali cloth has been increased to Rs. 120 per bundle. M/s XYZ Enterprises disposed of that cloth of 20,000 bundles to the seller at the market prevailing rate without taking any delivery of stocks, Total revenue from sale of cloth aggregates to Rs. 2,400,000, Therefore, the Enterprise earned income of Rs. 400,000.

Total administrative and general expenses of Rs. 1,000,000 were incurred during the year 20YY. Compute the taxable income and tax liability.

It is worth mentioning that carry forward loss of the Enterprise was Rs. 1,000,000 in respect of business. Whereas speculation loss was Rs. 250,000.

► Answer

Particulars	Speculation Business	Trading Business	Total
Gross Revenue	2,400,000	10,000,000	12,400,000
Gross Profit	400,000	2,000,000	2,400,000
Expenditure (1,000,000 x 2,400,000/12,400,000)	193,548	806,452	1,000,000
Net income	206,452	1,193,548	1,400,000
Carry forward loss	250,000	1,000,000	1,250,000
Taxable Income/ (loss) for the year	*(43,548)	193,548	

*Speculation loss carried forward

** Loss of speculation business cannot be set off with trading business.

2 DEDUCTIONS AGAINST BUSINESS INCOME

2.1 Deductions admissible – general provisions

Section 20 of the Ordinance prescribes general principles with respect to admissibility of deductions the said section states that:

- A deduction shall be allowed for any expenditure incurred by the person in the year wholly and exclusively for the purposes of business. Wholly and exclusively does not mean necessarily. It is the business to decide whether any expenditure should be incurred in the course of its business. Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for the promotion of business and to earn profits, the business can claim deduction.
- Deduction equal to the difference of the amount of actual cost of animals used for the purposes of business or profession (otherwise than as stock in trade) and the amount realized in respect of carcasses or animals shall be allowed where the animals have died or become permanently useless for such purposes.

2.2 Inadmissible deductions

Section 21 of the Ordinance provides that no deduction shall be allowed in computing the income of a person under the head “Income from Business” for:

- Any cess, rate or tax paid or payable by the person in Pakistan or a foreign country that is levied on the profits or gains of the business or assessed as a percentage or otherwise on the basis of such profits or gains;

Note: In case where sales tax/federal excise duty paid by a taxpayer is not charged by him to his customer, such sales tax/federal excise duty paid shall be allowed as deduction.

- Any amount of tax deducted at source under the provisions of the Income Tax Ordinance, 2001 from an amount derived by the person;
- Any expenditure from which the person is required to deduct or collect tax under the Income Tax Ordinance, 2001, unless the person has paid or deducted and paid the tax:

Provided that disallowance in respect of purchases of raw materials and finished goods under this clause shall not exceed 20% of purchases of raw materials and finished goods:

If a person fails to deduct or collect the required tax but pays it themselves (under section 161), or he pays tax as instructed by the Commissioner (under section 162), this amount will be considered as tax that has been paid. In other words, the recovery of any tax amount under these sections will be treated as if the tax obligation has been fulfilled.

- Any amount of commission paid or payable in respect of supply of products listed in the Third Schedule of the Sales Tax Act, 1990, where the amount of commission paid exceeds 0.2% of gross amount of supplies thereof unless the person to whom commission is paid or payable, as the case may be, is appearing in the active taxpayer list under this Ordinance.
- Any entertainment expenditure in excess of such limits or in violation of such conditions as may be prescribed;

Limits prescribed for allowing any expenditure on entertainment are as under (Rule 10).

Expenditure should be incurred in deriving income from business chargeable to tax and should not be in excess of following limits or in violation of condition specified:

- Such expenditure is:
 - Incurred outside Pakistan on entertainment in connection with business transactions: or
 - Allocated as head office expenditure; or
- Incurred in Pakistan on the entertainment of foreign customers & suppliers;

- c) Incurred on the entertainment of customer & clients at the person's business premises
- d) Incurred on the entertainment at the meeting of shareholders, agents, directors or employees
- e) Incurred on entertainment at the opening of branches.

Note: All these people (who are entertained) should be related directly to the person's business.

- Any contribution made by the person to a fund that is not a recognized provident fund, approved superannuation fund, or approved gratuity fund or approved pension fund;
- An amount in excess of fifty percent of total contribution made by a person (employer) to approved gratuity fund, approved pension fund or an approved superannuation fund.
- Any contribution made by the person to any provident or other fund established for the benefit of employees of the person, unless the person has made effective arrangements to secure that tax is deducted from any payments made by the fund in respect of which the recipient is chargeable to tax under the head "Salary";
- Any fine or penalty paid or payable by the person for the violation of any law, rule or regulation;
- Any personal expenditures incurred by the person;
- Any amount carried to a reserve fund or capitalised in any way;
- Any profit on debt, brokerage, commission, salary or other remuneration paid by an association of persons to a member of the association;
- Any salary paid or payable exceeding Rs. 32,000 per month other than by a crossed cheque or direct transfer of funds to the employee's bank account or through digital means;
- Any expenditure paid or payable of a capital nature. However, depreciation or amortization shall be allowed in respect of a depreciable asset, intangible or pre-commencement expenditure
- However, depreciation expense will be disallowed in all relevant tax years, in respect of capital assets where at the time of payment against purchase, required withholding taxes have not been deducted and deposited under the relevant provisions of the Ordinance.

Note: The term "capital assets" used in this context appears to be a drafting oversight. The correct term should be "depreciable assets" since depreciation is only relevant for assets eligible for depreciation under the Income Tax Ordinance, 2001. This distinction is critical because "capital assets" is a broader term that includes non-depreciable assets (e.g., land) which are not subject to depreciation.

- Any expenditure in respect of sales promotion, advertisement and publicity in excess of 10% of turnover incurred by pharmaceutical manufacturers.
- Expenditure upto 8%, claimed by a person who, where required, fails to integrate his business with the FBR through approved fiscal electronic device and software, will be disallowed.
- Any expenditure for a transaction, paid or payable under a single account head which, in aggregate, exceeds Rs. 250,000, made other than by a crossed cheque drawn on a bank or by crossed bank draft or crossed pay order or any other crossed banking instrument showing transfer of amount from the business bank account of the taxpayer:

However, online transfer of payment from the business account of the payer to the business account of payee as well as payments through credit card shall be treated as transactions through the banking channel, subject to the condition that such transactions are verifiable from the bank statements of the respective payer and the payee:

It is important to note that the above provisions shall not apply in the case of:

- expenditures not exceeding Rs. 25,000;
- expenditures on account of:
 - utility bills;
 - freight charges;
 - travel fare;

- postage; and
- payment of taxes, duties, fee, fines or any other statutory obligation Any withholding tax to be borne by taxpayer itself is also not allowed as expense except in case of salary.
- Any deduction for which taxpayer fails to provide documentary evidence (**Ref: Sec 174(2)**)
- any expenditure on account of utility bill in excess of such limits and in violation of such conditions as may be prescribed; and
- Ten percent of the purchases made from persons not having National Tax Number (excluding agricultural produce bought directly from growers) shall not be allowable as a deduction. This clause shall only apply in case of agricultural produce where purchases have been made from middleman. The Board is empowered to exempt persons or classes of persons from the operation of this clause.

► **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 a NTN holder, 10% of the claimed expenditure will be disallowed.

- Where a taxpayer receives payment exceeding two hundred thousand rupees otherwise than through a banking channel or digital means against a single invoice, fifty percent of the corresponding expenditure shall be disallowed.

► **Example:**

If a transaction of sale is made for PKR 400,000 and the corresponding expense for such a transaction, say is PKR 300,000, then in the event the payment is received in cash exceeding PKR 200,000 from the customer, 50% of PKR 300,000 i.e. PKR 150,000 will be disallowed.

► **Exercise:**

Following payments of expenses are made otherwise than through crossed cheque.

Head Of Account	Amount
Rent to Mr. X for Lahore office rented premises	720,000
Air Tickets purchased	520,000
One month salary of Mr Ali only	125,000
Repair of car	420,000
Electricity bill	950,000
Telephone bill	270,000
Professional tax	200,000
Audit fee	350,000
Tax consultant fee	550,000

Required:

Compute the additions to be made to the profit of the person under Section 21(l) & (m) of the Income Tax Ordinance, 2001.?

► *Answer:*

No addition is required on account of payments relating to Air Ticketing, Electricity, Telephone and Professional Tax. The balance addition under section 21(l) is computed as under:

Nature of payment	Amount
Rent paid to Mr. X for Lahore office rented premises	720,000
Payment of Salary to Mr. Ali u/s 21(m)	125,000
Bill paid for repair of car	420,000
Paid audit fee	350,000
Paid tax consultant	550,000
Addition under Section 21(l) & (m)	2,165,000

2.3 Deductions admissible – Special provisions

- Any expenditure incurred by the person in the year wholly and exclusively for the purposes of business.
- Animals used for the purposes of the business or profession otherwise as stock in trade.
- Depreciation of tangible fixed assets where they have a useful life of more than one year.
- Initial allowance on eligible depreciable assets.
- Amortization of intangibles where they have a useful life of more than one year.
- Pre-commencement expenditure.
- First year allowance
- Scientific research expenditures
- Employee training facilities expenditure.
- Profit on debt if it is related to taxable business income.
- Entertainment expenditures in the limits as prescribed
- Bad debts written off in the accounts subject to fulfilment of certain conditions.

Deductions in respect of depreciation, initial allowance, first year allowance, accelerated depreciation to alternate energy projects, amortization and, pre-commencement expenditures are discussed in detail in chapter 8 of the study text whereas deductions on account of scientific research expenditure, employee training, profit on debt and bad debts are discussed below:

Scientific research expenditure (Sec 26)

- A person shall be allowed a deduction for scientific research expenditure incurred in **Pakistan** in a tax year wholly and exclusively for the purpose of deriving income from business chargeable to tax.

► *Definitions*

- **“Scientific research”** means any activity undertaken in Pakistan in the fields of natural or applied science for the development of human knowledge;
- **“Scientific research expenditure”** means any expenditure incurred by a person on scientific research undertaken in Pakistan for the purposes of developing the person’s business, including any contribution to a scientific research institution to undertake scientific research for the purposes of the person’s business, other than expenditure incurred:
 - in the acquisition of any depreciable asset or intangible;
 - in the acquisition of immovable property; or

- for the purpose of ascertaining the existence, location, extent or quality of a natural deposit; and
- “Scientific research institution” means any institution certified by the Board as conducting scientific research in Pakistan.

Employee training and facilities (Sec 27)

- A person shall be allowed a deduction for any expenditure (other than capital expenditure) incurred in a tax year in respect of:
 - any educational institution or hospital in Pakistan established for the benefit of the person’s employees and their dependents;
 - any institute in Pakistan established for the training of industrial workers recognized, aided, or run by the Federal Government or a Provincial Government or a Local Government; or
 - The training of any person, being a citizen of Pakistan, in connection with a scheme approved by the Board for the purposes of this section.

Profit on debt, financial costs and lease payments (Sec 28)

- Following amounts incurred in a tax year shall be allowed as deduction in computing income under the head Income from Business:
 - Profit on debt if and to the extent the proceeds of debt are utilized for business purpose.
 - Lease rentals of an asset to a scheduled bank, financial institution, an approved modaraba or leasing company or a Special Purpose Vehicle (SPV) on behalf of the Originator.

Provided that for the purpose of determining the deduction on account of lease rentals the cost of a passenger transport vehicle not plying for hire to the extent of principal amount shall not exceed two and a half million rupees;

- Financial cost of securitization of receivables by an originator in respect of SPV
- Share of profit under musharika scheme to a bank
- Share of profit to a certificate holder under a musharika scheme approved by SECP and Religious Board under Modaraba Ordinance
- On funds borrowed from a modaraba or participation term certificate holders
- By a bank to a person maintaining PLS account or a deposit with the bank
- SBP shares of profit by House Building Finance Corporation, National Development Leasing Corporation or Small and Medium Enterprises Bank on any investment or credit line provided by the SBP.

► Exercise:

XYZ Limited engaged in the business of manufacturing and sale of chemicals has incurred the following expenditures for tax year 2026:

- Rs. 150,000 given as a scholarship to Mr. Sameel, a citizen of Pakistan, for his technical training in connection with a scheme approved by the Federal Board of Revenue under the relevant provision of the law. Mr. Sameel is not an employee of XYZ Ltd.
- Maintenance of XYZ’s shares records has been outsourced. The total expenditure incurred was Rs. 400,000, including the fee paid of Rs. 245,000 to increase the company’s authorized capital.
- Contribution of Rs. 200,000 to unrecognized provident fund. XYZ Ltd, in its accounting system, has ensured that when any payment is made from the fund to an employee, tax would be deducted at source from the amount of the payment, if the amount is chargeable to tax as the salary income of the employee.
- Rs. 50,000 paid as motor vehicle tax on the company’s vehicles.
- Rs. 500,000 paid for the valuation of the assets of another company which XYZ Ltd intended to acquire.

- vi. Rs. 45,000 paid as a penalty imposed by the Commissioner for late filing of the annual return of income for the tax year 2025.
- vii. New computer purchased for Rs. 300,000 on 20 June 2026 for which installation could not be made until 15 July 2026.
- viii. Compulsory annual fee of Rs. 200,000 paid in cash, to the Engineering Development Board established by the Federal Government.
- ix. Donation in kind to a relief fund runs by the Government of Sindh.
- x. Rs. 1,530,000 out of travelling expenses, being the travel and hotel expenses for XYZ's technical manager's visit to Japan. The travel to Japan was entirely for business purposes. It was necessary for the firm's technical manager to travel to Japan for the purpose of selecting a second-hand mixing machine, so as to ensure that the machine was compatible with the company's existing plant.
- xi. Cash flow statement shows that an amount of Rs. 2 million has been paid as legal and professional charges to one of the company consultants. The said amount was overdue since tax year 2017. XYZ Ltd has claimed this amount as an expense in tax year 2026 also.
- xii. XYZ Limited entered into a forward contract for the purchase of raw materials used in its business of manufacturing edible oils to guard against loss through price fluctuations. On the date of maturity of the forward contract, XYZ Ltd did not take delivery of the raw materials but the contract was settled by a payment of Rs. 950,000.

Required

Being tax consultant of the company you are required to explain the admissibility/inadmissibility of the above along with reason keeping in view the provisions of the Income Tax Ordinance, 2001

► Answer

- i. Since the scholarship has been granted to a Pakistani citizen for his technical training under a scheme approved by the Federal Board of Revenue, the expenditure is admissible. The beneficiary of the scholarship does not need to be an employee of the taxpayer. [S.27(c)]
- ii. The fee paid (Rs. 245,000) to increase in XYZ's authorized capital is capital expenditure in nature, hence not allowable. The remaining expenditure being of revenue in nature is admissible
- iii. A contribution made to an unrecognized provident fund is not deductible u/s 21(e) of the ITO, 2001 although admissible expenses u/s 21(f) as the employer has made effective arrangements to ensure that tax would be deducted from any payments made by the fund in respect of which the recipient is chargeable to tax under the head 'Salary'
- iv. Motor vehicle tax is for the purposes of business and revenue in nature. Further, it does not fall in the list of inadmissible deductions, therefore, it is admissible. [S.20(1) read with S.21(a)]
- v. Expenses incurred at Rs. 500,000 relate to the acquisition of another company. The expense, therefore, being capital in nature, is disallowed. [S.21(n)]
- vi. A penalty of Rs. 45,000 paid for the late filing of a return of income is an inadmissible expense on either of the following two grounds:
 - a) A penalty for the late filing of a return of income is included in tax as defined in the Income Tax Ordinance, 2001 (the 'Ordinance'). Tax is an inadmissible deduction under the law. [S.21(a)]
 - b) It was imposed for violation of the provisions of the Ordinance, hence not admissible. [S.21(g)]
- vii. The purchase of the computer is a capital expenditure and cannot be treated as an expense. Since it was not utilized during the year ending on 30 June 2026, it is not eligible for any depreciation or initial allowance either.

- viii. Any expenditure, in aggregate, under a single accounting heading in excess of Rs. 250,000 other than by crossed bank cheque or crossed bank draft or any other banking instrument is not deductible with certain exceptions. One of the exceptions is any fee expenditure. Hence, the Rs. 200,000 paid, in cash, to the Engineering Development Board established by the Federal Government is allowable and no adjustment is required. [2nd proviso to S.21(l)]
- ix. A donation in kind to a relief fund run by the Government of Sindh is not for the purpose of business, hence not allowable as expenditure. However, it is eligible for tax credit under the law. [S.20(1) & 61]
- x. The expenditure of Rs. 1,530,000 incurred solely to secure the purchase of a mixing machine, is capital expenditure and is not deductible. Rs. 1,530,000 should be added to the cost of the mixing machine for tax purposes and tax depreciation shall be computed accordingly
- xi. Where a person has been allowed a deduction for any expenditure incurred in deriving income chargeable to tax under the head Income from Business and the person has not paid the liability or a part of the liability to which the deduction relates within three years of the end of the tax year in which the deduction was allowed, the unpaid amount of the liability shall become chargeable to tax under the head Income from Business in the first tax year following the end of those three years.

However, if the person subsequently pays the liability or a part of the liability, the person shall be allowed a deduction for the amount paid in the tax year in which the payment is made. [Ref: S 34(5) and 34(6)]

Therefore, amount will be added back to the taxable income of the taxpayer in tax year 2021, whereas it will be again allowed as an expense in tax year 2026.
- xii. The forward contract entered into by XYZ Ltd for the purchase of raw materials used in its business of manufacturing edible oils is in the nature of a hedging contract which was entered into to guard against loss from future price fluctuations. Such contracts have specifically been excluded from the definition of speculative business. Therefore, the Rs. 950,000 paid to settle the forward contract is an expenditure incurred in the normal course of business and is a deductible expenditure.

Bad debts (Sec 29)

- A person shall be allowed a deduction for a bad debt in a tax year if the following conditions are satisfied, namely:
 - The amount of the debt was:
 - previously included in the person's income from business chargeable to tax; or
 - in respect of money lent by a financial institution in deriving income from business chargeable to tax;
 - The debt or part of the debt is written off in the accounts of the person in the tax year; and
 - There are reasonable grounds for believing that the debt is irrecoverable.
- The amount of the deduction allowed to a person for a tax year shall not exceed the amount of the debt written off in the accounts of the person in the tax year.
- Where a deduction is allowed in a tax year for a bad debt written off and in a subsequent tax year the person receives in cash or kind any amount in respect of that debt, a computation shall be made as under:

a- b

Here

- a) is amount received against the written off debt; and
- b) is the difference between whole amount of bad debt and bad debt allowed as a deduction under Income Tax Ordinance, 2001.

If (a) is greater than (b), the difference shall be treated as income of the person. In other case, where (a) is less than (b) the difference shall be treated as bad debts for the year in which the amount is received.

- Provision for bad debts is not allowed to be deducted from accounting profit. Only actual bad debts against taxable sales are allowed to be deducted from business income.

► *Exercise:*

ABC Ltd. has an accounting profit of PKR 500,000. During the year, they created a provision for bad debts amounting to PKR 30,000. At the end of the year, it was determined that actual bad debts against taxable sales amounted to PKR 25,000. You are requested to compute the taxable business income?

► *Answer:*

Accounting Profit	500,000
Add: Provision for doubtful debts	30,000
Less: Actual Bad debts	(25,000)
Taxable Business Income	505,000

Bad debts against the loan, exempt income or income taxable under FTR is not allowed.

► *Exercise:*

XYZ Company has incurred the following bad debts during the tax year:

- PKR 10,000 against taxable sales.
- PKR 5,000 against a loan given to a customer.
- PKR 8,000 from income that was exempt from tax.
- PKR 7,000 from income taxable under the Final Tax Regime (FTR).

How much of the bad debts can XYZ Company deduct from its business income?

► *Answer:*

According to Income Tax Provision, bad debts against loans, exempt income, or income taxable under the Final Tax Regime (FTR) are not allowed to be deducted. Only bad debts against taxable sales are deductible.

Given bad debts:

- PKR 10,000 against taxable sales (deductible)
- PKR 5,000 against a loan (not deductible)
- PKR 8,000 from exempt income (not deductible)
- PKR 7,000 from income taxable under FTR (not deductible)

Therefore, XYZ Company can only deduct the bad debts against taxable sales i.e. PKR 10,000.

- If bad debts allowed in any tax period are recovered in any subsequent tax period, the difference between the actual bad debts and the amount allowed shall be adjusted in the profit for the period in which the recovery was made. It will be assumed that the profit has been increased by the total amount of the debt recovered which shall be reversed

► *Exercise:*

ABC Ltd. Accounting profit for the year is PKR 1 million whereas they have claimed a bad debt deduction of PKR 50,000 in the tax year 20X5 but CIR allowed them PKR 40,000. In the tax year 20X6, they recovered PKR 30,000 of this bad debt. How should ABC Ltd. adjust their profit in the tax year 20X6?

► *Answer*

According to Income Tax provisions, the difference between the actual bad debts and the amount recovered shall be adjusted in the profit for the period in which the recovery was made. Their actual bad debts are PKR 20,000 (50,000-30,000).

Accounting Profit	1,000,000
Less: Bad debts recovered (as per accounts)	(30,000)
Adjustment: Allowed - Actual (40,000- 20,000)	20,000
Taxable Business Income	990,000

► *Exercise:*

Noor Enterprises (NE) has an accounting profit of PKR 2 million for the year. They claimed a bad debt deduction of PKR 50,000 in the tax year 20X5 related to a sale made to Mr. Usama, but the CIR allowed only PKR 10,000. In the tax year 20X6, despite their efforts, NE recovered only PKR 15,000 from Mr. Usama. How should NE adjust their profit in the tax year 20X6?

► *Answer*

According to Income Tax provisions, the difference between the actual bad debts and the amount recovered shall be adjusted in the profit for the period in which the recovery was made. Their actual bad debts are PKR 50,000 (50,000-NIL).

Accounting Profit	1,000,000
Less: Bad debts recovered (as per accounts)	(15,000)
Adjustment: Allowed -Actual (10,000- 50,000)	(40,000)
Taxable Business Income	945,000

► *Exercise:*

Ms. Shagufta is running a business in the name of Al Nafay Business Solutions. In the tax year 2025, she claimed bad debts of Rs. 1,000,000 and Rs. 1,500,000 from its clients Mr. Junaid and Mr. Nawaz. She was allowed deduction of bad debts of Rs. 750,000 and Rs. 800,000 with respect of receivable from Mr. Junaid and Mr. Nawaz in Tax year 2025. During 2026, she received following sums from these two debtors:

Mr. Junaid	Rs.900,000
Mr. Nawaz	Rs. 500,000

Work out the amount to be added/allowed on account of bad debts in the tax year 2026.

► *Solution:*

		Mr Junaid	Mr Nawaz
Bad Debts Claimed in 2025	A	1,000,000	1,500,000
Allowed in 2025	B	750,000	800,000
Receipts during 2026	C	900,000	500,000
Actual Bad Debts	D=A-C	100,000	1,000,000

Tax Treatment:

Tax Income / (Expenses)	B-D	650,000	(200,000)
Reversal of Accounting Income	E	900,000	500,000

The accounting profit will be reduced by Rs. 1,400,000 (Rs. 900,000 + Rs. 500,000). Regarding receipts from Mr. Junaid, Rs. 650,000 will be treated as income (being the difference between Allowed and Actual Rs. 750,000 - Rs. 100,000). On the other hand, further bad debts of Rs. 200,000 will be allowed as a tax expense (i.e., the difference between allowed and actual: Rs. 800,000 - Rs.1,000,000) against receipts from Mr. Nawaz.

3 TAX ACCOUNTING

3.1 General accounting

The question arises how to compute the income under this head of income. Therefore, it is essential to know the method of accounting required by the law in order to ascertain the actual income of a taxpayer:

3.2 Method of accounting (Sec 32)

- A person's income chargeable to tax shall be computed in accordance with the method of accounting regularly employed by such person.
- A company shall account for income chargeable to tax under the head "Income from Business" on an accrual basis, while other persons may account for such income on cash or accrual basis.
- The Board may prescribe that any class of persons shall account for income chargeable to tax under the head "Income from Business" on a cash or accrual basis.
- An application may be made by a person, in writing, for a change in the person's method of accounting to the Commissioner. The Commissioner may by an order, in writing approve such an application but only if he is satisfied that the change is necessary to clearly reflect the person's income chargeable under the head "Income from Business".
- If a person's method of accounting has changed, the person shall make adjustments to items of income, deduction, or credit or to any other items affected by the change so that no item is omitted and no item is taken into account more than once.

3.3 Cash Basis Accounting (Sec 33)

A person accounting for income chargeable to tax under the head "Income from Business" on a cash basis shall derive income when it is received and shall incur expenditure when it is paid.

3.4 Accrual Basis Accounting (Sec 34)

- A person accounting for income chargeable to tax under the head "Income from Business" on an accrual basis shall derive income when it is due to the person and shall incur expenditure when it is payable by the person.
- An amount shall become due to the person when the person becomes entitled to receive it or is liable to pay it even if the time for receipt / payment is postponed or the amount is payable by instalments.
- An amount shall become payable by a person when all the events, that determine liability, have occurred and the amount of the liability can be determined with reasonable accuracy.
- If the liability or a part of the liability for which the deduction claimed is not paid within three years from the end of the tax year in which the deduction was allowed, the unpaid amount of the liability shall be chargeable to tax under the head "Income from Business" in the first tax year following the end of the three years.
- If an unpaid liability which is charged to tax as above is subsequently paid in full or in part, the person shall be allowed a deduction for the amount paid in the tax year in which the payment is made.
- Where a person has been allowed a deduction in respect of a trading liability and such person has derived any benefit in respect of such trading liability, the value of such benefit shall be chargeable to tax under head "Income from Business" for the tax year in which such benefit is received.

3.5 Valuation of stock in trade (Sec 35)

- The cost of stock-in-trade disposed of by the person in the year shall be computed in accordance with the following formula, namely:

$$(A + B) - C$$

► *Where:*

- a) is the opening value of the person's stock-in-trade for the year;
- b) is cost of stock-in-trade acquired by the person in the year; and
- c) is the closing value of stock-in-trade for the year.
 - The opening value of stock-in-trade of a person for a tax year shall be:
 - i. the closing value of the person's stock-in-trade at the end of the previous year; or
 - ii. where the person commenced to carry on business in the year, the fair market value of any stock-in-trade acquired by the person prior to the commencement of the business. This fair market value shall be determined at the time the stock is ventured in the business.
 - The closing value of a person's stock-in-trade for a tax year shall be the lower of cost or net realisable value of the person's stock-in-trade on hand at the end of the year.
 - A person accounting for income chargeable to tax under the head "Income from Business" on a cash basis may compute the person's cost of stock-in-trade on the prime-cost method or absorption-cost method, and a person accounting for such income on an accrual basis shall compute the person's cost of stock-in-trade on the absorption-cost method.
 - Where particular items of stock-in-trade are not readily identifiable, a person may account for that stock on the first-in-first-out method or the average-cost method but, once chosen, a stock valuation method may be changed only with the written permission of the Commissioner and in accordance with any conditions that the Commissioner may impose.

In this section:

► *Definitions*

- **"Absorption-cost method"** means the generally accepted accounting principle under which the cost of an item of stock-in-trade is the sum of direct material costs, direct labour costs, and factory overhead costs;
- **"Prime-cost method"** means the generally accepted accounting principle under which the cost of stock-in-trade is the sum of direct material costs, direct labour costs, and variable factory overhead costs;
- **"Direct labour costs"** means labour costs directly related to the manufacture or production of stock-in-trade;
- **"Direct material costs"** means the cost of materials that become an integral part of the stock-in-trade manufactured or produced, or which are consumed in the manufacturing or production process;
- **"Factory overhead costs"** means the total costs of manufacturing or producing stock-in-trade, other than direct labour and direct material costs;
- **"First-in-first-out method"** means the generally accepted accounting principle under which the valuation of stock-in-trade is based on the assumption that stock is sold in the order of its acquisition;
- **"Average-cost method"** means the generally accepted accounting principle under which the valuation of stock-in-trade is based on a weighted average cost of units on hand;
- **"Stock-in-trade"** means anything produced, manufactured, purchased, or otherwise acquired for manufacture, sale or exchange, and any materials or supplies to be consumed in the production or manufacturing process, but does not include stocks or shares; and
- **"Variable factory overhead costs"** means those factory overhead costs which vary directly with changes in volume of stock-in-trade manufactured or produced.

► *Example:*

You are requested to compute taxable business income from the accounting profit before tax of Rs 400,000, which includes opening stock of Rs 100,000 and closing stock of Rs 200,000 on a marginal basis, be adjusted to comply with tax laws requiring stock valuation on an absorption basis, where the absorption values for opening stock and closing stock are Rs 150,000 and Rs 300,000 respectively? It is assumed that the methods of accounting in last and current year is same i.e. accrual basis.

Profit before tax	400,000	
Adjustments:		
Opening Stock (+100,000-150,000)	(50,000)	Accrual
Closing Stock (-200,000+300,000)	100,000	Accrual
Taxable Business Income	450,000	

► *Example:*

You are requested to compute taxable business income from the accounting profit before tax of Rs 400,000, which includes opening stock of Rs 100,000 and closing stock of Rs 200,000 on a marginal basis, be adjusted to comply with tax laws requiring stock valuation on an absorption basis, where the absorption values for opening stock and closing stock are Rs 150,000 and Rs 300,000 respectively?

Please note that the methods of accounting in last year was Cash basis whereas in the current year they have changed their methods from cash basis to accrual basis. The CIR gave them approval for the change.

Profit before tax	400,000	
Adjustments:		
Opening Stock (No need for adjustment)	100,000	Cash Basis
Closing Stock (-200,000+300,000)	100,000	Accrual
Taxable Business Income	500,000	

► *Example:*

You are requested to compute taxable business income from the accounting profit before tax of Rs 400,000, which includes the cost of opening stock of Rs 100,000 and cost of closing stock of Rs 200,000. Please note that the NRV of the opening stock and closing stock are Rs 70,000 and Rs 175,000 respectively?

(The cost should be started at lower of cost or NRV).

Profit before tax	400,000
Adjustments:	
Opening Stock (+100,000-70,000)	30,000
Closing Stock (-200,000+175,000)	(25,000)
Taxable Business Income	405,000

► *Example:*

You are requested to compute taxable business income from the accounting profit before tax of Rs 400,000, which includes the cost of opening stock of Rs 100,000 and cost of closing stock of Rs 200,000. Please note that the NRV of the opening stock and closing stock are Rs 170,000 and Rs 175,000 respectively? (The cost should be started at lower of cost or NRV).

Profit before tax	400,000
Adjustments:	
Opening Stock (+100,000-170,000)	N/A
Closing Stock (-200,000+175,000)	(25,000)
Taxable Business Income	375,000

► *Example:*

You are requested to compute taxable business income from the accounting profit before tax of Rs 400,000, which includes the cost of opening stock of Rs 100,000 and cost of closing stock of Rs 200,000. Please note that both opening stock and closing stock are computed on the basis of LIFO whereas the value of opening stock and closing stock on FIFO basis Rs 50,000 and Rs 375,000 respectively? (The stock should be stated at FIFO or Weighted Average assumptions not on LIFO).

Profit before tax	400,000
Adjustments:	
Opening Stock (+100,000-50,000)	50,000
Closing Stock (-200,000+375,000)	175,000
Taxable Business Income	625,000

► *Example:*

You are requested to compute taxable business income from the accounting profit before tax of Rs 400,000, which includes the cost of opening stock of Rs 100,000 and cost of closing stock of Rs 200,000. Please note that both opening stock and closing stock are computed on the basis of LIFO whereas the value of opening stock and closing stock on FIFO basis Rs 200,000 and Rs 155,000 respectively? (The stock should be stated at FIFO or Weighted Average assumptions not on LIFO).

Profit before tax	400,000
Adjustments:	
Opening Stock (+100,000-200,000)	(100,000)
Closing Stock (-200,000+155,000)	(45,000)
Taxable Business Income	255,000

4 TAXATION OF DIGITAL TRANSACTIONS WITHIN PAKISTAN

- A tax has been introduced at the rate of 1% (Digital Means or banking channels by payment intermediary) and 2% (Cash on Delivery by courier service) of the gross amount, on every person who receives payment for supply of digitally ordered goods or services which are delivered from within Pakistan using locally operated online platforms including online marketplace or websites.
- The online marketplace includes online interfaces that facilitate, for a fee, the direct interaction between multiple buyers and multiple sellers via digital orders for supply of goods and services.
- The tax so charged is a final discharge of tax liability.
- Export proceeds subjected to withholding under section 154 and 154A shall not fall within the ambit of this section. (Export of goods-MTR, Export of services-FTR)
- Digitally delivered services' has been defined to mean any service delivered over the internet or electronic networks, where the delivery is automated and require minimal or no human intervention including music, audio and video streaming services, cloud services, online software applications services, services delivered through online inter-personal interaction i.e., tele medicines, e-learning etc., online banking services, architectural design services, research and consultancy reports, accounting services in the form of digital files or any other online facility.
- Furthermore, every payment intermediary including a courier business collecting cash from a buyer under Cash on Delivery (CoD) is required to collect tax from the gross amount payable to the seller at the aforementioned rates.
- "courier service" means any specialized entity that provides fast, secure and often tracked transportation of documents, packages and small freight, typically offering door-to-door delivery solutions of goods within specific timeframes and such delivery service provider includes but not limited to:
 - Logistics services;
 - ride-hailing services;
 - food delivery platforms; and
 - e-commerce services.
- "payment intermediary" means any third party including a banking company, financial institution, a licensed foreign exchange company or payments gateways that facilitate the transfer of funds or payment instructions between two or more parties to enable, process, route or settle payments in a financial transaction.
- Every payment intermediary and courier service responsible for deducting tax, as above, is also required to file a quarterly income tax withholding tax statement in respect of tax deduction regarding sale of digitally ordered goods and services.
- Moreover, every online marketplace is also required to file a monthly statement containing prescribed particulars of vendors registered on its platform supplying digitally ordered goods and services.
- Every person selling digitally ordered goods/services from within Pakistan using online marketplace/courier service, is required to obtain registration with the FBR.
- Online marketplaces are mandatorily required to allow only such vendors who are registered with the FBR to carry out e-commerce transactions.

In Brief

A final tax is imposed on sellers of digitally ordered goods and services delivered within Pakistan:

- 1% if payment is received via digital means or banking channels
- 2% if payment is received through Cash on Delivery (CoD) by courier services

This applies to transactions on locally operated online platforms or marketplaces. Export proceeds taxed under sections 154 and 154A are excluded.

INCOME FROM BUSINESS – PART TWO

IN THIS CHAPTER:

1. Depreciation
2. Intangibles
3. Pre-commencement expenditures
4. Taxation of digital transactions

1 DEPRECIATION

1.1 Depreciable assets and general principles relating to depreciation (Sec 22)

- Section 22 of the Ordinance deals with the depreciation in the following manner: A person is allowed a deduction for the depreciation of the person's depreciable assets used in the person's business in the tax year.
- The term depreciable asset is defined in sub-section (15) of section 22 of the Ordinance in the following manner:

► *Definitions: Depreciable Asset*

“Depreciable asset” means any tangible movable property, immovable property (other than unimproved land), or structural improvement to immovable property, owned by a person that:

- has a normal useful life exceeding one year;
- is likely to lose value as a result of normal wear and tear, or obsolescence; and
- is used wholly or partly by the person in deriving income from business chargeable to tax,

but shall not include any tangible movable property, immovable property, or structural improvement to immovable property in relation to which a deduction has been allowed under another section of this Ordinance for the entire cost of the property or improvement in the tax year in which the property is acquired or improvement made by the person; and

Provided that where a depreciable asset is jointly owned by a taxpayer and an Islamic financial institution licensed by the State Bank of Pakistan or Securities and Exchange Commission of Pakistan, as the case may be, pursuant to an arrangement of Musharika financing or diminishing Musharika financing, the depreciable asset shall be treated to be wholly owned by the taxpayer.

“Structural improvement” in relation to immovable property, includes any building, road, driveway, car park, railway line, pipeline, bridge, tunnel, airport runway, canal, dock, wharf, retaining wall, fence, power lines, water or sewerage pipes, drainage, landscaping or dam.

Depreciation shall be allowed on the written down value (WDV) of the asset at the beginning of the year at the rates specified in Third Schedule, as given below:

Sr. No	Type of Asset	Rate
i.	Building (all types).	10%
ii.	Furniture (including fittings) and machinery and plant (not otherwise specified), Motor vehicles (all types), ships, technical or professional books.	15%
iii.	Computer hardware including printer, monitor and allied items, Machinery & Equipment used in manufacture of IT Products, aircrafts and aero engines.	30%
iv.	In case of mineral oil concerns the income of which is liable to be computed in accordance with the rules in Part-I of the Fifth Schedule. • Offshore platform and production Installations.	20%
v.	A ramp built to provide access to persons with disabilities not exceeding Rs. 250,000 each.	100%

- Depreciation expense will be disallowed in all relevant tax years where at the time of payment against purchase of assets, required withholding taxes have not been deducted and deposited under the relevant provisions of the Ordinance.
- Depreciation is allowed on proportional basis if the asset was also used for the purpose other than deriving business income in a tax year.

- Full year depreciation will be allowed in the year of acquisition whereas no depreciation will be allowed in the year of disposal.
- The written down value of a depreciable asset of a person at the beginning of the tax year shall be:
 - a) where the asset was acquired in the tax year, the cost of asset to the person as reduced by any initial allowance in respect of the asset under section 23; or
 - b) in any other case, the cost of the asset to the person as reduced by the total depreciation deductions (including any initial allowance under section 23) allowed to the person in respect of the asset in previous tax years.
 - c) Explanation,- For the removal of doubt, it is clarified that where any building, furniture, plant or machinery is used for the purposes of business during any tax year for which the income from such business is exempt, depreciation admissible under sub-section (1) shall be treated to have been allowed in respect of the said tax year and after expiration of the exemption period, written down value of such assets shall be determined after reducing total depreciation deductions (including any initial allowance under section 23) in accordance with clauses (a) and (b) of this sub-section.

► *Example:*

First year	Rupees in '000'
Cost of building	500,000
Depreciation on (Rs. 500,000 @ 10%)	(50,000)
Written down value carried forward	450,000
Second year	Rupees in '000'
WDV Brought forward	450,000
Depreciation @ 10%	45,000
WDV carried forward	405,000
Third year	Rupees in '000'
WDV Brought forward	405,000
Depreciation @ 10%	(40,500)
WDV carried forward	364,500

- WDV of the asset, in case asset is used partly for business and partly for non-business purpose, shall be computed on the basis that the asset has been solely used to derive business income. It means that depreciation allowed as well as disallowed shall be deducted from the cost of the asset in arriving at the WDV. However, the WDV of the asset shall be increased by the amount of depreciation disallowed on account of non-business use at the time of disposal.

► *Example:*

Computer equipment partly for business use and partly for non-business	Rs. in '000
WDV Brought forward	100,000
Used for business purpose	80%
Used for private purpose	20%
Annual depreciation @ 30% (100,000 x 30%)	30,000
Fair proportional depreciation deduction for business purpose (80% of Rs. 30,000)	24,000
WDV carried forward (WDV minus annual depreciation i.e. 100,000 - 30,000)	70,000

- The total deductions allowed to a person on account of depreciation and initial allowance during the period of ownership of a depreciable asset shall not exceed the cost of the asset.
- Where a person disposes of a depreciable asset in any tax year, no depreciation deduction shall be allowed in that year. Further, on disposal
 - i. if the consideration received exceeds the written down value of the asset at the time of disposal, the excess shall be chargeable to tax in that year under the head “Income from Business”;
 - ii. If the consideration received is less than the written down value of the asset at the time of disposal, the difference shall be allowed as a deduction in computing the person’s income chargeable under the head “Income from Business” for that year.
- An asset owned by a financial institution or leasing company and leased to another person is treated as used in the financial institution or leasing company’s business and the depreciation deductions allowed to a leasing company, investment bank, a modaraba, a scheduled bank or a development financial institution in respect of assets owned by them and leased to another person shall be deductible only against the lease rental income derived in respect of such assets.
- The cost of a depreciable asset being a passenger transport vehicle not plying for hire shall not exceed seven and half million rupees.
- In case of disposal of such vehicle, sale consideration of the passenger transport vehicle shall be computed according to the following formula: -

Cost of vehicle on which

Depreciation is allowed*

Actual cost of vehicle x Amount received on disposal of vehicle

*(i.e.) Rs. 7.5 Million

- The cost of immovable property or a structural improvement to immovable property shall not include the cost of the land.
- For computing gain on disposal of immovable property, the consideration received shall be treated as the cost of the property if the consideration exceeds its cost (Gain on disposal shall be equal to the depreciation previously allowed).
- Where a depreciable asset that has been used by a person in Pakistan is exported or transferred out of Pakistan, the person shall be treated as having disposed of the asset at the time of the export or transfer for a consideration received equal to the cost of the asset. (Gain on disposal shall be equal to the depreciation allowed).

► **Example:**

During the tax year 2026, CFG (Pvt.) Limited disposed off the following assets:

- a) Immoveable property was sold for Rs. 150 million. The cost of the property was Rs. 100 million. Upto tax year 2025, tax depreciation of Rs. 30 million had been allowed on the immoveable property.
- b) A machine used in the business in Pakistan, was exported to USA. The export proceeds amounted to Rs. 45 million. The cost and written down value of the machinery was Rs. 35 million and 28 million respectively.
- c) Two buses were disposed off for Rs. 2.5 million. They were acquired in tax year 2024. The tax written down value of buses at the beginning of the tax year 2026 was Rs. 2.4 million. The trucks were being used partly i.e. 60% for business purpose. Tax rate of depreciation is 15%.

Required

Calculate tax gain on loss on disposal of above assets

► Answer

(a)	Rs. In Million
Sale Proceed	150
Cost (Note)	150
Depreciation allowed	(30)
WDV at the time of disposal	(120)
Gain on disposal	30

Note: For computing gain on disposal of immovable property, the consideration received shall be treated as the cost of property if the consideration exceeds its cost (Gain on disposal shall be equal to the depreciation allowed).

(b)	Rs. In Million
Consideration received equal to actual cost	35
WDV at the time of disposal	(28)
Gain on disposal	7

For computing gain on disposal of depreciable asset by way of export that has been used previously in Pakistan, the consideration received shall be treated as the cost of asset (Gain on disposal shall be equal to depreciation allowed)

(c)	Rs. In Million
Sale proceed	2.5
Less: WDV at beginning of the year	(2.4)
Depreciation not allowed	
$(2.4/0.85 \times 0.15 \times 0.40)$	(0.17)
Loss on disposal	(0.07)

WDV of the asset, in case asset is used partly for business and partly for non-business purpose, shall be computed on the basis that the asset has been solely used to derive business income. It means that depreciation allowed as well as disallowed shall be deducted from the cost of the asset in arriving at the WDV. However, the WDV of the asset shall be increased by the amount of depreciation disallowed on account of non-business use at the time of disposal.

1.2 Initial allowance (Sec 23)

The aforesaid provision elucidates that the written down value shall be computed after deduction of initial allowance. The provision regarding initial allowance is contained in section 23 of the Ordinance and the said section states that:

1. A person who places an **eligible depreciable asset** into **service in Pakistan** for the first time in a tax year shall be allowed an initial allowance provided the asset is used by the person for the purposes of his business for the first time or the tax year in which commercial production is commenced, whichever is later.

► Definition: Eligible Depreciable Asset

“Eligible depreciable asset” means a depreciable asset other than:

- a) any road transport vehicle unless the vehicle is plying for hire;
- b) any furniture, including fittings;
- c) any plant or machinery that has been used previously in Pakistan; or
- d) any plant or machinery in relation to which a deduction has been allowed under another section of the Ordinance for the entire cost of the asset in the tax year in which the asset is acquired.
- e) Immoveable property or structural improvements to the immoveable property.

2. The amount of initial allowance of a person shall be computed at the rate of 25% for plant and machinery. The rules contained in section 76 shall apply in determining the cost of an eligible depreciable asset.
3. An initial allowance allowed to a lessor in respect of assets owned by him and leased to another person shall be deductible only against the lease rental income derived in respect of such assets.

► *Definition: Sec 2(29C), Industrial Undertaking*

“Industrial undertaking” means —

- a) an undertaking which is set up in Pakistan and which employs,—
 - i. ten or more persons in Pakistan and involves the use of electrical energy or any other form of energy which is mechanically transmitted and is not generated by human or animal energy; or
 - ii. twenty or more persons in Pakistan and does not involve the use of electrical energy or any other form of energy which is mechanically transmitted and is not generated by human or animal energy;

and which is engaged in—

- i. the manufacture of goods or materials or the subjection of goods or materials to any process which substantially changes their original condition; or
- ii. ship-building; or
- iii. generation, conversion, transmission or distribution of electrical energy, or the supply of hydraulic power; or
- iv. the working of any mine, oil-well or any other source of mineral deposits;
- v. from the 1st day of May, 2020, a person directly involved in the construction of buildings, roads, bridges and other such structures or the development of land, to the extent and for the purpose of import of plant and machinery to be utilized in such activity, subject to such conditions as may be notified by the Board;
- vi. from the first day of July, 2020 a resident company engaged in the hotel business in Pakistan;
- vii. telecommunication companies operating under the license of Pakistan Telecommunication Authority (PTA)

► *Example: Depreciation*

Opening tax WDV of plant and machinery	1,000,000
Purchase of plant during the year eligible for initial allowance	500,000
Tax WDV of disposals during the year	200,000

Compute the tax depreciation and initial allowance on the above assets for the tax year 2026.

► *Answer*

Particulars	WDV	Depreciation
Opening WDV	1,000,000	
Tax WDV on disposal of P & M as no depreciation is charged in the year of disposal	(200,000)	
Balance WDV--- A	800,000	
Additions during the year	500,000	
Initial Allowance @ 25%	(125,000)	125,000
Balance WDV--- B	375,000	
WDV for Normal Depreciation (A+B)	1,175,000	
Normal Depreciation (1,175,000 x 15%)		176,250
Total Depreciation (125,000 + 176,250)		301,250

2 INTANGIBLES

2.1 Introduction

The nomenclature of this term gives the impression that it only includes the cost of non-physical assets. However, definition of this term under the tax law is far wider than this general impression. The definition of intangible is given in section 24 of the Ordinance in the following manner:

► **Definition:**

“Intangible” means any patent, invention, design or model, secret formula or process, copyright, trade mark, scientific or technical knowledge, computer software, motion picture film, export quotas, franchise, licence, intellectual property, or other like property or right, contractual rights and any expenditure that provides an advantage or benefit for a period of more than one year (other than expenditure incurred to acquire a depreciable asset or unimproved land) but shall not include self-generated goodwill or any adjustment arising on account of accounting treatment in the manner as may be prescribed.

The above definition reveals that it also includes any expenditure that provides an advantage or benefit for a period of more than one year. Therefore, amortisation of any cost which has useful life of a period exceeding one year is allowed.

2.2 Intangibles eligible for amortisation [Sec 24]

- A person shall be allowed an amortisation deduction in a tax year for the cost of the person’s intangibles:
 - i. that are wholly or partly used by the person in the tax year in deriving income from business chargeable to tax; and
 - ii. that has a normal useful life exceeding one year.
- The terms cost as used in the aforesaid provision is defined in the following manner in the Ordinance:

► **Definition:**

“cost” in relation to an intangible, means any expenditure incurred in acquiring or creating the intangible, including any expenditure incurred in improving or renewing the intangible

- No amortisation deduction shall be allowed if a deduction has been allowed under any other section of the Ordinance for the entire cost of the intangible in the tax year in which it was acquired.
- The total deductions allowed to a person in the current tax year and all previous tax years in respect of an intangible shall not exceed the cost of the intangible.

2.3 Method for computation of amortisation charge

The amortization deduction of a person for a tax year shall be computed according to the following formula, namely:

$$A/B$$

Where:

A is the cost of the intangible; and

B is the normal useful life of the intangible in whole years.

- An intangible which does not have an ascertainable useful life, shall be treated as if it had a normal useful life of fifteen (15) years.
- If an intangible is used in a tax year partly in deriving income from business chargeable to tax and partly for another use, the deduction allowed for that year shall be restricted to the fair proportional part of the amount that would be allowed if the intangible were wholly used to derive income from business chargeable to tax.
- Where an intangible is not used for the whole of the tax year in deriving income from business chargeable to tax, the deduction allowed under this section shall be computed according to the following formula, namely:

$$A \times B/C$$

Where:

A is the amount of amortization computed in accordance with the above provisions

B is the number of days in the tax year the intangible is used in deriving income from business chargeable to tax; and

C is the number of days in the tax year.

2.4 Gain/loss on disposal

- Where, in any tax year, a person disposes of an intangible, no amortisation deduction shall be allowed for that year and:
 - i. if the consideration received by the person exceeds the written down value of the intangible at the time of disposal, the excess shall be income of the person chargeable to tax in that year under the head “Income from Business”; or
 - ii. if the consideration received is less than the written down value of the intangible at the time of disposal, the difference shall be allowed as a deduction in computing the person’s income chargeable under the head “Income from Business” in that year.
- For the purpose of calculating any gain or loss on disposal of intangible:
 - i. the written down value of an intangible at the time of disposal shall be the cost of the intangible reduced by the total deductions allowed to the person under this section in respect of the intangible or, where the intangible is not wholly used to derive income chargeable to tax, the amount that would be allowed under this section if the intangible were wholly so used; and
 - ii. the consideration received on disposal of an intangible shall be discussed in heading 4.4 in this chapter determined in accordance with section 77 of the Ordinance.

An intangible that is available for use on a day (including a non-working day) is treated as used on that day.

► Exercise:

Briefly explain the tax treatment in respect of each of the following independent situations for the Tax year 2026:

- i. Aiza (Pvt.) Ltd has revalued its Building in accordance with International Accounting Standards and consequently charged depreciation on the revalued amount.
- ii. Aiza (Pvt.) Ltd during the year has opened an overseas office in France and has claimed initial allowance and depreciation on eligible depreciable assets purchased by the office.
- iii. Uzair Limited has charged impairment in respect of one of its depreciable assets. The Commissioner is of the view that impairment expense will not be allowed as an expense.
- iv. Uzair Limited has discontinued a major product line of its business and envisages selling off the machinery related to this product line over a period of one to two years to get the right price. Uzair Ltd wants to claim depreciation on the idle machinery until disposed of.
- v. Ms. Sana sells a number of personal vehicles in a tax year and makes a significant amount of profit in the process. She is of the view that the said income is exempt from tax.
- vi. XYZ Ltd has recorded a gain on revaluation of its foreign currency balances at the year end. The gain comprises of both realized and unrealized amount.
- vii. On May 2026, Ms. Sana purchased a vehicle not plying for hire amounting to Rs. 4,210,000 to be used solely for the purpose of her business. While preparing the tax return she has claimed initial allowance and depreciation as per the prescribed rates given in the Income Tax Ordinance, 2001 for the full year on Rs. 4,210,000.

- viii. In April 01, 2026 Mr. Azhar purchased accounting software amounting to Rs. 5 million for his business. The software has a useful life of 30 years. Mr. Azhar has charged full year amortization on straight line basis over the useful life of the software.
- ix. Entertainment expense payable amounting to Rs. 210,000 has been debited to profit & loss account of ABC Ltd. The company has not deducted any tax on the said expense.
- x. ABC (Pvt.) Ltd has charged depreciation according to the rates admissible under the tax law amounting to Rs. 125,000 on machinery taken on a lease from a scheduled bank in August 2019. Lease rentals paid during the tax year 2026 amounted to Rs. 220,000. The leased machinery was transferred to owned assets on maturity on 30 April 2026. On maturity the accounting WDV of the assets was Rs. 500,000, market value was Rs. 800,000 whereas residual value of the asset was Rs. 50,000.

► *Answer*

- i. Deduction for depreciation is associated with tax written down values of assets calculated with reference to specific provisions. Accounting revaluation of assets has no bearing on tax written down value of assets. Consequently, depreciation will be allowed on tax written down values of building without taking into account the effect of revaluation. [Ref: S 22(5)]
- ii. Initial allowance is only available on assets used in Pakistan. Accordingly, the company will not be entitled for deduction on account of initial allowance on assets purchased by the branch for use in business outside Pakistan. The company will however be allowed to claim normal depreciation on all depreciable assets. [Ref: S 23(1) and S 22]
- iii. The contention of the Commissioner is correct. Charge for impairment of fixed assets is not a tax deductible expense. As the impairment charge will be ignored for tax purpose, the written down value of assets will not be reduced by the charge and depreciation will be calculated as if no impairment has taken place.
- iv. One of the criteria for an asset to qualify as 'depreciable asset' is that it should be used partly or wholly for deriving business income. As the product line has been discontinued and the machinery is no more in use, therefore, it ceases to qualify as a 'depreciable asset'. Accordingly, no deduction will be allowed for depreciation. [Ref: S 22 and S 75(3A)]
- v. Income from sale of personal motor vehicles is not taxable under the head Capital Gains. If the vehicles are bought and sold with the motive of trade, the resultant gain will constitute business income. However, vehicle intended for personal use are excluded from the definition of capital assets. [Ref: S 37(5)(d)]
- vi. Unrealized gain on revaluation of foreign currency balances is notional income in nature and is not liable to tax. Foreign exchange gains will be included in the taxable income for the tax year in which realized.
- vii. Normal depreciation should be charged on full value of Rs. 4,210,000. As vehicle is not an eligible depreciable asset, therefore, initial allowance cannot be claimed.
- viii. Amortization should be allowed for 91 days over the useful life of 25 years only. [Sec 24(4), 24(6)]
- ix. Tax is required to be deducted only at the time of payment. Since the expense is still payable, therefore, company has rightly claimed the said expense.
- x. In case of assets taken on finance lease, lease rentals are an admissible deduction instead of depreciation. Further, as the asset was transferred during the tax year 2026, therefore, full year depreciation will be allowed on the residual value of the asset if the residual value has not been claimed as lease rentals. No initial allowance will be allowed as the asset was already in use. [S. 22, S.28(1)(B) & S 23]

3 PRE-COMMENCEMENT EXPENDITURE

3.1 Pre-commencement expenditure (Sec 25)

Section 25 of the Ordinance deals with the admissibility of pre-commencement expenditure and the said section states that:

- A person shall be allowed a deduction for any pre-commencement expenditure @ 20% per annum on straight line basis.
- The term pre-commencement expenditure is defined in section 25 of the Ordinance in the following manner:

► *Definition:*

“Pre-Commencement Expenditure” means any expenditure incurred before the commencement of a business wholly and exclusively to derive income chargeable to tax, including the cost of feasibility studies, construction of prototypes, and trial production activities, but shall not include any expenditure which is incurred in acquiring land, or which is depreciated or amortised under section 22 or 24 of the Ordinance.

- The total deductions allowed under this section in the current tax year and all previous tax years in respect of an amount of pre-commencement expenditure shall not exceed the amount of the expenditure.
- No deduction shall be allowed under this section where a deduction has been allowed under another section of this Ordinance for the entire amount of the pre-commencement expenditure in the tax year in which it is incurred.

4 ASSETS

4.1 Disposal of assets (Sec 75)

- An asset shall be treated to have been disposed off at the time the owner parts with the ownership of the asset. This shall include when the asset is
 - i. sold, exchanged, transferred or distributed; or
 - ii. cancelled, redeemed, relinquished, destroyed, lost, expired or surrendered.
- The transmission of an asset by succession or under a will shall be treated as a disposal of the asset by the deceased at the time asset is transmitted.
- The application of business assets (including stock or depreciable asset) to personal use shall be treated as a disposal of the asset by the owner of the asset at the time the asset is so applied.
- Where a business asset is discarded or ceases to be used in business, it shall be treated to have been disposed off.
- A disposal shall include the disposal of a part of an asset.

4.2 Acquisition of assets (Sec 75)

A person shall be treated as having acquired an asset at the time the person begins to own the asset, including at the time the person is granted any right.

The application of a personal asset to business use shall be treated as an acquisition of the asset by the owner at the time the asset is so applied

4.3 Purchase of assets through banking channel or digital means (Sec 75A)

No person shall purchase (otherwise than by a crossed cheque or through demand draft or pay order or any other crossed banking instrument or digital means showing transfer of amount from one bank account to another bank account);

- a) immovable property having fair market value greater than five million Rupees; or
- b) any other asset having fair market value more than one million Rupees

In case the transaction is not undertaken by the banking channel as specified above then;

- i. such asset shall not be eligible for any allowance (i-e. depreciation, initial allowance, amortisation and pre-commencement expenditure etc.)
- ii. such amount shall not be treated as cost in terms of section 76 for computation of any gain on sale of such asset.

"Digital means" means digital payments and financial services including but not limited to:

- i. online portals or platforms for digital payments/receipts
- ii. online interbank fund transfer services
- iii. online bill or invoice presentment and payment services
- iv. over the Counter digital payment services or facilities
- v. card payments using Point of Sale terminals, QR codes, mobile devices, ATMs, Kiosk or any other digital payments enabled devices or
- vi. Any other digital or online payment modes.

4.4 Cost (Sec 76)

The cost of acquisition under different situations is explained in section 76 of the Ordinance in the following manner:

- The cost of an asset purchased by a person shall be the sum of the following amounts, namely:-
 - i. consideration given for the asset, which shall include:
 - a) fair market value of any consideration given in kind; plus
 - b) any cash or cash equivalent paid as consideration.
 - ii. any incidental expenditure incurred by the person in acquiring and disposing of the asset; and
 - iii. any expenditure incurred by the person to alter or improve the asset

► *Example: Cost*

Purchase of a moulding machine in exchange for old machine	
Particulars	Rs. In '000'
Purchase price paid – Cheque drawn on business bank account	100,000
Add: Bringing to present location – Transportation freight paid in cash	5,000
Add: Making fit for intended use – Installation expenditure paid	10,000
Add: Non-cash benefit given – Fair market value of old moulding Machine	25,000
Add: Debt incurred – Bank paid to the supplier against loan repayable in ten monthly instalments	75,000
Cost of the moulding machine for the purposes of depreciation deduction	215,000

- The cost of a personal asset treated as acquired by the business shall be the fair market value of the asset determined at the date it is applied to business use.
- The cost of an asset produced or constructed by a person shall be the total costs incurred by the person in producing or constructing the asset plus any expenditure incurred by the person on the alteration, improvement or disposal of such asset.

► *Example: Cost*

Boiler Produced in house by the entity for its factory	Rs. In '000'
Cost incurred to produce	
Material	50,000
Wages	7,500
Consumables (Welding rods etc.)	3,000
Fuel and power (electricity, gas, etc.)	2,000
Factory overheads	1,500
Cost of the boiler for the purposes of depreciation deduction	64,000

- Cost of depreciable asset acquired by the lessee on maturity or pre-mature termination of finance lease agreement is the residual value or bargain purchase price as the case may be.

► *Example: Cost*

Motor vehicle	Rs.
Cost at the time acquired	1,000,000
Finance obtained under finance lease	1,000,000
Bargain purchase price:	
Before payment of 7 th installment	1,000,000
After payment of 7 th but before payment of 11 th installment	750,000
After payment of 11 th but before payment of 17 th installment	500,000
After payment of 17 th but before payment of 22 th installment	250,000
Residual value on maturity of lease	70,000
Monthly lease rentals	60,000
No. of installments	22

► *Answer*

Cost of motor vehicle for the purpose of depreciation deduction	
Before payment of 7 installments	1,000,000
After paying 7 installments	750,000
After paying 11 installments	500,000
After paying 17 installments	250,000
On maturity of lease i.e. after paying 22 installments	70,000

- If an asset has been acquired by a person with a loan denominated in a foreign currency and, before full and final repayment of the loan, there is an increase or decrease in the liability of the person under the loan as expressed in rupees, the amount by which the liability is increased or reduced shall be added to or deducted from the cost of the asset, as the case may be.

► *Explanation:*

Difference, if any, on account of foreign currency fluctuation, shall be taken into account in the year of occurrence for the purposes of depreciation.

In determining whether the liability of a person has increased or decreased, account shall be taken of the person's position under any hedging agreement relating to the loan.

- Where a part of an asset is disposed of by a person, the cost of the asset shall be apportioned between the part of the asset retained and the part disposed of in accordance with their respective fair market values determined at the time the person acquired the asset.
- Where the acquisition of an asset by a person is the **derivation of an amount chargeable to tax**, the cost of the asset shall be the amount so charged plus any amount paid by the person for the asset.
- Where the acquisition of an asset by a person is the **derivation of an amount exempt from tax**, the cost of the asset shall be the exempt amount plus any amount paid by the person for the asset.
- The cost of an asset does not include the amount of any grant, subsidy, rebate, commission or any other assistance (other than a loan repayable with or without profit) received or receivable by a person in respect of the acquisition of the asset, except to the extent to which the amount is chargeable to tax under this Ordinance.
- The Board may prescribe rules for determination of cost for any asset.

► **Example:**

Burewala Express Limited (BEL) is in the business of manufacturing and sale of component parts for automobile assembly industry. On 1 January 2024, BEL took a loan of US\$ 500,000 from GHI Bank, USA, which was utilized for purchasing the plant. The loan is repayable in 5 equal instalments in US Dollars. The rate of exchange on 1 January 2024 was US\$ 1 equal to Rs.196 and the loan liability was recorded in the books of account of BEL at Rs. 98,000,000 (US\$ 500,000 x Rs.196). Other relevant information is as follows:

1. The Project was completed in June 2025, but was only commissioned for use on 31 July 2025. The total amount spent by BEL on the plant was Rs.200,000,000
2. On 1 July 2025, the Government of Pakistan (GOP) voluntarily paid BEL Rs.10,000,000 as a subsidy in respect of the plant installed in the Project.
3. The first instalment of US\$ 100,000 towards repayment of the US Dollar loan was paid to GHI Bank on 30 June 2026 when the exchange rate was US\$ 1= Rs.198.

Required:

Calculate the initial allowance, depreciation and written down value of the plant on 30 June 2026 for preparing the tax return for tax year 2026.

► **Answer**

Description	Note	Amount
Cost of the plant		200,000,000
Subsidy	1	(10,000,000)
Exchange fluctuation	2	200,000
Cost of the plant		190,200,000
Less: Initial allowance @ 25%		(47,550,000)
Written down value		142,650,000
Less: Depreciation @ 15%		(21,397,500)
Written down value		121,252,500

Notes:**N-1:**

In determining the cost of an asset for tax purposes the actual amount spent by a person in acquiring an asset is required to be reduced by the amount of any grant, subsidy, rebate, commission or any other assistance received or receivable by the person in respect of the acquisition of the asset except where the said amount received is chargeable to tax [S.76 (10)]. Further the amount of Rs. 10 million is not income for tax purpose but is a capital receipt on the grounds that

- a) The amount was voluntarily paid by GOP without any consideration
- b) The company did not ask for the subsidy
- c) Amount received did not arise out of any legal or contractual obligation
- d) The amount is not traceable nor even remotely connected to any source of income

N-2:

An amount of Rs. 200,000 will be added to the cost of the asset due to the depreciation of the Pakistani Rupee from Rs. 98 to Rs. 100 against the dollar.

Where a person has acquired an asset with a foreign currency loan (repayable in foreign currency) and before the loan is fully repaid, there is an increase or decrease in the loan liability of the person in terms of Pakistan rupees, due to a change in the rate of exchange of the foreign currency, the amount by which the liability has increased or decreased is to be added to or reduced from the cost of the asset. In other words, the cost of the asset acquired with the foreign currency loan is recomputed for tax purposes [S.76(5)].

4.5 Consideration received (Sec 77)

Section 77 contains provisions relating to consideration received' in connection with disposal of assets. These are described below:

- The consideration received by a person on disposal of an asset shall be the aggregate of:
 - i. amount received by the person for asset or the fair market value thereof, whichever is higher; plus
 - ii. the fair market value of any consideration received in kind determined at the time of disposal.
- If an asset has been lost or destroyed by a person, the consideration received for the asset shall include any compensation, indemnity or damages received by the person under:
 - i. an insurance policy, indemnity or other agreement;
 - ii. a settlement; or
 - iii. a judicial decision.
- The consideration received for an asset treated as disposed of when applied to personal use or is discarded or ceased to be used shall be the fair market value of the asset determined at the time it is applied to personal use or discarded or ceased to be used in business, as the case may be.

► *Example: Consideration*

Example – Personal computer applied to business use	Rs. In '000'
Purchase price paid – At the time it was acquired in June 2023	50,000
Fair market value today when applied to business use	35,000
Cost of computer for the purposes of depreciation deduction	35,000

Example – Structural improvement to immovable property (building) applied to business use	Rs. In '000'
Purchase price paid – At the time it was acquired in June 2017	500,000
Fair market value today when applied to business use	700,000
Cost of Structural improvement to immovable property (building) for the purposes of depreciation deduction	700,000

- The consideration received by a scheduled bank, financial institution, modaraba, or leasing company approved by the Commissioner in respect of an asset leased by the company to another person shall be the residual value received by the leasing company on maturity of the lease agreement subject to the condition that the residual value plus the amount realized during the term of the lease towards the cost of the asset is not less than the original cost of the asset.
- Where two or more assets are disposed of by a person in a single transaction and the consideration received for each asset is not specified, the total consideration received by the person shall be apportioned among the assets disposed of in proportion to their respective fair market values determined at the time of the transaction.
- The Board may prescribe rules for determination of consideration received for any asset.

IN THIS CHAPTER:

1. Capital gains and capital asset
2. Computation of capital gain
3. Deduction of losses in computing income chargeable under the head capital gains
4. Capital gain on immoveable property and securities

1 CAPITAL GAINS AND CAPITAL ASSET

1.1 Capital Gain and Basis of Chargeability

As per Section 37 of the Income Tax Ordinance 2001 a gain arising on the disposal of a capital asset by a person in a tax year, other than a gain that is exempt from tax shall be chargeable to tax in that year under the head “Capital Gains”.

A person maintaining his books of accounts on cash basis will generally calculate capital gain when he will receive cash but section 37 categorically says that such income shall be added in the taxable income of the tax year in which disposal arises (takes place). For example, if disposal takes place in the tax year 2025 and cash is received in tax year 2026, taxpayer will have to include the gain in the tax year 2025 although cash is received in tax year 2026.

The understanding of aforesaid provision of law is very much linked with the knowledge of the following two terms:

- Capital Asset
- Disposal

1.2 Capital Asset

This term is defined in sub-section (5) of section 37 of the Ordinance in the following manner:

► *Definition: Capital Asset*

Capital asset means property of every kind held by a person, whether or not connected with a business, but does not include:

- any stock-in-trade, consumable stores or raw materials held for the purpose of business;
- any property with respect to which the person is entitled to a depreciation deduction under section 22 or amortization deduction under section 24; or
- any movable property held for personal use by the person or any member of person's family dependent on the person excluding capital assets mentioned under section 38(5) i.e. painting, sculpture, drawing or other work of art, jewellery, rare manuscript, folio, book, postage stamp, first day cover, coin, medallion or an antique.

► *Definition: Bonus shares*

Sec 2(9), “bonus shares” includes bonus units in a unit trust

Common examples of capital assets are ordinary shares, right shares, bonus shares, Modaraba Certificates, Participation Term Certificates, Term Finance Certificates, Musharika Certificates, PTC Vouchers, goodwill, patent, copyrights etc.

1.3 Disposal of Asset

The legislature intentionally used the word “disposal” and avoided using the words “sale”. The reason to use this term is that the term “disposal” has a wider connotation than sale. The term “disposal” has been defined in section 2(18) read with section 75.

Section 75 says that a person who holds an asset shall be treated as having made a disposal of the asset at the time the person parts with the ownership of the asset, including when the asset is:

- sold, exchanged, transferred or distributed; or
- cancelled, redeemed, relinquished, destroyed, lost, expired or surrendered.

The transmission of an asset by succession or under a will shall be treated as a disposal of the asset by the deceased at the time asset is transmitted.

The application of a business asset to personal use shall be treated as a disposal of the asset by the owner of the asset at the time the asset is so applied.

Where a business asset is discarded or ceases to be used in business, it shall be treated to have been disposed of.

A disposal shall include the disposal of a part of an asset.

It is important to note that a:

- **“Business asset”** means an asset held wholly or partly for use in a business, including stock-in-trade and a depreciable asset; and
- **“Personal asset”** means an asset held wholly for personal use.

2 COMPUTATION OF CAPITAL GAIN

2.1 Computation of gain/loss on disposal of capital asset

Capital gain arising on the disposal of a capital asset by a person shall be computed by the formula:

$$\text{Capital Gain} = A - B$$

Where:

A is the consideration received on disposal of the asset; and

B is the cost of the asset.

- Gain is taxable under the normal tax regime (NTR). Further, 100% gain will be taxable even if capital asset has been held by a person for more than one year.

2.2 Determination of cost of capital asset

Sub sections (4) of section 37 the Ordinance explicate the cost of capital asset in **two situations** in the following manner:

- No amount shall be included in the cost of a capital asset for any expenditure incurred by a person:
 - that is deductible from income earned under any other head of income; or
 - any expenditure which is not a deductible expense under section 21, deductions not allowed.

2.3 Consideration capital asset

The consideration received shall be the total amount received or the fair market value (FMV), whichever is higher.

For a listed company, FMV shall be determined by the market value according to the stock exchange quotation. In the case of an unlisted company, the break-up value of the company's shares shall be considered the FMV.

If an asset is lost or destroyed, the consideration received shall be the scrap value, along with any compensation, indemnity, or damages received under an insurance policy, agreement, settlement, or judicial decision.

3 DEDUCTION OF LOSSES IN COMPUTING INCOME CHARGEABLE UNDER THE HEAD CAPITAL GAINS

3.1 Deduction of losses

Section 38 of the Ordinance stipulates the provisions regarding deduction of losses in computing the amount chargeable to tax under the head “Capital Gains” is explained as follows;

- Loss sustained on the disposal of another capital asset (capital loss) shall be deducted from capital gain.
- No loss shall be deducted on the disposal of a capital asset where a gain on the disposal of such asset would not be chargeable to tax.
- The loss arising on the disposal of a capital asset by a person shall be computed in accordance with the following formula, namely:

$$\text{Capital Loss} = A - B$$

Where:

A is the cost of the asset; and

B is the consideration received by the person on disposal of the asset.

- No loss shall be recognized on the disposal of the following capital assets, namely:—
 - A painting, sculpture, drawing or other work of art;
 - Jewellery;
 - A rare manuscript, folio or book;
 - A postage stamp or first day cover;
 - A coin or medallion; or
 - An antique.

In other words, loss on the disposal of the above capital assets shall not be deductible from capital gain [38(5)(f)].

Treatment of ‘adjustment’ and ‘carry forward’ of capital losses is explained in section 59 of the Income Tax Ordinance, 2001 in the following manner:

A capital loss sustained by a person during a tax year shall not be set-off against income of same person under any other head of income for the same tax year.

The amount of capital loss which cannot be set-off shall be carried forward up to six tax years immediately succeeding the tax year for which the loss was first computed.

In the subsequent years, this loss can only be set-off against the capital gain for that tax year.

Where a person has a loss carried forward for more than one tax year, the loss of earliest tax year shall be set-off first. (Treatment for capital loss been discussed in detail in chapter 11 of this Study Text).

Deduction of withholding tax on sale of shares (Sec-37(6)(10))

- Through Finance (Supplementary) Act 2023 new sub-sections (6) to (10) were inserted in section 37 providing for deduction of tax on sale of shares transactions other than on Securities (section 37A).
- The person acquiring a capital asset, being shares of a company (other than listed companies shares settled through NCCPL) shall deduct advance adjustable tax at the rate of ten percent (10%) of the fair market value of the shares, at the time of payment or at the time of registration of shares by SECP/SBP whichever is earlier.
- As a result of the above provisions, deduction of tax will be required where shares have been registered even if actual payment against the same has not been made. The tax so deducted shall be paid to the Commissioner by way of credit to the Federal Government, within fifteen days of the payment.

- The fair market value of shares shall be determined without deduction of liabilities as envisaged in Rule 19H of the Income Tax Rules, 2002.
- State Bank of Pakistan must not permit the transfer or registration of repatriable shares unless the seller provides a prescribed certificate from the Commissioner confirming that the tax liability has been discharged. (SRO 776(I)/2023)
- The person acquiring the shares may seek certificate of exemption or reduced rate certificate from the Commissioner holding the jurisdiction where the person considers the transaction of sale of shares is either exempt or subject to reduced rate of tax under any of the provisions of the Ordinance.
- A person disposing of the shares is required within 30 days to furnish to the Commissioner holding jurisdiction over the case, information or documents in a statement as may be prescribed. However, Commissioner can call for the said information or documents within less than 30 days by a notice in writing if necessitated.
- Moreover, proviso has been inserted in section 37A ousting shares of listed companies not traded on registered stock exchange and not settled through NCCPL from ambit of section 37A. In such cases provisions of section 37 shall apply with respect to collection and payment of taxes. This is done to capture off market transactions of shares of listed companies which are not traded through registered stock and not settled by NCCPL.

4 CAPITAL GAIN ON IMMOVEABLE PROPERTY AND SECURITIES

4.1 Capital gain on immovable property [Section 37(1A)]

A gain arising on the disposal of immovable property (open plot or constructed property) situated in Pakistan by a person in a tax year shall be chargeable to tax as separate block on the basis of holding period as under:

	Properties acquired on or before 30 June 2024				Properties acquired after 01 July 2024
S.no	Holding period	Open plot	Constructed property	Flats	All properties
1.	Where holding period does not exceed one year	15%	15%	15%	Active taxpayers 15% Non-active persons at the progressive slab rates specified in Division I for individuals and AOP (this rate shall not be less than 15% in any case) and at corporate tax rate specified in Division II for companies.
2.	Exceeds one year but does not exceed 2 years	12.5%	10%	7.5%	
3.	Exceeds 2 years but does not exceed 3 years	10%	7.5%	0%	
4.	Exceeds 3 years but does not exceed 4 years	7.5%	5%	-	
5.	Exceeds 4 years but does not exceed 5 years	5%	0%	-	
6.	Exceeds 5 years but does not exceed 6 years	2.5%	-	-	
7.	Exceeds 6 years	0%	-	-	

Note: In this context, "immovable property" refers specifically to capital assets and does not include offices, factories, or immovable property held by real estate dealers.

Exemption on Capital Gain

As per clause 114B Part I of the Second Schedule, Capital gain is exempt on first sale of immovable property acquired/allotted by Federal or Provincial Government or any certified allotment authority and property acquired is in recognition of services rendered by:

- a person who dies while in the service of the Pakistan Armed Forces (PAF) or the service of Federal or Provincial Government.
- War wounded person while in service of PAF or Federal or Provincial Government.
- Ex-serviceman and serving personnel of PAF or Federal or Provincial Government.

As per clause 9A Part III of the Second Schedule, capital Gain Tax rates have been reduced by 50% of the above rates in case of the first sale of immovable property acquired or allotted to ex-servicemen and serving personnel of Armed Forces or ex-employees or serving personnel of Federal and Provincial Governments, being original allottees of the immovable property, duly certified by the allotment authority.

Moreover, in case of any capital gain arising after completion of three years from date of acquisition of immovable property the amount of tax payable shall be reduced by 75%.

Purchase of immovable property in cash (Sec 75A)

In case any immovable property having fair market value (FBR value or DC rate whichever is higher) greater than five million rupees is purchased in cash, then it will have following implications:

- Such amount shall not be treated as cost for computation of any gain on disposal (sale value will be treated as capital gain)
- Such person shall pay a penalty of 5% of the FBR value or DC rate whichever is higher.

► *Exercise*

On 15 January 2026, Mr.A sold a shop situated in Karachi for Rs. 15,000,000. He had purchased this shop in July 2025 for Rs. 19,000,000 out of which Rs. 6,000,000 was paid in cash.

► *Answer*

Cash exceeding Rs.5 million will not be considered as cost. Therefore, gain of Rs. 15-13= 2 million will be chargeable to tax. Mr.A will also have to pay penalty of Rs.6 x 5%= 0.3 million.

► *Exercise*

Mr. B purchased an open plot on 22.09.2025 which cost him Rs.2,000,000. The plot was sold on 25.03.202 at Rs.8,000,000. Another constructed property was acquired on 05.09.2025 at Rs.6,000,000 and sold at Rs.12,000,000 on 23.05.2026. Assuming that both properties were acquired and sold as per value notified by the Board.

Required:

Compute the capital gain and tax thereon?

► *Answer*

Gain on sale of plot = 6,000,000 (8m-2m)

Gain on sale of constructed property = 6,000,000 (12m-6m)

Total capital gain Rs.6m+6m = 12,000,000

Tax liability @ 15% = 1,800,000

As both properties are acquired after 01 July 2024, 100% gain will be taxable @ 15%

► *Exercise*

Mr. Y purchased an open plot on 22.05.2023 at a cost of Rs.4,000,000. The plot is sold on 25.06.2025 at Rs.7,000,000. Another constructed property is acquired on 08.09.2023 at Rs.9,000,000 and sold at Rs. 14,000,000 on 25.06.2025. Assuming that both properties were acquired and sold as per value notified by the Board.

Required:

Compute the capital gain and tax thereon?

► *Answer*

Gain on sale of plot = 7,000,000 - 4,000,000 = Rs.3,000,000

As the holding period of plot is more than two but less than 3 years, it will be taxable @ 10%.

Gain on sale of constructed property = 14,000,000 - 9,000,000 = Rs.5,000,000

As the holding period of the constructed property is more than one but less than 2 years, it will be taxable @ 10%.

Total capital gain = Rs.3,000,000 + Rs.5,000,000 = Rs.8,000,000

Tax liability @ 10% = 800,000

4.2 Taxation on deemed income (Sec 7E)

- A resident person owning capital assets in Pakistan will be taxed on deemed income arising from capital assets for tax year 2022 and onwards.
- **Note:** Provisions of section 7E are applicable only on resident persons. Non-resident individuals including non-resident Pakistanis are not required to pay tax under section 7E.
- An exclusionary definition of 'capital asset' has been provided, which effectively means that such tax is leviable only in respect of 'immovable property' (e.g. house, any building, manufacturing plant etc.) situated in Pakistan owned by resident persons.

- Deemed income shall be computed as 5% of the Fair Market Value (as determined by the FBR under section 68 i.e. FBR Value or DC Rate) of capital assets situated in Pakistan held on the last day of the tax year.
- The rate of tax on such income is prescribed as 20%. This translates into an effective tax at 1% of Fair Market Value of capital assets.
- For the purposes of such tax; however, following immovable properties shall stand excluded from the scope of such tax:
 - i. One immovable property owned by the resident person;
 - ii. Any property from which income is chargeable to tax under the Ordinance and tax leviable is paid thereon (for example property subject to rental income);
 - iii. Immovable property in the first tax year of acquisition where withholding tax under section 236K has been paid at the time of purchase;
 - iv. Where the fair market value of the capital assets in aggregate excluding the capital assets mentioned in clauses (i) to (iii) above and (v) to (ix) below does not exceed Rs 25 million;
Provided that the exclusions mentioned at clauses (i) to (iv) above shall not apply in case of a person not appearing in the active taxpayers' list, other than persons who are not required to file return covered in rule 2 of the Tenth Schedule;
 - v. Self-owned business premises from where the business is carried out by the persons appearing on the active taxpayers' list at any time during the year;
 - vi. self-owned agriculture land where agriculture activity is carried out by person excluding farmhouse and land annexed thereto;

Note: Farmhouse means a house constructed on a total minimum area of 2000 square yards with a minimum covered area of 5000 square feet used as single dwelling unit.

 - vii. immovable property allotted to:
 - a) a shaheed or dependents of a shaheed belonging to Pakistan Armed Forces.
 - b) a person or dependents of the person who dies while in the service of Pakistan armed forces or Federal or provincial government.
 - c) a war wounded person while in service of Pakistan armed forces or Federal or provincial government or
 - viii. an ex-serviceman and serving personnel of armed forces or ex-employees or serving personnel of Federal and provincial governments, being original allottees of the capital asset duly certified by the allotment authority; Immovable property owned by a provincial government or a local government; or
 - ix. Immovable property owned by a local authority, a development authority, builders and developers for land development and construction.

If the tax liability under section 7E is not discharged, then the registrar or the person registering the transfer is required not to register the transfer of the subject property.

4.3 Capital gain on sale of securities (Sec 37A)

Section 37A of the Income Tax Ordinance, 2001 and Rules 13A-13N of the Income Tax Rules, 2002 contain provisions regarding taxation of capital gain on sale of securities.

► Definitions:

Security

Security means share of a public company, voucher of Pakistan Telecommunication Corporation, Modaraba Certificate, an instrument of redeemable capital, unit of exchange traded fund, debt securities and derivative products.

Derivative Products

“Derivative products” means a financial product which derives its value from the underlying security or other asset, may be traded on stock exchange of Pakistan and includes deliverable future contracts, cash settled future contracts, contracts of rights and options.

“Debt Securities” means

- a) Corporate Debt Securities such as Term Finance Certificates (TFCs), Sukuk Certificates (Sharia Compliant Bonds), Registered Bonds, Commercial Papers, Participation Term Certificates (PTCs) and all kinds of debt instruments issued by any Pakistani or foreign company or corporation registered in Pakistan; and
- b) Government Debt Securities such as Treasury Bills (T-bills), Federal Investment Bonds (FIBs), Pakistan Investment Bonds (PIBs), Foreign Currency Bonds, Government Papers, Municipal Bonds, Infrastructure Bonds and all kinds of debt instruments issued by Federal Government, Provincial Governments, Local Authorities and other statutory bodies.

The gain arising on the disposal of a security by a person shall be computed in accordance with the following formula:

$$\text{Gain} = A - B$$

Where-

A is the consideration received by the person on disposal of the security; and

B is the cost of acquisition of the security.

However, normal tax liability as applicable under section 37 shall apply on disposal of following:

- i. of a listed company made otherwise than through registered stock exchange and which are not settled through NCCPL;
- ii. through initial public offer during listing process except where the detail of such disposal is furnished to NCCPL for computation of capital gains and tax thereon under section 37A.

In case of a **Market-Based Transaction** involving any security, a notional expense equal to 0.5% of the sale proceeds and 0.5% of the security's cost will be applied instead of actual charges like brokerage, commission, levy, and other related incidental expenses. This notional deduction, however, does not apply to open-ended mutual funds' units or future contracts initiated by PMEX members.

For clarification, a **"Market-Based Transaction"** refers to a transaction conducted at a registered stock exchange in Pakistan or on the platform of the National Clearing Company of Pakistan Ltd (NCCPL).

- Capital gain arising on disposal of securities shall be chargeable to tax at the following rates:

Tax year 2026-Where securities acquired after 01 July 2024

Holding period	Rate of Tax for active taxpayers
Regardless of holding period	Active taxpayers 15% for persons appearing on the Active Taxpayers List on the date of acquisition and the date of disposal of securities Non-active taxpayers Progressive rates specified in Division I for individuals and association of persons and (29%) Division II for companies. However, the rate of tax shall not be less than 15% in any case.

Tax year 2026 - Where securities acquired on or after 01 July 2022

Holding period	Rate of Tax for active taxpayers
Less than one year	15%
More than one year but less than two years	12.5%
More than two years but less than three years	10%
More than three years but less than four years	7.5%
More than four years but less than five years	5%
More than five year but less than six years	2.5%
More than 6 years	0%

Tax year 2026 - Where securities acquired between 01 July 2013 to 30 June 2022

Holding period	Rate of Tax for active taxpayers
Irrespective of the holding period	12.5%

Tax year 2026 - Where securities acquired before 01 July 2013

Holding period	Rate of Tax for active taxpayers
Irrespective of the holding period	0%

Capital gain rate for future commodity contracts entered into by members of Pakistan Mercantile Exchange will be 5% regardless of date of acquisition.

Gain on disposal of immovable property and securities shall be treated as a separate block of income and taxable at above respective prescribed tax rates.

- On the other hand, gain on disposal of capital assets will be added to the normal income of the taxpayer and taxable on the basis of the tax rates applicable to such person.
- The holding period shall reckon from the date of acquisition to the date of disposal.
- Capital gain arising on the disposal of any security shall be computed on the basis of First in First out (FIFO) inventory accounting method. However, FIFO method shall not apply in respect of sale of shares purchased on the same trading day. In that case gain or loss shall be computed by applying the average method.
- Loss sustained by a person on disposal of securities shall be set off only against the gain of the person from disposal of any other securities chargeable. Such loss from tax year 2019 can only be carried forward upto three tax years immediately succeeding the tax year for which the loss was first computed.

Capital loss adjustment disallowed (Rule 13 F)

Capital loss adjustment as mentioned above shall not be admissible in the following cases, namely

Wash Sale

Where capital loss realized on disposal of a specific security by an investor is preceded or followed in one month's period by purchase of the same security by the same investor or its related parties, thus maintaining his portfolio.

Cross Trade

Where coordinated reshuffle of securities between two related accounts of the same investor or between two related brokerage houses is undertaken and securities accumulating unrealized losses are sold to related accounts to artificially realize capital losses in one account without actually selling the securities to an outsider.

Tax Swap sale

Where the investor having realized loss on a particular security does not repurchase the same security but chooses another similar security in the same sector thus not only minimizing or eliminating altogether liability on account of tax on capital gain, but also maintaining the portfolio broadly at the same risk return profile.

The above provisions shall not apply to a banking company or an insurance company.

Payment of tax on capital gain (Rule 13H)

Every investor shall calculate tax on capital gain arising on securities held for a period upto six months, and above six months to one year, after the end of each tax year at the prescribed rates.

Every investor other than individual shall e-file statement of advance tax on capital gain on the prescribed format within seven days after the end of each quarter with the tax authority.

The liability to pay the due tax on capital gain shall lie on the investor who held the securities during the period for which tax on capital gain is to be paid.

4.3 Special provision relating to capital gain tax

- Capital gains on disposal of listed securities and tax thereon shall be computed, determined, collected and deposited in accordance with the provisions of section 37A read with rules laid down in the Eighth Schedule.
- Provisions of section 37A and Eight Schedule of the Income Tax Ordinance, 2001 shall not apply to the following persons, namely:
 - a banking company
 - an insurance company

► Exercise

Briefly explain the income tax implications in respect of each of the following independent situations for the tax year 2026

- i. 1 January 2026: Ilyas entered into a contract for the sale of his 250 Square Yards plot in Islamabad to Mr. Sohail for a consideration of Rs. 50,000,000. Sohail paid Rs. 5,000,000 at the time of the contract for sale. However, he failed to pay the balance of the amount by 30 April 2026 and Ilyas forfeited the Rs. 5,000,000 in accordance with the terms of the contract. Subsequently, the plot was sold for Rs. 49,000,000 to Mr. Mumtaz on 30 June 2026. Ilyas had inherited the house on 25 June 2019, on which date the fair market value of the plot was estimated at Rs. 45,000,000. His father had originally purchased the plot for Rs. 39,000,000 in 1 July 2002.
- ii. 15 February 2026 Bilal discarded a machine which he had imported from China for Rs. 1,000,000 on 1 January 2026 to start the business. However, the machine was badly damaged during the shipment, rendering it unfit for use. The shipping company paid him Rs. 850,000 as damages. The scrap value of the machine on the date it was discarded was estimated to be Rs. 200,000. The documentation charges incurred in connection with the claim for damages were Rs. 25,000.
- iii. On March 01, 2026 Mr. Aleem sold 10,000 shares in Pakistan Telecommunication Limited, a company listed on Karachi Stock Exchange, for Rs. 300,000. He had purchased these shares on July 01, for Rs. 200,000. Brokerage and other expenses on sale transaction were Rs. 1,500. Mr. Aleem is in the active taxpayers list under the Income tax Law.
- iv. The disposal is made otherwise than through registered stock exchange and which are not settled through NCCPL.
- v. How tax would be changed if Mr. Saleem disposed these share through registered stock exchange and which are settled through NCCPL?
- vi. On June 15, 2026 Imran sold his personal car for Rs. 1,500,000. The car has been originally purchased for Rs. 1,200,000 on September 13, 2023.
- vii. Mr. Salman sold his antique watch for Rs. 150,000 in tax year 2026. The watch had been gifted to him by his mother back in 2010. Its fair market value at the time of gift was Rs. 250,000. His mother originally purchased the watch for Rs. 50,000.

► Answer

i. Transaction with Mr. Sohail

The amount of Rs. 5,000,000 forfeited by Ilyas in accordance with the terms of the contract for the sale of his plot to Sohail is to be treated as rent received [s.15(2)] and taxed under the head Income from Property.

Transaction with Mr. Mumtaz

Consideration for the sale of the plot on 30 June 2026	49,000,000
Deemed Cost on 25 June 2019, the date of inheritance by	(39,000,000)
Capital gains	10,000,000
Capital gain on disposal of plot after six years 10 m x 0% = Exempt	

ii. Disposal of machine

Since Bilal was not entitled to claim depreciation on this machine, the machine falls within the definition of a capital asset. [S.37(5)(b)] Discarding an asset is also treated as a disposal of the asset. [S.75(3A)] The capital gain is determined as:

Consideration received 15 February 2026

	Rs.
Damages from the shipping company	850,000
Scrap value of the machine	200,000
	1,050,000
Cost of the machine on 1 January 2026	
Purchase price of the machine	1,000,000
Documentation charges incurred	25,000
	(1,025,000)
Capital gain	25,000

Full amount of capital gain is taxable. [S.37(3)]

iii. A) If Disposal is Made otherwise than Stock Exchange:

Sale of shares [Public Ltd. Company]

	Rs.
Consideration received	300,000
Less Cost: Original cost	(200,000)
Brokerage & Commission	(1,500)
Capital Gain	98,500

Although it is a public company but disposal is made otherwise than through registered stock exchange and which are not settled through NCCPL. Therefore, gain will be taxable under normal tax regime.

B) if disposal is made through registered stock exchange

However, if disposal is made through registered stock exchange and which are settled through NCCPL then the gain will be taxable as separate block in the following manner:

Consideration received	300,000
Less Cost: Original cost	(200,000)
Notional Expenses @0.5% of Purchase and cost price (500K x 0.5%)	(2,500)
Capital Gain	97,500

The above capital gain is taxed at the rate of 15% as a separate block of income

iv. Sale of personal car

A moveable asset in the personal use of the taxpayer is not a capital asset. Capital receipts are exempt from taxation unless the government chooses to tax them. Since personal assets, such as cars, are not subject to taxation under the law, they also fall under the exempt category.

v. Antique

The gain shall be calculated as follows:

Sale price of antique watch	150,000
Less: Deemed Cost Ref: Sec 79(3)(b)	(50,000)
Capital gains	100,000

► **Exercise**

Mr. Mobeen owns different assets. The detail of these assets along with mode and value of acquisition and nature of transactions is as under:

- On 15 June, 2026, Mr. Mobeen sold 5,000 shares of M/s ABC (Pvt.) Limited for a sum of Rs. 625,000. These shares were gifted to him by his friend on 13 September, 2025 on which date the fair market value of the shares was Rs 525,000. His friend has originally purchased these shares in tax year 2022 for a sum of Rs 500,000.
- Mr. Mobeen has also 10,000 shares of XYZ Limited, a listed company, which were transferred to him through inheritance from father date to be specified 01/07/2025. His father was original allottee of these shares at Rs.10 per share. FMV of these shares at the time of inheritance was Rs. 12 per share. On 30 January 2026, Mr. Mobeen sold 2,000 shares out of them at Rs. 40,000, through NCCPL. The break-up value of these shares as per balance sheet of the company was Rs. 15 per share; however, the price ruling in the market on the date of sale was Rs. 20 per share. Ignore notional cost.
- Mr. Mobeen has also paid a sum of Rs. 60,000 for purchase of dining table set on 15 January 2012 for his personal use. He sold the said set to Mr. Gufran for a sum of Rs. 90,000 on 27 June, 2026.
- Mr. Mobeen also has a habit of collection of postage stamps. His collection includes 2,000 stamps of different countries and occasions. He collected these stamps in many years. The cost of these stamps aggregates to Rs. 275,000. However, due to paucity of space in the home, he is not able to continue this habit therefore he sold these stamps for a sum of Rs.740,000 in a stamp exhibition.

Required:

You are required to compute the taxable income and tax liability of Mr. Mobeen for tax year 2026?

► Answer

MR MOBEEN

COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY

TAX YEAR 2026

STATUS: RESIDENT PERSON

Particulars	Consideration	Cost/Deemed Cost	Gain	Taxable Gain	Remarks
Capital Gains					
Sales of shares	625,000	525,000	100,000	100,000	For assets acquired by gift from relatives (there is no acquisition cost for the person acquiring the asset), the original cost of the transferor at the time of its acquisition is treated to be the cost of the asset [(Ref: Sec 79 (3)(b)]. Since friends do not fall under the category of relatives, the fair market value should be considered, which is the same value at which his friend was taxed during the disposal.
Sale of Inherited listed shares	40,000	20,000 (10,000 x 10)	20,000	20,000	U/s 37A, any gain on disposal of securities through NCCPL acquired after 01 July 2022 is taxable as separate block of income@ 15%. Assuming him as in the list of ATL under the Income tax Law.
Sale of dining table set	90,000	60,000	30,000	Nil	Any movable property for personal use, except for painting, sculpture, drawing, jewellery, rare manuscript, folio, book, postage stamps, first day cover, coin, medallion or an antique, is not chargeable to tax.
Sale consideration of postage stamps	740,000	275,000	465,000	465,000	No loss is recognizable on sale of stamps; however, any gain is fully taxable.
Total Capital Gain				610,000	
Tax on capital gain (without listed securities taxable as SBI)				Nil	Rs. 590,000 taxable at normal tax rates applicable to business. The tax rate for non-salaried individual up to Rs.600,000 is 0%, so it is exempt from tax.
Listed Securities CG 20,000 @ 15%				3,000	
Total Tax				3,000	

Note:- Remarks are added for guidance purposes only. Students are requested not to include remarks unless specifically required by the examiner.

INCOME FROM OTHER SOURCES

IN THIS CHAPTER:

1. Description
2. Admissible deductions

1 DESCRIPTION

1.1 Introduction to the 'income from other sources'

This is a residuary head of income, all kinds of income, which are not covered within the ambit of other heads of income, are covered under this head of income. Section 39 of the Ordinance elaborates its scope in the following manner:

1.2 Scope, basis of chargeability and contents

- Income of every kind received by a person in a tax year, if it is not included in any other heading, other than income exempt from tax under this Ordinance, shall be chargeable to tax in that year under the heading "Income from Other Sources."
- As may be seen from above, income from other sources is chargeable to tax on 'receipt basis'. Thus, any income from other sources which is accrued for a tax year but is not received is not chargeable in that tax year.
- Income from other sources may include the following namely:
 - i. Dividend
 - ii. Royalty;
 - iii. Profit on debt;
 - iv. Additional payment on delayed refund under any tax law;
 - v. Ground rent;
 - vi. Rent from the sub-lease of land or a building;
 - vii. Income from the lease of any building together with plant or machinery;
 - viii. Income from provision of amenities, utilities or any other service connected with renting of building;
 - ix. Income deemed u/s 111- unexplained assets or income;
 - x. Any annuity or pension;
 - xi. Any prize bond, or winnings from a raffle, lottery, prize on winning a quiz or cross-word puzzle;
 - xii. Any other amount received as consideration for the provision, use or exploitation of property, including from the grant of a right to explore for, or exploit, natural resources;
 - xiii. The fair market value of any benefit, whether convertible to money or not, received in connection with the provision, use or exploitation of property; and,
 - xiv. Any amount received by a person as consideration for vacating the possession of a building or part thereof, reduced by any amount paid by the person to acquire possession of such building or part thereof. This income shall be taxable in 10 years from the year of receipt in equal proportion.
 - xv. Any amount received by a person from Approved Income Payment Plan or Approved Annuity Plan under Voluntary Pension System Rules, 2005.
 - xvi. any amount or fair market value of any property received without consideration or received as gift, other than gift received from: an ancestor, a descendant of any of the grandparents, or an adopted child, of the individual, or of a spouse of the individual or a spouse of the individual or of any person specified above.

Note 1: Any gift received in cash even from above persons will be taxable under IFOS.

- xvii. Any amount received as a loan, advance, deposit for issuance of shares or gift by a person in a tax year from another person other than a banking company or financial institution or not through digital means/crossed cheque drawn on a bank or a banking channel or not from a person holding a National Tax Number. However, advance for the sale of goods or supply of services is outside the scope of this clause.
- xviii. Income arising to the shareholder of a company, from the issuance of bonus shares

- Where any profit on debt derived from National Savings Deposit Certificate including DSCs is paid to a person in arrears and as a result his income is chargeable to higher rate of tax than would have been applicable if the amount had been paid in the tax year to which it relates, he may by a notice in writing to the Commissioner by the due date for furnishing persons return of income, elect for the amount to be taxed at the rates that would have been applicable if the amount had been paid in the tax year to which it relates.

1.3 Tax Treatment of Gifts Under Various Income Heads

1.3.1. Gifts Received from an Employer

- **Tax Treatment:** Any gift received from your employer is considered part of your income and is taxable under the head "Salary."
- **Rationale:** Since the gift is provided by the employer, it is viewed as a form of compensation or benefit related to your employment, similar to a bonus or other fringe benefits. As such, it is added to your taxable salary and taxed according to the applicable income tax rates.

1.3.2. Gifts in the Form of Assets Received from Relatives

- **Tax Treatment:** Gifts received in the form of assets (such as property, jewellery, or other valuables) from relatives are exempt from tax.
- **Rationale:** Gifts from close family members are generally not considered taxable income. The tax law provides this exemption to avoid the burden of taxation on transfers within families, recognizing these as personal, non-commercial transactions.

1.3.3. Gifts Received from Relatives or Friends in the Form of Cash

- **Tax Treatment:** Gifts received in the form of **CASH** from relatives or friends are taxable under the head "Income from Other Sources. The fair market value of **ANY** gift received from friends is taxable under the head "Income from Other Sources"
- **Rationale:** Cash gifts, unlike asset gifts from relatives, are considered a potential source of income. Therefore, to prevent the misuse of cash gifts for tax evasion, they are taxed under "Income from Other Sources," unless specifically exempt under certain conditions.

1.3.4. Gifts Received from a Tenant

- **Tax Treatment:** Gifts received from a tenant are taxable under the head "Income from Property."
- **Rationale:** A gift from a tenant is considered a form of rental income, possibly linked to the property rented out. As such, it falls under "Income from Property" since it arises due to the landlord-tenant relationship and is related to the rental income stream.

1.3.5. Gifts Received Under a Business Relationship

- **Tax Treatment:** Gifts received in the course of a business relationship are taxable under the head "Income from Other Sources."
- **Rationale:** Gifts exchanged in a business context are viewed as income since they could be related to transactions, services rendered, or other business dealings. To ensure fairness and prevent underreporting of business earnings, such gifts are included as "Income from Other Sources."

1.3.6. Gifts Received from a Company as a Shareholder

- **Tax Treatment:** If a shareholder receives a gift from a company, it is treated as a dividend.
- **Rationale:** Gifts from a company to its shareholders are considered a distribution of profits, akin to dividends. The tax law treats these gifts as dividends to prevent companies from disguising profit distributions as gifts to avoid dividend taxation.

1.4 Important aspects of taxability

Income, which does not fall under any other head of income, would fall within this heading of income. Therefore, the kinds of income elaborated above from (i) to (xviii) if fall within any other head of income, then the same may not be included again under this head of income. For example, sole business of the banks is earning profit on debt and it is therefore, classified as “income from business” in their hands, hence, the said income cannot be classified as “Income from other sources” again. Section 39(5) of the Ordinance therefore, specifically inserted to clarify this position and the said section stipulates that:

Therefore, it is imperative to decide the classification of an income under a specific head of income after considering the scope of activities of the taxpayer.

For example: The sole business of a company is to manage its investment in different subsidiaries of a group. Then the ultimate income of the said company would be dividend income and capital gains from sale of shares. The income of the company from dividends then would be chargeable to tax under the head income from business and not under the head income from other sources. However, on the other hand, in case a manufacturing company earns dividend income in addition to income arising from sale of manufactured goods, then the said dividend income would be chargeable to tax under the head income from other sources.

1.5 Special provisions relating to different incomes covered under income from other sources

Now we will discuss the key aforesaid incomes and their manner of taxation one by one in the ensuing paragraphs:

1.5.1 Dividend

Dividend income is generally taxable under final tax regime in respect of all taxpayers including companies.

► **Definition:** Section 2(19) “Dividend” includes —

any distribution by a company of accumulated profits to its shareholders, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets including money of the company;

- i. any distribution by a company, to its shareholders of debentures, debenture-stock or deposit certificate in any form, whether with or without profit, to the extent to which the company possesses accumulated profits whether capitalised or not;
- ii. any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not; any distribution by a company to its shareholders on the reduction of its capital, to the extent to which the company possesses accumulated profits, whether such accumulated profits have been capitalised or not; any payment by a private company as defined in the Companies Act, 2017 or trust of any sum (whether as representing a part of the assets of the company or trust, or otherwise) by way of advance or loan to a shareholder or any payment by any such company or trust on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company or trust, in either case, possesses accumulated profits; but does not include —
- iii. a distribution made in accordance with sub-clause (c) or (d) in respect of any share for full cash consideration, or redemption of debentures or debenture stock, where the holder of the share or debenture is not entitled in the event of liquidation to participate in the surplus assets;
- iv. any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company;
- v. any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e) to the extent to which it is so set off; or
- vi. remittance of after tax profit by a branch of Petroleum Exploration and Production (E&P) foreign company, operating in Pakistan.
- vii. remittance of after tax profit of a branch of a foreign company operating in Pakistan;

► *Exercise*

Mr. Mobeen declared the following particulars:

- Income from salary Rs. 1,750,000.
- Received a dividend warrant of Rs. 19,500 from a listed company. The amount is net of income tax @ 15% and Zakat of Rs.500.

You are required to compute the taxable income and tax liability of Mr. Mobeen.

► *Answer*

MR. MOBEEN

COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY

STATUS: RESIDENT PERSON

Particulars	Gross amount	Taxable	Tax liability	Remarks
Salary income	1,750,000	1,749,500 (1,750,000-500)	83,687	Taxable Salary (Salary LESS Zakat) As a salaried case tax is calculated as: Rs.112,425= 30,000 + 15% x (1,749,500 - 1,200,000)
Income from other source:				
Dividend income	23,530	23,530	3,530	Taxable income: Amount before Zakat deduction (19,500 + 500 = 20,000) grossed up 20,000/85 = 23,530 Tax liability is Rs. 3,530 =15% x 23,530

1.5.2 Profit on debt

The term profit on debt is defined in section 2(46) of the Ordinance in the following manner:

► *Definition: Profit on debt*

- any profit, yield, interest, discount, premium or other amount, owing under a debt, other than a return of capital; or
- any service fee or other charge in respect of a debt, including any fee or charge incurred in respect of a credit facility which has not been utilized;

This definition not only explains the term for the recognition of income but it also gives the basis of ascertaining the nature of profit on debt as “admissible expenditure”. We already clarified the basis for taxation of profit on debt with the example of a bank; the same matter is elucidated in section 18 in the following manner:

- Any profit on debt derived by a person where the person’s business is to derive such income shall be chargeable to tax under the head “Income from Business” and not under the head “Income from Other Sources”.
- Where a lessor, being a scheduled bank or an investment bank or a development finance institution or a modaraba or a leasing company has leased out any asset, whether owned by it or not, to another person, any amount paid or payable by the said person in connection with the lease of said asset shall be treated as the income of the said lessor and shall be chargeable to tax under the head “Income from Business”.
- Any amount received by a banking company or a non-banking finance company, where such amount represents distribution by a mutual fund or a Private Equity and Venture Capital Fund out of its income from profit on debt, shall be chargeable to tax under the head “Income from Business” and not under the head “Income from Other Sources”.

The aforesaid provisions of law only specify head of income under which certain types of income would be assessed and subsequently subjected to tax. However, except in case of a company, profit on debt is covered within final tax regime as contained in section 169 read with section 151 of the Income Tax Ordinance 2001. Such income would not be included in any head of income.

For Individuals and AOP's

- i. Profit on debt upto Rs. 5 million is taxable as separate block @ 15% under section 7B if received from prescribed persons mentioned in section 151(1) i.e. from banks, any government, national saving scheme etc.
- ii. Any profit on debt exceeding Rs. 5 million would be taxable under normal tax regime under the head income from other source at applicable slab rates.
 - While making payments to individual and AOP, the withholding agents shall deduct tax at the rate of 20% for yield on bank deposits and at the rate of 5% for yield on all other investments/instruments..
 - Payment on account of interest on loan through loan agreement is not subject to tax deduction and therefore the same is taxable under the normal tax regime in case of all persons (**individual**, AOP, Company) under the head income from other source.
 - Similarly, in case of individual, profit on debt on behbood saving certificates/pensioners benefit account is taxable under NTR with maximum tax rate @ 5%.

1.4.3 Some examples of amounts covered under income from other sources

Following are examples of some amounts which are covered under the head of income from other sources and are part of syllabus:

- Rent from the sub-lease of land or a building
- An arrangement in which a lessee of land or a building, against an agreed rent, sub-leases the said land or building.
- Income from provision of amenities, utilities or any other service connected with renting of building.
- An amount received as consideration for vacating the possession of building or part thereof, reduced by any amount paid by the person to acquire possession of such building or part thereof. The amount so received shall be chargeable to tax under the head "Income from Other Sources" in the tax year in which it was received and the following nine tax years in equal proportion.

2 ADMISSIBLE DEDUCTIONS

2.1 Admissible deductions

- In computing the income under the head "Income from Other Sources", the following allowances and deductions shall be made, namely:
 - i. Any expenditure paid for earning Income from Other Sources other than expenditure of capital nature. It is important to note that as the basis of chargeability of income from other sources is 'receipt basis', therefore the basis for allow ability of deductions is 'paid basis'.
 - ii. In the case of profit on debt not falling under final tax regime, any Zakat paid (at the time of receipt of profit) by the person under Zakat & Usher Ordinance, 1980.
 - iii. In the case of income from sub-lease of land or a building or from lease of building together with machinery or plant, deduction for depreciation on plant, machinery and building u/s 22 and initial allowance on plant and machinery only u/s 23.
- No deduction is allowable to a person under this head to the extent that the expenditure is deductible in computing the income of the person under another head of income.
- The provisions of section 21 - Deductions not allowed shall apply in determining the deductions allowed to a person under this head in the same manner as they apply in determining the deductions allowed in computing the income of the person under the head "Income from Business".
- Expenditure is of a capital nature if it has a normal useful life of more than one year.

► Exercise

On 13 September 2025, Azhar purchased a building which had been previously used as a factory in the Sundar Industrial Estate for Rs. 5,000,000 and installed in the building an item of second-hand plant previously used in Pakistan, costing Rs. 3,000,000. Azhar leased the Sundar property consisting of the building together with the plant on 1 January 2026 to Mr. Atif for a composite rent of Rs. 400,000 per month payable in advance.

Azhar is also the owner of a residential building in Gulberg which was let out to Beta Limited on 1 August 2025 for a monthly rent of Rs. 250,000. Rent for the two years was received in advance on 1 August 2025 after deduction of tax at the prescribed rate.

Following expenses were incurred by Azhar on the two properties during the tax year 2026:

Description	Sundar Industries	Gulberg
Repair to building	140,000	63,000
Repair to plant	50,000	-
Rent Collection charges	5,000	5,000
Insurance	48,000	20,000
Total	243,000	88,000

Required:

Please calculate Mr. Azhar's taxable income for the tax year 2026, considering the relevant head of income, and provide explanations regarding how both properties are treated for taxation?

MR. AZHAR**COMPUTATION OF TAXABLE INCOME****TAX YEAR: 2026**

Description	Note	Head of income	
		Other Source	Income from Property
Rent (400,000x 6)/(250,000x11)	1 & 2	2,400,000	2,750,000
Less: Deductions			
Repair to building/allowance	3	140,000	550,000
Repair to plant		50,000	-
Rent Collection Charges		5,000	5,000
Insurance		48,000	20,000
Depreciation: Plant	4	450,000	
Building		500,000	
		1,193,000	
Taxable income (3,382,000)		1,207,000	2,175,000

Notes:**N-1: Rent received in advance**

Rent is not chargeable to tax on receipt basis. Rent relating to a tax year, whether received or receivable, is chargeable to tax in that tax year. Therefore, rent received in advance amounting to Rs.3,000,000 (250,000x 12) will be charged to tax in the tax year (TY 2026) to which it relates.

N-2: Income from lease of building with plant

A composite rent of Rs. 2,400,000 (400,000x6) was received as consideration for the lease of the Sundar Industrial property consisting of building together with the plant installed in the building. Such income after permissible deductions is chargeable to tax as "Income from Other Sources" of the Income Tax Ordinance, 2001. Further all the Expenditure incurred in deriving such expense (along with depreciation and initial allowance) will be allowed.

N-3: Repair expense/allowance

In case of income from other source, actual expense incurred will be allowed as deduction, whereas in case of income from property, 1/5th repair allowance will be allowed.

N-4: Depreciation for full year computed as the assets are already in use and brought forward.

	Building	Plant
Cost	5,000,000	3,000,000
Rate of depreciation	10%	15%
Total	500,000	450,000

LOSSES, DEDUCTIBLE ALLOWANCES, TAX CREDITS AND EXEMPTIONS

IN THIS CHAPTER:

1. Treatment of losses
2. Deductible allowances and tax credits
3. Exemptions and tax concessions

1 TREATMENT OF LOSSES

1.1 Set-off of losses

While computing income of a person under a head of income, if the total deductions allowed to a person under the head exceed the total amounts chargeable to the person under that head, then the said person is said to have sustained a loss under the said head of income.

The income tax law includes comprehensive provisions which stipulate the mechanism for adjustment of the loss under a head against the income under other heads of income and against the income for the ensuing years. Sections 56 to 58 of the Ordinance deal with this issue and the said sections are discussed below:

Set-off of losses (Sec 56)

- If a person sustains a loss under any head of income in a tax year, the same can be set-off against the income from any other head of income except for “income under the heads ‘salary’”. However, the following are exception to the said rule:
 - i. Loss in speculation business cannot be set-off against any other income.
 - ii. Adjustment of business loss shall not be allowed against income from property for the tax year
 - iii. Capital loss cannot be set-off against any other income.
 - iv. Losses cannot be adjusted against FTR (Final Tax Regime) income, and losses will not be incurred on FTR income..
 - v. Loss in a case where the income would have been an exempt income e.g. loss of agriculture income cannot be set-off against any taxable income.
- No loss except loss under the head “Income from Business” (including income from speculation business) and “Capital gain” can be carried forward.
- If a person sustains loss under the head “Income from Business” in addition to loss under any other head, the loss under the head “Income from Business” shall be set-off last.

► Exercise:

For tax year 2026, taxable income/(loss) of Mr. Bilal under various heads of income is as follows:

	Rs.
Salary	500,000
Dividend Income	125,000
Income from property	250,000
Income from business	300,000
Loss from capital gain	100,000
Loss from income from other source	100,000
Loss from speculation business	100,000

Required:

Calculate the total income of Mr. Bilal after making adjustment of losses and income under keeping in view the provisions of Income Tax Ordinance, 2001? You are also requested to support your answer with explanations?

► *Answer*

	Note	Amount
Income from salary	1	500,000
Income from property	2	250,000
Income from business	3	200,000
Loss from speculation and capital gain	4	-
Dividend Income	5	-
Total income under NTR		950,000

Note 1

No loss is allowed to be adjusted against income from salary

Note 2

Income from property is chargeable to tax under normal tax regime

Note 3

Income from business amounting to Rs. 300,000 is adjusted against loss under the head income from other source amounting to Rs. 100,000.

Note 4

Loss from speculation business and capital gain will be carried forward. These losses cannot be set-off against any other head of income. However, it is pertinent to mention here that although speculation losses and capital gain losses cannot be set-off against income in any other head but vice versa is not prohibited. For instance, loss under the head income from business can be set-off against any profit of speculation business in the same tax year.

Note 5

Dividend Income is chargeable to tax under section 5 on the gross amount. No loss is allowed to be adjusted.

Carry forward of business losses (Sec 57)

- If business loss (other than depreciation, amortization and speculation loss) sustained in a tax year cannot be fully set-off in that year with income under any other head, it can be carried forward to subsequent tax years.
- In subsequent years, this loss can only be set-off against the person's income under the head "Income from Business".
- No loss shall be carried forward to more than six tax years immediately succeeding the tax year in which the loss was first computed. If a person has a business loss carried forward for more than one tax years, the loss of earliest tax year shall be set-off first.
- Where a loss, referred above relating to a tax year commencing on or after the First day, of July, 2020 is sustained by a resident company engaged in the hotel business in Pakistan the said loss shall be carried forward for a period of eight years.
- To create attraction for the investors interested in acquiring the Government's stake in PIA, loss of PIA relating to tax year commencing on or after January 2017 is allowed to be carried forward for a period of ten years.

- The loss attributable to deductions allowed under depreciation, initial allowance, first year allowance, accelerated depreciation and amortisation that has not been set off against income, shall be set off against 50% of the person's balance income chargeable under the head "income from business" in the following tax year, after setting off loss under the head "income from business" and so on until completely set off. Such loss shall be set off against 100% of the said balance income if the taxable income for the year is less than Rs. 10 million.
- While computing person's taxable income, the deductions available for depreciation, initial depreciation, first year allowance, accelerated depreciation and amortisation shall be taken into account last.

► **Exercise:**

The business loss of a company for a tax year amounts to Rs. 900 million arrived at as follows:

	Rs. Million
Gross Revenue	2,000
Less Expenses:	
Tax depreciation	100
Initial Allowance	200
Amortization of intangibles	100
Other deductions	2,500
Business loss for the year	(900)

Required:

Calculate the business loss and depreciation/amortization loss. Also mention the number of years for which the said loss can be carried forward.

► **Answer**

The tax loss of Rs. 900 million will be considered as made up of Rs. 100 million on account of depreciation, Rs. 200 million on account of initial allowance, Rs. 100 million on account of amortization of intangibles and the balance amount of Rs. 500 million on account of other deductions. Accordingly, tax loss of Rs. 900 million will be carried forward as follows:

On account of:	Rs. In "Million"
Depreciation + initial allowance + amortization	400
Business loss	500
	900

Loss under the head income from business can be carried forward for a maximum period of six years immediately succeeding the tax year in which it was first computed.

Depreciation, initial allowance and amortization loss not set off shall be set off against 50% of the person's balance income chargeable under the head "income from business" after setting off business loss, in the following tax year and so on until completely set off. Such loss shall be set off against 100% of the said balance income if the taxable income for the year is less than Rs. 10 million.

Carry forward of speculation business losses (Sec 58)

- If a person sustains a loss in a tax year from any speculation business (as defined in section 19), he can set off such loss only against profits of any other speculation business carried on by him during the same tax year.
- If any loss cannot be so set-off, either wholly or partly, such portion of loss can be carried forward up to six tax years immediately succeeding the tax year in which it was sustained.

- In the subsequent years too, the speculation loss can be set-off against income of any speculation business only. It means that loss from speculation business cannot be adjusted against income under any other head.
- If a person has a speculation loss carried forward for more than one tax years, the loss of earliest tax year shall be set-off first.

Carry forward of capital losses (Sec 59)

- A capital loss sustained by a person during a tax year cannot be set-off against income of that person under any other head of income, for that tax year.
- The amount of capital loss which cannot be set-off shall be carried forward up to six tax years immediately succeeding the tax year in which the loss was sustained.
- In the subsequent years too, capital loss can be set-off against capital gain only. It means that capital loss cannot be adjusted against income under any other head.
- If a person has a capital loss carried forward for more than one tax year, the loss of earliest tax year shall be set-off first

Limitations on set off and carry forward of losses (Sec 59A)

- An AOP whose profits are chargeable to tax under Income Tax Ordinance, 2001 shall be entitled to a set off or carry forward and set-off any loss of AOP against the income of AOP in the manner explained above.
- Any members of an AOP shall not be entitled to set off or carried forward and set off loss of AOP against his income.
- Any person who has succeeded in the business of another person otherwise than by inheritance, shall not be entitled to set off or carry forward and set off loss of predecessor.

Limitations on set off unabsorbed depreciation and amortization - Sec 57(4)

Subject to the condition where the taxable income is **TEN MILLION OR MORE** in a tax year, and when, in computing the taxable income for any tax year, full effect cannot be given to the loss related to deductions for depreciation, initial depreciation, first-year allowance, accelerated depreciation, and amortization due to the absence of sufficient profits or gains chargeable for that year, or when such profits or gains are less than the said loss, the loss or part of the loss, as the case may be, shall be set off against 50% of the person's income chargeable under the head "Income from Business" for the following year.

If there is no "Income from Business" for that year, the loss shall be set off against 50% of the person's income chargeable under the head "Income from Business" for the next following year, and so on for succeeding years.

Business loss, speculation loss, and capital loss cannot be carried forward and set off unless they are determined by an order made or treated as made under sections 120, 121, or 122 of the Income Tax Ordinance, 2001.

► Example 1 (taxable income greater than 10 million)

Tax Year 1	Rupees
Sales	50,000,000
Less: Business deductions excluding depreciation/amortization	(30,000,000)
Business income before dep.& amortization	20,000,000
Less: Deductions u/s 22, 23, 23A, 23B & 24	(40,000,000)
Business Loss for the year to be carried forward on account of unabsorbed de	(20,000,000)

Tax Year 2	Rupees
Sales	70,000,000
Less: Total admissible deductions for the tax year 2	(40,000,000)
Business income for the year	30,000,000
Brought forward loss (un-absorbed depreciation and Initial allowances) 20 million, exceeding 50% of the taxable income	
Less: Loss set off against 50% of business income	(15,000,000)
Taxable income after setting off losses	15,000,000
Balance loss to be carried forward to Tax Year 3 (20m-15m)	(5,000,000)

► *Example 2 (taxable income LESS than 10 million)*

Tax Year 1	
Sales	50,000,000
Business deductions excluding depreciation/amortization	30,000,000
Deductions u/s 22, 23, 23A, 23B & 24	40,000,000
Loss for the year	(20,000,000)

Tax Year 2	
Sales	45,000,000
Total admissible deductions for the tax year 2	40,000,000
Business income for the year	5,000,000
Loss for Tax Year 1 shall be set off against 100% of business income as taxable income for the year is less than Rs. 10 million.	(20,000,000)
Taxable income after setting off losses	Rs. Nil
Balance loss to be carried forward to Tax Year 3 (20m-5m)	(15,000,000)

► *Example 3*

Tax Year 1	
Sales	50,000,000
Business deductions excluding depreciation/amortization	80,000,000
Deductions u/s 22, 23, 23A, 23B & 24	0
Business loss C/F of tax year 1	(30,000,000)

Tax Year 2	
Sales	70,000,000
Less: Business deductions excluding depreciation/amortization	(20,000,000)
Less: Brought forward business loss	(30,000,000)
	20,000,000
Less: Deductions u/s 22, 23, 23A, 23B & 24	(80,000,000)
Loss for the year to be carried forward on account of unabsorbed dep	(60,000,000)

Tax Year 3	
Sales	90,000 ,000
Less: Total admissible deductions including depreciation of Rs.20,000,000	(40,000,000)
Business income for the year before unabsorbed tax depreciation (90-40)	50,000 ,000
Unabsorbed depreciation to be set off upto 50% of Rs.50,000,000	(25,000,000)
Taxable income after setting off loss	25,000,000

Balance loss attributable to deductions u/s 22, 23, 23A, 23B & 24 to be carried forward to tax year 4 is (Rs. 35,000,000 i.e. 60m-25m)

2 DEDUCTIBLE ALLOWANCES AND TAX CREDITS

2.1 Deductible allowances

As discussed in Chapter 4, according to section 9 of the Income Tax Ordinance 2001, taxable income of a person for a tax year shall be the total income other than exempt income of the person reduced (but not below zero) by the sum of any deductible allowances of the person for that tax year.

As per sections 60, 60A, 60B, 60C and 60D of the Income Tax Ordinance, 2001, a person is entitled to following deductible allowances

- i. Zakat
- ii. Workers' welfare fund
- iii. Workers' participation fund
- iv. Education expenses

These deductible allowances are discussed in chapter 4 of this study text.

2.2 Tax credits

While computing the tax liability of a person, the person may be allowed to reduce certain amounts from the gross amount of his tax liability on fulfilment of certain conditions. These reductions are termed as 'tax credits'.

If at the time of calculating income tax payable, a person has more than one type of tax credits available, these tax credits shall be applied in the following order:

- i. Foreign tax credit (will be discussed in chapter 13 of this study text.)
- ii. Tax credit on donations, investment, etc.,
- iii. Quarterly advance tax and tax deducted/collected at source

Following are the tax credits available under Part X Chapter III of the Ordinance, for;

- Charitable donations (Sec 61)
- Contribution to approved pension fund (Sec 63)
- Certain person (Sec 65F)
- Specified industrial undertakings (Sec 65G)
- Point of sale machines (Sec 64D)

Now we discuss them one by one hereunder:

Charitable donations, voluntary contribution and subscription (Sec 61)

A person is entitled to a tax credit in respect of any sum paid, or any property given by the person in the tax year as a donation, voluntary contribution or subscription to:

- any board of education or any university in Pakistan established by, or under, a Federal or a Provincial law;
- any educational institution, hospital or relief fund established or run in Pakistan by Federal Government or a Provincial Government or a local Government; or
- any non-profit organization or any person eligible for tax credit under section 100C of the ITO, 2001.
- Entities, organizations and funds mentioned in the thirteenth (13th) schedule
- **Note:** No deductible allowance is now allowed on donation paid to any second schedule institution. All those institutions previously mentioned in second schedule have now been consolidated in new schedule namely thirteenth (13th) schedule. Donation made to these entities would now entitle the donor for a tax credit.

- The amount of a person's tax credit allowed for a tax year shall be computed according to the following formula, namely:

$$\text{Tax Credit} = (A/B) \times C$$

Where:

A is the amount of tax assessed to the person for the tax year before allowance of any tax credit

B is the person's taxable income for the tax year; and

C is the lesser of:

- the total amount of the person's donations including the fair market value of any property given; or
- where the person is:
 - an individual or association of persons, 30% of the taxable income of the person for the year; or
 - a company, 20% of the taxable income of the person for the year.

Provided that where any sum is paid or any property is given to an associate by a donor, clause (b) of component C shall be, in the case of—

- an individual or association of persons, 15% of the taxable income of the person for the year; or
 - a company, 10% of the taxable income of the person for the year.
- The fair market value of any property given as donation shall be determined at the time it is given.
 - An amount paid by a person as a donation shall be taken into account only if it is paid by a crossed cheque drawn on a bank.

► Exercise

Mr. Hamza made a total contribution of Rs. 150,000 as donation to an approved institution mentioned in 13th schedule. His total income from business during the tax year 2026 is Rs.1,800,000. Calculate Hamza's taxable income and tax liability?

► Answer

a)

In this case donation will be allowed as tax credit:		
Taxable income	1,800,000	
Tax liability (non-salaried)		
Rs.170,000 + [(1,800,000 – 1,600,000) x 30%]	230,000	
Gross Tax	230,000	A
Eligible amount for tax credit- W-1 (Rs.150,000)		
Tax credit (230,000/1,800,000 x 150,000)	(19,167)	B
Tax liability for the year	210,833	A-B
W-1		
Amount of charitable donations (1)	150,000	
30% of taxable income (2)	540,000	
Eligible amount lower of 1 or 2	150,000	

Contribution to an Approved Pension Fund (Sec 63)

- An eligible person as defined in sub-section (19A) of section 2 deriving income chargeable to tax under the head “Salary” or the head “Income from Business” shall be entitled to a tax credit for a tax year in respect of any contribution or premium paid in the year by the person in approved pension fund under the Voluntary Pension System Rules, 2005.
- As per section 2(19A) Eligible Person”, for the purpose of Voluntary Pension System Rules, 2005, means an individual Pakistani who holds a valid National Tax Number or Computerized National Identity Card or National Identity Card for Overseas Pakistanis issued by the National Database and Registration Authority:
- Provided that the total tax credit available for the contribution made to approved employment pension or annuity scheme and approved pension fund under Voluntary Pension System Rules, 2005, should not exceed the limit prescribed or specified in section 63.
- The amount of a person’s tax credit allowed for a tax year shall be computed according to the following formula, namely: -

$$\text{Tax Credit} = (A/B) \times C$$

Where;

A is the amount of tax assessed to the person for the tax year, before allowance of any tax credit

B is the person’s taxable income for the tax year; and

C is the lesser of -

- the total contribution or premium paid by the person in the year; or
- 20% of the eligible person’s taxable income for the relevant tax year;
- The transfer by the members of approved employment pension or annuity scheme or approved occupational saving scheme of their existing balance to their individual pension accounts maintained with one or more pension fund managers shall not qualify for tax credit under this section.

Tax credit for interest paid on low-cost housing loan (Sec 63A)

- The Finance Act, 2025 has introduced a new tax credit on profit on debt, share in rent or share in appreciation for value of house or flat paid by an individual in the year on low-cost housing loans obtained from the following:
 - a scheduled bank or any other financial institution regulated by the Securities and Exchange Commission of Pakistan
 - Government or the Local Government; or
 - a statutory body or a public company listed on a registered stock exchange in Pakistan.
- For this purpose, the loan is required to be utilized for the construction (including land) or acquisition of a personal house or flat within prescribed size limits i.e. 2,500 square feet in case of a house and 2,000 square feet in case of a flat.
- The tax credit is calculated using a formula as follows:

$$(A/B) \times C \text{ Where}$$

A is the amount of tax assessed to the person for the tax year

B is the person’s taxable income for the tax year; and

C is the lesser of

- a) the total profit on debt paid by person in the year; or
- b) 30% of taxable income
- However, if such tax credit is claimed, the individual shall not be entitled to claim credit for another house or flat for subsequent 15 tax years. The person shall also not be entitled to take tax credit for any profit deductible in computing income chargeable under the head “Income from Property”.

Tax credit for point of sale machine (Sec 64D)

All Tier 1 retailers are required to integrate with Board's Point of Sale online real time reporting system. In order to encourage integration with point of sale real time reporting system of FBR, tax credit for POS machines has been introduced through introduction of new section 64D.

As per section 64D, a person who is required to integrate with FBR's computerized system for real time reporting of sale or receipt is entitled to a tax credit in respect of the amount invested in purchase of point of sale machine.

The tax credit will be allowed for the tax year in which the point of sale machine is installed, integrated and configured with the FBR's computerized system, at the lower of

- i. amount actually invested in purchase of point of sale machine; or
- ii. PKR 150,000/ machine

The term 'point of sale machine' is defined as a machine meant for processing and recording the sale transactions for goods or services, either in cash or through credit and debit cards or online payments in an internet enabled environment.

Miscellaneous provisions and tax credits for members of AOP (Sec 65)

- Where the above mentioned tax credits are allowed to a person who is also a member of an association of persons who is chargeable to tax u/s 92(1), the amount of taxable income shall include the share of person in the profit of the AOP (which is otherwise exempt) and tax payable shall be an amount payable on taxable income including shares in the profit of AOP.
- If any tax credit as mentioned above, is not fully credited due to the credit being in excess of tax payable, the excess amount shall not be refunded, carried forward to a subsequent tax year or carried back to a preceding tax year
- However, if the person is the member of an AOP the amount of tax credit which cannot be applied as above by the member, can be claimed by the association of which he is member, in the same year. For this purpose, a copy of written agreement between the member and the association shall be furnished along with the return of association.

Final tax and minimum taxes shall be determined after deducting tax credits undersections 65B, 65D and 65E of the Income Tax Ordinance, 2001.

Tax credits available for tax year 2026

i. Tax credit for certain persons (Sec 65F)

Income of the following taxpayers shall be allowed a tax credit equal to one hundred per cent of the tax payable including minimum tax and final taxes upon fulfilment of certain conditions/limitations:

- a) Persons engaged in coal mining projects in Sindh, to the extent, the income is derived from supplying coal to power generation projects
- b) A start-up as defined in Clause (62A) of Section 2 for the tax year in which the startup is certified by the Pakistan Software Export Board and for the following two years.

It may be noted that the above persons were provided exemption from tax under the Second Schedule, however, by virtue of Section 65F, they are now entitled to tax credit subject to the following conditions:

- a) Annual return of income has been filed:
- b) Tax required to be deducted or collected has been deducted or collected and deposited in the government treasury;
- c) Withholding tax statements for the relevant tax year have been filed, where the person is a withholding agent; and
- d) Monthly sales tax returns for the tax periods corresponding to the relevant tax year have been filed.

ii. Tax credit for specified industrial undertakings (Sec 65G)

Section 65G provides for tax credit of 25% of eligible investment amount made by eligible persons. This tax credit will be available against normal tax payable including minimum tax and final taxes, if any. Unadjusted amount of tax credit may be carried forward to two subsequent tax years.

Eligible investment means any investment made in the purchase and installation of new machinery, buildings, equipment, hardware and software except self-created software and used capital goods.

Eligible persons means:

- a) Green field industrial undertaking as defined in clause 27(A) of section 2 engaged in:
 - the manufacture of goods or materials or the subsection of goods or materials to any process which substantially changes their original condition or
 - Ship building
- b) Industrial undertaking set up by the 30th day of June 2023 and engaged in the manufacture of plant, machinery, equipment and items with dedicated use (no multiple use) for generation of renewable energy from sources like solar and wind for a period of five years beginning from the date such industrial undertaking is set up.

In case of greenfield industrial undertaking it is provided that the said tax credit would be available to such undertakings which are incorporated between 30 June 2019 and 30 June 2024 and are not formed by the splitting up or reconstitution of an undertaking already in existence.

Greenfield industrial undertaking means-

- a) a new industrial undertaking which is:
 - i. setup on land which has not previously been utilized for any commercial, industrial or manufacturing activity and is free from constraints imposed by any prior work;
 - ii. built without demolishing, revamping, renovating, upgrading, remodeling or modifying any existing structure, facility or plant;
 - iii. not formed by the splitting up or reconstitution of an undertaking already in existence
 - iv. using any process or technology that has not earlier been used in Pakistan and is so approved by the Engineering Development Board; and
- b) is approved by the Commissioner

As regards industrial undertaking engaged in the manufacture of plant, machinery, equipment and items with dedicated use (no multiple uses) for generation of renewable energy from sources like solar and wind, they are required to be setup by 30 June 2023. It is interesting to note that the scheme of tax credit under Section 65G provides a period of maximum three tax years during which the tax credit would be available for adjustment.

However, in respect of the above industrial undertakings, a period of five years beginning from the date of setup of such industrial undertaking has been prescribed.

3 EXEMPTIONS AND TAX CONCESSIONS

3.1 Covered in various sections (Sec 41-55)

Agriculture income (Sec 41)

- Agriculture income means an income, which satisfies the following conditions:
 - i. The income is derived from land. The income may be in the form of rent or revenue;
 - ii. The land must be used for agriculture purpose and be situated in Pakistan;
- Agricultural Income derived by a person during the tax year shall be exempt from tax.
- Various sources of agriculture income are:
 - a) Income of the cultivator or receiver of rent-in-kind from the sale of agriculture produce without performing any further process.
 - b) Income from the performance of any process by the cultivator or receiver of rent-in-kind, generally employed to render the produce fit to be taken to market.
 - c) Income from building shall also be agriculture income, subject to the following conditions
 - a) Building is owned and occupied by the cultivator or receiver of rent-in-kind;
 - b) Building is situated in the immediate vicinity of the land used for agricultural purposes;
 - c) Building is required as a dwelling house, a store house or other out building by the cultivator or the receiver of rent-in-kind due to his connection with the agriculture land.

Agriculture produce as raw material (Rule-11)

- Where a person who is a cultivator or receiver of agricultural produce as rent in kind uses agriculture produce as raw materials in his business, then the income chargeable to tax under the head income from business shall be computed as follows:

Total income	xxx
Market value of agricultural produce used in the business as raw material	(xxx)
	xxxx

- Only the market value of agriculture produce is deducted. No further deduction shall be allowed in respect of any expenditure incurred by a taxpayer as cultivator or as a receiver of rent in kind.
- The market value shall be calculated as follows:
 - i. where the agricultural produce is ordinarily sold in the market in its raw state or after application of any process ordinarily employed by a cultivator or receiver of agricultural produce as rent-in-kind to render it fit to be taken to market, the market price for the produce at the time it is used as raw materials in the person's business
 - ii. in any other case, the sum of the following amounts, namely
 - a) the expenses of cultivation; and
 - b) the land revenue rent paid for the area in which the produce is grown.

Diplomatic and United Nations Exemptions (Sec 42)

- Income of an individual entitled to privileges under the Diplomatic and Consular Privileges Act, 1972 or United Nations (Privileges and Immunities) Act, 1948 shall be exempt from tax under this ordinance to the extent provided for in these acts.
- Any pension received by a person being citizen of Pakistan from United Nations or its specialized agencies by virtue of the person's former employment, if the salary from such organization was exempt from tax under the Income Tax Ordinance, 2001.

Foreign Government Officials (Sec 43)

- Salary received by an employee of foreign government working in Pakistan shall be exempt from tax if:
 - i. The employee is a citizen of foreign country and not a citizen of Pakistan.
 - ii. The services performed are similar to those performed by employees of Federal Government in foreign countries; and
 - iii. The foreign government grants similar exemptions to employees of Federal Government of Pakistan performing similar services in such foreign country.

Exemptions under International Agreements (Sec 44)

- Any Pakistan source income shall be exempt if Pakistan is not permitted to tax it under a tax treaty.
- Any salary received by an individual (who is not a citizen of Pakistan) shall be exempt from tax under the Ordinance to the extent provided for in an Aid Agreement between the Federal Government and a Foreign Government or Public International Organization, where:
 - i. the individual is either not a resident individual or a resident individual solely by reason of the performance of services under the Aid Agreement;
 - ii. if any Aid Agreement is with a foreign country, the individual is a citizen of that country; and
 - iii. the salary is paid by the foreign government or public international organization out of funds or grants released as aid to Pakistan in pursuance of such Agreement.
- Any income received by a person engaged as a contractor, consultant, or expert on a project in Pakistan. This income shall be exempt from tax to the extent provided for in a bilateral or multilateral agreement between the Federal Government and a foreign government or public international organization, where:
 - i. the project is financed out of grant funds in accordance with the agreement;
 - ii. the person is either a non-resident person or a resident person solely by reason of the performance of services under the agreement; and
 - iii. the income is paid out of the funds of the grant in pursuance of the agreement.
- The Federal Government is empowered to grant exemption on income of any person on a case-to-case basis through a notification in the Official Gazette in respect of an official development assistance financed loans and grant-in-aid, subject to such conditions and limitations as may be specified.

Exemption under foreign investment (Promotion and Protection) Act, 2022 (Sec 44A)

- In December 2022, 'Foreign Investment (Promotion and Protection) Act, 2022 ['FIPPA'] was passed with a view to attract, encourage, and protect, large scale investments in Pakistan. Through section 3 of FIPPA, the Federal Government has been empowered to notify any investment, sector, industry or project as 'Qualified Investment' by listing it in the First Schedule to FIPPA. Presently, the Reko Diq Project in the Province of Balochistan, including the Reko Diq Mining Company (Private) Limited and its associated companies, have been listed in the First Schedule to the FIPPA as Qualified Investment.

- The FIPPA further elaborately defines the term ‘Investment Incentive’ to include inter alia exemptions from and reduction/concessions in the rates of any Federal, Provincial or local duties, charges, taxes, levies, fees and cesses as may be mutually agreed by an investor and a concerned government through an investment agreement.
- The Second and Third Schedules to FIPPA, as passed by the parliament on December 13, 2022, contained a list of certain amendments in the Income Tax Ordinance, 2001, Sales Tax Act, 1990, Federal Excise Act, 2005 and the Customs Act, 1969 vis-à-vis the Reko Diq Project, Reko Diq Mining Company (Private Limited) and its associated companies. Whilst as a result of the above enactment already passed by the Parliament, the respective amendments have already been made and consequently all concessions and exemptions envisaged in FIPPA have been legally enforceable. However, in order to avoid procedural hassle relating to implementation of these concessions with regard to FBR’s system, all income tax concessions are now incorporated in Income Tax Ordinance, 2001 in the following manner:
 - i. Taxes on income (including capital gains), advance tax, withholding taxes, minimum and final taxes under this Ordinance shall, for the period and to the extent provided in the Second and Third Schedules to the Foreign Investment (Promotion and Protection) Act, 2022 in respect of qualified investment as specified at Sr. No.1 of the First Schedule to the said Act or investors, be exempt or subject to tax at the rate and in the manner specified under the said Act.
 - ii. All investors and shareholders of the qualified investment, their associates and companies specified in the Second and Third Schedules to the said Act including third party lenders on account of any loan shall also be exempt from taxes and other provisions of this Ordinance or subject to tax at the rate and in the manner specified under the said Act for the period and to the extent provided in the Second and Third Schedules to the said Act.
 - iii. Provisions of this Ordinance relating to Anti-Avoidance, for the period and to the extent specified in the said Act including sections 106, 106A, 108, 109 and 109A, shall not apply to the persons and amounts mentioned in (i) and (ii).
 - iv. Rates of depreciation, initial allowance and pre-commencement expenditure under sections 22, 23 and 25 as on the 20th day of March, 2022 shall continue to be applicable for thirty years as provided in the Third Schedule to the said Act in respect of persons mentioned in (i) and (ii) above.
 - v. For the purpose of this section, the terms defined under the Second and Third Schedules to the said Act shall apply mutatis mutandis to this Ordinance.

President’s Honours (Sec 45)

Any allowance attached to any Honour, Award or Medal as well as any monetary award granted to a person by President of Pakistan shall be exempt.

Profit on Debt (Sec 46)

Any profit received by a **non-resident person** on a security issued by a resident person shall be exempt from tax if:

- i. the persons are not associates;
- ii. the security was widely issued outside Pakistan for the purposes of raising a loan outside Pakistan for use in a business carried on by the resident person in Pakistan;
- iii. the profit was paid outside Pakistan; and
- iv. the security is approved by the Board for the purposes of this section.

Scholarship (Sec 47)

Any scholarship granted to a person to meet the cost of the person’s education shall be exempt from tax if it is not paid directly or indirectly by an associate.

Support Payments under an Agreement to Live Apart (Sec 48)

Any amount received by a spouse as support payment under an agreement to live apart shall be exempt from tax.

Federal Government, Provincial Government, and Local Government] income (Sec 49)

- The income of the Federal Government shall be exempt from tax under this Ordinance.
- The income of a Provincial Government or a Local Government in Pakistan shall be exempt from tax under this Ordinance, other than income chargeable under the head “Income from Business” derived by a Provincial Government or Local Government from a business carried on outside its jurisdictional area.
- Any payment received by the Federal Government, a Provincial Government or a Local Government shall not be liable to any collection or deduction of advance tax.
- Exemption under this section shall not be available in the case of corporation, company, a regulatory authority, a development authority, other body or institution established by or under a Federal law or a Provincial law or an existing law or a corporation, company, a regulatory authority, a development authority or other body or institution set up, owned and controlled, either directly or indirectly, by the Federal Government or a Provincial Government, regardless of the ultimate destination of such income as laid down in Article 165A of the Constitution of the Islamic Republic of Pakistan.

Foreign-source income of short-term resident individuals (Sec 50)

- The foreign-source income of an individual, shall be exempt if:
 - i. the person is a resident individual solely by reason of the individual’s employment and
 - ii. the person’s stay in Pakistan does not exceed three years.
- This exemption shall not be available to:
 - i. any income derived from a business of the person established in Pakistan; or
 - ii. any foreign source income brought into or received in Pakistan by the person.

Foreign Source Income of Returning Expatriates (Sec 51)

- Foreign Source Income of a Citizen of Pakistan shall be exempt from tax in the year in which the person became resident and following one tax year. For this purpose, the individual must not remained resident in any of the four preceding tax years from the year in which the person became resident.
- Where a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during that tax year, any salary income earned by him outside Pakistan (only during that tax year) shall be exempt from tax.

Exemptions and tax provisions in other laws (Sec 54)

No provision contained in any other law providing for:

- i. an exemption from any tax imposed under the Ordinance
 - ii. a reduction in the rate of tax imposed under the Ordinance
 - iii. a reduction in tax liability of any person under the Ordinance
 - iv. an exemption from the operation of any provision of the Ordinance,
- shall have legal effect unless it is also provided for in the Ordinance

Limitation of exemption (Sec 55)

Where any income is exempt from tax under the Income Tax Ordinance 2001, the exemption shall be, in the absence of a specific provision to the contrary contained in the Ordinance, limited to the original recipient of that income and shall not extend to any person receiving any payment wholly or in part out of that income.

3.2 Covered in the Second Schedule (Sec 53)

- The income or classes of income, or person or classes of persons specified in Second Schedule shall be:
 - i. exempt from tax under the Ordinance, subject to any conditions and to the extent specified therein (Part I of the schedule)
 - ii. at such rates, which are less than the rates specified in the First Schedule (Part II of the schedule)
 - iii. allowed a reduction in tax liability under the Ordinance subject to certain conditions specified (Part III of the schedule)
 - iv. exempted from the operation of any provision of the Ordinance subject to any condition specified (Part IV of the schedule)
- Where any income is exempt from tax under any provision of Second Schedule, it shall be included in the total income, however, the tax shall not be payable in respect of such income. This inclusion shall be made where it is required by the relevant clause of Second Schedule and shall be subject to such conditions as may be specified in the said clause.
- The Federal Government or Board with the approval of the Federal Minister-in-charge may, from time to time, pursuant to the approval of the Economic Coordination Committee of the Cabinet is empowered to make such amendment in the Second Schedule as the Government thinks fit. The amendment may include:
 - i. adding any clause or condition therein;
 - ii. omitting any clause or condition therein, or
 - iii. making any change in any clause or condition therein.
- The amendments shall be effective from such tax year (as notified by the Government) beginning on any date before or after the commencement of the financial year in which the notification is issued.
- The Federal Government shall place before the National Assembly, all amendments made to the Second Schedule in a financial year.

TAXATION OF INDIVIDUAL AND ASSOCIATION OF PERSONS

IN THIS CHAPTER:

1. Principles of taxation of Individuals
2. Association of Persons (AOP) and its taxation
3. Income splitting and tax liability in certain cases

1 PRINCIPLES OF TAXATION OF INDIVIDUALS

1.1 Taxation of individuals - classification

In order to calculate the taxable income and tax liability, individuals are broadly categorized as:

- i. Salaried individuals – Taxable salary income exceeds 75% of the taxable income (See section 2.4)
- ii. Non-Salaried Individuals – Either no salary income or taxable salary income is less than 75% of the taxable income. It is explained in section 2.4 of this Chapter.

Tax rates for salaried individual

Where the income of an individual chargeable under the head “salary” exceeds 75% of his taxable income, the rates of tax to be applied shall be as set out in the following table, namely:—

Sr. No.	Taxable Income	Rate of Tax
1.	Where the taxable income does not exceed Rs. 600,000	0%
2.	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	1% of the amount exceeding Rs. 600,000
3.	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 2,200,000	Rs. 6,000 plus 11% of the amount exceeding Rs. 1,200,000
4.	Where taxable income exceeds Rs. 2,200,000 but does not exceed Rs. 3,200,000	Rs. 116,000 plus 23% of the amount exceeding Rs. 2,200,000
5.	Where taxable income exceeds Rs. 3,200,000 but does not exceed Rs. 4,100,000	Rs. 346,000 plus 30% of the amount exceeding Rs. 3,200,000
6.	Where taxable income exceeds Rs. 4,100,000	Rs. 616,000 plus 35% of the amount exceeding Rs. 4,100,000

1.2 Principle of taxation of individuals

Section 86 of the Ordinance deals with the taxation of individuals and the said section stipulates that taxable income and tax liability of each individual shall be determined separately.

1.3 Taxation of certain individuals

Deceased individual:

Although the section 86 of the Ordinance states that every person shall be charged to tax separately, however, there are certain exceptions to this general provision.

Section 87 of the Ordinance deals with the taxation of income of a deceased individual:

Legal representative is a person who in law represents the estate of a deceased person. Any person to whom the estate of the deceased person passes on his death or who intermeddles with such estate is also treated as legal representative.

- Legal representative is liable for:
 - i. any tax that the deceased would have become liable for if he had not died; and
 - ii. any tax payable in respect of the income of deceased’s estate.

- Liability of the legal representative shall be limited to the extent to which deceased estate is capable of meeting the liability.
- Any proceedings taken against the deceased before his death shall be treated as taken against the legal representative and may be continued against him from the stage at which the proceedings stood on the date of deceased death.
- Any proceedings which could have been taken against the deceased if he had survived may be taken against the legal representative.

The aforesaid provision of law clearly states that the income of a deceased person is taxable in the hands of its legal representative and the said representative is liable to pay tax on such income to the extent of estate of the said deceased person capable for meeting the tax liability.

Authors (Sec 89)

According to section 89 of the Ordinance, where the time taken by an author of a literary or artistic work to complete the work exceeds twenty-four months, the author may elect to treat any lump sum amount received by him in a tax year on account of royalties as having been received in that tax year and the preceding two tax years in equal proportions.

Income of a minor child (Sec 91)

► *Definition: Sec 2(33), Minor child*

“Minor child” means an individual who is under the age of eighteen years at the end of a tax year.

Section 91 of the Ordinance states the procedure for levy of tax on the income of a minor child in the following manner:

- Any income of a minor child for a tax year chargeable under the head "Income from Business" shall be chargeable to tax as the income of the parent of the child with the highest taxable income for that year.
- The above provisions shall not apply to the income of a minor child from a business acquired by the child through an inheritance.

2 ASSOCIATION OF PERSONS (AOP) AND ITS TAXATION

2.1 Association of persons

“Association of persons” includes a firm, a Hindu undivided family, any artificial juridical person and anybody of persons formed under a foreign law, but does not include a company.

Sec 2(32), “member” in relation to an association of persons, includes a partner in a firm;

“Firm” means the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

2.2 Basic principles for taxation of AOP

- An association of persons is considered a separate entity from its members (partners). Accordingly, the AOP is liable to tax separately from the members of the association.
- An AOP is treated as tax resident for a tax year if the control and management of its affairs is situated wholly or partly in Pakistan at any time during that tax year.
- A resident AOP is taxable on its worldwide income.
- If the AOP has paid tax for a tax year, the amount received by a member of the association in the capacity as member out of the income of the association shall be exempt from tax. However, such share of member is included in income of the member for determination of tax rate i.e. for rate purpose (discussed below in detail).
- However, in case an association of persons has a turnover of three hundred (Rs.300) million or more during the tax year or any of the preceding tax years, the share of a member will not be exempt from tax unless the association files financial statements duly audited by a firm of Chartered Accountants or a firm of Cost and Management Accountants along with the income tax return.
- If at least one of the members of an AOP is a company, the share of such company or companies shall be excluded for the purpose of computing the total income of the AOP and the company or companies shall be taxed separately at the rates applicable to the companies, according to their share.
- The AOP is entitled to set off and carry forward its losses as per normal procedure. However, share of loss from AOP is neither adjustable against the income of its members nor it is considered for rate purpose.
- Where a change occurs in the constitution of a firm during a tax year, the firm's income is apportioned amongst the members on a time basis.
- The responsibility for filing the tax return of a firm for any tax year rests with the persons who are members in the firm on the date the firm is required to file its tax return.
- Where a firm dissolves or discontinues carrying on business, any tax payable by the firm is recoverable from any person who was a member in the firm at the time of dissolution or discontinuance of business. Tax payable can also be recovered from legal heirs of the deceased partners.

2.3 Individual as a member of AOP

If, for a tax year, an individual has taxable income besides exempt share of profit from AOP, then the amount of tax payable on the taxable income of the individual shall be computed in accordance with the following formula:

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

Where

- A** is the amount of tax that would be assessed to the individual for the year if the amount or amounts exempt from tax (i.e. share of profit from AOP) were chargeable to tax
- B** is the taxable income of the individual for the year if the amount or amounts exempt from tax under (i.e. share of profit from AOP) were chargeable to tax; and
- C** is the individual's actual taxable income for the year

Key points for solving AOP numerical

Following points should be kept in mind when solving AOP numerical:

- Any profit on debt, brokerage, commission, salary or other remuneration paid by an association of persons to a member of the association is not allowed as an expense; hence it should be added back to the taxable income of AOP.
- FBR has clarified that it is the profit before tax of AOP that will be included in the taxable income of its members for rate purpose.
- Share of loss from AOP is neither adjustable against income of its members nor it is considered for rate purpose.
- If an AOP has any income that falls under final tax regime (FTR) then members share from such income shall not be added in the taxable income of the member. Section 4(4) read with Section 169(2) clearly states that income falling under FTR is not to be included in any taxable income.
- If AOP has any exempt income, the share received in the capacity as member out of the income of association shall remain exempt. However, if an AOP has a turnover of Rs.300million or more during the tax year or any of the preceding tax years, the share of a member will not be exempt from tax unless the association files financial statements duly audited by a firm of Chartered Accountants or a firm of Cost and Management Accountants
- Share of Minor Partner in Firm shall be added in the hands of Parents with highest taxable income for rate purpose.
- In case of an AOP that is a professional firm which is prohibited from incorporation by any law or the rules of the body regulating their profession, the maximum rate applicable on income exceeding Rs.5.6 million shall be 40% instead of 45%.

2.4 Tax rates for non-salaried individuals and AOP

Tax rates for non-salaried individuals and Association of Persons

Sr. No.	Taxable Income (Rs.)	Rate of Tax
1.	Where the taxable income does not exceed Rs.600,000	0%
2.	Where the taxable income exceeds Rs.600,000 but does not exceed Rs. 1,200,000	15% of the amount exceeding Rs.600,000
3.	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,600,000	Rs. 90,000 plus 20% of the amount exceeding Rs. 1,200,000
4.	Where taxable income exceeds Rs. 1,600,000 but does not exceed Rs. 3,200,000	Rs. 170,000 plus 30% of the amount exceeding Rs. 1,600,000
5.	Where taxable income exceeds Rs. 3,200,000 but does not exceed Rs. 5,600,000	Rs. 650,000 plus 40% of the amount exceeding Rs. 3,200,000
6.	Where taxable income exceeds Rs. 5,600,000	Rs. 1,610,000 plus 45% of the amount exceeding Rs.5,600,000

A surcharge shall also be payable by every individual (including salaried) and Association of person (AOP) @ 10% of the Gross tax liability where taxable income exceeds Rs.10 million.

In case of an AOP that is a professional firm which is prohibited from incorporation by any law or the rules of the body regulating their profession, the maximum rate applicable on income exceeding Rs.5.6 million shall be 40% instead of 45%.

The following examples will explain the salaried and non-salaried status and tax liability of four individual having salary and other taxable income:

Individuals	Mr. A	Mr. B	Mr. C	Mr. D
Taxable Salary	900,000	100,000	600,000	900,000
Taxable Other income	100,000	1,000,000	400,000	250,000
Total Taxable Income	1,000,000	1,100,000	1,000,000	1,150,000
Percentage of Salary to taxable Income	90%	9.09%	60%	78.26%
Status	Salaried	Non-Salaried	Non-Salaried	Salaried
Tax liability	4,000	75,000	60,000	5,500

The above examples shows that the taxable income of Mr D is higher than Mr. B and Mr. C but even then his tax liability is low due to his status as salaried case.

► Exercise

Associated Consultants is a joint venture (JV) of Mr. Ghulam Rasool and Consultancy Enterprises, a sole proprietorship of Mr. Ahsan. The JV is not registered with registrar of firms. The proportion of interest of the members in the JV is 70:30 between Mr. Ghulam Rasool and Mr. Ahsan respectively. The JV is engaged in the providing of accounting, taxation and other services to different departments. During the year, total Income of the JV under the normal tax regime was Rs.2,000,000 against the total revenue of Rs.30,000,000. It is worth mentioning that Mr. Ahsan earned following income during the year:

Salary from Joint Venture = Rs. 450,000

Profit on debt from joint venture = Rs. 400 000

Required:

Compute the taxable income and tax liability of the Joint Venture for tax year 2026 and the share from AOP of each member (Ignore the minimum tax provision.)

► Answer

Profit as per accounts	2,000,000
Add Inadmissible deductions	
Salary paid to members	450,000
Profit on debt paid to members	400 000
Taxable income	2,850,000
Tax on taxable income (Rs. 2,850,000) of JV i.e. Rs. 170,000 + 30% on income exceeding Rs. 1.6m	545,000

Share of members out of profits of JV

Nature of income	Mr. Ghulam Rasool	Mr. Ahsan	Total
Share in Profit	70%	30%	100%
Salary received	-	450,000	450,000
Profit on debt received	-	400,000	400,000
Balance Share	1,400,000 (70% x 2,000,000)	600,000 (30% x 2,000,000)	2,000,000 (Balancing fig. 2.85 m -450K-400k)
Income in hands of members of AOP	1,400,000	1,450,000	2,850,000

► **Exercise**

Mr. Rizwan and Mr. Wajahat are two lawyers and working together as a firm in the name and style of “Rizwan Wajahat Associates”. During the year, the firm has earned aggregate profit of Rs. 300,000. The aforesaid profit includes following deductions:

Salaries to Partners

- Mr. Rizwan Rs. 100,000
- Mr. Wajahat Rs. 150,000

Expenses on which tax has not been deducted	Rs. 40000
Payments exceeding	Rs. 50000
[made otherwise than crossed cheques]	Rs. 60000
Profit on debt to Rizwan	Rs. 50000

Both partners have equal sharing in the firm. Mr. Rizwan has no other income. Mr. Wajahat is also running a business of printing and advertising services. He earned income of Rs. 150,000 from the said business.

Required:

- a) Determine the tax liability of the firm, and its members for the tax year 2026.
- b) Assume that the income of Mr. Wajahat is Rs. 1,000,000/- then what would be his taxable income and tax liability?

► **Answer****(a) Tax liability of the Firm****For the Tax Year 2026**

Particulars	Amount (Rs)
Profit as per accounts	300,000
Add	
Partners salaries (100,000+150,000)	250,000
Inadmissible expenses due to non-deduction of tax	40,000
Payments otherwise than banking channel (within Rs. 250,000)	-
Profit on debt payable to a partner	50,000
Total taxable income	640,000
Tax liability i.e. 15% on sum exceeding Rs. 600,000	(6,000)

Computation of Share from AOP of Each member

Particulars	Mr. Rizwan	Mr. Wajahat	Total
Share in Profit	50%	50%	100%
Salaries paid to partners	100,000	150,000	250,000
Profit on debt	50,000	-	50,000
Balance share after tax	170,000 (50% x 340,000)	170,000 (50% x 340,000)	340,000 (balancing fig. 640K-250K-50K)
Income in hands of members of AOP	320,000	320,000	640,000

Note: In the absence of information Minimum Tax liability u/s 113 has not been considered.

Mr. Rizwan**Computation of tax liability**

As Mr. Rizwan has no other source of income, therefore, his income is not chargeable to tax any further.

Tax liability of Mr. Wajahat (Advertising Income Rs.150,000)

Share from AOP (Exempt, but included for rate purpose)	Rs. 320,000
Add: Income from printing and advertising income	Rs. 150,000
Total Income including share from AOP	Rs.470,000
Tax on income	Rs. Nil

Note:

As income of Wajahat is below Rs. 600,000 even after addition of AOP share, therefore, no tax shall be payable.

(b) Tax liability of Mr. Wajahat (Advertising Income Rs.1,000,000)

Share from AOP (Exempt, but included for rate purpose)	Rs. 320,000
Add: Income from printing and advertising income	Rs. 1,000,000
Taxable Income including share from AOP	Rs. 1,320,000
Tax on Taxable Income (Non-Salaried Case)	
$90,000 + 20\% \times (1,320,000 - 1,200,000) =$	Rs.114,000
Tax on taxable income (Excluding share from AOP)	
$(114,000 / 1,320,000 \times 1,000,000)$	86,364

3 INCOME SPLITTING AND TAX LIABILITY IN CERTAIN CASES

3.1 Transfers of assets (Section 90)

Tax in relation to property income is generally payable by the person who owns the property. However, in certain cases, transfer of rented property may be considered as a tax avoidance measure. To avoid such practice, relevant provisions provided in the Income Tax Ordinance, 2001 are as follows:

- Where any property is transferred to another person but asset remains the property of transferor, rental income of such property will be treated as income of the transferor
- In case of revocable transfer, property income is treated as income of the transferor. However, the said rule will not apply in case transfer is irrevocable during the lifetime of the transferee and transferor derives no direct or indirect benefit from the income
- Where property is transferred by a person to his spouse or minor child (other than a married daughter) or to another person for the benefit of spouse or minor child, property income will be treated as income of the transferor. However, in case transfer is for
 - a) Adequate consideration
 - b) In connection with an agreement to live apart

Property income will not be treated as income of the transferor.

- If the property has been acquired by the transferee with funds provided by the transferor, the transfer will not be considered as made for adequate consideration. The transfer will also not be accepted if it is not evidenced by registration or mutation, wherever required.

3.2 Change in constitution of an AOP (Section 98A)

Where a change occurs in the constitution of a firm during a tax year, the firm's income is apportioned for rate purposes amongst the partners on a time basis (Sec-98A). The responsibility for filing the tax return in this case rests with the persons who are partners in the firm on the date the firm is required to file its tax return.

3.3 Discontinuance of business or dissolution of an AOP (Section 98B)

Where an AOP dissolves or discontinues carrying on business, any tax payable by the firm is recoverable from any person who was a partner in the firm at the time of dissolution or discontinuance of business. Tax payable can also be recovered from legal heirs of the deceased partners.

3.4 Succession to business otherwise than on death (Section 98C)

- Where a person carrying on any business or profession has been succeeded in any tax year by any other person (hereafter in this section referred to as the "predecessor" and "successor" respectively), otherwise than on the death of the predecessor, and the successor continues to carry on that business or profession:
 - a) the predecessor shall be liable to pay tax in respect of the income of the tax year in which the succession took place upto the date of succession and of the tax year or years preceding that year; and
 - a) the successor shall be liable to pay tax in respect of the income of such tax year after the date of succession.
- Notwithstanding anything mentioned above, where the predecessor cannot be found, the tax liability in respect of the tax year in which the succession took place upto the date of succession and of the tax year or years preceding that year shall be that of the successor in like manner and to the same extent as it would have been that of the predecessor, and all the provisions of this Ordinance shall, so far as may be, apply accordingly.
- Where any tax payable under this section in respect of such business or profession cannot be recovered from the predecessor, it shall be recoverable from the successor, who shall be entitled to recover it from the predecessor.

FOREIGN SOURCE INCOME OF A RESIDENT PERSONS

IN THIS CHAPTER:

1. Taxation of foreign source income of resident persons
2. Other provisions with respect to foreign source income

1 TAXATION OF FOREIGN SOURCE INCOME OF RESIDENT PERSONS

1.1 Principles of taxation of foreign source income of resident persons

As discussed in Chapter 4 of the study text, a resident person is liable to tax in respect of his worldwide income meaning thereby that he pays tax on his Pakistan-sourced income as well as his foreign-sourced income. Accordingly, where a resident person carries out business outside Pakistan, income derived from such foreign operations is chargeable in Pakistan.

1.2 Computation of income

- Foreign sourced income is computed separately from Pakistan-sourced income. Consequently, expenditure incurred in deriving foreign-sourced income is deductible only from foreign-sourced income and not deductible against Pakistan-sourced income and vice versa.
- Foreign sourced income is computed separately for each head of income. Accordingly, foreign-sourced income under the head “income from other source” will be computed separately from foreign-sourced income chargeable under any other head of income.
- Foreign-sourced business income is computed using the same principles as these apply to computation of Pakistan-sourced business income.
- Foreign losses are not adjustable against Pakistan-sourced income

1.3 Foreign tax credit

Section 103 of the Ordinance lays down different aspects of foreign tax credit in the following manner:

1. In case a resident taxpayer derives foreign source income chargeable to tax in respect of which he has paid foreign income tax, the taxpayer shall be allowed a tax credit of an amount equal to the lesser of:
 - a) the foreign income tax paid; or
 - b) the Pakistan tax payable in respect of the income.
2. The Pakistan tax payable in respect of foreign source income shall be computed by applying the average rate of Pakistan income tax applicable to the taxpayer for the year against the taxpayer’s net foreign source income for the year.
3. If a taxpayer has foreign income under more than one head of income, this principle shall apply separately to each head of income.
4. Income derived by a taxpayer from carrying on a speculation business shall be treated as a separate head of income.
5. If a person has more than one type of tax credits available to him, these shall be applied in the following order:
 - a) Foreign tax credit u/s 103
 - b) Tax credit/rebate on donations, investment, enlistment, etc.,
 - c) Advance tax and tax deducted/collected at source
6. Any tax credit or part of a tax credit allowed for a tax year which is not credited shall not be refunded, carried back to the preceding tax year, or carried forward to the following tax year.
7. A foreign tax credit shall be allowed only if the foreign income tax is paid within two years after the end of the tax year in which the foreign income to which the tax relates was derived by the resident taxpayer.

► *Definition: Average rate of Pakistan Income Tax*

- “average rate of Pakistan income tax” in relation to a taxpayer for a tax year, means the percentage that the Pakistani income tax (before allowance of the tax credit under this section) has of the taxable income of the taxpayer for the year;
- “foreign income tax” includes a foreign withholding tax; and
- “net foreign-source income” in relation to a taxpayer for a tax year, means the total foreign-source income of the taxpayer charged to tax in the year, as reduced by any deductions allowed to the taxpayer for the year that:
 - relate exclusively to the derivation of the foreign-source income; and
 - are reasonably apportioned to the derivation of foreign-source income in accordance with section 67.

Note: Section 67 provides the method for apportionment of expenditure relevant to different sources of incomes

1.4 Foreign tax losses

1. Section 104 of the Ordinance deals with treatment of foreign losses and it states that: Deductible expenditures incurred by a person in deriving foreign source income chargeable to tax under a head of income shall be deductible only against that income.
 2. If the total deductible expenditures exceed the total foreign source income for a tax year chargeable to tax under a head of income (hereinafter referred to as a “foreign loss”), the foreign loss shall be carried forward to the following tax year and set off against the foreign source income chargeable to tax under that head in that year, and so on, but no foreign loss shall be carried forward to more than six tax years immediately succeeding the tax year for which the loss was computed.
 3. Where a taxpayer has a foreign loss carried forward for more than one tax year, the loss for the earliest year shall be set off first.
- Section 67-Apportionment of deductions shall apply for the purposes of this section on the basis that:
 - income from carrying on a speculation business is a separate head of income; and
 - foreign source income chargeable under a head of income including a speculation business is a separate head of income.

► *Exercise:*

KL is an Association of Persons having two partners, Mr. K and Mr. L sharing profit and loss equally. During the tax year 2026, KL’s Pakistan source income amounted to Rs. 2,500,000 and tax payable thereon amounted to Rs.722,500.

Following are the details of its foreign source incomes, tax paid thereon for the tax year 2026 and foreign losses brought forward from tax year 2026:

Heads of income	Foreign income / (loss)	Foreign tax paid	Foreign losses brought forward
Speculation business	500,000	125,000	(250,000)
Non-speculation business	(1,000,000)	-	-
Income from other source	1,250,000	187,500	-
Capital gain	750,000	75,000	(1,500,000)

► Answer

Particulars	Pakistan source Income	Foreign source				Total Pakistan and foreign source
		Speculation	Non-Speculation	Capital gain	Other source	
Net income for the year	2,500,000	500,000	(1,000,000)	750,000	1,250,000	
Brought forward losses		(250,000)	-	(1,500,000)	-	
Income after B/F losses	2,500,000	250,000	(1,000,000)	(750,000)	1,250,000	
Losses carried forward			(1,000,000)	(750,000)		
Balance income	2,500,000	250,000			1,250,000	4,000,000

Pakistan income tax:

Tax on taxable Income (Rs. 650,000 + 40% x (4,000,000 - 3,200,000))						970,000
Gross Tax						970,000
Less: Foreign Tax Credit (on Income from other sources)						
Average tax rate 24.25% = (970,000 / 4,000,000 x 100)						
Foreign tax (A)					187,500	
Proportionate Pakistan Income Tax on foreign source income (B)			(1,250,000 x 24.25%)		303,125	(187,500)
Net tax payable						782,500

Remarks for students only:

1. Unadjusted foreign tax credit cannot be refunded, carried back to preceding year or carried forward to the following year.
2. As foreign source capital gain is not taxable in Pakistan, so no tax credit is allowed.

2 OTHER PROVISIONS WITH RESPECT TO FOREIGN SOURCE INCOME

2.1 Foreign source income of a short term resident individuals

Section 50 of the Income Tax Ordinance states that:

1. Foreign source income of an individual shall be exempt from tax in Pakistan if he is:
 - a resident individual solely by reason of the individual's employment; and
 - present in Pakistan for a period or periods not exceeding three years,
2. The above exemption shall not apply to:
 - any income derived from a business of the person established in Pakistan; or
 - any foreign-source income brought into or received in Pakistan by the person.

2.2 Foreign source income of returning expatriates

Section 51 of the Income Tax Ordinance, 2001 states that:

- Any foreign source income derived by a citizen of Pakistan in a tax year who was not a resident individual in any of the four tax years preceding the tax year in which the individual became a resident shall be exempt from tax in the tax year in which he became a resident individual and in the following tax year.
- If a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during that tax year, any foreign source salary earned by him outside Pakistan during that tax year shall be exempt from tax.

2.3 Foreign source salary income of a resident person

Section 102 of the Ordinance states that:

- Any foreign-source salary received by a resident individual shall be exempt from tax if the individual has paid foreign income tax in respect of the salary.
- A resident individual shall be treated as having paid foreign income tax if tax has been withheld from his foreign source salary by his employer and paid to the revenue authority of the foreign country in which the employment was exercised.

2.4 Exemptions to certain foreign residents or foreign source income of residents

Following exemptions are available to foreigners or the foreign source income of residents which are discussed in detail in Chapter 11 of this study text:

- Diplomatic and United Nations exemptions.
- Foreign government officials
- Exemption under international agreements

► Exercise:

Mr. Akhtar has served in South Africa (SA) for last five years. He was Chief Engineer at a multinational Company in SA. He returned to Pakistan in September 2024. Detail of his income for the tax year 2026 is as under:

1. His emoluments for the last July to September converted into Pak Rupees are as under:

Particulars	Amount
Pay	1,500,000
Expatriate allowance	680,000
Medical allowance	320,000
Total	2,500,000

2. Mr. Akhtar spent his whole income for personal expenses and balance amount was invested in a Consultancy business. He was a member in an engineering consulting AOP of South Africa. His investment in the firm still exists and during the tax year 2026, he earned income equivalent to Rs. 750,000 after paying tax of Rs. 125,000. He has not drawn any sum from the share of his profit.
3. Mr. Akhtar also received rent in Pakistan of his apartment situated in SA. The rental income earned and received aggregates to Rs.1,200,000.
4. Mr. Akhtar received pension amounting to Rs. 250,000 during the year from his employer at SA. This pension was paid to his son in South Africa to meet his educational expenses.
5. Mr. Akhtar deposited his cumulative pension in the SA special bonds and earned profit on debt amounting to Rs. 325,000 during the year from the said investment. Mr. Akhtar opted to invest the profit in the said bonds in order to avoid reduction in interest rates which are applicable on fresh investments.
6. In Pakistan, Mr. Akhtar joined Gatron International Limited on 10 October 2025 and received following salary income from the company:

Particulars	Amount
Basic Pay	2,800,000
Utilities allowance	280,000
Medical allowance	280,000
Total	3,360,000

7. South African Revenue Authorities raised a tax demand against Mr. Akhtar equivalent to Rs.25,000 on the rental income in view of claim of inadmissible expenses there against and Mr. Akhtar paid this demand in August 2026

Required:

You are required to compute Pakistan tax liability of Mr. Akhtar for the tax year 2026. It is worthwhile to mention here that the nationality of Mr. Akhtar is not confirmed, therefore, it is desired that the Pakistan tax of Mr. Akhtar should be worked out considering that:

- a) Mr. Akhtar is Pakistani National
- b) Mr. Akhtar is SA National

► Answer

Mr. Akhtar

Situation Number 1

Mr. Akhtar is Pakistani National Person

As per information provided, he remained outside Pakistan since last five years, therefore, foreign source income of Mr. Akhtar is exempt from levy of tax under section 51 of the Ordinance and tax liability on the Pakistan source income is as under:

Particulars	Gross Income	Exempt	Taxable
Basic Pay	2,800,000		2,800,000
Utilities allowance	280,000		280,000
Medical allowance	280,000	280,000	
Total taxable income			3,080,000
Tax (Rs. 116,000 + 23%% of the amount exceeding Rs. 2,200,000)			318,400

Situation Number 2

Mr. Akhtar is a national of South Africa

Under section 50 of the Ordinance, the foreign source income of a short term resident individual is not taxable in Pakistan if it is not received in Pakistan. Therefore, Income of Mr. Akhtar is only taxable to the extent it is received in Pakistan. The bare perusal of the question reveals that Mr. Akhtar received only rental income in Pakistan from abroad. Therefore, the same will be taxed with the Pakistan source income. It is also assumed that he is in Pakistan solely for his employment.

Particulars	Notes	Taxable Amount
Income from salary	As in Situation 1	3,080,000
Foreign source rental income (received in Pakistan)		1,200,000
Taxable income		4,280,000
Tax Liability (Non-Salaried Case)		
Tax (Rs. 650,000 + 40% of the amount exceeding Rs. 3,200,000)		1,082,000

CHAPTER 14

RETURNS

IN THIS CHAPTER:

1. Tax return
2. Persons liable to file a tax return
3. Method of filing of tax return
4. Revision of tax return
5. Due dates for filing of tax return
6. Filing of wealth statement
7. Filing of tax return on discontinuance of business
8. Extension of time for furnishing of tax return

1 TAX RETURN

1.1 Introduction to tax return

A tax return is the prescribed document made for a tax year which is prepared by the taxpayer in order to declare his taxable income and tax liability thereon to the FBR. Income tax rules, 2002 prescribe the forms to be used for returns of income.

Tax return allows a taxpayer to calculate his tax liability, schedule tax payments or request refund for the overpayment of taxes. In Pakistan, tax returns must be filed annually with reportable income, including salary, income from property, business income, dividends, capital gains and income from other sources.

► *Definitions:*

Sec 2(30AC), “Iris” means a web-based computer programme for operation and management of Inland Revenue taxes and laws administered by the Board

2 PERSONS LIABLE TO FILE A TAX RETURN

2.1 Persons liable to file a tax return

The following persons are required to furnish a return of income for a tax year:

- i. Every company;
- ii. Every person (other than a company) whose taxable income for the year exceeds the maximum amount that is not chargeable to tax; or
- iii. Any non-profit organisation
- iv. Every person whose income for the year is subject to final taxation under any provision of the Ordinance;
- v. persons or classes of persons notified by the Board with the approval of the Minister in-charge

In addition to the above, return is also required to be filed by the person who,-

- i. has been charged to tax in respect of any of the two preceding tax years;
- ii. claims a loss carried forward for a tax year;
- iii. owns immovable property with a land area of 500 square yards or more or owns any flat located in areas falling within the municipal limits existing immediately before the commencement of local government laws in the provinces; or areas in a cantonment; or the Islamabad capital territory.
- iv. owns immovable property with a land area of five hundred square yards or more located in a rating area;
- v. owns a flat having covered area of two thousand square feet or more located in a rating area;
- vi. owns a motor vehicle having engine capacity above 1000 CC;
- vii. has obtained National Tax Number or
- viii. is the holder of commercial or industrial connection of electricity where the amount of annual bill exceeds Rs.500,000.
- ix. Is a resident person registered with any chamber of commerce and industry or any trade or business association or any market committee or any professional body including Pakistan Engineering Council, Pakistan Medical and Dental Council, Pakistan Bar Council or any Provincial Bar Council, Institute of Chartered Accountants of Pakistan or Institute of Cost and Management Accountants of Pakistan.
- x. is a resident person being an individual required to file foreign income and assets statement under section 116A; or
- xi. every individual whose income under the heading 'Income from business' exceeds Rs.300,000 but does not exceed Rs. 400,000 is also required to file tax return.

2.2 Business bank account (Section 2(10A), 21, 114A)

- Business bank account” means a bank account utilized by the taxpayer for business transaction declared to the Commissioner through original or modified registration form prescribed under section 181.
- Only businesses i.e. sole proprietor, AOP or companies are required to declare through FBR e-portal.
- Every taxpayer shall declare to the Commissioner the bank account utilized by the taxpayer for business transactions.

Legal implications for not declaring a bank account

An expense incurred for business purpose shall be inadmissible while computing income from business under section 21.

2.3 Persons not liable to file tax return

Under section 115, the following persons are granted immunity from the aforesaid provision of filing of tax return:

- Following persons:
 - a widow;
 - an orphan below the age of twenty-five years;
 - a disabled person; or
 - a non-resident person.

Shall not be required to furnish a return of income for a tax year solely by reason of:

1. owning immovable property with a land area of 500 square yards or more or any flat located in areas falling within the municipal limits, existing immediately before the commencement of local government laws in the provinces; or areas in a cantonment; or the Islamabad capital territory.
2. owns immovable property with a land area of five hundred square yards or more located in a rating area;
3. owns a flat having covered area of two thousand square feet or more located in a rating area;
4. owns a motor vehicle having engine capacity above 1000 CC;

2.4 Powers to call returns and statements

Section 114 empowers the Commissioner of income tax to call for return, the Commissioner may, by notice in writing, require a person, or a person's representative, as the case may be, to furnish a return of income by the date specified in the notice for a period of less than twelve months, where:

- the person has died;
- the person has become bankrupt or gone into liquidation;
- the person is about to leave Pakistan permanently;
- the Commissioner otherwise considers it appropriate to require such a return to be furnished.

The Commissioner may, by notice in writing, require any person who, in the Commissioner's opinion, is required to file a return of income for a tax year or assessment year but who has failed to do so to furnish a return of income for that year within thirty days from the date of service of such notice or such longer or shorter period as may be specified in such notice or as the Commissioner may allow. Any such notice may be issued in respect of one or more of the last five completed tax years or assessment years.

Provided that in case of a person who has not filed return for any of the last five completed tax years, notice may be issued in respect of one or more of the last ten completed tax years.

Provided further that the above time-limitation shall not apply if the Commissioner is satisfied on the basis of reasons to be recorded in writing that a person who failed to furnish his return has foreign income or owns foreign assets.

2.5 Powers to enforce filing of returns

- The Board shall have the powers to issue income tax general order in respect of persons who are not appearing on ATL but are liable to file return.
- The income tax general order issued may entail any or all of the following consequences for the persons mentioned therein, namely:
 - disabling of mobile phones or mobile phone Sims
 - discontinuance of electricity and gas connection
 - restriction on foreign travel from the country for a citizen of Pakistan, excluding persons holding National Identity Card for Overseas Pakistanis (NICOP), minors, students, persons proceeding abroad for Hajj or Umrah and such other classes of persons as notified by the Board.

- The Board or the Commissioner having jurisdiction over the person mentioned in the income tax general order may order restoration of mobile phones, mobile phone sims and connections of electricity and gas, in cases where he is satisfied that the return has been filed or person was not liable to file return.
- No person shall be included in the general order unless following conditions have been met with, namely:
 - notice under section 114(4) has been issued by Commissioner demanding return of income
 - date of compliance of the notice under sub-section (4) of section 114 has elapsed and
 - the person has not filed the return.

2.6 Restriction placed on economic transactions by certain persons (Section 114AC, 15th Schedule)

► Definitions

Ineligible Person means a person who is not an eligible person.

Eligible person in case of individual means a person who has filed:

- return of income of the immediately preceding tax year and has sufficient resources in the wealth statement in the case of an individual or in the financial statements in the case of company/AOP respectively OR
- sources of investment and expenditure statement declaring sufficient resources and furnishing explanation thereof for a particular purchase.

In the case of the individual, the eligible person shall include his immediate family members.

Sufficient resources shall mean one hundred and thirty percent (130%) of the cash and equivalent assets comprising market value of all the assets declared by a person either in his sources of investment and expenditure statement, or wealth statement/financial statement filed for the latest tax year.

Immediate family members in respect of an individual, shall include his parents, spouse and dependent children.

Sources of investment and expenditure statement shall mean a declaration by a person filed on the Board's web portal, specifying the sources of funds for making such transaction. This statement shall not be construed as nature and source of income for the purposes of section 111.

Restriction for ineligible person (Subject to the Board Notification in future)

The Finance Act, 2025 has introduced the following restrictions on an ineligible person:

- Booking, purchasing, or registering motor vehicles having invoice value exceeding Rs.7 million
- Registering or transferring immovable property having FBR value/DC rate exceeding Rs.100 million
- Opening or maintaining securities or investment accounts having acquisition cost exceeding Rs.50 million. This will only apply where the investment amount up to PKR 50 million shall be new investment in any financial year.
- Cash withdrawals from bank accounts exceeding Rs.100 million in all bank accounts held by an individual.

Exceptions from the above restrictions

Public companies and non-residents are only barred from making cash withdrawals and other restrictions as above will not apply.

Exchange transactions for acquisition of vehicle/property/securities

Where an asset has been purchased by way of exchange of capital assets already declared in the wealth statement, or financial statement, or sources of investment and expenditure statement, the disposal of such capital assets shall be treated to be part of cash equivalent assets to the extent of the value mentioned in the agreement.

3 METHOD OF FILING OF TAX RETURN

3.1 Method of filing of Tax Return [Sec 114(2) & 118]

A return of income shall be in the prescribed form and shall be accompanied by such annexure, statements or documents as may be prescribed;

- a) shall fully state all the relevant particulars or information as specified in the form of return, including a declaration of the records kept by the taxpayer; and
- b) shall be signed by the person, being an individual, or the person's representative where section 172 applies.
- c) shall be accompanied with due payment of tax as per return of income;
- d) shall be accompanied with a wealth statement as required under section 116 and
- e) shall be accompanied with a foreign income and assets statement as required under section 116A.

A return of income filed electronically on the web or any magnetic media or any other computer readable media as may be specified by the Board shall also be deemed to be a return and the Board may, by notification in the official Gazette, make rules for determining eligibility of the data of such returns and e-intermediaries who will digitise the data of such returns and transmit the same electronically to the Income Tax Department under their digital signatures and other matters relating to electronic filing of returns, statements or documents etc..

Every return purporting to be made or signed by, or on behalf of a person shall be treated as having been duly made by the person or with the person's authority until the person proves the contrary.

4 REVISION OF TAX RETURN

4.1 Filing of revised return or statement

Any person who, having furnished a return, discovers any omission or wrong statement therein, may file revised return subject to the following conditions, namely:

- f) it is accompanied by the revised accounts or revised audited accounts, as the case may be;
Provided that Commissioner may waive this condition if Commissioner is satisfied that filing of revised accounts or audited accounts is not necessary.
- g) the reasons for revision of return, in writing, duly signed, by the taxpayers are filed with the return;
- h) it is accompanied by approval of the Commissioner in writing for revision of return. However, this condition shall not apply if revised return is filed within sixty (60) days of filing of return. Further, where the Commissioner has not made an order or approval in writing, for revision of return, before the expiration of sixty days from the date when the revision of return of sought, the approval so required shall be deemed to have been granted by the Commissioner, and the specified condition shall not apply. The mode and manner for seeking the permission for revision shall be prescribed by the Board; and
- i) taxable income declared is not less than and loss declared is not more than income or loss, as the case may be, determined by an order issued under Best Judgement assessment, Amendment of assessment, Revision by the Commissioner, Decision in appeal, Disposal of appeals by the Appellate Tribunal, Reference to High Court or Rectification of mistakes under sections 121, 122, 122A, 129, 132, 133 or 221. (These sections are discussed in detail in the next chapter)

If any of the above conditions is not fulfilled, the return furnished shall be treated as an invalid return as if it had not been furnished.

Provided also that condition specified in clause (c) shall not apply and the approval required thereunder shall be deemed to have been granted by the Commissioner, if-

- a) the Commissioner has not made an order of approval in writing, for revision of return, before the expiration of sixty days from the date when the revision of return was sought; or
- b) taxable income declared is more than or the loss declared is less than the income or loss, as the case may be, determined under Assessments (section 120).

4.2 Procedure for filing of revised return and statement [S 114(6A)]

If a taxpayer files a revised return voluntarily along with deposit of the amount of tax short paid or amount of tax sought to be evaded along with the default surcharge, whenever it comes to his notice, before receipt of notice under sections 177 (Audit) or section 122(9) (Amendment of Assessments), no penalty shall be recovered from him

In case the taxpayer deposits the amount of tax as pointed out by the Commissioner during the audit or before the issuance of notice under the provisions of Amendment of Assessments (sub-section (9) of section 122), he shall deposit the amount of tax sought to be evaded, the default surcharge and twenty-five per cent of the penalties leviable under the ordinance along with the revised return:

In case the taxpayer revises the return after the issuance of a show cause notice under sub-section (9) of section 122, he shall deposit the amount of tax sought to be evaded, default surcharge and fifty per cent of the leviable penalties under the ordinance along with the revised return and thereafter, the show cause notice shall stand abated.

5 DUE DATES FOR FILING TAX RETURN

5.1 Due dates for filing tax returns

Following are the different dates for tax reporting purposes

Section	Tax Return Filer	Return Period	Due Date
118(1)	A return of income of a company	Tax year ending between 1 st January to 30 June	On or before 31 December next following the end of the tax year
118(1) & (3)	All other cases of person filing returns including companies other than above.	All year ends	On or before 30 September next following the end of tax year
118(5)	Return in response to notice under section 117 (discontinuance of business)	Year end as specified in notice	Due date fixed for submission of tax return.
114(4)	Return in response to notice under section 114(5) (return liable to be filed but not filed)	Year end as specified in notice	Due date specified in the notice for submission of tax return or thirty days from the date of issuance of notice.

According to section 118(2A), where salary income for the tax year is Rs.500,000 or more, the taxpayer is required to file return of income electronically in the prescribed form and it shall be accompanied by the proof of deduction or payment of tax and wealth statement as required under section 116. However, according to SRO 791(I)/2015 dated 10 August 2015 it has been directed that all individuals earning taxable salary shall be liable to file their returns electronically from tax year 2015 onwards. Consequently, the threshold of Rs.500,000 or more, as stated above, shall no more be applicable.

6 FILING OF WEALTH STATEMENT

6.1 Wealth statement [Sec 116]

Wealth statement is a statement of assets and liabilities, for any year, which a person is required to file, in the prescribed form and verified in prescribed manner giving particulars of

- the person's total assets including foreign assets and liabilities including foreign liabilities as on the date or dates specified in such notice;
- the total assets including foreign assets and liabilities including foreign liabilities of the person's spouse, minor children, and other dependents as on the date or dates specified in such notice;

Explanation: For removal of doubt, it is clarified that assets of spouse shall only be included in the wealth statement of the person if the spouse is dependent.

- any assets including foreign assets transferred by the person to any other person during the period or periods specified in such notice and the consideration for the transfer; and
- the total expenditures incurred by the person, and the person's spouse, minor children, and other dependents during the period or periods specified in the notice and the details of such expenditures; and
- the reconciliation statement of wealth.

Every resident taxpayer being an individual, filing a return of income for any tax year shall furnish a wealth statement and wealth reconciliation statement for that year along with such return.

Further, every member of an association of persons shall also furnish wealth statement and wealth reconciliation statement for the year along with return of income of the association.

Where a person, who has furnished a wealth statement, discovers any omission or wrong statement therein, he may, without prejudice to any liability incurred by him under any provision of this ordinance, furnish a revised wealth statement along with the revised wealth reconciliation and the reasons for filing revised wealth statement, under intimation to the commissioner in the prescribed form and manner, at any time before the receipt of notice for amendment in assessment, for the tax year to which it relates, is made;

Provided that where the Commissioner is of the opinion that the revision under this sub section is not for the purpose of correcting a bona fide omission or wrong statement, he may declare such revision as void through an order in writing after providing opportunity of being heard.

Explanation: For the removal of doubt it is clarified that wealth statement cannot be revised after the expiry of five years from the due date of filing of return of income for that tax year.

6.2 Foreign Income and Assets Statement [Sec 116A]

- Every resident taxpayer being an individual having foreign income of not less than ten thousand United States dollars or having foreign assets with a value of not less than one hundred thousand United States dollars shall furnish a statement, hereinafter referred to as the foreign income and assets statement, in the prescribed form and verified in the prescribed manner giving particulars of —
 - a) the person's total foreign assets and liabilities as on the last day of the tax year;
 - b) any foreign assets transferred by the person to any other person during the tax year and the consideration for the said transfer; and
 - c) Complete particulars of foreign income, the expenditure derived during the tax year and the expenditure wholly and necessarily for the purposes of deriving the said income.
- The Commissioner may by a notice in writing require any person being an individual who, in the opinion of the Commissioner on the basis of reasons to be recorded in writing, was required to furnish a foreign income and assets statement but who has failed to do so to furnish the foreign income and assets statement on the date specified in the notice.”;

6.3 How to prepare a wealth statement

Preparation of wealth statement is a technical task but familiarity with the method of preparation of financial statements helps a lot in solving such problems. The manner of preparation of wealth statements is given hereunder:

Wealth statement is primarily a balance sheet of an individual taxpayer where personal assets and liabilities of a person are reflected on any given date i.e. the date on which the taxpayer closes his accounts or the date as demanded through a notice in writing. It is worthwhile to mention here that wealth statement only gives details of personal assets and liabilities held by a person but does not reflect the status of business assets and liabilities. However, it does show net equity or shareholding of that person in any business. A wealth statement is incomplete without reconciliation statement showing accretion, no change or decrease in wealth.

Cash and bank reconciliation statement is derived from the cash and bank account. It starts from taking opening balance of cash and bank balances and after adding cash inflows and subtracting cash outflows, the remaining amount portrays closing balances of cash and bank account(s). This closing balance is included in the assets of the wealth statement. It is important to bear in mind that where expenditure side is not explained through the cash receipt side, then the difference could be un-explained investment as income for the year. To avoid this treatment, figures need to be tallied with investments worked out through wealth reconciliation statement.

Now after taking the figure of the cash and bank reconciliation, wealth statement for the current year is complete and a person can easily calculate the figure of increase/decrease in the net wealth by subtracting the last year's net wealth figure from the current year's net wealth figure shown in the current year wealth statement.

While preparing wealth statement assets and liabilities are recorded at historical cost irrespective of their present market value.

6.4 Exercise

► *Exercise:*

Mr. Nadeem has filled following wealth statement as on 30.06.2025

	Rupees
Plot in Lahore	3,500,000
Capital in ABC & Co	2,500,000
Jewelry	500,000
Shares in XYZ (Pvt.) Ltd	1,000,000
Bank	3,500,000
TOTAL ASSETS	11,000,000
Less: Personal Loan	(1,000,000)
TOTAL WEALTH	10,000,000

During the year following information is provided:

He earned salary income of Rs. 1,300,000 and paid tax Rs.100,000.

He sold share of Rs. 200,000 for a consideration of Rs. 350,000.

He settled his personal loan of Rs. 500,000.

His household expenses aggregates to Rs. 850,000.

He has given gift of Rs. 400,000 to his brother Kamran through crossed cheque.

He has earned profit on ABC & Co of Rs.450,000. His drawings from the firm during the year was Rs. 275,000. He paid tax of Rs. 40,000 on firm income.

He purchased a new plot at XYZ society for total consideration Rs. 2,000,000 payable in 20 installments. During the year he paid Rs. 700,000 in installments.

On 30th June 2026, his bank balance was Rs. 475,000.

Required:

Prepare the wealth reconciliation statement and wealth statement as on June 30, 2026.

► **Answer**

MR. NADEEM

Wealth reconciliation statement

	Amount
<i>Opening Wealth</i>	10,000,000
Add: Sources	
Salary Income	1,300,000
Gain on sale of shares	150,000
Profit on ABC & CO	450,000
Total	11,900,000
Less:	
Gift to brother	400,000
Tax deducted from salary	100,000
Tax on profit of ABC & Co.	40,000
Household expenses	850,000
	1,390,000
Total (Rs. 11,900,000–1,390,000)	10,510,000
Note 2	
Cash and Bank Reconciliation	
Opening bank	3,500,000
Add:	
Salary	1,300,000
Drawings	275,000
Sale of shares	350,000
	1,925,000
Total	5,425,000
Less:	
House hold expenses	850,000
Taxes	140,000
Gift	400,000
Plot instalments	700,000
Loan instalment	500,000
	2,590,000
	2,835,000

	Amount
Wealth statement 2026	
Plot in Lahore	3,500,000
Capital in ABC (Note 1)	2,675,000
Advance for plot at XYZ society	700,000
Jewellery	500,000
Shares in XYZ	800,000
Bank	2,835,000
Total	11,010,000
Less:	
Loan	(500,000)
Closing wealth	10,510,000
Note 1: Capital	
Opening	2,500,000
Profit	450,000
	2,950,000
Drawings	275,000
Total	2,675,000

7 FILING OF TAX RETURN ON DISCONTINUANCE OF BUSINESS

7.1 Notice of discontinued business [Sec 117]

Any person discontinuing a business shall give the Commissioner a notice in writing to that effect within fifteen days of the discontinuance.

The person discontinuing a business shall, under the provisions of the Ordinance or on being required by the Commissioner by notice, in writing, furnish a return of income for the period commencing on the first day of the tax year in which the discontinuance occurred and ending on the date of discontinuance and this period shall be treated as a separate tax year for the purposes of this Ordinance.

Where no notice has been given by taxpayer but the Commissioner has reasonable grounds to believe that a business has discontinued or is likely to discontinue, the Commissioner may serve a notice on the person who has discontinued the business or is likely to discontinue the business to furnish to the Commissioner within the time specified in the notice a return of income for the period specified in the notice.

A return furnished under this case shall be treated for all purposes of the Ordinance as a return of income, including the application of Section 120.

In case of non-compliance to file return in response to notice by CIR, the CIR may proceed with best judgment assessment u/s 121. To determine taxable income for best judgment assessments, CIR may use sectoral benchmark ratios (GP ratio, wastage ratio, NP ratio etc.) as notified by the Board.

8 EXTENSION OF TIME FOR FURNISHING OF TAX RETURN

8.1 Extension of time for furnishing returns and other documents [Sec 119]

A person required to furnish return or wealth statement may apply, in writing, to the Commissioner for an extension of time to furnish the return or wealth statement, as the case may be.

The application for extension must be made by the due date of filing of the return or wealth statement, as the case may be.

Extension in due date may be granted if the Commissioner is satisfied that the taxpayer was unable to furnish return, or statement due to

- a) absence from Pakistan;
- b) sickness or other misadventure; or
- c) any other reasonable cause

An extension of time as discussed above should not exceed fifteen days from the due date for furnishing the return of income or statement, as the case may be, unless there are exceptional circumstances justifying a longer extension of time.

Provided that where the Commissioner has not granted extension for furnishing return under sub-section (3) or sub-section (4), the Chief Commissioner may on an application made by the taxpayer for extension or further extension, as the case may be, grant extension or further extension for a period not exceeding fifteen days unless there are exceptional circumstances justifying a longer extension of time.”;

An extension of time granted as discussed above shall not change the due date for payment of income tax payable on the basis of return and default surcharge shall be chargeable for delayed payment of tax due.

Important Dates

Para No.	Context / Section	Relevant Date / Deadline	Details
1.1	Normal Tax Year	Jul-01 to June	A tax year in Pakistan starts on July 1 of the previous year.
5.1	Filing deadline for companies with year ending Jan to June	December 31	Section 118(1)
5.1	Filing deadline for all other cases	September 30	Section 118(1) & 118(3)
5.1	Filing upon discontinuation of business	As specified in notice	Section 118(5); must respond by the date fixed in notice.
5.1	Filing on Commissioner's notice (Sec 114(4))	Within 30 days or as specified in notice	Applies if return was not filed and Commissioner issues a notice.
4.1	Filing revised return	Within 60 days (without needing Commissioner's approval)	After this, written approval is required unless deemed granted due to delay in response.
8.1	Extension of filing deadline	Application before due date; up to 15 days (usually)	Under exceptional circumstances, longer extension possible by Chief Commissioner.
6.1	Wealth Statement revision limit	Within 5 years from due date	Cannot revise after 5 years from the original due date of return.
7.1	Notice for business discontinuance	Within 15 days of discontinuation	Section 117 requires written notice to Commissioner.

ASSESSMENT, RECORDS AND AUDIT

IN THIS CHAPTER:

1. Assessment
2. Special provisions with respect to assessment
3. Amendment of assessment
4. Action against assessment / Amended assessment order
5. Records and Audit

1 ASSESSMENT

1.1 Assessment

► Definitions:

Sec 2(5), “assessment” includes provisional assessment, re-assessment and amended assessment and the cognate expressions shall be construed accordingly.

Sec 2(5A), “assessment year” means assessment year as defined in the repealed Ordinance

Assessment under the Income Tax Ordinance, 2001 is generally made on the basis of returns filed for a tax year. This is termed as Universal Self-Assessment Scheme (USAS) by the FBR, though no such words are used in the Ordinance.

1.2 Ways of framing the assessment

Various ways of framing the assessment under the Income Tax Ordinance, 2001 are as under:

- Normal assessment, usually referred to as ‘assessment’
- Best judgment assessment
- Provisional assessment in certain cases

Now we will discuss them one by one in the ensuing paragraphs.

1.3 Normal assessment [Sec 120]

- Section 120 of the Ordinance states that: If a taxpayer has furnished a complete return of income other than a revised return, the Commissioner shall be treated to have assessed the income and tax due thereon equal to the respective amounts adjusted under section 120(2A)
- Return shall be treated to be an assessment order issued to the taxpayer by the Commissioner on the day the adjustments were made under section 120(2A).
- Return shall be taken to be complete if it is in the prescribed form accompanied by such annexures, statements or documents, fully state all the relevant particulars or information, duly signed with evidence of payment due and accompanied with a wealth statement in accordance with section 114(2).

Adjustments to be made in declared respective amounts of the return [Section 120(2A)]

A return of income furnished under sub-section (2) of section 114 shall be processed through automated system to arrive at correct amounts of total income, taxable income and tax payable by making adjustments for—

- i. any arithmetical error in the return;
- ii. any incorrect claim, if such incorrect claim is apparent from any information in the return;
- iii. disallowance of any loss, deductible allowance or tax credit as specified; and
- iv. disallowance of carry forward of any loss under clause (b) of sub-section (1) of section 182A.

Provided that no such adjustments shall be made unless a system generated notice is given to the taxpayer specifying the adjustments intended to be made:

Provided further that the response received from the taxpayer, if any, shall be considered before making any adjustment, and in a case where no response is received within 30 days of the issue of such notice, adjustments shall be made.

Provided also that where no such adjustments have been made within 6 month of filing of return, the amounts specified in the return as declared by the taxpayer shall be deemed to have been taken as adjusted amounts on the day the return was filed and the taxpayer shall be intimated automatically through IRIS.

Provided also that the provisions of this sub-section shall apply from the date notified by the Federal Board of Revenue in the official Gazette.]

Note: FBR has thus far not notified any date. Resultantly, the concept of self-assessment is still applicable.

(7) For the purposes of this section,—

- a) **"arithmetical error"** includes any wrong or incorrect calculation of tax payable including any minimum or final tax payable.
- b) **"an incorrect claim apparent from any information in the return"** shall mean a claim, on the basis of an entry, in the return,—
 - i. of an item, which is inconsistent with another entry of the same or some other item in such return;
 - ii. regarding any tax payment which is not verified from the collection system; or
 - iii. in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction.
- However, in addition to above deemed assessment, the Commissioner has powers to conduct audit of income tax affairs of any person under section 177 and all the provisions of that section shall apply accordingly.

Assessment in case of incomplete return

- If the return of income furnished is not complete, the Commissioner shall issue a notice to the taxpayer informing him of the deficiencies (other than incorrect amount of tax payable on taxable income, as specified in the return, or short payment of tax payable) and directing him to provide certain information, particulars, statement or documents by the date specified in the notice in order to make the return a 'complete return'.
- If a taxpayer fails to fully comply, by the due date, with the requirements of the notice the return furnished shall be treated as an invalid return as if it had not been furnished. However, if the taxpayer fully complies with the requirements of the notice, by the due date, the return furnished shall be treated to be complete on the day it was furnished.
- Such notice shall not be issued after expiry of 180 days from the end of the financial year in which return was furnished.

1.4 Best judgment assessment [Sec 121]

- This type of judgment is made where a person fails to:
 - furnish return of income in response to notice of a Commissioner under sub section (3) or sub section (4) of section 114; or
 - furnish a return as required under section 143 or section 144 (return to be filed by air carrier or shipping companies); or
 - furnish the wealth statement as required under section 116; or
 - furnish return of income in response to notice under sec 117(3) notice of business discontinuance. produce before the commissioner, or a special audit panel appointed under sub-section (11) of section 177 or any person employed by a firm of chartered accountants or a firm of cost and management accountants under section 177, accounts, documents and records required to be maintained under section 174, or any other relevant document or evidence that may be required by him for the purpose of making assessment of income and determination of tax due thereon.
- Under any of the above cases, the Commissioner may, based on any available information or material and to the best of his judgment, make an assessment of the taxable income of the person and the tax due thereon. Under such a case, the assessment, if any, treated to have been made on the basis of return or revised return filed by the taxpayer shall be of no legal effect.
- For the purposes of making a best judgment assessment, the Commissioner may determine taxable income on the basis of sectoral benchmark ratios prescribed by the Board.

- **Explanation:** The expression **sectoral benchmark ratios** means standard business sector ratios notified by the Board on the basis of comparative cases and includes financial ratios, production ratios, gross profit ratio, net profit ratio, recovery ratio, wastage ratio and such other ratios in respect of such sectors as may be prescribed.
- As soon as possible after making a best judgment assessment, the Commissioner shall issue the assessment order to the taxpayer stating:
 - the taxable income;
 - the amount of tax due;
 - the amount of tax paid, if any; and
 - the time, place and manner of appealing against the assessment order.
- An assessment order under section 121 shall only be issued within six years from the end of the tax year to which it relates.

Provided that where notice for furnishing a return of income to any person under sub-section (4) of section 114 is issued by a Commissioner in respect of one or more of the last ten completed tax years in pursuance of proviso to sub-section (5) of section 114, an assessment order under this section shall only be issued within two years from the end of tax year in which such notice is issued.

1.5 Provisional assessment in certain cases [Sec 123]

► Definitions:

Sec 2(13AA), concealment of income includes;

- a) the suppression of any item of receipt liable to tax in whole or in part, or failure to disclose income chargeable to tax;
- b) claiming any deduction or any expenditure not actually incurred;
- c) any act referred to in sub-section (1) of section 111; and
- d) claiming of any income or receipt as exempt which is otherwise taxable.

Explanation - For removal of doubt it is clarified that none of the aforementioned acts would constitute concealment of income unless it is proved that taxpayer has knowingly and willfully committed these acts;

Sec 123(3) Concealed asset means any property or asset which, in the opinion of Commissioner, is acquired from any income chargeable to tax but could not be charged to tax.

- This type of assessment is applicable in case where any concealed asset of a person is impounded by any agency of Federal or Provincial Government. In such a case, the Commissioner is empowered to make provisional assessment before making a best judgment assessment or amended assessment.
- Where an offshore asset of any person, not declared earlier, is discovered by the Commissioner or any department or agency of the Federal Government or a Provincial Government, the Commissioner may at any time before issuing any assessment order under section 121 or amended assessment order under section 122, issue to the person a provisional assessment order or provisional amended assessment order, as the case may be, for the last completed tax year of the person taking into account the offshore asset discovered.
- Where any concealed asset is impounded, it shall be taken into account in the computation of taxable income and tax payable for the last completed tax year of the person during which the concealed asset was accounted for.
- The Commissioner shall finalize the provisional order or provisional amended assessment order as soon as possible.

2 SPECIAL PROVISIONS WITH RESPECT TO ASSESSMENT

Following are three provisions which are associated with framing of assessment order:

2.1 Assessment in relation to disputed property [Sec 125]

Where the ownership of any property the income from which is chargeable to tax is in dispute in any civil court in Pakistan, an assessment order or amended assessment order in respect of such income may be issued at any time within one year after the end of the financial year in which the decision of the court is made.

2.2 Evidence of Assessment [Sec 126]

- The production of an assessment order or its certified copy shall be conclusive evidence of due making of assessment. The assessment order or its certified copy shall also be a conclusive evidence that the amounts and all other particulars are correct except in cases where the proceedings relating to assessment are under appeal.
- Any order of assessment or other document required to be made under Income Tax Ordinance, 2001, may not be:
 - i. quashed or void or voidable for want of form; or
 - ii. affected due to any mistake, defect or omission therein
- However, an order shall be quashed or void:
 - i. if it is in substance and effect, not in conformity with Income Tax Ordinance, 2001; or
 - ii. the person assessed or intended to be assessed or effected by the document is not designated in it according to common understanding.

3 AMENDMENT OF ASSESSMENT

3.1 Amendment of assessment [Sec 122]

Method of amendment of assessment is elaborated in section 122 of the Ordinance.

- Commissioner is empowered to amend an assessment order treated as issued on self-assessment basis u/s 120 or an assessment order made to the best of Commissioner's judgment u/s 121. The Commissioner may make such alteration or additions as he considers necessary.
- Amendment of assessment shall not be made after the expiry of 5 years, from the end of the financial year in which the order is issued or treated as issued.
- If a taxpayer furnishes a revised return of income
 - i. the Commissioner shall treat the revised return as amended assessment of the taxable income and tax payable thereon as set out in the revised return; and
 - ii. the taxpayer's revised return shall be taken to be an amended assessment order issued to the taxpayer by the Commissioner on the day the revised return was furnished.
- Commissioner is also empowered to amend further as many times as may be necessary, the original assessment order as amended previously within the later of:
 - i. five years from the end of the financial year in which the original assessment order is issued or treated as issued by the Commissioner; or
 - ii. one year from the end of the financial year in which the amended assessment order is issued or is treated as issued.
- An assessment order shall only be amended, or an amended assessment shall only be further amended as above, where the Commissioner has definite information, acquired from an audit or on the basis of definite information the Commissioner is satisfied, that:
 - i. any taxable income has escaped assessment;
 - ii. total income has been under assessed or assessed at too low tax rate or has been the subject of excessive relief or refund; or
 - iii. any amount under a head of income has been misclassified.
- Definite information includes information relating to sales or purchases of any goods made by the taxpayer, receipts of the taxpayer from services rendered or other receipts relating to the acquisition / possession / disposal of any money / asset / valuable article, or investment made or expenditure incurred by the taxpayer.
- The Commissioner may amend, or further amend, an assessment order, if he considers that it is erroneous in so far it is prejudicial to the interest of revenue.
- Once the order of assessment is amended, the Commissioner shall issue an amended assessment order as soon as possible stating:
 - i. the amended taxable income of taxpayer;
 - ii. the amended amount of tax due;
 - iii. the amount of tax paid, if any, and
 - iv. the time, place and manner of appealing the amended assessment
- No assessment shall be amended or further amended without giving the taxpayer an opportunity of being heard.
- Order under this section shall be made within one year of issuance of show cause notice or within such extended period as the Commissioner may, for reasons to be recorded in writing, so however, such extended period shall in no case exceed ninety days.

- Any period during which the proceedings are adjourned on account of a stay order or Alternative Dispute Resolution proceedings or agreed assessment proceedings under section 122D or the time taken through adjournment by the taxpayer not exceeding sixty days shall be excluded from the computation of the period specified above.

3.2 Detailed explanation

The above provisions relating to amendment of assessment carry much significance. Following points should be kept in mind:

1. An assessment can only be amended in two situations i.e. on the basis of audit or on the basis any definite information or where the assessment is erroneous and prejudicial to the interest of revenue.
2. An assessment can be erroneous however, in case the same is not prejudicial to the interest of revenue then tax authorities cannot initiate the proceedings of amendment of assessment under section 122(5A) of the Ordinance. Thus, co-existence of both situations i.e. first error in the assessment secondly tax loss suffered by the tax authorities, is very necessary to invoke provisions of section 122(5A) [amendment of assessment].
3. Any change of opinion does not constitute any definite information or makes the assessment as erroneous and prejudicial to the interest of revenue.
4. No amendment is allowed unless the taxpayer has been given proper opportunity of being heard.

4 ACTION AGAINST ASSESSMENT/AMENDED ASSESSMENT ORDER

4.1 Duties

From the Tax department

- Revision by the Commissioner
- Revision by the Chief Commissioner
- Modification of orders

From the Tax payer

- Rectification of mistake
- Appeal (see Chapter 16)
- Alternate dispute resolution committee (see Chapter 16)

4.2 Revision of assessment by the Commissioner [Sec 122A]

Process of revision of assessment is defined in section 122A of the Ordinance in the following manner:

- The Commissioner may, suo-moto call for the record of any proceeding in which an order has been passed by any Officer of Inland Revenue.
- Where, after making such inquiry as is necessary, Commissioner considers that the order requires revision, the he may make such revision to the order as he deems fit.
- Any such order shall not be prejudicial to the person to whom the order relates.
- The Commissioner shall not revise any order if:
 - a) an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal and the time within which such appeal may be made has not expired; or
 - b) The order is pending in appeal before the Commissioner (Appeals) or has been made the subject of an appeal to the Appellate Tribunal.
- If any order is remanded back to any lower authority by the Commissioner for modification, alteration, implementation of directions or de novo proceedings, the order giving effect to the directions of the Commissioner shall be issued within one hundred and twenty days.

4.3 Revision by Chief Commissioner [Sec 122B]

- The Chief Commissioner may, either of his own motion or on an application made by the taxpayer for revision, call for the record of any proceedings relating to issuance of an exemption or lower rate certificate with regard to collection or deduction of tax at source under Income Tax Ordinance, 2001. Record of such proceedings shall be called in which an order has been passed by any authority subordinate to him.
- If, after making such inquiry as is necessary, The Chief Commissioner considers that the order requires, revision, he may make such order as he may deem fit in the circumstances of the case. However, he shall provide a reasonable opportunity of being heard to the taxpayer.

4.4 Powers of tax authorities to modify orders, etc. [Sec 124A]

- The modification of orders is elaborated in section 124A of the Ordinance in the following way: This applies where a question of law is decided either by a High Court or the Appellate Tribunal in case of a taxpayer.
- In such a case the Commissioner may proceed to amend the assessment, to the extent it needs revision due to the decision of High Court or Appellate Tribunal on the question of law. In this regards the Commissioner shall ignore the fact that either an appeal is preferred or an application for reference is made against the order of High Court or Appellate Tribunal.

- Where decision of High Court or Appellate Tribunal is reversed or modified, the Commissioner may modify assessment in which the said decision was followed within one year of the date of receipt of decision. In making such modification, the provisions of Income Tax Ordinance, 2001 relating to time limit for making an assessment or amended assessment shall be ignored.

4.5 Agreed assessment in certain cases [Sec 122D]

- Where a taxpayer, in response to a notice under sub-section (9) of section 122-Amendment of assessment, intends to settle his case, he may file offer of settlement in the prescribed form before the assessment oversight committee, hereinafter referred to as the Committee, in addition to filing reply to the Commissioner.
- The Committee after examining the aforesaid offer may call for the record of the case and after affording opportunity of being heard to the taxpayer, may decide to accept or modify the offer of the taxpayer through consensus and communicate its decision to the taxpayer.
- Where the taxpayer is satisfied with the decision of the Committee:
 - c) the taxpayer shall deposit the amount of tax payable including any amount of penalty and default surcharge as per decision of the Committee;
 - d) the Commissioner shall amend assessment in accordance with the decision of the Committee after tax payable including any amount of penalty and default surcharge as per decision of the Committee has been paid;
 - e) the taxpayer shall waive the right to prefer appeal against such amended assessment; and
 - f) no further proceedings shall be undertaken under this Ordinance in respect of issues decided by the Committee unless the tax as per clause (c) has not been deposited by the taxpayer.
- Where the Committee has not been able to arrive at a consensus or where the taxpayer is not satisfied with the decision of the Committee, the case shall be referred back to the Commissioner for decision on the basis of reply of the taxpayer in response to notice under sub-section (9) of section 122 notwithstanding proceedings or decision, if any, of the Committee.
- The Committee shall comprise the following income tax authorities having jurisdiction over the taxpayer, namely:-
 - a) the Chief Commissioner Inland Revenue;
 - b) the Commissioner Inland Revenue; and
 - c) the Additional Commissioner Inland Revenue.
- This section shall not apply in cases involving concealment of income or where interpretation of question of law is involved having effect on other cases.

5 RECORDS AND AUDIT

5.1 Records [Sec 174]

- Every taxpayer shall maintain in Pakistan such accounts, documents and records as may be prescribed.
- The Commissioner may disallow or reduce a taxpayer's claim for a deduction if the taxpayer is unable, without reasonable cause to provide a receipt, or other record or evidence of the transaction or circumstances giving rise to the claim for the deduction.
- The accounts and documents required to be maintained shall be maintained for six years after the end of the tax year to which they relate;
- However, where any proceeding is pending before any authority or court the taxpayer shall maintain the record till final decision of the proceedings.
- Moreover, time limit of 6 years will not be applicable in case of foreign source income, assets, expenses etc. and taxpayer is required to maintain record for indefinite period of time.
- Pending proceedings include proceedings for assessment or amendment of assessment, appeal, revision, reference, petition or prosecution and any proceedings before an Alternative Dispute Resolution Committee.
- Deduction means any amount debited to trading account, manufacturing account, receipts and expenses account or profit and loss account.
- The Commissioner may require any person to install and use an Electronic Tax Register of such type and description as may be prescribed for the purpose of storing and accessing information regarding any transaction that has a bearing on the tax liability of such person.

► **Definition:**

Sec 2(19C), "electronic record" includes the contents of communications, transactions and procedures under this Ordinance, including attachments, annexes, enclosures, accounts, returns, statements, certificates, applications, forms, receipts, acknowledgements, notices, orders, judgments, approvals, notifications, circulars, rulings, documents and any other information associated with such communications, transactions and procedures, created, sent, forwarded, replied to, transmitted, distributed, broadcast, stored, held, copied, downloaded, displayed, viewed, read, or printed, by one or several electronic resources and any other information in electronic form

5.2 Prescribed books of accounts (Rule 28-33)

Rule	Taxpayer required to maintain proper books of account, documents and records	Records to be kept
28	Every taxpayer deriving income from business	• all sums of money received and expended by the taxpayer and the matters in respect of which the receipt and expenditure takes place. • all sales and purchases of goods and all services provided and obtained by the taxpayer. • all assets of the taxpayer • all liabilities of the taxpayer; and • in case of a taxpayer engaged in assembly, production, processing, manufacturing, mining or like activities, all items of cost relating to the utilization of materials, labour and other inputs.

Rule	Taxpayer required to maintain proper books of account, documents and records	Records to be kept
		- the books of account, documents and records to be maintained under this chapter shall be maintained for six years after the end of the tax year to which they relate. - the provision of maintaining the books shall not apply where any proceeding under the Ordinance is pending before any authority or court the taxpayer shall maintain the record till final decision of the proceedings.
29	Every taxpayer other than companies, deriving income chargeable under the head Income from business	
30(1)	Taxpayers with business income upto Rs.500,000 and new taxpayers deriving income from business	- Serially numbered and dated cash-memo / invoice / receipt for each transaction of sale or receipt containing the following - taxpayer's name or the name of his business, address, national tax number or CNIC and sales tax registration number, if any - the description, quantity and value of goods sold or services rendered; - Where each transaction does not exceed - Rs. 100, one or more cash-memos per day for all such transactions may be maintained - Daily record of receipts, sales, payments, purchases and expenses a single entry in respect of daily receipts, sales, purchases and different heads of expenses will suffice; and - Vouchers of purchases and expenses.
30(2)	Taxpayers with business income exceeding Rs. 500,000 and wholesalers, distributors, dealers and commission agents	- Serially numbered and dated cash-memo / invoice / receipt for each transaction of sale or receipt containing the following - taxpayer's name or the name of his business, address, national tax number or CNIC and sales tax registration number, if any - the description, quantity and value of goods sold or services rendered; and - in case of a wholesaler, distributor, dealer and commission agent, where a single transaction exceeds Rs. 10,000, the name and address of the customer Provided that where each transaction does not exceed Rs.100, one or more cash-memos per day for all such transactions may be maintained - Cash book and/or bank book or daily record of receipts, sales, payments, purchases and expenses; a single entry in respect of daily receipts, sales, purchases and different heads of expenses will suffice.

Rule	Taxpayer required to maintain proper books of account, documents and records	Records to be kept
		- General ledger or annual summary of receipts, sales, payments, purchases and expenses under distinctive heads. - Vouchers of purchases and expenses and where a single transaction exceeds Rs. 10,000 with the name and address of the payee; and - Where the taxpayer deals in purchase and sale of goods, quarterly inventory of stock-in-trade showing description, quantity and value.
30(3).	Professionals like medical practitioners, legal practitioners, accountants, auditors, architects, engineers etc.	- Serially numbered and dated patient-slip / invoice /receipt for each transaction of sale or receipt containing the following - taxpayer's name or the name of his business or profession, address, national tax number or CNIC and sales tax registration number, if any - the description, quantity and value of medicines supplied or details of treatment/ case/ services rendered (confidential details are not required) and amount charged - the name and address of the patient / clien Provided that the condition of recording address of the patient on the patient slip under this clause shall not apply to general medical practitioners
		- Daily appointment and engagement diary in respect of clients and patients provided that this clause shall not apply to general medical practitioners - Daily record of receipts, sales, payments, purchases and expenses; a single entry in respect of daily receipts, sales, purchases and different heads of expenses will suffice - Vouchers of purchases and expenses
30(3).330d.	Manufacturers (with turnover exceeding Rs. 2.5 million): [30(4)]	- Serially numbered and dated cash-memo / invoice /receipt for each transaction of sale or receipt containing the following - taxpayer's name or the name of his business address, national tax number or CNIC and sales tax registration number, if any - the description, quantity and, value of goods sold - where a single transaction exceeds Rs. 10,000 with the name and address of the customer - Cash book and/or bank book - Sales day book and sales ledger (where applicable) - Purchases day book and purchase ledger (where applicable)

Rule	Taxpayer required to maintain proper books of account, documents and records	Records to be kept
		- General ledger - Vouchers of purchases and expenses and where a single transaction exceeds Rs. 10,000 with the name and address of the payee; - Stock register of stock-in-trade (major raw materials and finished goods) supported by gate in-ward and outward records and quarterly inventory of all items of stock-in-trade including work-in-process showing description, quantity and value.
31.	Every taxpayer deriving income chargeable under the head income from salary, property, capital gains or other sources	Salary - Salary certificate indicating the amount of salary and tax deducted there from. Income from property - Tenancy agreement, if executed - Tenancy termination agreement, if executed - Receipt for amount of rent received - Evidence of deductions claimed in respect of premium paid to insure the building, local rate, tax, charge or cess, ground rent, profit/interest or share in rent on money borrowed, expenditure on collecting the rent, legal services and unpaid rent. Capital gain - Evidence of cost of acquiring the capital asset - Evidence of deduction for any other costs claimed - Evidence in respect of consideration received on disposal of the capital asset. Income from other sources Dividends - Dividend warrants Royalty - Royalty agreement. Profit on debt - Evidence and detail of profit yielding debt - Evidence of profit on debt and tax deducted thereon, like certificate in the prescribed form or bank account statement; and - Evidence of Zakat deducted, if any.

Rule	Taxpayer required to maintain proper books of account, documents and records	Records to be kept
		Ground rent, rent from the sub-lease of land or building, income from the lease of any building together with plant or machinery and consideration for vacating the possession of a building or part thereof a) Lease agreement b) Lease termination agreement. Annuity or Pension - Evidence of amount received. Prize money on bond, winning from a raffle, lottery or cross word puzzle - Evidence of income and tax deducted thereon, like certificate in the prescribed form. Provision, use or exploitation of property - Agreement. Loan, advance, deposit or gift - Evidence of mode of receipt of a loan, advance, deposit or gift i.e., by a crossed cheque or through a banking channel. General - Evidence of deduction for any other expenditure claimed.

5.3 Books of accounts, documents and records to be kept at specified place (Rule 33)

S. No	Taxpayer required to maintain proper books of account, documents and records	Records to be kept
1.	Income from business	The books of accounts, documents and records required to be maintained by a taxpayer shall be kept at the place where the taxpayer is carrying on the business or, where the business is carried on in more places than one, at the principal place of business or at each of such places if separate books of accounts are maintained in respect of each place.
2.	Income from sources other than business	Where a person derives income from sources other than from business, the books of accounts, documents and records shall be kept at the person's place of residence or such other place as may be so declared by such person.
3.	Place to be clearly stated on tax returns	The place or places where the books of accounts, documents and records are kept shall be clearly stated on the tax return form in the column requiring the details of the records maintained.

5.4 National Database and Registration Authority (Sec 175B)

- The National Database and Registration Authority shall, on its own motion or upon application by the Board, share its records and any information available or held by it, with the Board, for broadening of the tax base.
- The National Database and Registration Authority may identify in relation to any person, (whether a taxpayer or not) income, receipts, assets, properties, liabilities, expenditures, or transactions that have escaped assessment or are under-assessed or have been assessed at a low rate, or have been subjected to excessive relief or refund or have been misdeclared or misclassified under a particular head of income.
- The Board may use and utilize any information communicated to it by the National Database and Registration Authority and forward such information to an income tax authority having jurisdiction.
- The National Database and Registration Authority may compute indicative income and tax liability of anyone mentioned above by use of artificial intelligence, mathematical or statistical modelling or any other modern device or calculation method.
- The indicative income and tax liability computed by the National Database and Registration Authority shall be notified by the Board to the person in respect of whom such indicative income and tax liability has been determined, who shall have the option to pay the determined amount on such terms, conditions, instalments, discounts, reprieves pertaining to penalty and default surcharge, and time limits that may be prescribed by the Board.
- In case the person against whom a liability has been determined, does not pay such liability within the time prescribed, the Board shall take action under this Ordinance, upon the basis of tax liability computed above.
- If the person against whom the liability has been determined pays such liability, such payment shall be construed to be an amended assessment order under section 120 or sub-section (1) of section 122 or sub-section (4) of section 122 as the case may be.

5.5 Posting of officer of Inland Revenue (Sec-175C)

Subject to such conditions and restrictions, as deemed fit to be imposed, the Board or the Chief Commissioner may post an officer of Inland Revenue or such other officials with any designation working under the control of the Board or the Chief Commissioner, to the business premises of any person or class of such persons, to monitor production, supply of goods or rendering of services and the stock of goods not sold at any time for determining tax payable under this Ordinance

5.6 Audit [Sec 177]

- The Commissioner may call for any record or documents including books of accounts maintained under the Ordinance or any other law for the time being in force for conducting audit of the income tax affairs of the person
- Where such record or documents have been kept on electronic data, the person shall allow access to the Commissioner or the officer authorized by the Commissioner for use of machine and software on which such data is kept and the Commissioner or the officer may have access to the required information
- The Commissioner shall not call for record or documents of the taxpayer after expiry of six years from the end of the tax year to which they relate.
 - For the purpose of sub-section (2), the Commissioner may conduct audit proceedings electronically through video links, or any other facility as prescribed by the Board. [Section 177(2A)]
 - **Audit on the basis of sectoral Benchmark Ratios prescribed by the Board [Section 177(2AA)]**
Where a taxpayer—
 - a) has not furnished record or documents including books of accounts;
 - b) has furnished incomplete record or books of accounts; or

- c) is unable provide sufficient explanation regarding the defects in records, documents or books of accounts,
- d) it shall be construed that taxable income has not been correctly declared and the Commissioner shall determine taxable income on the basis of sectoral benchmark ratios prescribed by the Board.

Explanation— The expression “sectoral benchmark ratios” means standard business sector ratios notified by the Board on the basis of comparative cases and includes financial ratios, production ratios, gross profit ratio, net profit ratio, recovery ratio, wastage ratio and such other ratios in respect of such sectors as may be prescribed.”;

- After obtaining the record of a person, the Commissioner shall conduct an audit of the income tax affairs.
- After completion of the audit the Commissioner may, if considered necessary, after obtaining taxpayer’s explanation on all the issues raised in the audit, issue an audit report containing audit observations and findings.
- After issuing the audit report, the Commissioner may, if considered necessary, amend the assessment under sub-section (1) or sub-section (4) of section 122, as the case may be, after providing an opportunity of being heard to the taxpayer under sub-section (9) of section 122.”
- The provisions of section 177 shall not apply to a person whose income tax affairs have been audited in any of the preceding four tax years. However, Commissioner may select a person under section 177 for audit with the approval of the Board.
- The Board may appoint a firm of Chartered Accountants or a firm of Cost and Management Accountants to conduct an audit of the income tax affairs of any person or classes of persons and the scope of such audit shall be as determined by the Board or the Commissioner on a case to case basis.
- Where a person fails to produce before the Commissioner or a firm of Chartered Accountants or a firm of Cost and Management Accountants appointed by the Board or the Commissioner to conduct an audit, any accounts, documents and records, required to be maintained under section 174 or any other relevant document, electronically kept record, electronic machine or any other evidence that may be required by the Commissioner or the firm of Chartered Accountants or the firm of Cost and Management Accountants for the purpose of audit or determination of income and tax due thereon, the Commissioner may proceed to make best judgment assessment under section 121 and the assessment treated to have been made on the basis of return or revised return filed by the taxpayer shall be of no legal effect.
- Power of the Commissioner under section 177 is independent of the powers of the Board under section 214C and nothing contained in section 214C restricts the power of the Commissioner to call for the record or documents including books of accounts of a taxpayer for audit and to conduct audit under this section.
- The provision of section 177 for selection of person for audit shall not apply whose income tax affairs have been selected for audit in any of the preceding three tax years.
- Provided, Commissioner may select a person for audit u/s 177 with the approval of the Board.

Special Panel and its composition

The Board may appoint as many special audit panels as may be necessary, to conduct an audit, including a forensic audit, of the income tax affairs of any person or classes of persons and the scope of such audit shall be as determined by the Board or the Commissioner on a case to case basis. Relevant provisions in this regard are summarized below:

- a) The panel shall comprise of any two or more members from:
 - an officer of Inland Revenue;
 - a firm of chartered accountants;
 - a firm of cost and management accountants; or
 - any other person as directed by the Board.

- b) The Panel shall be headed by a Chairman who shall be an officer of Inland Revenue;
- c) Powers under section 175 and 176 for the purpose of conducting an audit shall only be exercised by an officer of Inland Revenue who are member or members of the panel, and authorized by the Commissioner;
- d) Where a person fails to produce before the Commissioner or a special audit panel appointed to conduct an audit, any accounts, documents and records, required to be maintained under section 174 or any other relevant document, electronically kept record, electronic machine or any other evidence that may be required by the Commissioner or the panel for the purpose of audit or determination of income and tax due thereon, the Commissioner may proceed to make best judgment assessment under section 121 and the assessment treated to have been made on the basis of return or revised return filed by the taxpayer shall be of no legal effect.
- e) If any member of the panel, not being the Chairman, is absent from conducting an audit, the proceedings may continue and the audit conducted by the special audit panel shall not be invalid or be called into question merely on account of such absence;
- f) Functions performed by the officer or officers of Inland Revenue as members of the special audit panel to conduct audit, shall be treated as having been performed by the special audit panel;
- g) The Board may prescribe the mode and manner of constitution, procedure and working of the special audit panel.

APPEALS, REFERENCES AND PETITIONS

IN THIS CHAPTER:

- 1 Appeals and circumstances giving rise to appeal
- 2 Appeals to the Commissioner (Appeals)
- 3 Appeals before Appellate Tribunal
- 4 Reference application before High Court
- 5 Alternative Dispute Resolution Committee
- 6 Other appeal related matters

1 APPEALS

1.1 What is appeal?

- Most appeals arise on account of disagreement between the taxpayer and the tax collectors (income tax department) regarding the quantification of the taxable income and tax liability thereon as well as levy of default surcharge, penalties, etc. To resolve such disagreements law lays down the procedure, which gives the taxpayer right of appeal.
- Usually an agreement is reached through correspondence or discussion and in most cases disputes are settled with the taxpayers at the Taxation Officer's / Commissioner's level, saving time and trouble all around.

1.2 Forums of appeals

Following forums of appeal are available to an aggrieved person:

- Commissioner (Appeals)
- Appellate Tribunal
- High Court
- Supreme Court of Pakistan (against decision of reference to High Court). (Although the Ordinance does not provide anything on the subject, but any person can prefer to SC under the Constitution); and
- Alternative Dispute Resolution

1.3 Circumstances giving rise to appeal to the Commissioner (Appeal) Circumstances giving rise to an appeal may include:

- i. A best judgment assessment (ex-parte assessment) based on any available information or material to the best of the Taxation Officer's / Commissioner's judgment.
- ii. An amendment of assessment
- iii. An order holding an individual personally liable to pay the amount of tax, which was required to be collected or deducted by him/her or having collected or deducted fails to pay the same as required by the law
- iv. An order declaring or treating a person as a representative of a non-resident person
- v. An order refusing to rectify the mistake, either in full or in part
- vi. An order having the effect of enhancing the assessment or reducing a refund or otherwise increasing the tax liability
- vii. No appeal in above cases, shall be made by a taxpayer against an order of assessment unless the taxpayer has paid the amount of tax due under subsection (1) of section 137 (tax due at time of furnishing the return).

2 APPEALS TO THE COMMISSIONER (APPEALS)

2.1 Procedure for filing of appeal before the Commissioner (Appeals)

The taxpayer may file appeal against an assessment or assessment order in addition to many other actions prejudicial to the taxpayer, before the Commissioner (Appeals). Section 127 deals with this issue in the following manner:

Filing of appeal to the Commissioner (Appeals)

- Any person other than State Owned Enterprise (SOE) who is aggrieved by an order passed by the Commissioner or a Taxation Officer, can file the appeal before the Commissioner (Appeals).
- **However, an aggrieved person may have the option to either file appeal before Commissioner (Appeals) directly or may surrender his right of appeal before Commissioner (Appeals) and avail the next statutory appellate forum by filing the appeal directly before the Appellate Tribunal Inland Revenue**
- Every appeal shall be filed in the prescribed form, verified in the prescribed manner, be accompanied by the prescribed fee and shall precisely state the grounds upon which the appeal is made.
- In case appeal is made against an order of assessment the application shall be accompanied by fee of Rs.5,000 where appellant is a company and Rs. 2,500 where appellant is not a company
- In case of any other order, fee of Rs. 5,000 in case of company and Rs. 1,000 in other cases, shall be payable.
- No appeal shall be filed if the taxpayer has not paid tax due u/s 137(1) (i.e.) tax payable with return).
- The appeal should be filed:
 - where the appeal relates to an order of assessment or penalty, within 30 days from the date of service of notice of demand u/s 137(2) in respect of any order of assessment or penalty; and
 - in any other case within 30 days of the service of intimation of order against which appeal is to be filed.
- However, Commissioner (Appeals) may condone the delay in filing of an appeal upon application in writing by the appellant.

2.2 Procedures for disposal of appeals

Section 128 of the Ordinance outlines the procedure for disposal of appeal in the following manner:

- The Commissioner (Appeals) shall give notice of the day fixed for the hearing of the appeal to the appellant and to the Commissioner against whose order the appeal has been made.
- Where in a particular case, the Commissioner (Appeals) is of the opinion that the recovery of tax levied, shall cause undue hardship to the taxpayer, he, after affording opportunity of being heard to the Commissioner against whose order appeal has been made, may stay the recovery of such tax for a period not exceeding thirty days in aggregate.
- The Commissioner (Appeals), after affording opportunity of being heard to the Commissioner against whose order appeal has been made, may stay the recovery of such tax for a further period of thirty days, provided that the order on appeal shall be pass within the said period of thirty days.
- The Commissioner (Appeals) may adjourn the hearing of the appeal from time to time.
- The Commissioner (Appeals) may, before the hearing of an appeal, allow an appellant to file any new ground of appeal not specified in the grounds of appeal already filed by the appellant where the Commissioner (Appeals) is satisfied that the omission of the ground from the form of the appeal was not wilful or unreasonable.
- The Commissioner (Appeals) may, before disposing of an appeal, call for such particulars as the Commissioner (Appeals) may require respecting the matters arising in the appeal or cause further enquiry to be made by the Commissioner.

- The Commissioner (Appeals) shall not admit any documentary material or evidence which was not produced before the Commissioner unless the Commissioner (Appeals) is satisfied that the appellant was prevented by sufficient cause from producing such material or evidence before the Commissioner.

2.3 Decision in appeal

- In disposing of an appeal, the Commissioner (Appeals) may:
 - make an order to confirm, modify or annul the assessment order after examining such evidence as required by him respecting the matters arising in appeal or causing such further enquires to be made as he deems fit; or
 - in any other case, make such order as the Commissioner (Appeals) thinks fit.
- The Commissioner (Appeals) shall not increase the amount of any assessment order or decrease the amount of any refund unless the appellant has been given a reasonable opportunity of showing cause against such increase or decrease, as the case may be.
- Where, as the result of an appeal, any change is made in the assessment of an association of persons or a new assessment of an association of persons is ordered to be made, the Commissioner (Appeals) may authorise the Commissioner to amend accordingly any assessment order made on a member of the association and the time limit specified in section 122(2) shall not apply to the making of such amended assessment.
- As soon as practicable after deciding an appeal, the Commissioner (Appeals) shall specify in the order the amount of tax upheld and serve his order on the appellant and the Commissioner.

Provided that such order shall be passed not later than one hundred and twenty days from the date of filing of appeal or within an extended period of sixty days, for reasons to be recorded in writing by the Commissioner (Appeals):

Provided further that any period during which the hearing of an appeal is adjourned at the request of the appellant or is postponed due to any appeal or proceedings or stay order, remand or alternative dispute resolution proceedings or for any other reason, shall be excluded in the computation of the aforementioned periods.

3 APPEALS BEFORE APPELLATE TRIBUNAL

3.1 Appointment of Appellate Tribunal

- This Tribunal is under the administrative control of the Ministry of Law, Justice and Parliamentary Affairs and therefore enjoys independence from the Board and the assessment machinery.
 - The Appellate Tribunal shall consist of a chairperson and such other members as are appointed by the Federal Government having regard to the needs of the tribunal.
 - Existing members including Chairman of the Appellate Tribunal shall continue to hold office, on the same terms and conditions as applicable to them prior to the commencement of the Tax Laws (Amendment) Act, 2024, till the completion of their term of office unless resigned or removed earlier.
 - A person may be appointed as member of the Appellate Tribunal if the person:
 - a) is an advocate of a High Court for not less than fifteen years and possesses such other qualifications as may be prescribed by rules under this section
 - b) has for an aggregate period of not less than ten years been:
 - i. in practice as a chartered accountant, either individually or in a firm of the chartered accountants, within the meaning of Chartered Accountants Ordinance, 1961
 - ii. a chartered accountant, within the meaning of the Chartered Accountants Ordinance, 1961, and has been in employment of a chartered accountant in practice as specified in sub-clause (i) above at least for a period of ten years
 - c) has for a period of not less than ten years practiced professionally as a cost and management accountant within the meaning of the Cost and Management Accountants Act, 1966.
 - d) is an officer of the Inland Revenue in BS-21 or above; or
 - e) is an officer of the Inland Revenue in BS-20, having served in such grade for three years or more.
 - The Federal Government shall appoint a member of the Appellate Tribunal as Chairperson of the tribunal. The Chairman shall hold office for a period of three years provided that the Federal Government may reappoint the Chairman for such further term or terms as it may deem appropriate.
 - The members including the Chairman shall cease to hold office on attaining the age of sixty-two years provided that the members falling under clauses (d) and (e) shall cease to hold office on attaining the age of superannuation, under the law regulating their service:
 - Provided that a member including the Chairman may resign or may be removed by the Federal Government, on the recommendation of performance review committee, to be constituted, at any time before the expiry of his term or attaining the age of superannuation, as the case may be, on grounds, interalia, of inefficiency or misconduct.
 - The procedure of the Appellate Tribunal Inland Revenue including constitution of benches, case management system, distribution of cases and other matters ancillary or incidental thereto shall be regulated by the rules.
- viii. A businessman purchased a vehicle for his private use by drawing cash from business. However, he also uses it for coming to the office.

3.2 Appeal to the Appellate Tribunal [Sec 131]

The taxpayer or tax department may file appeal before the Income Tax Appellate Tribunal under section 131 of the Ordinance. This section provides that:

- Where the taxpayer, or the Commissioner objects to an order passed by the Commissioner (Appeals), the taxpayer or Commissioner may appeal to the Appellate Tribunal against such order within thirty days of the receipt of such order:

Provided that the taxpayer may directly appeal against the order of the Officer Inland Revenue or the Commissioner as the case may be to the Appellate Tribunal by exercising the option as provided in subsection (1) of section 127.

- An appeal shall be:
 - a) in the prescribed form;
 - b) verified in the prescribed manner;
 - c) accompanied, by the prescribed fee and
 - d) Preferred to the Appellate Tribunal within thirty days of the date of service of order on the taxpayer
- The prescribed fee shall be Rs. 20,000 in case of company and Rs. 5,000 in cases other than company.
- The Appellate Tribunal may, upon application in writing, admit an appeal after the expiration of the above said 30 days if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within that period.
- Notwithstanding that an appeal has been filed before the Appellate Tribunal, tax shall, unless recovery thereof has been stayed by the Appellate Tribunal, be payable in accordance with the assessment made in the case:

Provided that if on filing of application in a particular case, the Tribunal, after affording opportunity of being heard to the Commissioner having jurisdiction, for reasons to be recorded, may stay the recovery of such tax for 90 days:

Provided further that the stay order shall cease to have effect, and the Commissioner shall be entitled to recover tax, if the taxpayer does not adhere to the hearing schedule for the appeal, as determined by the Appellate Tribunal in accordance with the rules:

Provided also that where an appeal is not decided within the statutory period by the Appellate Tribunal, the stay order under the second proviso shall not cease to have effect till finalization of the appeal by the Appellate Tribunal.

3.3 Procedure for disposal of appeal by Appellate Tribunal [Sec 132]

The mechanism for disposal of appeals by the Appellate Tribunal has been described in section 132 of the Ordinance in the following manner:

- The Appellate Tribunal shall decide the appeal within ninety days of its filing

Provided that appeals pending before the Appellate Tribunal on the date of commencement of the Tax Laws (Amendment) Act, 2024 shall be decided within one hundred and eighty days:

Provided further that where an appeal is not decided within the aforesaid period, the Appellate Tribunal shall seek condonation from the Minister of Law and Justice and such condonation shall not extend beyond ninety days.

- At the first hearing of appeal, the Appellate Tribunal shall
 - a) bring to the notice of the taxpayer, the provisions relating to alternative dispute resolution under section 134A of this Ordinance; and
 - b) if the taxpayer declines the option of alternative dispute resolution and wishes to continue with the appeal, fix date or dates for hearing and decision of the appeal in consultation with the taxpayer and Commissioner and in accordance with the rules.
- The Appellate Tribunal shall ensure strict adherence by the taxpayer and the Commissioner, to the hearing schedule as prescribed, and shall hear and decide the appeal on the date or dates fixed, and no adjournment shall be granted, except

- a) where there are compelling reasons for adjournment, to be recorded by the Appellate Tribunal; and
- b) on mandatory payment of such cost as the Appellate Tribunal may deem fit, which shall not be less than fifty thousand rupees.
- Where the appeal relates to an assessment order, the Appellate Tribunal may make an order to:
 - a) affirm, modify or annul the assessment order; or
 - b) remand the case to the Commissioner for making such enquiry or taking such action as the Tribunal may direct; or
 - c) make such order as the Appellate Tribunal may deem fit.
- The Appellate Tribunal shall not increase the amount of any assessment or penalty or decrease the amount of any refund unless the taxpayer has been given a reasonable opportunity of showing cause against such increase or decrease, as the case may be.
- Where, as the result of an appeal, any change is made in the assessment of an association of persons or a new assessment of an association of persons is ordered to be made, the Appellate Tribunal may authorise the Commissioner to amend accordingly any assessment order made on a member of the association and the time limit specified in of section 122(2) shall not apply to the making of such amended assessment.
- Where the appeal relates to a decision other than in respect of an assessment, the Appellate Tribunal may make an order to affirm, vary or annul the decision, and issue such consequential directions as the case may require.
- The Appellate Tribunal shall communicate its order to the taxpayer and the Commissioner.
- Except as provided in section 133, the decision of the Appellate Tribunal on an appeal shall be final.

4 REFERENCE APPLICATION BEFORE HIGH COURT

4.1 Reference application before High Court

- Within sixty days of the communication of the order of the Appellate Tribunal, the aggrieved person or the Commissioner may file a reference, in the prescribed form along with a statement of the case, before the High Court, stating any question of law arising out of such order.
- The applicant shall also file complete record of the Appellate Tribunal within fifteen days of preferring an application.
- The statement to the High Court shall set out the facts, the determination of the Appellate Tribunal and the question of law which arises out of its order.
- Where, on an application made, the High Court is satisfied that a question of law arises out of such order, it may proceed to hear the case.
- A reference to the High Court shall be heard by Special Bench or the Special Benches to be constituted by the Chief Justice, as deemed necessary for hearing cases under this section, comprising of not less than two judges of the High Court and, in respect of the reference, the provisions of section 98 of the Code of Civil Procedure, 1908 shall apply, so far as may be, notwithstanding anything contained in any other law for the time being in force.
- The Special Bench shall decide a reference within six months from the date of its filing
- The High Court shall establish a case management system to ensure that sufficient number of Special Benches are constituted, so as to ensure that a reference filed under this section is decided within the stipulated six months.
- The High Court upon hearing a reference under this section shall decide the question of law raised by the reference and pass judgment thereon specifying the grounds on which such judgment is based and the Appellate Tribunal's order shall stand modified accordingly.
- The High Court shall send a copy of the judgment under the seal of the High Court to the Appellate Tribunal.
- Notwithstanding that a reference has been made to the High Court, the tax shall be payable in accordance with the order of the Appellate Tribunal. However, the tax recovery shall not be made by the Commissioner for thirty days from the date of communication of the order of the Appellate Tribunal.
- If the amount of tax is reduced as a result of the judgment in the reference by the High Court and some amount of tax is found to be refundable, the High Court may, on application by the Commissioner within thirty days of the receipt of the judgment of the High Court that he wants to prefer petition for leave to appeal to the Supreme Court, make an order authorizing the Commissioner to postpone the refund until the disposal of the appeal by the Supreme Court.
- On an application filed in a particular reference and after affording an opportunity of being heard to the Commissioner, the High Court may stay recovery of tax, subject to deposit with the assessing authority of not less than thirty percent of the tax determined by the Appellate Tribunal.
- Where recovery of tax has been stayed by the High Court by an order, such order shall cease to have effect on the expiration of a period of six months following the day on which it was made unless the reference is decided or such order is withdrawn by the High Court earlier.
- An application by the aggrieved person other than the Commissioner shall be accompanied by a fee of fifty thousand rupees.
- No application filed by the Commissioner shall be entertained unless it is accompanied by a written authorization by the relevant Chief Commissioner.

4.2 Petition before Supreme Court

Supreme Court is the final forum for appeal available to the aggrieved parties against any judgment of the High Court. Article 185 of the Constitution of Pakistan provides that any aggrieved party to the decision of the High Court can prefer appeal before the Supreme Court of Pakistan. Accordingly, no provision in this regard is required in the Income Tax Ordinance, 2001.

5 ALTERNATIVE DISPUTE RESOLUTION COMMITTEE

5.1 Alternative Dispute Resolution Committee

Another mechanism for settling disputes provided in the income tax law is the Alternative Dispute Resolution under section 134A. This envisages formation of an alternate Dispute Resolution Committee. The said section is as under:

- An aggrieved person may apply for resolution of a dispute pending before any court of law or appellate forum, through ADR mechanism in following cases:
 - a) Where the liability of tax is Rs 50 million or above or admissibility of refund;
 - b) The extent of waiver of default surcharge & penalty; or
 - c) Any other specific relief required to resolve the dispute.
- may apply to the Board for the appointment of a committee for the resolution of any hardship or dispute mentioned in detail in the application, which is under litigation in any court of law or an appellate authority, except where criminal proceedings have been initiated.
- Where the aggrieved person is a state-owned enterprise (SOE), the limit of tax liability of fifty million rupees or above mentioned in clause (a) of sub-section (1) shall not apply and it shall be mandatory for such aggrieved SOE to apply to the Board for the appointment of a committee for the resolution of any dispute under this section
 - No suit, prosecution, or other legal proceedings shall lie against the SOE or the committee in relation to the dispute resolved under this section.
 - The application for dispute resolution as above shall be accompanied by an initial proposition for resolution of the dispute, including an offer of tax payment an undertaking that the applicant shall accept the decision of the Committee which shall be binding on him in all respects and shall on receipt of the decision immediately withdraw any and all pending litigation or cases of any kind in respect of the dispute, mentioning details thereof.
 - If the applicant is an SOE, it shall withdraw any and all such pending litigation and cases immediately and mention the details thereof in the undertaking.
 - If the Committee fails to decide within the period of sixty days, the Board shall dissolve the Committee by an order in writing and the matter shall be decided by the court of law or the appellate authority where the dispute is pending under litigation.
 - However, in the case of a state-owned enterprise, if the Committee fails to decide within a period of sixty days, the Board shall reappoint a Committee that shall decide the dispute in accordance with sub-section (5) of this section.
 - In case of a state-owned enterprise, the Board shall dissolve the Committee by an order in writing, if the reappointed Committee fails to decide the matter within a further period of sixty days. In that scenario, matter shall be decided by the court of law or the appellate authority where the dispute is pending under litigation.
 - The Board may, after examination of the application of an aggrieved person, appoint a committee, within fifteen days of receipt of such application in the Board, comprising, -
 - i. a retired judge not below the rank of a judge of a High Court, who shall also be the Chairperson of the Committee, to be nominated by the Board from a panel notified by the Law and Justice Division for such purpose;
 - ii. the Chief Commissioner Inland Revenue having jurisdiction over the case; and

- iii. a person to be nominated by the taxpayer from a panel notified by the Board comprising
- chartered accountants, cost and management accountants and advocates having a minimum of ten years' experience in the field of taxation;
 - officers of the Inland Revenue Service who stood retired in BS 21 or above; or
 - reputable businessmen as nominated by the Chambers of Commerce and Industry:

Provided that the taxpayer shall not nominate a chartered accountant or an advocate if the said chartered accountant or the advocate is or has been an auditor or an authorized representative of the taxpayer.

- The Board shall communicate the order of appointment of Committee to the aggrieved person, court of law or the appellate authority where the dispute is pending and to the concerned Commissioner.
- The Committee appointed shall examine the issue and may, if it deems necessary, conduct inquiry, seek expert opinion, direct any officer of the Inland Revenue or any other person to conduct an audit and shall decide the dispute by majority, within forty-five days of its appointment extendable by another fifteen days for the reasons to be recorded in writing.
- The decision by the Committee shall not be cited or taken as a precedent in any other case or in the same case for a different tax year.
- The recovery of tax payable by a taxpayer in connection with any dispute for which a Committee has been appointed shall be deemed to have been stayed on the constitution of Committee till the final decision or dissolution of the Committee, whichever is earlier.
- The decision of the Committee shall be binding on the Commissioner when the aggrieved person, being satisfied with the decision, has withdrawn the appeal pending before the court of law or any appellate authority in respect of dispute as mentioned above and has communicated the order of withdrawal to the Commissioner
- Provided that if the order of withdrawal is not communicated to the Commissioner within sixty days of the service of decision of the Committee upon the aggrieved person, the decision of the Committee shall not be binding on the Commissioner.
- The Commissioner shall also withdraw the appeal, if any, pending before any court of law or an appellate authority within thirty days of the communication of the order of withdrawal by the aggrieved person to the Commissioner.
- The aggrieved person shall make the payment of income tax and other taxes and within such time as decided by the Committee and all decisions and orders made or passed shall stand modified to that extent.
- The Board shall communicate the order of dissolution to the aggrieved person, court of law or the appellate authority and to the Commissioner.
- On receipt of the order of dissolution, the court of law or the appellate authority shall decide the appeal within 90 days of the communication of the said order.
- The Board may prescribe the amount to be paid as remuneration for the services of the members of the Committee, other than Chief Commissioner.
- The Board may, by notification in the official Gazette, make rules for carrying out the purposes of this section.

6 OTHER APPEAL RELATED MATTERS

6.1 Assessment giving effect to an order [Sec 124]

- The various situations and time limitations are tabulated below:

Decision of appellate authority	Time within which the new assessment order has to be made
Direct relief provided to taxpayer	Two months from the date the order is served on the commissioner
Assessment order wholly or partly set aside	One year from the end of the financial year in which the commissioner or Commissioner (Appeals) is served with the order provided no further appeal or reference is preferred against the order of the appellate authority either by the commissioner or the taxpayer
Any other decision	Two years from the end of the financial year in which the commissioner is served with the order

- Where the Commissioner (Appeals), Appellate Tribunal, High Court or Supreme Court has confirmed the tax payable as determined in the order appealed against no appeal effect order will be required to be issued and the Commissioner shall proceed to effect recovery.
- Where the Appellate Tribunal, High Court, or Supreme Court partially sets aside an order while confirming or modifying other issues in the appeal, the Commissioner will be required to issue an appeal effect order in the prescribed form. The Commissioner will then determine the tax payable based on the confirmed or modified issues, excluding any tax related to matters that have been set aside or remanded back. The tax so assessed on the confirmed or modified issues will be paid or recovered in accordance with the applicable provisions of the Ordinance.
- In case of an assessment order is set aside or modified, the proceedings may commence from the stage next preceding the stage where the setting aside or modification took place. In these cases, Commissioner shall not be entitled to re-issue any notice which was earlier issued or shall not require refurnishing or re-filing of any return, statement or other particulars which were earlier furnished or filed.
- Where in consequence of an order of any appellate forum or court any income is excluded from the computation:
 - of taxable income of a person for any year and included in the computation of taxable income for another year; or
 - of taxable income of one person is included in the taxable income of other person.

the assessment or amended assessment made as above shall be treated as assessment in consequence of such order.
- In case of an assessment order passed under section 124 (Appeal effect), the tax payable shall become payable immediately instead of payment within 30 days.

6.2 Burden of Proof [Sec 136]

Section 136 of the Ordinance points to one very important aspect of appeal and states that in any appeal by a taxpayer, the burden shall be on the taxpayer to prove, on the balance of probabilities:

- In the case of an assessment order, the extent to which the order does not correctly reflect the taxpayer's tax liability for the tax year; or
- In the case of any other decision, that the decision is erroneous.

SCOPE OF SALES TAX LAW AND RULES FOR REGISTRATION AND DEREGISTRATION

IN THIS CHAPTER:

1. Introduction
2. Basic concepts and definitions
3. Scope of tax
4. Liability to pay sales tax
5. Zero rating and exemption
6. Registration
7. De-registration

1 INTRODUCTION

1.1 Preamble

The preamble of Sales Tax Act, 1990 states that it is an act to consolidate and amend the law relating to the levy of a tax on the sale, importation, exportation, production, manufacture or consumption of goods.

The aforesaid preamble clarifies that the sales tax is not only leviable on the sale of goods but is also on import, export, production, manufacture and consumption of goods. Before we study these terminologies in the ensuing paragraphs, we would like to describe the jurisdiction and extent of applicability of Sales Tax Act, 1990.

1.2 Extent and applicability of Sales Tax Act, 1990

Section 1 states that the Sales Tax Act, 1990 extends to the whole of Pakistan. The territories of Pakistan as per Article 1(2) of the Constitution comprise the following:

1. the Provinces of Balochistan, Khyber Pakhtunkhwa, Punjab and Sindh;
2. the Islamabad Capital territory hereinafter referred to as the Federal Capital; and
3. such States and territories as are or may be included in Pakistan, whether by accession otherwise.

Keeping in view the aforesaid discussion, it means that the Sales Tax Act, 1990 is applicable to the whole of Pakistan. Now we discuss the tax covered under the sales tax law:

1.3 Taxes under sales tax law

► Definition

“sales tax” [2(29A)] means—

- the tax, additional tax, or default surcharge levied under this Act;
- a fine, penalty or fee imposed or charged under this Act; and
- any other sum payable under the provisions of this Act or the rules made thereunder.

2 BASIC CONCEPTS AND DEFINITIONS

2.1 Taxable supplies

► *Definition: Taxable Supply [Section 2(41)]*

"Taxable supply" means a supply of taxable goods made by an importer; manufacturer, wholesaler (including dealer), distributor or retailer other than a supply of goods which is exempt under section 13 and includes a supply of goods chargeable to tax at the rate of zero per cent under section 4.

It is imperative to ascertain the answer of the following questions which would eventually clarify whether any transaction is taxable supply or not:

- i. Whether the transaction constitutes a "supply"?
- ii. Whether the supply relates to any "taxable goods"?
- iii. Whether these taxable goods are supplied by importer; manufacturer, wholesaler (including dealer), distributor or retailer?
- iv. Which goods are exempted from levy of tax?
- v. What are "zero rated supplies"?
- vi. What are "supplies without payment of sales tax"?

2.2 Supply

Definition The term supply is defined in section 2(33) of the Act in the following way:

Supply means "A sale or other transfer of the right to dispose of goods as owner, including such sale or transfer under a hire purchase agreement and also includes"

- i. putting to private, business or non-business use of goods produced or manufactured in the course of taxable activity for purposes other than those of making a taxable supply;
- ii. auction or disposal of goods to satisfy a debt owed by a person;
- iii. possession of taxable goods held immediately before a person ceases to be a registered person;
- iv. in case of manufacture of goods belonging to another person, the transfer or delivery of such goods to the owner or to a person nominated by him;

Provided that the Board with approval of the Federal Minister Incharge, may by notification in the official Gazette, specify such other transactions which shall or shall not constitute supply.

2.3 Taxable goods

► *Definitions:*

The definition of term "taxable goods" as given in section 2(39) of the Sales Tax Act, 1990 is as under:

- "Taxable goods" means all goods other than those which have been exempted under section 13;

The term "goods" is elaborated in section 2(12) of the Act in the following way:

- "Goods" include every kind of movable property other than actionable claims, money, stocks, shares and securities;

It is important to place on record that under section 8(6) of the Act, the Board with approval of the Federal Minister In-charge is empowered to prohibit registered persons from supplying taxable goods to specified un-registered persons.

2.4 Exempt supplies

► Definition

"Exempt supply" means a supply which is exempt from tax under section 13. [Section 2(11) of the Sales Tax Act, 1990]

Section 13 stipulates that following goods are exempt from levy of sales tax:

- Supply or import of goods listed in sixth schedule
- Goods specified by Federal Government through its SROs to the extents and from the date specified therein

The sixth schedule includes a list of items on which no sales tax is levied.

2.5 Zero rated supplies

► Definition

The term "Zero rated supplies" is elaborated in section 2(48) of the Act in the following manner:

"Zero-rated supply" means a taxable supply which is charged to tax at the rate of zero per cent under section 4.

Section 4 of the Act elucidates following items which are chargeable to tax at the rate of zero per cent:

- a) Goods exported, or the goods specified in the **Fifth Schedule**;
- b) Supply of stores and provisions for consumption aboard a conveyance proceeding to a destination outside Pakistan as specified in section 24 of the Customs Act, 1969;
- c) such other goods, as the Federal Government may specify by notification in the official Gazette, whenever circumstances exist to take immediate action for the purposes of national security, natural disaster, national food security in emergency situations and implementation of bilateral and multilateral agreements:

Provided that nothing in this section shall apply in respect of a supply of goods which –

- i. are exported, but have been or are intended to be re-imported into Pakistan; or
- ii. have been entered for export under Section 131 of the Customs Act, 1969, but are not exported; or
- iii. have been exported to a country specified by the Federal Government, by Notification in the official Gazette

Provided further that the Federal Government may by a notification in the official Gazette, restrict the amount of credit for input tax actually paid and claimed by a person making a zero-rated supply of goods otherwise chargeable to sales tax.

2.6 Supplies without payment of sales tax

Under section 60 of the Act, the Federal Government is empowered to prescribe any specified taxable goods which can be imported without payment of whole or part of sales tax.

2.7 Importer, manufacturer, wholesaler, distributor and retailer

Goods supplied by an importer; manufacturer, wholesaler (including dealer), distributor or retailer are taxable goods. Therefore, the goods supplied by persons other than by these are not taxable goods e.g. supplies by an agriculturist or a bank. These persons are defined in the law in the following manner:

► *Definitions*

Importer [Section 2(13)]

Importer is any person who imports any goods into Pakistan

Manufacturer or producer [Section 2(17)]

Manufacturer means a person who engages, whether exclusively or not, in the production or manufacture of goods whether or not the raw material of which the goods are produced or manufactured are owned by him; and shall include:

- i. a person who by any process or operation assembles, mixes, cuts, dilutes, bottles, packages, repackages or prepares goods by any other manner;
- ii. an assignee or trustee in bankruptcy, liquidator, executor, or curator or any manufacturer or producer and any person who disposes of his assets in any fiduciary capacity; and
- iii. any person, firm or company which owns, holds, claims or uses any patent, proprietary or other right to goods being manufactured, whether in his or its name, or on his or its behalf, as the case may be, whether or not such person, firm or company sells, distributes, consigns or otherwise disposes of the goods.

Provided that for the purpose of refund under this Act, only such person shall be treated as manufacturer-cum-exporter who owns or has his own manufacturing facility to manufacture or produce the goods exported or to be exported;

The bare reading of the definition clarify that manufacturing services provided by a person on behalf of a principal are covered within the definition of manufacturing. For example, dyeing services, toll manufacturing, knitting services etc. Moreover, any person who either produces goods himself or out-sources such manufacture is also treated as a manufacturer.

► *Definition:*

"Manufacture" or "produce" [Section 2(16)] includes:

- i. Any process in which an article singly or in combination with other articles, materials, components, is either converted into another distinct article or product or is so changed, transformed or reshaped that it becomes capable of being put to use differently or distinctly and includes any process incidental or ancillary to the completion of a manufactured product;
- ii. Process of printing, publishing, lithography and engraving; and
- iii. Process and operations of assembling, mixing, cutting, diluting, bottling, packaging, repacking or preparation of goods in any other manner.

► *Definition: Retailer [Section 2(28)]*

Means a person supplying goods to general public for the purpose of consumption.

Provided that any person, who combines the business of import and retail or manufacture or production with retail, shall notify and advertise wholesale prices and retail prices separately, and declare the address of retail outlets.

► *Definition: Retail Price [Section 2(27)]*

With reference to the Third Schedule, means the price fixed by the manufacturer or the importer, in case of imported goods, inclusive of all duties, charges and taxes (other than sales tax) at which any particular brand or variety of any article should be sold to the general body of consumers or, if more than one such price is so fixed for the same brand or variety, the highest of such price;

Provided that the board may through a general order specify zones or areas for the purpose of determination of highest retail price for any brand or variety of goods.

Provided further that reduction in price on account of chilling charges or any other similar charges in case of aerated water, beverages, mineral water, or fruit juices shall not be more than five percent of the price inclusive of sales tax, federal excise duty and all taxes other than income tax on which such goods are actually sold to the general body of consumers.

Provided also that, where the Board deems it necessary it may, by notification in the official gazette, fix the retail price of goods specified in the third schedule

Provided also that, in case of imported goods specified in the Third Schedule, the retail price shall not be less than one hundred thirty percent of Custom Assessed Value (CAV).

► *Definition: Distributors [Section 2(7)]*

A person appointed by a manufacturer, importer or any other person for a specified area to purchase goods from him for further supply and includes a person who in addition to being a distributor is also engaged in supply of goods as a wholesaler or a retailer.

► *Definition: Wholesaler [Section 2(47)]*

Includes a dealer and means any person who carries on, whether regularly or otherwise, the business of buying and selling goods by wholesale or of supplying or distributing goods, directly or indirectly, by wholesale for cash or deferred payment or for commission or other valuable consideration or stores such goods belonging to others as an agent for the purpose of sale; and includes a person who deducts income tax at source under the Income Tax Ordinance, 2001.

2.8 Registered person

Any importer, distributor, exporter, manufacturer or wholesaler is not liable to sales tax until and unless he is a registered person. The term "Registered person" is reproduced hereunder as defined in section 2(25) of the Act:

► *Definition: Registered Person*

Means a person who is registered or is liable to be registered under this Act

Provided that a person liable to be registered but not registered under this act shall not be entitled to any benefit available to a registered person under any of the provisions of this act or the rules made thereunder.

It is evident that a person liable to be registered is covered within the definition of registered person. Hence, a person not registered but liable to be registered can equally be held liable to pay sales tax on the goods supplied during the period that he remained un-registered. However, such person is not entitled to get the benefit of input tax credit or other benefit available to a registered person as the same are not claimed by way of filing tax returns.

► *Definition:*

Person [Section 2(21)]

Means,

- individual;
- a company or association of persons incorporated, formed, organized or established in Pakistan or elsewhere;
- the Federal Government;
- a Provincial Government;
- a local authority in Pakistan; or
- a foreign government, a political subdivision of a foreign government, or public international organization

2.9 Taxable activity

► *Definition: Taxable Activity [Section 2(35)]*

Means any economic activity carried on by a person whether or not for profit, and includes—

- a) an activity carried on in the form of a business, trade or manufacture;
 - b) an activity that involves the supply of goods, the rendering or providing of services, or both to another person;
 - c) a one-off adventure or concern in the nature of a trade; and
 - d) anything done or undertaken during the commencement or termination of the economic activity,
- but does not include—

the activities of an employee providing services in that capacity to an employer;

an activity carried on by an individual as a private recreational pursuit or hobby; and

an activity carried on by a person other than an individual which, if carried on by an individual, would fall within sub-clause (b).

2.10 Value of supply

► *Definition: Value of Supply [Section 2(46)]*

- i. In respect of a taxable supply, the consideration in money including all Federal and Provincial duties and taxes, if any, which the supplier receives from the recipient for that supply but excluding the amount of tax:

Provided that:

- a) In case the consideration for a supply is in kind or is partly in kind and partly in money, the value of the supply shall mean the open market price of the supply excluding the amount of tax;
 - b) In case the supplier and recipient are associated persons and the supply is made for no consideration or for a consideration which is lower than the open market price, the value of supply shall mean the open market price of the supply excluding the amount of tax; and
 - c) In case a taxable supply is made to a consumer from general public on installment basis on a price inclusive of mark up or surcharge rendering it higher than open market price, the value of supply shall mean the open market price of the supply excluding the amount of tax.
- ii. In case of trade discounts, the discounted price excluding the amount of tax provided the tax invoice shows the discounted price and the related tax and the discount allowed is in conformity with the normal business practices;
 - iii. In case where for any special nature of transaction it is difficult to ascertain the value of a supply, the open market price;
 - iv. In case of imported goods, the value determined under the Customs Act, including the amount of customs-duties and federal excise duty levied hereon;
 - v. In case where there is sufficient reason to believe that the value of a supply has not been correctly declared in the invoice, the value determined by the Valuation Committee comprising representatives of trade and the Inland Revenue constituted by the Commissioner; and
 - vi. In case the goods other than taxable goods are supplied to a registered person for processing, the value of supply of such processed goods shall mean the price excluding the amount of sales tax which such goods will fetch on sale in the market;
 - vii. In case of a taxable supply, with reference to retail tax, the price of taxable goods excluding the amount of retail tax, which a supplier will charge at the time of making taxable supply by him, or such other price as the Board may, by a notification in the official Gazette, specify.

- viii. In case of supply of electricity by an independent power producer or WAPDA, the amount received on account of energy purchase price only; and the amount received on account of capacity purchase price, energy purchase price premium, excess bonus, supplemental charges etc. shall not be included in the value of supply;
- ix. In case of supply of electric power and gas by a distribution company, the total amount billed including price of electricity and natural gas, as the case may be, charges, rents, commissions and all duties and taxes local, provincial and federal but excluding the amount of late payment surcharge and the amount of sales tax; and
Note: It is clarified that value of supply does not include the amount of subsidy provided by federal government or provincial government to the electricity consumers and has never been chargeable to tax under the Act.
- x. in case of registered person who is engaged in purchasing used vehicles from general public on which sales tax had already been paid at the time of import or manufacturing, and which are, later on, sold in the open market after making certain value addition, value of supply will be the difference between sale and purchase price of the said vehicle on the basis of the valuation method prescribed by the Board.

Provided that, where the Board deems it necessary it may, by notification in the official Gazette, fix the value of any imported goods including those as specified in the Third Schedule or taxable supplies or class of supplies and for that purpose fix different values for different classes or description of same type of imported goods or supplies.

Provided further that where the value at which import or supply is made is higher than the value fixed by the Board, the value of goods shall, unless otherwise directed by the Board, be the value at which the import or supply is made.

The aforesaid definition used two further terms i.e. associated person and open market price. These two terms are defined in the Act in the following manner:

Associates or associated persons [Section 2(3)] means, –

Associates" or "associated persons" shall have the same meaning as defined in Section 85 of the Income Tax Ordinance, 2001. According to Section 85 of the Income Tax Ordinance, 2001, these terms are defined as:

- i. Two persons are associate where the relationship between the two is such that one may reasonably be expected to act in accordance with the intentions of the other, or both persons may reasonably be expected to act in accordance with the intentions of a third person;
- ii. one person sufficiently influences, either alone or together with an associate, the other person.

Note: Two persons shall be treated as sufficiently influencing each other, where one or both persons are economically and financially dependent on each other and, decisions are made in accordance with the directions, instructions or wishes of each other for common economic goal

- i. one person enters into a transaction, directly or indirectly, with the other who is a resident of jurisdiction with zero taxation regime.
- ii. Two persons shall not be associates solely by reason of the fact that one person is an employee of the other or both persons are employees of a third person;
- iii. Without limiting the generality of the above provisions the following shall be treated as associates, namely:
 - a) an individual and a relative of the individual;
 - b) members of an association of persons;
 - c) a member of an association of persons and the association, where the member, either alone or together with an associate or associates under another application of this section, controls fifty per cent or more of the rights to income or capital of the association;
 - d) trust and any person who benefits or may benefit under the trust;

- e) a shareholder in a company and the company, where the shareholder, either alone or together with an associate or associates under another application of this section, controls either directly or through one or more interposed persons–
 - Fifty per cent or more of the voting power in the company;
 - Fifty per cent or more of the rights to dividends; or
 - Fifty per cent or more of the rights to capital; and
- f) two companies, where a person, either alone or together with an associate or associates under another application of this section, controls either directly or through one or more interposed persons –
 - Fifty per cent or more of the voting power in both companies;
 - Fifty per cent or more of the rights to dividends in both companies; or
 - Fifty per cent or more of the rights to capital in both companies.
- i. Two persons shall not be associates under sub-clause (a) or (b) of paragraph (iii) above, where the Commissioner is satisfied that neither person may reasonably be expected to act in accordance with the intentions of the other.
- ii. In this clause, “relative” in relation to an individual, means:
 - a) An ancestor, a descendant of any of the grandparents, or an adopted child, of the individual, or of a spouse of the individual; or
 - b) A spouse of the individual or of any person specified in sub-clause (a).

► **Definition: Open Market Price [Section 2(19)]**

Means the consideration in money which that supply or a similar supply would generally fetch in an open market;
The term similar supply is elaborated in the following way:

► **Definition: Similar Supply [Section 2(31)]**

In relation to the open market price of goods, means any other supply of goods which closely or substantially resembles the characteristics, quantity, components and materials of the aforementioned goods;

► **Exercise**

- a) Waqar Ltd. has supplied 2000 tons of steel to Shoaib Limited. The market price of the supply is Rs. 2.8 million exclusive of sales tax. Owing to financial difficulties, Shoaib Limited has requested to settle the price by transferring a portion of building having a market value of Rs. 2.5 million and to pay Rs. 75,000 in final settlement along with the applicable sales tax by way of a cheque drawn in favour of Waqar Ltd.
- b) Atif's son started his business in July 2025. In order to assist him, Atif supplied him the goods at a discounted price of Rs. 2,500,000. The discount rate allowed was 18% against the normal business practice of allowing a discount at 8%. What would be the correct value of supply on which Atif would be chargeable to sales tax.
- c) Usama has supplied 200 kg of material, falling under the Third schedule to Munawar Limited at wholesale price of Rs. 500 per kg. The retail price of the material is Rs. 900 per Kg.

Required:

Determine the value of supply on which sales tax would be levied under the provisions of the Sales Tax Act, 1990.

► **Answer**

- a) Supply partly in kind

In case the consideration for a supply is in kind or is partly in kind and partly in money, the value of supply shall mean the open market price of the supply excluding the amount of tax. Therefore, value of supply shall be Rs. 2,800,000 and not the consideration received. i.e. Rs. 2,575,000.

However, if the sales tax invoice reflects trade discount of Rs. 225,000 and discount allowed is in conformity with the normal business practices, then the value of taxable supply will be taken at Rs. 2,575,000.

b) Discounted price

The transaction is with an associate and not at arm's length. In the case of trade discounts, sales tax is levied on the discounted price excluding the amount of tax, provided that the sales tax invoice shows the discounted price and related tax. Further, the discount allowed should be in conformity with normal business practice.

In this case, the discounted price for charging sales tax will be computed by allowing a discount at 8% instead of 18% as below:

	Rs.
Price at 18% discount	2,500,000
Price at 8% discount	2,804,878
$(2,500,000 / 0.82 \times 0.92)$	

c) Retail price

On Third Schedule items, sales tax is charged on the retail price of goods excluding the amount of retail tax. Therefore, sales tax would be charged @ 18% on Rs. 180,000 (200kgs x Rs. 900/kg).

2.11 Time of supply

► *Definition: Time of Supply [Section 2(44)]*

in relation to,

- a supply of goods, other than under hire purchase agreement, means the time at which the goods are delivered or made available to the recipient of the supply or the time when any payment is received by the supplier in respect of that supply, whichever is earlier.
- a supply of goods under a hire purchase agreement, means the time at which the agreement is entered into; and
- services, means the time at which the services are rendered or provided;
Provided in respect of clause (a), (b) or (c) above where any part payment is received for a supply in a tax period
- it shall be accounted for in the return for that tax period; and
- In respect of exempt supply, it shall be accounted for in the return for the tax period during which the exemption is withdrawn from such supply.

2.12 Other definitions/concepts

► *Definition: Cottage industry [Section 2(5AB)]*

cottage industry" means a manufacturing concern, which fulfils each of following conditions, namely:-

- does not have an industrial gas or electricity connection;
- is located in a residential area;
- does not have a total labour force of more than ten workers; and
- annual turnover from all supplies does not exceed eight million rupees;

Treatment of supplies by cottage industry

Local supplies of goods made by a cottage industry are exempt from sales tax. [Sr. No. 3 of Table 2 of the Sixth Schedule to the Sales Tax Act, 1990]

► *Definition: Due Date [Section 2(9)]*

In relation to the furnishing of a return means the 15th day of the month following the end of the tax period, or such other date as the Board may, by notification in the official Gazette, specify and different dates may be specified for furnishing of different parts or annexures of the return.

► *Definition: Provincial Sales Tax [Section 2(22A)]*

Means tax levied under the provincial laws or laws relating to Islamabad Capital Territory, declared by the Federal Government through notification in the official Gazette to be provincial sales tax for the purpose of input tax.

► *Definition: Tax Period [Section 2(43)]*

Means a period of one month or such other period as the Board with the approval of the Federal Minister in-chagre may, by notification in the official Gazette, specify.

► *Definition: e-intermediary [Section 2(9A)]*

Means a person appointed as e-intermediary under section 52A for filing of electronic returns and such other documents as may be prescribed by the Board from time to time, on behalf of a person registered under section 14.

► *Definition: Company [Section 2(5AA)]*

Means

- a) a company as defined in the Companies Ordinance, 1984;
- b) a body corporate formed by or under any law in force in Pakistan;
- c) a modaraba;
- d) a body incorporated by or under the law of a country outside Pakistan relating to incorporation of companies;
- e) a trust, a co-operative society or a finance society or any other society established or constituted by or under any law for the time being in force; or
- f) a foreign association, whether incorporated or not, which the Board has, by general or special order, declared to be a company for the purposes of the Income Tax Ordinance 2001

3 SCOPE OF TAX

3.1 Normal rate of sales tax

- Sales tax @ 18% is charged, levied and paid on the value of:
 - i. taxable supplies made by a registered person in the course or furtherance of any taxable activity carried on by him; and
 - ii. goods imported into Pakistan irrespective of their final destinations in territories of Pakistan.
- Where the taxable supplies are made to a person who has not obtained registration number or he is not an active taxpayer, there shall be charged, levied and paid a further tax at the rate of 4% of the value in addition to the normal rate of 18%.
- However Federal Government may, by notification in the official Gazette specify the taxable supplies in respect of which the further tax shall not be charged, levied and paid.
- SRO 648(1)/2013 dated 9th July, 2013 provides following list of persons on which this further tax @ 4% is not charged, levied or paid on the taxable supplies of:
 - i. Electricity energy supplied to domestic and agricultural consumers.
 - ii. Natural gas supplied to domestic consumers and CNG stations.
 - iii. Motor oil, diesel oil, jet fuel, kerosene oil and fuel oil.
 - iv. Goods sold by the retailers to end customers.
 - v. Supply of goods directly to end customers including food, beverages, fertilizers and vehicles.
 - vi. Items listed in Third Schedule to the Sales Tax Act, 1990.
 - vii. Second hand worn clothing and other worn articles falling under PCT heading 6309.0000.
 - viii. Supplies by steel-melters, re-rollers and ship breakers
 - ix. Supplies covered under the Fifth Schedule to the Sales Tax Act, 1990.
 - x. Supplies made to Government, semi-government and statutory regulatory bodies.
 - xi. Supply of white crystalline sugar (PCT heading 1701.9910 and 1701.9920).
 - xii. Supply of foam or spring mattresses and other foam products for household use
 - xiii. Supplies by steel sector and edible oil sector.

3.2 Tax on taxable supplies specified in third schedule [Sec 3(2)(a)]

- Taxable supplies and import of goods specified in the Third Schedule shall be charged to tax at the rate of eighteen per cent of the retail price or in case such supplies or imports are also specified in the Eighth Schedule, at the rates specified therein.
- The manufacturer or the importer shall legibly, prominently and indelibly print or emboss retail price along with the amount of sales tax on the packet, container, package, cover or label etc.
- Board, may exclude from or include into said schedule any taxable supply by notification in the official Gazette.
- Goods specified in the third schedule are:

Sr. No.	Description	Sr. No.	Description
1.	Fruit Juices and Vegetable Juices	11.	Toilet Soap
2.	Detergents	12.	Shampoo

Sr. No.	Description	Sr. No.	Description
3.	Toothpaste	13.	Milky Drinks
4.	Shaving Cream	14.	Powder Drinks
5.	Perfumery and Cosmetics	15.	Toilet paper & tissue paper
6.	Ice Cream	16.	Spices sold in retail packing bearing brand names and trademarks.
7.	Tea	17.	Cement sold in retail packing
8.	Aerated Waters or Beverages	18.	Shoe polish and shoe cream
9.	Syrups and Squashes	19.	Mineral / Bottled water
10.	Cigarettes	20.	Other household and specified items

- Import of following items:

Sr. No.	Description
11.	Import of pet food including of dogs and cats
12.	Import of coffee sold in retail packing
13.	Import of chocolates sold in retail packing
14.	Import of cereal bars sold in retail packing

- Federal Government may, subject to such conditions and restrictions as it may impose, by notification in the official Gazette, declare that the tax on goods specified in the Third Schedule shall be collected and paid at such higher rate or rates on the retail price thereof, as may be specified in the said notification.
- As per SRO 297(I)/2023 dated 08 March 2023 Federal Government has directed to charge sales tax @ 25% on **import and subsequent supply** of following third schedule goods:

Sr. No.	Imported goods/Articles
1.	Aerated water or beverages
2.	Cigarettes, Cigars and e-cigarettes
3.	Cosmetic and shaving items
4.	Tissue papers
5.	Household articles including crockery, kitchenware and tableware
6.	Home appliances in CBU
7.	Ice cream
8.	Fruit and vegetable juices
9.	Mattress and sleeping bags
10.	Shampoos

3.3 Special rates of tax [Sect 3(2)(b)]

The Federal Government is empowered to prescribe any higher or lower rate of tax in respect of any class of taxable goods. Vide SRO 297(I)/2023 dated 08 March 2023 Federal Government has directed to charge sales tax @ 25% on import and subsequent supply of following goods:

Sr. No.	Imported goods/Articles
1.	Confectionery
2.	Vehicles in CBU Condition
3.	Sanitary and bathroom wares
4.	Carpets (excluding those from Afghanistan)
5.	Chandeliers and lighting devices or equipment
6.	Chocolates
7.	Corn flakes and other ready to use cereals
8.	Decorations or ornamental articles
9.	Dog and cat food only
10.	Doors and window frames
11.	Fish
12.	Footwear
13.	Fruits and dry fruits (excluding those imported through land route or barter mechanism)
14.	Furniture
15.	Jams, jellies and preserved fruits
16.	Leather jackets and apparels
17.	Fresh, chilled, frozen, preserved or processed meat
18.	Musical instruments
19.	Pasta
20.	Arms and ammunition excluding defence stores
21.	Sunglasses
22.	Tomato ketchup and sauces
23.	Travelling bags and suitcases
24.	A ship designed or adapted for use of recreation or pleasure or private use
25.	An aircraft designed or adapted for use for recreation or pleasure or private use
26.	Articles of jewellery
27.	Wristwatches

Moreover, sales tax @ 25% will be charged on supply of following locally manufactured goods:

Sr. No.	Supply of locally manufactured goods
1.	Locally manufactured or assembled vehicles having engine capacity of 1400cc and above
2.	Locally manufactured or assembled vehicles if invoice value (excluding sales tax) exceeds Rs. 4 million
3.	Locally manufactured or assembled double cabin (4x4) pick up vehicles

Note: Enhanced rates of SRO 297 dated 8.3.2023 shall not be applicable on goods specified in 8th Schedule.

3.4 Extra tax [Sec 3(5)]

The Federal Government is empowered to levy and collect tax at such extra rate or amount not exceeding 18% in addition to the amount of sales tax or retail tax, levied under Sales Tax Act, 1990. This tax shall be levied on the value of such goods or class of goods, on such persons or class of persons, in such mode, manner and at time and subject to such conditions and limitations as may be prescribed.

3.5 Capacity tax [Sec 3(1B)]

On the goods specified in the Tenth Schedule, in lieu of levying and collecting tax on taxable supplies, the tax shall be levied and collected, in the mode and manner specified therein on:-

- a) production capacity of plants, machinery, undertaking, establishments or installations producing or manufacturing such goods; or
- b) fixed basis, as it may deem fit, from any person who is in a position to collect such tax due to the nature of the business.

3.6 Tax on retailers [Sec 3(9)]

- Tier-I category retailers shall pay tax in normal manner at standard rate of 18%.
- Tax shall be charged from retailers other than those falling in Tier-1, through their monthly electricity bills in the following manner:
 - i. Sales tax @ 5% where the monthly bill amount does not exceed Rs 20,000.
 - ii. Sales tax @ 7.5% where the monthly bill amount exceeds Rs 20,000.

The electricity supplier shall deposit the amount so collected directly without adjusting against his input tax.

The above tax on other than tier-I retailers is other than normal tax of 18%, further tax of 4% and extra tax.

3.7 Tax on steel products/ship plates [Sec 3(9AA)]

In respect of goods, specified in the Thirteenth Schedule, the minimum production for a month shall be determined on the basis of a single or more inputs as consumed in the production process as per criterion specified in the Thirteenth Schedule and if minimum production so determined exceeds the actual supplies for the month, such minimum production shall be treated as quantity supplied during the month and the liability to pay tax shall be discharged accordingly.

3.8 Tax on supply to CNG stations

- In case of supply of natural gas to CNG stations, the Gas Transmission and Distribution Company shall charge sales tax from the CNG stations at the rate of 18% on the value of supply to the CNG consumers.
- Value for the purpose of levy of sales tax shall include price of natural gas, charges, rents, commissions and all local, provincial and Federal duties and taxes but excluding the amount of sales tax

3.9 Special Powers to the Federal Government [Sec 3(6)]

The Federal Government or the Board is authorised to levy, in lieu of Sales Tax, by notification in the Official Gazette such amount of tax as it may deem fit on any supplies or class of supplies or any goods or class of goods. They are also authorized to specify the mode, manner or time of payment of such tax.

3.10 Taxation of digital transactions within Pakistan

- Supply of digitally ordered goods would be subject to sales tax withholding at a rate of 2% on gross value of supplies from the persons supplying digitally ordered goods from within Pakistan through online marketplace, website, software applications.
- Whereas such withholding tax would be final discharge of sales tax liability for cottage industry and retailers (other than tier-I retailers). However, no input tax adjustment will be allowed to them and such persons are not required to obtain sales tax registration.

- The liability to collect and pay sales tax at the rate of 2% will be on the “courier” for supplies made on a CoD basis and on the “payment intermediary” in case of digital payments, The terms courier and payment intermediary are defined as under:

“courier” means any entity engaged in the delivery of goods and collection of cash on behalf of a seller including logistic services and ride-hailing services.

“Payment intermediary” means a banking company, any financial institution including a licensed foreign exchange company or payment gateway that facilitate the transfer of funds or payment instructions between two or more parties to enable, process, route, or settle payments in a financial transaction, without being the ultimate source or recipient of the payment.

- The Act provides mandatory registration for every person (except Cottage Industry and the persons other than Tier-1 retailers), including a non-resident person, selling goods from within Pakistan through an online marketplace, website or software application, in the prescribed form and manner.
- To implement the registration measure for such persons, the Act provides to restrict any person to use services of online marketplaces and couriers from conducting e-commerce transactions unless that person is registered for income and sales tax purposes.
- To ensure accuracy and compliance with the aforementioned legal provisions, the Act provides the submission of a monthly statement in the prescribed form by online marketplaces, payment intermediaries and couriers. This statement will detail vendor-wise amount of supplies made of taxable digitally ordered goods, corresponding tax due and any other prescribed information, irrespective of the economic ownership of supplies from within Pakistan

► *Example*

ABC Traders is a **small retailer** based in Lahore that sells household items through an online marketplace called *E-Mart Online*. A customer places an order for goods worth **Rs. 100,000**, selecting **Cash on Delivery (CoD)** as the payment method. The goods are delivered by *SpeedX Logistics*, a courier company.

As per the **Finance Act, 2025**, under the **Eleventh Schedule** to the **Sales Tax Act, 1990**, a **courier company is required to withhold 2% sales tax** on the **gross value** of digitally ordered goods supplied from within Pakistan. This **withheld amount constitutes the final sales tax liability** in the case of **retailers other than Tier-1 retailers**.

Required

Calculate the amount of tax to be withheld by the courier and explain the tax treatment for ABC Traders.

► *Answer*

1. Gross Supply Value = Rs. 100,000
2. Sales Tax Withheld (2%) = Rs. 100,000 × 2% = Rs. 2,000
3. Net Payment to ABC Traders = Rs. 98,000

Tax Treatment:

- **ABC Traders**, being a **non-Tier-1 retailer**, is not required to register for sales tax.
- The **2% tax withheld by the courier** is treated as **final discharge** of ABC Traders' sales tax liability for that transaction.
- ABC Traders is **not entitled to input tax adjustment**.
- The **courier (SpeedX Logistics)** must **deposit the Rs. 2,000** to the FBR and submit a **monthly statement** under **Section 26**, listing seller-wise details.

4 LIABILITY TO PAY SALES TAX

4.1 Liability to pay tax [Sect 3(3)]

- The liability to pay the tax shall be:
 - i. In the case of supply of goods in Pakistan, of the person making the supply, and
 - ii. In the case of goods imported into Pakistan, of the person importing the goods.
- The Board with the approval of the Federal Minister in-chagre may specify the goods in respect of which the liability to pay tax shall be of the person receiving the supply.

4.2 Collection of excess sales tax [Sec 3B]

- Any person who has collected or collects any tax or charge, whether under misapprehension of any provision of this Act or otherwise, which was not payable as tax or charge or which is in excess of the tax or charge actually payable and the incidence of which has been passed on to the consumer, shall pay the amount of tax or charge so collected to the Federal Government.
- Any amount payable to the Federal Government shall be deemed to be an arrear of tax or charge payable under this Act and shall be recoverable accordingly and no claim for refund in respect of such amount shall be admissible.
- The burden of proof that the incidence of tax or charge has been or has not been passed to the consumer shall be on the person collecting the tax or charge.

► Exercise

Hassan (Pvt.) Ltd. under misapprehension collected additional sales tax of Rs. 100,000 from one of its customers. 65% of the goods on which additional sales tax was collected are still lying with the customer as unsold stock.

► Answer

In the above scenario, since 65% of the stock, on which excess tax of (100,000 x 65%) Rs. 65,000 was collected, is still unsold, Hassan Ltd should return this amount to its customer. However the balance amount of Rs. 35,000, the incidence of which has been passed on to the consumers should be deposited with the Federal Government.

4.3 Joint and several liability of registered persons in supply chain where tax unpaid (Sec 8A)

- Where a registered person receiving a taxable supply from another registered person is in the knowledge or has reasonable grounds to suspect that some or all of the tax payable in respect of that supply or any previous or subsequent supply of the goods supplied would go unpaid of which burden to prove shall be on the department, such person as well as the person making the taxable supply shall be jointly and severally liable for payment of such unpaid amount of tax.
- Provided that the Board may by notification in the official gazette, exempt any transaction or transactions from the provisions of this section.

5 ZERO RATING AND EXEMPTION

5.1 Goods charged to tax @ 0%

- Value of following goods shall be charged to tax at the rate of zero percent:
 - i. goods exported, or the goods specified in the Fifth Schedule;
 - ii. supply of stores and provisions for consumption aboard a conveyance proceeding to a destination outside Pakistan as specified in the Customs Act, 1969; and
 - iii. such other goods, as the Federal Government may specify by notification in the official Gazette, whenever circumstances exist to take immediate action for the purposes of national security, natural disaster, national food security in emergency situations and implementation of bilateral and multilateral agreements

5.2 Exception to the above rule

- Provision relating to zero rating shall not apply in respect of a supply of goods which:
 - i. are exported, but have been or are intended to be re-imported into Pakistan; or
 - ii. have been entered for export under the Customs Act, 1969, but are not exported; or
 - iii. have been exported to a country specified by the Federal Government, by Notification in the official Gazette.
- Federal Government may, by a notification in the Official Gazette, restrict the amount of credit for input tax actually paid and claimed by a person making a zero-rated supply of goods otherwise chargeable to sales tax.

5.3 Relevant extracts from the Fifth Schedule is given hereunder

Sr. #	Description
1	Supplies of raw materials, components and goods for further manufacture of goods in the Export Processing Zone.
2	Supply to diplomats, diplomatic missions, privileged persons and organizations
3	Supplies made to exporters under the Duty and Tax Remission Rules, 2001
4	Supplies of raw materials, components and goods for further manufacture of goods in the Gwadar Free Zone and export thereof

5.4 Goods exempt from sales tax [Sec 13]

- Supply of goods or import of goods specified in the Sixth Schedule shall, subject to such conditions as may be specified by the Federal Government, be exempt from tax under Sales Tax Act. The provisions of section 13 shall apply notwithstanding anything contained in section 3.
- the Federal Government may, whenever circumstances exist to take immediate action for the purposes of national security, natural disaster, national food security in emergency situations and implementation of bilateral and multilateral agreements, by notification in the official Gazette, exempt any supplies made or imports, of any goods or class of goods from the whole or any part of the tax chargeable under this Act, subject to the conditions and limitations specified therein; Exemption from tax chargeable under above second paragraph above may be allowed from any previous date specified in the notification issued or order made.
- The Board shall place before the National Assembly all exemptions related notifications issued during the financial year.
- Any notification issued above, if not earlier recommended stand rescinded on the expiry of financial year in which it has issued.

► *Exercise:*

Distinguish the concept of zero rating with exempt supply as laid down in the Sales Tax Act 1990.

Distinction points	Zero Rated Supply	Exempt Supply
Definition under section 2	(48) "Zero rated supply means a taxable supply which is charged to tax at the rate of zero per cent under section 4"	(11) "Exempt Supply means a supply which is exempt from tax under section 13"
Products covered	Goods exported, notified by FBR or listed in the Fifth Schedule are charged to sales tax at the rate of zero per cent.	Goods listed in Sixth Schedule are exempt supplies. Moreover, Federal Government and FBR may specify any goods exempt from levy of tax.
Invoicing Requirements	Invoice shall be raised for the goods supplied but sales tax shall be charged at the rate of zero per cent	No sales tax invoice shall be raised.
Registration	A person engaged in zero rated supplies has to be registered with the Sales tax department.	A person engaged exclusively in the exempt supplies is not liable to be registered under the sales tax Act.
Input tax credit	Input Tax paid related to zero rated supplies is refundable.	Input Tax paid related to Exempt supplies is inadmissible, therefore, neither adjustable nor refundable.

6 REGISTRATION

6.1 Registration and person required to be registered [Sec 14]

- Every person engaged in making taxable supplies in Pakistan, including zero-rated supplies, in the course or furtherance of any taxable activity carried on by him, falling in any of the following categories, if not already registered, is required to be registered under this Act, namely:-
 - a) a manufacturer who is not running a cottage industry;
 - b) a retailer who is liable to pay sales tax excluding such retailer required to pay sales tax through his electricity bill;
 - c) an importer;
 - d) an exporter who intends to obtain sales tax refund against his zero-rated supplies;
 - e) a wholesaler, dealer or distributor; and
 - f) a person who is required, under any other Federal law or Provincial law, to be registered for the purpose of any duty or tax collected or paid as if it were a levy of sales tax to be collected under the Act;
- Persons not engaged in making of taxable supplies in Pakistan, if required to be registered for making imports or exports, or under any provisions of the Act, or any other Federal law, may apply for registration.
- The registration shall be regulated in such manner as the Board may, by notification in the official Gazette, prescribe.

► Exercise

Under the provisions of Sales Tax Act, 1990 and Rules made thereunder, briefly explain whether the persons under each of the following situations are required to be registered with Inland Revenue Department. Also compute the amount of sales tax, if any, payable by or refundable to such persons. The rate of sales tax is 18%.

- i. A manufacturer whose annual turnover during the last twelve months ended 31 March 2025 is Rs. 14,500,000 and the amount of his annual utility bills for the same period is Rs. 800,000.
- ii. A distributor whose annual turnover during the last twelve months is Rs. 3,000,000.
- iii. An importer whose annual turnover is Rs. 12,000,000.
- iv. A commercial exporter who intends to claim a refund of Rs. 200,000.

► Answer

Requirement of registration:

- i. Manufactures other than those classified as cottage industry are required to be registered under the Sales Tax Rules 2006. Cottage industries are those that will fulfil the conditions specified in section 2(5AB) of the STA, 1990.

Therefore, in this case since the manufacturer is a not cottage industry, it is required to be registered and pay any sales tax and compute its sales tax liability on monthly basis.

- ii. Since a distributor is required to be registered with Inland Revenue Department irrespective of his turnover, therefore, in this case the distributor would register with the Inland Revenue Department and pay sales tax of Rs. 540,000 on his turnover of Rs. 3,000,000.
- iii. Since an importer is required to be registered with Inland Revenue Department irrespective of his turnover, therefore, in this case the importer would be required to register himself with the Inland Revenue Department.

Sales tax at import stage would be paid on the basis of import value.

- iv. A commercial exporter is not required to be registered with Inland Revenue Department. However, an exporter who intends to obtain sales tax refund against his zero-rated supplies must get registration before making an application for such refund. Therefore, in this case since the exporter intends to claim a refund of Rs. 200,000 he must get himself registered with Inland Revenue Department.

6.2 Coercive actions for non-registration

The Act has introduced a sub-section 2(A) in section 14 of the ST Act authorizing the Commissioner or any other officer to compulsorily register a person who is required to be registered under the ST Act but fails to apply for the registration, after an appropriate inquiry.

Currently, the tool of compulsory registration is used under the ST Act to identify the undocumented sector that supplies taxable goods but has not registered for sales tax purposes. To address this issue, the Federal Government has introduced punitive measures that involves discontinuance of gas and electricity connections for unregistered individuals. This action would be enforced through general orders issued by the FBR.

Actions will be taken against the person who is liable to be registered but fails to do so through the introduction of Sections 14AC, 14AD, and 14AE. These three sections are summarized in the table below:

Section	Trigger condition	Procedure	Enforcement Measures
Bar on operation of bank accounts- Sec-14AC	Commissioner believes an individual/entity is supplying taxable goods/services without registration	Person given 3 separate show-cause notices and hearing opportunities. After failed response, intermittent suspensions of bank account through direction to banks.	- Suspension of bank account operations (each suspension lasts 3 working days, up to 3 times, with ≥ 1 week gap between the suspension) - Continuous non-compliance-Escalation by directing the bank to permanently bar operation of bank accounts
Bar on transfer of immoveable property- Sec-14AD	Failure to obtain registration within 15 days from issuance of order u/s 14AC- permanent bar of bank account	- Committee composition (Chief Commissioner + Commissioner + commerce/trade body rep) - Opportunity of being heard to taxpayer and to get registration within fifteen days prior to recommendation	- Committee recommendation to Commissioner for imposition of bar on transfer of immoveable property - Commissioner will direct the property registration authority to bar transfer of immoveable property
Other measures for non-registration- Sec-14AE	Continued non-registration and non-compliance even after action u/s 14AC and 14AD	- Committee composition (Chief Commissioner + Commissioner + commerce/trade body rep) - Issuance of public notice specifying date from which a sanction is to be imposed - Placement of decision on the Board website and newspaper.	Chief Commissioner shall have power to - Seal the business premises - seizure of movable assets - appointment of receivers for management of taxable activity

6.2 Registration application, Electronic filing of return (Rule 5,18)

Every person who intends to get itself registered is required to file an application for registration. The Sales Tax Rules prescribes the mechanism for filing of this application in the following manner:

- A person required to be registered, before making any taxable supplies, apply on the computerized system through owner, authorized member or partner or authorized director, as the case may be, in the Form STR-1. Such application shall specify the Regional Tax Office (RTO) in whose jurisdiction the registration is sought, as per criteria given below:
 - a) in case of listed or unlisted public limited company, the place where the registered office is located;
 - b) in case of other companies—
 - i. if the company is primarily engaged in manufacture or processing, the place where the factory is situated; and
 - ii. if the company is primarily engaged in business other than manufacture or processing the place where main business activities are actually carried on;
 - c) in case of a person not incorporated, the jurisdiction where the business is actually carried on; and
 - d) in case of a person not incorporated, having a single manufacturing unit and whose business premises and manufacturing unit are located in different areas, the jurisdiction where the manufacturing unit is located
- The jurisdiction of Large Taxpayers Units shall remain as specified by the Board. Further, the Board may transfer the registration of any registered person to a jurisdiction where the place of business or registered office or manufacturing unit is located.
- The applicant having NTN or income tax registration shall, using his login credentials, upload following information and documents:
 - a) bank account certificate issued by the bank in the name of the business;
 - b) registration or consumer number with the gas and electricity supplier;
 - c) particulars of all branches in case of multiple branches at various locations;
 - d) GPS tagged photographs of the business premises; and
 - e) in case of manufacturer, also the GPS tagged photographs of machinery and industrial electricity or gas meter installed.
 - f) in the case of an individual, association of persons and a company having only one shareholder or member, other than manufacturer, a balance sheet indicating the amount of business capital with corresponding assets in the bank, amounts attributable to partners with percentage.

Provided that where an individual, an association of persons and a company having only one shareholder or member, other than manufacturer, already registered, do not fulfil the requirement, the electronic filing of return shall only be allowed with prior authorization of the Commissioner through IRIS.

- Rule 5(4) previously required biometric verification only for new registrations. A proviso is now inserted through which every individual, partner of an association of persons and director of single member company are required to visit e-Sahulat Centre of NADRA during the month of July every year for biometric re-verification. In case of failure of biometric re-verification, the electronic filing of return shall only be made with prior approval of the Commissioner through IRIS.
- An individual, association of persons and a company having only one shareholder or member, will be required authorization from Commissioner through IRIS for filing of Sales Tax Return in case such registered person wants to declare it sales which is five times more than the sum of capital and liabilities declared in the balance sheet. This authorization is not required for persons registered as manufacturer.

6.3 Temporary registration (Rule 5A)

- Where a person files application for sales tax registration as a manufacturer without having installed machinery, for the purpose of import of machinery to be installed by him, temporary registration as manufacturer shall be allowed to him for a period of sixty days subject to furnishing of the complete list of machinery to be imported along with Bill of Lading (BL) or Goods Declaration (GDs).
- The temporary registration shall be issued by the computerized system within seventy-two hours of filing of the complete application.
- After receiving temporary registration, the person shall be allowed to import plant, machinery and raw materials, etc. as a manufacturer, subject to submission to the customs authorities of a post-dated cheque equal to the difference in duties and taxes to be availed as a manufacturer.
- In case the requirements prescribed in clause (h) of sub-rule (1A) and sub-rule (1B) of rule 5 are not fulfilled within sixty days of issuance of the temporary registration, such temporary registration shall be disabled and the post-dated cheques submitted shall be encashed.
- A person holding temporary registration shall file monthly return in the form STR-7, but shall not issue a sales tax invoice and if such invoice is issued, no input tax credit shall be admissible against such invoice.
- No sales tax refund shall be paid to the person during the period of temporary registration and the amount of input tax may be carried forward to his returns for subsequent tax periods.

6.4 Option to file application with Commissioner Inland Revenue (Rule 9)

- A person who is unable to file application for registration or change in particulars of registration directly in computerized system may submit the prescribed application and required documents to the concerned Commissioner Inland Revenue at RTO, which shall ensure entry of the application and documents in computerized system within three days.

6.5 Compulsory registration (Rule 6)

Rule 6 of the sales tax rules states that:

- if a person, who is required to be registered under the Act, does not apply for registration and the CIR or any other officer, as may be authorized by the Board, after such inquiry as deemed appropriate, is satisfied that such person is required to be registered, he shall issue notice to such person in the Form set out in Form STR-6.
- In case the CIR receives a written reply from the said person within the time specified in the above notice, contesting his liability to be registered, the CIR shall grant such person opportunity of personal hearing, if so desired by the person, and shall thereafter pass an order whether or not such person is liable to be registered compulsorily. Copy of the said order shall invariably be provided to that person. Where the CIR passes the order for compulsory registration, he shall cause the said person to be registered through computerized system.
- Where the person to whom a notice as given above, does not respond within the time specified in the notice, the CIR shall cause to compulsorily register the said person through computerized system under intimation to the said person through courier service.
- A person registered compulsorily as above is required to comply with all the provisions of the Act and rules made there under from the date of compulsory registration, and in case of failure to do so, the CIR having jurisdiction may issue notice U/S 25 of the Act for production of records or documents and appearance in person to assess the amount of sales tax payable U/S 11 of the Act, and take any other action as required under the law against such person:

Provided that if it is subsequently established that a person was not liable to be registered but was wrongly registered under this rule due to inadvertence, error or misconstruction, the CIR shall cause to cancel his registration through the computerized system. In case of such cancellation of registration, such person shall not be liable to pay any tax, default surcharge or penalty under the Act or rules made there under, subject to the conditions, limitations and restrictions prescribed U/S 3B of the Act.

6.6 Change in the particulars of registration (Rule 7)

- In case there is a change in the name, address or other particulars as stated in the registration certificate, the registered person shall notify the change in the Form STR-I to the computerized system, within fourteen (14) days of such change.
- The change of business category as 'manufacturer' shall be allowed subject to fulfilment of all applicable requirements as specified in rule 5.
- In case of approval of the change applied for, a revised registration certificate shall be issued through computerized system, which shall be effective from the date the person applied for the change.
- The CIR may, based on available information or particulars and after making such inquiry as he may deem necessary and after providing reasonable opportunity of being heard to a person, by an order in writing, make modifications in registration of the person.

6.7 Transfer of registration (Rule 8)

- The Board may, in accordance with rule 5 or otherwise, by an order, transfer the registration of a registered person from the jurisdiction of one LTU or RTO to another.
- On transfer of registration,--
 - a) all the records and responsibilities relating to such registered person shall be transferred to the LTU or RTO, in whose jurisdiction the registration has been so transferred;
 - b) notwithstanding the actions already taken, being taken or otherwise pending immediately before the transfer in respect of such registered person under any of the provisions of the Act or the rules made there under in the LTU or RTO from where his registration has been transferred, the LTU or RTO, in whose jurisdiction the registration is so transferred shall exercise the jurisdiction over such person in the manner as if it always had such jurisdiction.
- In case of transfer of registration as above, the Board shall issue intimation letter to the registered person along with copy to concerned LTU or RTO.
- In case a registered person intends to shift his business activity from the jurisdiction of one LTU or RTO to another, or he has any other valid reason for such transfer, he shall apply to the Board for transfer of his registration along with Form STR-I. The Board shall follow the procedure as provided above.

6.8 Cancellation of multiple registrations (Rule 10)

- In case a person holds multiple sales tax registrations, he shall retain only one registration and surrender all other registrations under intimation to concerned CIR at RTO.
- Provided that the Board may, subject to such conditions as it may deem appropriate, allow or allocate a person separate registration for manufacturing units located in different LTU or RTO.
- The tax liabilities against the registration cancelled as above shall be transferred against the registration retained and in case of such registrations being in different LTU or RTO, the CIR having jurisdiction over cancelled registrations shall ensure that tax arrears' files are transferred to the LTU or RTO, having jurisdiction over the registration so retained.

7 DE-REGISTRATION

7.1 De-registration (Sec 21)

- The Board or any Officer, authorised in this behalf, may deregister a registered person or such class of registered persons as are not required to be registered under the Sales Tax Act. The deregistration shall be made in accordance with the rules framed by Board.

In addition to aforesaid provision of the Sales Tax Act, 1990, following Rule 11 of Sales tax rules, 2006 are also prescribed in connection with de registration:

- A registered person may be liable for deregistration due to any of the following reasons:
 - i. He ceases to carry on his business;
 - ii. His supplies have become exempt from tax;
 - iii. He transfers or sells his business;
 - iv. Merger with another person; or
 - v. Failure to file tax return for six consecutive months.

7.2 Procedure of de-registration (Rule 11)

- Every registered person who ceases to carry on his business or whose supplies become exempt from tax, or who ceases to remain registered shall apply to the Commissioner Inland Revenue having jurisdiction for cancellation of his registration in Form STR-3, and the Commissioner, on such application or on its own initiative, may issue order of deregistration or cancellation of the registration of such person from such date as may be specified, but not later than ninety days from the date of such application or the date all the dues outstanding against such person are deposited by him, whichever is later and such person shall cause to be deregistered through computerized system accordingly. The Commissioner, upon completion of any audit proceedings or inquiry which may have been initiated consequent upon the application of the registered person for de-registration, shall complete the proceedings or inquiry within ninety days from the date of application and direct the applicant to discharge any outstanding liability which may have been raised therein by filing a final return under section 28:

Provided that the person applying for de-registration shall not be de-registered unless he provides record for the purpose of audit or inquiry.

- If a registered person fails to file tax return for six consecutive months, the Commissioner, without prejudice to any action that may be taken under any other provision of the Act, after issuing a notice in writing and after giving an opportunity of being heard to such person, shall issue order of de-registration of such person and the computerized system shall be caused to de-register the person accordingly. The obligations and liabilities of the person whose registration is cancelled under sub-rule (1) relating to the period when he conducted business as a registered person shall not be affected by the fact that his registration has been cancelled or that he has ceased to be a registered person.

7.3 Suspension and Blacklisting of registration [Sec-21]

- Where the Commissioner is satisfied that a registered person is found to have issued fake invoices or has otherwise committed tax fraud, he may issue an order of suspension and blacklisting such person or suspend his registration in accordance with such procedure as the Board may by notification in the official Gazette, prescribe
- The Commissioner shall, within ten days of issuance of order of suspension, issue a show cause notice to the registered person. Upon receipt of the reply to the notice and after giving an opportunity of hearing to the registered person, if the Commissioner is satisfied, he may order for revoking of suspension of the registered person or issue an appealable speaking order for blacklisting of the registered person within thirty days of receipt of the reply to the notice

- During the period of suspension of registration, the invoices issued by such person shall not be entertained for the purposes of sales Tax refund or input tax credit, and once such person is black listed, the refund or input tax credit claimed against the invoices issued by him, whether prior or after such black listing, shall be rejected through a self-speaking appealable order and after affording an opportunity of being heard to such person

7.3 Suspension of registration [Rule 12(a)]

- Where the Commissioner or Board has reasons to believe that the registered person is to be suspended or blacklisted, in order to ensure that the LTUs and RTOs follow a uniform policy for suspension and blacklisting of sales tax registered persons under section 21(2) of the Act and for subsequent proceedings in such cases, the following procedure shall be followed, namely:-

(a) Suspension

- i. Where a Commissioner, having jurisdiction, is satisfied that a registered person has issued fake invoices, evaded tax or committed tax fraud, registration of such person may be suspended by the Commissioner through the system, without prior notice, pending further inquiry. The basis for such satisfaction may inter alia include the following, namely:-
 - a. non-availability of the registered person at the given address;
 - b. refusal to allow access to business premises or refusal to furnish records to an authorized Inland Revenue Officer;
 - c. abnormal tax profile, such as taking excessive input tax adjustments, continuous carry-forwards, or sudden increase in turnover;
 - d. making substantial purchases from or making supplies to other blacklisted or suspended person;
 - e. non-filing of sales tax returns;
 - f. on recommendation of a commissioner of any other jurisdiction;
 - g. any other reason to be specified by the Commissioner;
- ii. the suspension of registration shall take place through a written order of the Commissioner concerned, giving reasons for suspension. This order shall be endorsed to the registered person concerned, all other LTUs/RTOs, the FBR's computer system, the STARR computer system and the Customs Wing computer system for information and necessary action as per law; 43 Substituted for the words —the procedure as prescribed by the Board shall be followed|| by Notification No. SRO. 494(I)/2015, dated 30th June, 2015. Sales Tax Rules, 2006
- iii. a registered person who does not file sales tax return for six consecutive months shall be caused to be suspended through the system without any notice;
- iv. in cases, where the buyers and suppliers of any such person, whose registration is being suspended, belongs to another LTU/ RTO, and these buyers / suppliers are also required to be suspended, the Commissioner shall intimate the Chief Commissioner of the concerned LTU/RTO in whose jurisdiction such buyers/suppliers fall, in writing explaining the complete facts of the case and the reasons on the basis of which these buyers/suppliers are to be suspended, to initiate proceedings for suspension/blacklisting of the buyers/suppliers;
- v. no input tax adjustment/refund shall be admissible to the registered person during the currency of suspension. Similarly, no input tax adjustment/refund shall be allowed to any other registered persons on the strength of invoices issued by such suspended person (whether issued prior to or after such suspension), during the currency of suspension;

- vi. the Commissioner shall, within seven days of issuance of order of suspension, issue a show cause notice (through registered post or courier service) to the registered person to afford an opportunity of hearing with fifteen days of the issuance of such notice clearly indicating that he will be blacklisted, in case–
 - a) there is no response to the notice;
 - b) he has not provided the required record;
 - c) he has not allowed access to his business record or premises; and
 - d) any other reason specified by the Commissioner;
- vii. in case show cause notice is not issued within seven days of the order of suspension, the order of suspension shall become void ab-initio;
- viii. in case of non-availability of the suspended person at the given address, the notice may be affixed on the main notice Board of the LTU/RTO;
- ix. on receipt of the reply to the notice and after giving an opportunity of hearing to the registered person, if the Commissioner is satisfied, he may order for revoking of suspension of the registered person;

7.4 Blacklisting [Rule 12(b)]

- in case, after giving an opportunity of hearing, the offence is confirmed, the Commissioner shall issue an appealable self-speaking order for blacklisting of the registered person, and shall proceed to take legal and penal action under the relevant provisions of the Act;
- the order of blacklisting shall contain the reasons for blacklisting, the time period for which any refund or input tax claimed by such person or by any other registered person on the strength of invoices issued by him from the date of his registration shall be inadmissible, any recovery to be paid or penalties to be imposed;
- the order of blacklisting shall be issued within ninety days of the issuance of the notice of hearing. In case, the order of blacklisting is not issued within this time period the suspension of registered person shall become void ab-initio;
- copies of the order shall be endorsed to the registered person concerned, all other LTUs/RTOs, the FBR/PRAL computer system, the STARR computer system and the Customs Wing computer system. Each LTU/RTO shall circulate all such lists to their refund sections, audit sections and other concerned staff to ensure that the order is implemented in letter and spirit by all concerned;
- all LTUs / RTOs shall further circulate the copies of the order along with a computer system-generated list of invoices issued by the blacklisted persons as referred to in the preceding clause, to all officers of Inland Revenue having jurisdiction over the registered persons who have claimed credit of input tax or refund on the strength of the invoices issued by the said blacklisted persons; and
- the officer of Inland Revenue receiving the aforesaid list under clause (v) shall issue show-cause notice under section 11 and sub-section (3) of section 21 of the Act to a registered person for rejecting the input tax or refund claimed against the invoices so circulated and further proceed to decide the matter as per law through a self-speaking appealable order and after affording a reasonable opportunity of being heard to such person, in the manner as provided in the said sub-section (3).].

7.5 Discontinuance of gas and electricity connections [Sec 14(AB)]

- FBR is empowered to discontinue the supply of gas and electricity to the following persons while notifying the gas and distribution companies:

Persons	Reasons
Any person including Tier-1 retailer	Fails to register for sales tax purpose
Registered tier 1 retailers	Not integrated with FBR System

- FBR shall restore their connections subsequent upon registration/integration.

DETERMINATION OF SALES TAX LIABILITY

IN THIS CHAPTER:

1. Determination of tax liability
2. Output tax
3. Input tax
4. Tax refunds, assessment and recovery

1 DETERMINATION OF TAX LIABILITY

1.1 Determination of tax liability [Sec 7]

- The liability of a registered person in respect of taxable supplies made by him during the tax period shall be the difference between:
 - i. Output tax due from him in respect of taxable supplies made during a tax period; and
 - ii. Input tax paid or payable during the said tax period for the purpose of taxable supplies made or to be made by him excluding the amount of further tax.
- Where a registered person did not deduct input tax within the relevant period, he may claim such tax in the return for any of the six succeeding tax periods.
- Credit for input tax paid on purchases which are not paid for as per the provisions of section 73, shall not be allowed.
- Deduction of input tax from the output tax payable by a registered person shall be allowed if:
 - i. In case of a claim for input tax in respect of a taxable supply made, he holds a tax invoice in his name and bearing his registration number in respect of such supply for which a return is furnished or in case of supply of electricity or gas, a bill bearing his registration number and the address where the connection is installed;
 - ii. In case of goods imported into Pakistan, he holds bill of entry or goods declaration in his name and showing his sales tax registration number, duly cleared by the customs under section 79, section 81 or section 104 of the Customs Act, 1969; and
 - iii. In case of goods purchased in auction, he holds a treasury challan bearing his name and his registration number showing payment of Sales Tax.
- The sales tax liability of a registered person is determined by the following equation:

Particulars	Rs.
Output sales tax on supplies +/ – effect of debit/credit notes	xxx
Admissible input sales tax on purchases or utilities	(xxx)
Balance sales tax payable/carried forwarded/ (refundable)	xxx / (xxx)

Certain transactions and input tax related thereto that are inadmissible (Sec 73)

1. Any payment exceeding 50,000 (excluding utilities) to single supplier in a tax period must be made using the banking channel.
2. Payment must be made from business bank account of buyer to business bank account of the supplier. Bank account of both buyer and supplier should be declared to the Board at the time of registration/through change of particulars subsequently.
3. Payment must be made within 180 days of issuance of tax invoice in case of credit transactions. (the Board may extend time through condonation u/s 74)

Adjustments made by a registered person in respect of amounts payable and receivable to and from the same party shall be treated as payments satisfying the provisions of this section subject to the conditions that sales tax has been charged and paid by both parties, wherever applicable and the registered person has sought prior approval of the Commissioner before making such adjustments.

If any of the above conditions are not fulfilled, then:

- a) Buyer will not be entitled to claim input tax/refund/zero rating.
- b) Supplier will not be entitled to claim input tax/refund/zero rating/ if amount not received in bank account.

Note 1: Input tax should be reversed in the month after lapse of 180 days.

Note 2: Sec 73 not applicable on registered person supplying goods to unregistered person. However, supplier should deposit cash in his business bank account to claim input tax

Restriction on input on supplies to unregistered persons (Sec 73(4), Sec 23, Sec 8)

1. A registered person shall not be entitled to claim input tax on supplies made to unregistered persons. The Federal Board of Revenue (FBR), with the approval of the Federal Government, will prescribe the applicable sales threshold in the future. Consequently, the previous threshold of Rs. 10 million per month or Rs. 100 million per year is no longer applicable.
2. Similarly as per section 23 read with section 8, any tax invoice issued shall bear the CNIC/NTN number in case supplies are made by manufacturer or importer to unregistered distributor. In case of non-compliance input tax attributable to supplies made to unregistered distributor on pro-rata basis is disallowed. Similarly, expense will be disallowed proportionate to total turnover in income tax.

1.2 Change in the rate of tax [Sec 5]

- If there is a change in the rate, tax shall be applicable as under:-
 - i. A taxable supply made by a registered person shall be charged to tax at such rate which is in force at the time of making supply;
 - ii. Imported goods shall be charged to tax at such rate as is in force:
 - a) in case the goods are entered for home consumption, on the date on which a goods declaration is presented under section 79 of the Customs Act, 1969; and
 - b) in case the goods are cleared from warehouse, on the date on which a goods declaration for clearance of such goods is presented under section 104 of the Customs Act, 1969.
- Where goods declaration is presented in advance of the arrival of the conveyance by which the goods are imported, the tax shall be charged at the rate as is in force on the date on which the manifest of the conveyance is delivered.

If the tax is not paid within seven days of the presenting of the goods declaration under section 104 of the Customs Act, the tax shall be charged at the rate as is in force on the date on which tax is actually paid.

► Exercise

Rate of sales tax has increased from 17% to 18% effective from 23 May 2025. The accountant of the company is unsure about the manner in which sales tax return for the month of May 2025 would need to be furnished.

► Answer

If there is a change in the rate of tax during a tax period, a separate return in respect of each portion of the tax period has to be furnished showing the application of the different rates of tax.

Therefore, company will furnish two returns:

- a return for the period from 1 May 2025 to 23 May 2025 with 17% rate; and
- a separate return for the period from 23 May 2025 to 31 May 2025 with 18% rate

Alternatively only one sales tax return may be filed if the single return will provide facility to incorporate both the sales tax rates as stated above.

1.3 Time and manner of payment [Sec 6]

Time of payment

- Time for payment of tax on goods imported

Tax in respect of goods imported into Pakistan shall be charged and paid in the same manner and at the same time as if it were a duty of customs payable under the Customs Act, 1969.

- Time for payment of tax on taxable supplies

Tax in respect of taxable supplies made during a tax period shall be paid by the date as prescribed in this respect by the registered person at the time of filing the return in respect of that period.

Mode of payment

- The tax due on goods imported or taxable supplies shall be paid in any of the following manners:
 - i. Tax on goods imported shall be paid in the manner as if it were a duty of customs payable under the Custom Act, 1969;
 - ii. The tax due on taxable supplies shall be paid by any of the following modes, namely:
 - a) through deposit in a bank designated by the Board; and
 - b) through such other mode and manner as may be specified by the Board.
- The Federal Government may, subject to such conditions, limitations and restrictions as it may impose, by notification in the official Gazette, allow payment of sales tax on installments basis by Federal or Provincial Governments or any public sector organization on import or supply of goods or class of goods. Moreover, such payment may be allowed from any previous date.

2 OUTPUT TAX

2.1 Output tax

Output tax is defined in section 2(20) in the following manner:

► *Definition*

In relation to a registered person, means-

- i. tax levied under this Act on a supply of goods, made by the person;
- ii. tax levied under the Federal Excise Act, 2005 in sales tax mode as a duty of excise on the manufacture or production of the goods, or the rendering or providing of the services, by the person;
- iii. provincial sales tax levied on services rendered or provided by the person;
- iv. sales tax levied on the services rendered or provided by the person under Islamabad Capital Territory (Tax on Services) Ordinance, 2001 (XLII of 2001)

2.2 Adjustment of debit and credit notes

Section 9 of the Act read with section 7 permits the adjustment of the debit/credit notes against output tax. These notes can be issued where a registered person has issued a tax invoice in respect of a supply made by him, however, due to the following circumstances, the said invoice may desire amendments:

- Cancellation of supply;
- Return of goods;
- A change in the nature of supply;
- Change in the value of the supply;
- Some such event the amount shown in the tax invoice; or
- Return needs to be modified.

2.2.1 Applicability (Rule 19)

The above adjustment can only be made where a registered person has issued a tax invoice in respect of a supply made by him and as a result of the issuance of debit / credit note; the amount shown in the tax invoice or the return needs to be modified.

2.2.2 Cancellation or return of supply (Rule 20)

- In case a registered person has made a supply, and such supply or part thereof is cancelled or returned, the buyer or the recipient shall issue a debit note (in duplicate) in respect of such supply or part thereof, indicating the quantity being returned or the supply of which has been cancelled, its value determined on the basis of the value of supply as shown in the tax invoice issued by the supplier and the amount of related sales tax paid thereon, as well as the following, namely:-
 - i. name and registration number of the recipient;
 - ii. name and registration number of the supplier;
 - iii. number and date of the original sales tax invoice;
 - iv. the reason of issuance of the debit note; and
 - v. signature and seal of the authorized person issuing the note.
- The original copy of the debit note shall be sent to the supplier and the duplicate copy shall be retained for record.

- In the case of cancellation of supplies made to, or return of goods by, an unregistered person, the supplier shall issue a credit note providing the same particulars as are specified above and keep a copy for record.
- A new proviso is inserted which requires seller to obtain prior approval of the Commissioner for preparation of credit note in case of cancellation of supplies or return of goods by an unregistered person. Regarding the credit note for registered person, the procedure is unchanged i.e. the buyer shall issue a Debit Note first and seller can then claim such note as credit note.

2.2.3 Change in Value of Supply or amount of sales tax (Rule 21)

Where for any valid reason the value of supply or the amount of sales tax mentioned in the invoice issued has increased, the supplier shall issue a debit note (in duplicate), with the following particulars, namely:-

- name and registration number of the supplier;
- name and registration number of the recipient;
- number and date of the original sales tax invoice;
- original value and sales tax as in original invoice;
- the revised value and sales tax;
- the difference of value and sales tax adjustable;
- the reason for revision of value; and
- signature and seal of the authorized person issuing the note.
- Where, for any valid reason, the value of supply or the amount of sales tax mentioned in the invoice issued has decreased, the supplier shall issue a credit note (in duplicate), with the same particulars as specified above. The original copy of the note shall be sent to the recipient and the duplicate shall be retained for record.

2.2.4 Adjustment of input and output tax (Rule 22)

- The buyer shall not be entitled to claim input tax in respect of the supply which has been cancelled or returned to the supplier or in respect of which the amount of tax was reduced.
- Where the buyer has already claimed input tax credit in respect of such supplies, he shall reduce or increase the amount of input tax by the corresponding amount as mentioned in the Debit Note or Credit Note, as the case may be, in the return for the period in which the respective note was issued.
- Where the supplier has already accounted for the output tax in the sales tax return for the supplies against which Debit Note was issued subsequently, he may increase or reduce the amount of output tax by the corresponding amount as mentioned in the Debit Note, in the return for the period in which the respective note was issued.
- Provided that in case of return of supplies by an unregistered person, the adjustment as aforesaid can be made against the Credit Note issued by the supplier.
- The adjustments as herein before noted which lead to reduction in output tax or increase in input tax can only be made if the corresponding Debit Note or Credit Note is issued within one hundred and eighty days of the relevant supply
- Provided that the Collector may, at the request of the supplier, in specific cases, by giving reasons in writing, extend the period of one hundred and eighty days by a further one hundred and eighty days.
- Where the goods relating to a returned or cancelled supply are subsequently supplied to the original buyer or some other person with or without carrying out any repairs, the supplier shall charge sales tax thereon in the normal manner and account for it in his return for the period in which these goods were supplied.

2.2.5 Destruction of goods (Rule 23)

Where any goods are returned by the buyer on the ground that the same are unfit for consumption and are required to be destroyed by the supplier, the goods shall be destroyed after obtaining permission from the Collector of sales tax having jurisdiction, and under the supervision of an inland revenue officer of sales tax not below the rank of an Assistant Collector as may be deputed by the Collector for the purpose and the input tax credit in respect of goods so destroyed shall not be admissible.

► Exercise

Following are results of Nadeem Associates for preparation of sales tax return for the month of June, 2026

Supplies	75,000,000
Purchases	55,000,000
Sales tax on utilities bills of factory	500,000
Sales returns of April 2026	6,500,000
Purchases returns of May 2026	1,200,000

Required:

Compute sales tax liability of Nadeem Associates

► Answer

Particulars	Value of supply	Sales tax
Output tax on supplies	68,500,000 (i.e. 75,000,000 - 6,500,000) x 18%	12,330,000
Less input tax	53,800,000 (55,000,000 - 1,200,000) x 18%	(9,684,000)
Less sales tax on utilities		(500,000)
Net sales tax payable		2,146,000

3 INPUT TAX

3.1 Definition of input tax

The peculiar meanings assigned to this widely used term are given in section 2(14) of the Act:

► *Definition: Input Tax [2(14)]*

In relation to a registered person, means;

- tax levied under this Act on supply of goods to the person;
- tax levied under this Act on the import of goods by the person;
- in relation to goods or services acquired by the person, tax levied under the Federal Excise Act, 2005 in sales tax mode as a duty of excise on the manufacture or production of the goods, or the rendering or providing of the services;
- Provincial Sales Tax levied on services rendered or provided to the person excluding those services as specified by the Board through notification in the official Gazette subject to such conditions, restrictions and limitations as mentioned therein; and
- levied under the Sales Tax Act, 1990 as adapted in the State of Azad Jammu and Kashmir, on the supply of goods received by the person;

3.2 Time of claim of input tax

Section 7 stipulates that a registered person shall not be entitled to deduct input tax from output tax unless:

- in case of a claim for input tax in respect of a taxable supply made in Pakistan, he holds a tax invoice in his name and bearing his registration number in respect of such supply for which a return is furnished;
- in case of goods imported into Pakistan, he holds the goods declaration duly cleared by the customs under section 79, section 81 or section 104 of the Customs Act, 1969;
- in case of goods purchased in auction, he holds a treasury challan in his name and bearing his registration number;
- the supplier declares the supplies in his return or pays the due tax as shown in this return.
- To claim input on advance paid, buyer must have advance payment receipt which is to be issued by seller and will be treated as equivalent to tax invoice.

3.3 Input tax not admissible [Sec 8]

- A registered person shall not be entitled to deduct input tax paid on:
 - i. the goods or services which are not used or not to be used for the manufacture or production of taxable goods or for taxable supplies made or to be made by him;
 - ii. the goods on which extra amount of tax is payable under sub-section (5) of section 3;
 - iii. any other goods or services which the Board with the approval of the Federal Government may by a notification in the official Gazette specify;
 - iv. the goods or services in respect of which sales tax has not been deposited in the Government treasury by the respective supplier;
 - v. fake invoices;
 - vi. purchases made by a registered person in case he fails to provide information relating to his imports, purchases, sales etc. as required by the Board through a notification u/s 26(5);
 - vii. purchases in respect of which a discrepancy is indicated by CREST or input tax of which is not verifiable in the supply chain;

- viii. goods and services not related to the taxable supplies made by the registered person;
 - ix. goods and services acquired for personal or non-business consumption;
 - x. goods used in, or permanently attached to, immovable property, such as building and construction materials, paints, electrical and sanitary fittings, pipes, wires and cables, but excluding pre-fabricated buildings and such goods acquired for sale or re-sale or for direct use in the production or manufacture of taxable goods;
 - xi. vehicles falling in the First Schedule to the Customs Act, 1969, parts of such vehicles, electrical and gas appliances, furniture furnishings, office equipment (excluding electronic cash registers), but excluding such goods acquired for sale or re-sale;
 - xii. services in respect of which input tax adjustment is barred under the respective provincial sales tax law;
 - xiii. import or purchase of agricultural machinery or equipment subject to sales tax at the rate of 7% under Eighth Schedule to this Act; and
 - xiv. from the date to be notified by the Board, such goods and services which, at the time of filing of return by the buyer, have not been declared by the supplier in his return or he has not paid amount of tax due as indicated in his return.
 - xv. Import of scrap of compressors.
 - xvi. the input goods or services attributable to supplies made by manufacturer or importer to unregistered distributor, on pro-rata basis, for which sale invoices do not bear the NIC number or NTN, as the case may be, of the recipient as stipulated in section 23.
- If a person deals in taxable and non-taxable supplies, he can reclaim only such portion of input tax as is attributable to taxable supplies computed in the following manner:

Residual input tax credit on taxable supplies tax	Value of taxable supplies	X Residual input tax
	Value of taxable + exempt supplies	

► **Exercise**

Omega Enterprises has submitted the following data for the month of July 2025.

	Rupees
Sales to registered persons	6,000,000
Export of goods	2,500,000
Supply of Exempt goods	500,000
Gross Purchases from Registered suppliers	6,500,000
Gross Purchases from Unregistered suppliers	500,000
Purchase Return to Registered suppliers	650,000

Required:

You are required to compute the sales tax liability of Omega Enterprises for the month of July 2025. For the sake of simplicity ignore the 90% adjustment of input tax against output tax rule as mentioned in section 8B.

► Answer

Output tax		Rs.
Sales to registered persons	Rs. 6,000,000 x 18%	1,080,0000
Export of goods	Rs. 2,500,000 x 0%	-
Exempt supplies	-	
	Output tax	1,080,0000
Input tax (w-1)		(702,000)
Balance payable		378,000
Input refundable pertaining to zero rated supplies		(292,500)
Working:		
W-1:		
Apportionment of input tax, as per apportionment of input tax rules, 2006		
Residual input (Rs.6,500,000-650,000) x 18%		1,053,000
Value of taxable supply	6,000,000	702,000
		(6M/9M x 1,053,000)
Zero rated supplies	2,500,000	292,500
		(2.5M/9M x 1,053,000)
Exempt supplies	500,000	58,500
		(0.5M/9M x 1,053,000)
	9,000,000	1,053,000

- Monthly adjustment of input tax claimed by a registered person shall be treated as provisional adjustment and at the end of each financial year, the registered person shall make final adjustment on the basis of taxable and exempt supplies made during the course of that year.
- Deduction of input tax from output tax shall not be allowed to a person who is not registered under Sale Tax Act.

3.4 Certain transactions and input tax related thereto that are inadmissible [Sec 73]

Where the sum received is partly in cash and partly in kind, then the same transaction would be allowed subject to the conditions:

- Goods received in kind represent taxable goods
- Goods received are reflected in records.
- The balance amount even less than Rs 50,000 is received through crossed banking instrument.

If the banking instrument is issued but the same is not encashed or deposited within 180 days then the input tax shall not be denied. However, it must be ensured that the amount is ultimately deposited in the seller account and the said instrument is not cancelled.

3.5 Adjustable input tax [Sec 8B]

Section 8B of the Sales Tax Act, 1990 states that:

- A registered person shall not be allowed to adjust input tax in excess of 90% of the output tax for that tax period.
- Restriction on the adjustment of input tax in excess of 90% of the output tax shall not apply in case of fixed assets or capital goods. However, the Board may, by notification in the official Gazette, exclude any person or class of persons from the purview of this para.
- A registered person may be allowed adjustment or refund of input tax not allowed as per the above provisions subject to the following conditions
 - i. In the case of registered persons, whose accounts are subject to audit under the Companies Act, 2017, upon furnishing a statement along with annual audited accounts, duly certified by the auditors, showing value additions less than the limit prescribed above; or
 - ii. In case of other registered persons, subject to the conditions and restrictions as may be specified by the Board by notification in the official Gazette.
- The adjustment or refund of input tax if any, shall be made on yearly basis in the second month following the end of the financial year of the registered person.
- The Board may, by notification in the official Gazette, prescribe any other limit of input tax adjustment for any person or class of persons.
- In order to limit input tax allowance, the Board may also use data based automated risk management system to defer certain input tax or fix higher or lower limits of input tax adjustment
Provided that the registered person may contest the action taken under this sub-section by filing application and documents with the Commissioner concerned, who shall decide the case within thirty days of such application.
- Any auditor found guilty of misconduct in furnishing the certificate mentioned above shall be referred to the Council for disciplinary action under section 20D of Chartered Accountants, Ordinance, 1961.
- Notwithstanding anything contained in sub-sections (1), (2) and (3), input tax allowed in case of locally manufactured electric vehicles subject to reduced rate of tax under the Eighth Schedule shall be limited to the extent of amount of output tax and no refund or carry forward of excess input tax shall be allowed.
- In case a Tier-1 retailer does not integrate his retail outlet in the manner as prescribed during a tax period or part thereof, the adjustable input tax for whole of that tax period shall be reduced by 60%.

► Exercise

In the light of the provisions of Sales Tax Act, 1990 explain as to the chargeability/adjustment of sales tax in respect of each of the following independent situations

- i. Sales tax of Rs. 100,000 was paid along with the electricity bill paid in cash during February 2026. The bill pertained to the manufacture of 50% of goods exported to the UAE and 50% of the goods which are exempt from sales tax.
- ii. Free replacement of defective parts is made in the case of taxable goods, which have been sold under warranty. During the month of May 2026 the market value of such replacement parts was Rs. 500,000
- iii. ABC Manufacturing Limited purchased raw material amounting to Rs. 100 million on credit. The payment was made after 240 days of the issuance of tax invoice by way of crossed cheque drawn on the business bank account of the supplier.
- iv. Destruction of damaged goods.
- v. Purchase of taxable goods from a person who has reputation of evading sales tax.
- vi. Payment of fuel to be used for machinery by the Director of the company using his own credit card.

► *Answer*

i. Sales tax paid on electricity bills

Sales tax paid along with an electricity bill is an admissible input tax only when the electricity was used to produce taxable goods. Further, in the case of utility bills, payment in cash does not disentitle a claim of input tax paid thereon. Therefore, input tax of Rs. 50,000 would be refundable, whereas, balance sales tax of Rs. 50,000 paid in respect of exempt supplies would not be allowed as input.

ii. Free replacement of defective parts

The free replacement of defective parts (open market value of Rs. 500,000) during the warranty period is considered as equivalent to the value of the original supply and not a separate supply. Such replacement is not chargeable to tax.

iii. Payment after 240 days

Due to the payment being made after 180 days, the input tax is no longer eligible to be deducted from the output tax. If the input tax has already been claimed in previous months, it will reduce the input tax of the current month due to the default in payment within the stipulated time. Despite the payment being made through a crossed cheque drawn on the seller's business bank account, the transaction is not admissible for the purpose of claiming input tax as it was made after 180 days from the issuance of the tax invoice.

iv. Destruction of damaged goods

Where any goods are returned by the buyer on the ground that the same are unfit for consumption and are required to be destroyed by the supplier, the goods shall be destroyed after obtaining permission from the Collector of Sales Tax having jurisdiction, and under the supervision of an Inland Revenue Officer not below the rank of an Assistant Collector as may be deputed by the Collector for the purpose and the input tax credit in respect of goods so destroyed shall not be admissible.

v. Joint and several liability of registered persons in supply chain where tax unpaid

Where a registered person receiving a taxable supply from another registered person is in the knowledge or has reasonable grounds to suspect that some or all of the tax payable in respect of that supply or any previous or subsequent supply of the goods supplied would go unpaid, of which the burden to prove shall be on the department, such person as well as the person making the taxable supply shall be jointly and severally liable for payment of such unpaid amount of tax

vi. Payment through credit card

Although payment made through credit card is considered as payment made through banking channel yet the payment must be verifiable from the business bank accounts of both the buyer and the seller. Since the director made the payment from his personal credit card, therefore, company will not be able to obtain input tax on its payment due to non-verifiability of the said payment from the business bank account of the company.

4 TAX REFUNDS, ASSESSMENT AND RECOVERY

4.1 Refund of input Tax [Sec 10]

- If the input tax paid by a registered person on taxable purchases made during a tax period exceeds the output tax on account of zero rated local supplies or export made during that tax period, the excess amount of input tax shall be refunded to the registered person not later than forty-five days of filing of refund claim in such manner and subject to such conditions as the Board may, by notification in the official Gazette specify.
- In case of excess input tax against supplies other than zero-rated or exports, such excess input tax may be carried forward to the next tax period and shall be treated as input tax for that period.
- The Board may, subject to such conditions and restrictions as it may impose, by notification in the official Gazette, prescribe the procedure for refund of excess input tax against other taxable supplies;
- The Board may, from such date and subject to such conditions and restrictions as it may impose, by notification in the official Gazette, direct that refund of input tax against exports shall be paid along with duty drawback at the rates notified in the said notification.
- If a registered person is liable to pay any tax, default surcharge or penalty payable under any law administered by the Board, the refund of input tax shall be made after adjustment of unpaid outstanding amount of tax or, default surcharge and penalty, as the case may.
- Where there is reason to believe that a person has claimed input tax credit or refund which was not admissible to him, the proceedings against him shall be completed within 60 days. For the purposes of enquiry or audit or investigation regarding admissibility of the refund claim, the period of 60 days may be extended up to 120 days by an officer not below the rank of an Additional Commissioner Inland Revenue and the Board may, for reasons to be recorded in writing, extend the aforesaid period which shall in no case exceed (9) nine months.

4.2 Best Judgment assessment [Sec 11D]

- If a person fails to file a sales tax return in response to a notice or does not produce requested accounts, records after a show cause notice is issued, the CIR may make a best judgement assessment based on available information and may also charge penalty and default surcharge.
- However, if the person files the return within sixty days of issuance of best judgement order and pays the amount of tax payable along with default surcharge and penalty, the notice to show cause and the order of assessment shall abate.
- Where FBR has specified conditions for the purpose of determination of minimum tax liability in respect of a person who is required to file return but who fails to file such return, the Officer of Inland Revenue shall determine such liability of the registered person in accordance thereof.
- Notwithstanding anything contained in this section, in case of person who is liable to be registered as Tier-01 retailer based on tax withheld under section 236G of Income Tax Ordinance, 200 and does not furnish a return upon notice, an officer of inland revenue may assess sales tax liability on the value addition on reasonable grounds including information obtained from the purchase data under section 236G of Income Tax Ordinance, 2001.

4.3 Assessment of tax and recovery of tax not levied or short levied or erroneously refunded. [Sec 11E]

1. Where due to any reason, any tax or charge has not been levied or short levied or where the officer of Inland Revenue not below the rank of Assistant Commissioner suspects on the basis of audit or otherwise that due to any reason a person has-
 - a) not paid or short paid due sales tax;
 - b) claimed input tax credit or refund which is not admissible; or

- c) has obtained an amount of refund not due, the officer of Inland Revenue after issuing a show cause notice to the person shall pass an order to determine and recover the amount of tax unpaid or short paid, inadmissible input tax or refund, or unlawful refund obtained and shall also impose penalty and default surcharge in accordance with sections 33 and 34:

Provided that this section shall not be applicable to the extent of proceedings initiated under section 37A of the Act.”;

2. For the purposes of sub-section (1), the officer of Inland Revenue may also disallow input tax on goods or services if the taxpayer is unable, without reasonable cause, to provide a receipt, or invoice or other record or evidence of the transaction or circumstances giving rise to such claim.
3. Where a tax or charge has not been levied under clause (a) of sub-section (1), the amount of tax shall be recovered as tax fraction of the value of supply.

4.5 Failure to withhold sales tax (Sec 11F)

Where any person, required to withhold sales tax, fails to withhold the tax or having withheld the tax fails to deposit the same in the prescribed manner, the officer of Inland Revenue not below the rank of Assistant Commissioner shall after a notice to such person to show cause pass an order to determine and recover the amount in default and impose penalty and default surcharge under section 33 and 34

4.6 Limitation of assessment (Sec 11G)

- The show cause notice under sections 11D to 11F shall be issued within five years, from the end of the financial year in which the relevant date falls.
- An order under sections 11D, 11E and 11F shall be made within one hundred and Eighty days of issuance of show cause notice or within such extended period as the Commissioner may, for reasons to be recorded, in writing specify, provided that such extended period shall in no case exceed from ninety days
- Any period during which the proceedings are adjourned on account of a stay order or Alternative Dispute Resolution proceedings or the time taken through adjournment by the registered person not exceeding sixty days shall be excluded from the computation of the said period
- For the purpose of sections 11D, 11E and 11F, the words “relevant date” means
 - a) the time of payment of sales tax or charge as provided under section 6;
 - b) the time of payment for goods or services on which sales tax was to be withheld under sub-section (7) of section 3; and
 - c) in a case where sales tax or charge has been erroneously refunded, the date of its refund.

4.7 Limitation for issuing orders in certain cases (Sec 11B)

For the purposes of issuing an assessment order or any other order in consequence of or to give effect to any order made by the Commissioner (Appeals), Appellate Tribunal, High Court, or Supreme Court, the provisions of section 124 of the Income Tax Ordinance, 2001 shall apply mutatis mutandis.

4.8 Recovery of short paid amounts without notice [Sec 11A]

- Where a registered person pays the amount of tax less than the tax due as indicated in his return, the short paid amount of tax along -with default surcharge shall be recovered from such person by stopping removal of any goods from his business premises and through attachment of his business bank accounts. Any of these actions may be taken without giving him a show cause notice and without prejudice to any other action prescribed under section 48 of this Act or the rules made there under.

Provided that no penalty under section 33 of this Act shall be imposed unless a show cause notice is given to such person.

- Provisions of this section shall apply notwithstanding any of the provisions of this Act.

RETURNS AND RECORDS

IN THIS CHAPTER:

1. Returns
2. Records
3. Miscellaneous

1 RETURNS

1.1 Returns [Sec 26 to 28]

- A Sales Tax return is the taxpayer's document of declaration through which taxpayer not only furnishes the details of transactions during a tax period but also determines his sales tax liability.
- On the return form, the taxpayer declares, for a particular tax period, his respective input tax and output tax for different categories of taxpayers, monthly, quarterly or annual returns may be filed on prescribed format.
- The officer of Inland Revenue may, by notice in writing, require any person who, in his opinion, is required to file a return under this section for a tax period or tax periods but who has failed to do so, to furnish the return or returns within fifteen days from the date of service of such notice or such longer or shorter period as may be specified in such notice or as the officer of Inland Revenue may allow
- Provided that the notice under this sub-section shall only be issued within fifteen years from the end of the financial year in which the return was to be filed, in cases of tax fraud and five years in all other cases
- Every online marketplace shall furnish not later than the due date a true, complete and correct monthly statement in the prescribed form, indicating the supplier-wise amount paid and tax due and such other information of the taxable supplies of digitally ordered goods irrespective of the economic ownership of the supplies from within Pakistan.
- Every payment intermediary and courier shall furnish not later than the due date a true, complete and correct monthly statement in the prescribed form, indicating the supplier-wise amount paid and tax due and such other information for taxable supplies of digitally ordered goods from within Pakistan through an online market place, website and software application and delivering goods using its payment platform or courier service as the case may be.

Following returns may be filed under the sales tax act by the taxpayers:

- Monthly return
- Quarterly return
- Annual return

Monthly Return

- Every registered person shall furnish a true, complete and correct return in the prescribed form upto the 15th day of month next following the end of tax period.
- The return shall be filed in the bank or any other office specified by Board. (Read with 1.3 below)

Quarterly Return

- The Board may, by notification in the official Gazette, require any person or class of persons to submit return on quarterly basis
- Further, the Board may, by notification in the official Gazette, require any person or class of persons to submit such return as may be prescribed annually in addition to the monthly return or quarterly return.

Annual return - Rule 17

A private or public limited company is required to file annual sales tax return, for a financial year by 30th September of the following financial year.

1.2 Return for person operating in different sectors - Rule 14(2)

In case a registered person operates in different sectors for which different dates of filing of return have been prescribed in any rules made under the Sales Tax Act, 1990 or the Federal Excise Act, 2005, such person shall file a single return for all such sectors by the due date applicable to his major activity in terms of sales tax or federal excise duty payable.

1.3 Electronic filing - Rule 18

- The return filed electronically on the web or any magnetic media or any other computer readable media (as may be specified by the Board) shall also be deemed to be a valid return filed. The Board is authorised to make rules for determining eligibility of the data of returns filed electronically and e-intermediaries who will digitize the data of such returns and transmit the same electronically under their digital signatures.
- Every registered person required to file return or other statement as prescribed or any notification issued thereunder shall file such a return or, as the case may be, statement, electronically in the manner as specified by the Board through a general order.
- A registered person filing returns electronically shall make payment of the amount of sales tax due, if any, in any of the designated branches of the National Bank of Pakistan.
- In case where due date has been prescribed as 15th of a month, the tax due shall be deposited by the 15th and the return shall be submitted electronically by 18th of the same month.
- Return filed by the buyer for a tax period shall be taken as provisional return in IRIS, until the respective seller files his return for the same tax period within up to the last day of the month in which the due date of filing of return falls.
- If the seller fails to file his return by the last day of the month in which the due date of filing of return falls, the invoices issued by the non-filer seller will be deleted by IRIS from the return of buyer and sales tax liability of the buyer will be calculated without corresponding input tax in the provisional return of the buyer. Such provisional return shall be taken as valid by IRIS after payment of the said computed sales tax liability.
- In cases where the seller files his return accompanied with payment of sales tax by the last day of the month in which the due date of filing of return falls, the provisional return of the buyer shall be taken as valid by IRIS with the claim of invoices and corresponding input tax.
- a registered person can only claim the amount of sales tax withheld by a withholding agent if he declares the corresponding sales to such withholding agent in his return. Otherwise, the amount of sales tax withheld and reduction in output tax shall not be allowed to such person.

1.4 Extension of time for furnishing returns

- A registered person required to furnish a return under section 26 may apply, in writing, to the Commissioner for an extension of time to furnish the return.
- An application for extension shall be made by the due date for furnishing the return in terms of section 2(9) for the period to which the application relates.
- Where an application has been made and the Commissioner is satisfied that the applicant is unable to furnish the return to which the application relates by the due date because of-
 - a) absence from Pakistan;
 - b) sickness or other misadventure; or
 - c) any other reasonable cause,the Commissioner may, by order in writing, grant the applicant an extension of time for furnishing the return.
- An extension of time shall not exceed fifteen days from the due date for furnishing the return, unless there are exceptional circumstances justifying a longer extension of time
Provided that where the Commissioner has not granted extension for furnishing the return the Chief Commissioner may on an application made by the registered person for extension or further extension, as the case may be, grant extension or further extension for a period not exceeding fifteen days, unless there are exceptional circumstances justifying a longer extension of time.
- An extension or further extension of time granted shall not, for the purpose of charge of default surcharge under section 34, change the due date for payment of sales tax under section.

1.5 Particulars of sales tax return

- i. The return shall indicate; Sales tax registration number (STRN), name and address of the supplier.
 - ii. name, address and registration, number of the recipient and NIC or NTN of the unregistered person, as the case may be, excluding supplies made by a retailer where the transaction value inclusive of sales tax amount does not exceed rupees one hundred thousand, if sale is being made to an ordinary consumer
 - iii. **Explanation**—For the purpose of this clause, ordinary consumer means a person who is buying goods for his own consumption and not for the purpose of resale or processing: Provided that the condition of NIC or NTN shall be effective from 1st August, 2019;
 - iv. Date of issue of invoice;
 - v. description, including count, denier and construction in case of textile yarn and fabric and quantity of goods;
 - vi. Tax credit carried forward from previous period.
 - vii. Value of supplies
 - viii. Output tax due on supplies as under:
 - a) Local taxable supplies
 - b) Exempted supplies
 - c) Zero rated supplies
 - ix. Value of purchases;
 - x. Input tax paid on purchases as under:
 - a) Local taxed goods
 - b) Imported taxed goods
 - c) Exempted purchases
 - d) Zero rated purchases
 - e) Other purchases
 - xi. Arrears payable
 - xii. Amount payable / refundable.
 - The registered person shall deposit in the banks, the amount of sales tax indicated as “Sales Tax Payable” in the return at the time of filing of return.
 - In case no amount of sales tax is payable by the registered person, he shall file “Nil” return without depositing any amount.
 - A registered person may file a revised return to correct any omission or wrong declaration made in a return filed under section 26 or 27, subject to approval of the Commissioner Inland Revenue having jurisdiction within 120 days of filing of return.
 - Provided that the approval under this sub-section shall not be required if revised return is filed within sixty days of filing of return and either the tax payable therein is more than the amount paid or the refund claimed therein is less than the amount as claimed, under the return sought to be revised.
 - Provided further that not more than one tax invoice shall be issued for a taxable supply:
 - Provided also that if it is subsequently proved that CNIC provided was by the purchaser was not correct, liability of tax or penalty shall not arise against the seller, in case of sale made in good faith.
- If a registered person wishes to file revised return voluntarily along with deposit of the amount of tax short paid or amount of tax evaded along with default surcharge, whenever it comes to his notice, before receipt of notice of audit, no penalty shall be recovered from him.

However, in case the registered person wishes to deposit the amount of tax as pointed out by the officer of Inland Revenue during the audit, or at any time before issuance of the show cause notice, he may deposit the evaded amount of tax, default surcharge under section 34, and twenty-five percent of the penalty payable under section 33 along with the revised return.

Further in case the registered person wishes to deposit the amount after issuance of show cause notice, he shall deposit the evaded amount of Sales Tax, default surcharge under section 34, and full amount of the leviable penalty under section 33 along with the revised return and thereafter, the show cause notice, shall stand abated.

- Board may require any person or classes of persons, for any goods of such description, or class, to furnish such summary or details or particulars relating to imports, purchases and supplies made by them during any tax period or periods in such format as may be specified.

1.6 Special return [Sec 27]

- In addition to the return specified u/s 26, a registered person may be required to file special return containing information relating to:
 - i. Quantity of goods manufactured or produced.
 - ii. Purchases made.
 - iii. Goods supplied.
 - iv. Payment of arrears made.
- This special return will be for such period as the Board may, by a notification in official Gazette, specify.
- The Commissioner may also require from any person whether, he is registered or not, a return in a prescribed form and such person shall furnish the return not later than the date specified in this regard. This return may be demanded from any person in respect of information relating to himself or relating to his principal if he is acting as agent.

1.7 Final return [Sec 28]

If a person applies for de-registration in terms of section 21, he shall before such de-registration, furnish a final return to the Commissioner in the specified form, in such manner and at such time as directed by the Commissioner.

1.8 Returns deemed to have been made [Sec 29]

A return purporting to be made on behalf of a person by his duly appointed representative shall, for all purposes, be deemed to have been made by such person or under his authority unless proved to the contrary.

1.9 Summary of returns and their filing dates

Summary of returns and their filing dates is given hereunder:

Filer	Nature of Return	Due Date
Registered Person	Monthly return	15 th of next month following any tax period (*Electronic filing – 18 th of next month, where sales tax payable with the return paid till 15 th day as specified above.)
Registered or unregistered	Special return	On the date specified by the commissioner in its notice calling for such return.
Person applied for de registration	Final return	On the date specified by the commissioner
Every private or Public Limited Company	Annual return	30 th of September following the year end.

2 RECORDS

2.1 Records [Sec 22]

- A registered person shall maintain the following records of goods purchased locally or imported and supplies (including zero-rated and exempt supplies)
- Records of supplies indicating
 - description
 - quantity
 - value of goods
 - name and address of the person to whom supplies were made
 - the amount of the tax charged;
- Records of goods purchased showing
 - description
 - quantity
 - value of goods
 - name, address and registration number of the supplier
 - the amount of the tax on purchases;
- Records of goods imported showing
 - description
 - quantity
 - value of goods
 - the amount of the tax paid on imports;
- Records of zero-rated and exempt supplies;
- Double entry sales tax accounts;
- Following further records is desired
 - Tax invoices
 - Credit notes, debit notes,
 - Bank statements,
 - Banking instruments in terms of section 73
 - Inventory records,
 - Utility bills,
 - Cash book
 - Salary and labour bills
 - Rental agreements,
 - Sale-purchase agreements and
 - Lease agreements;
 - Record relating to gate passes, inward or outward, and transport receipts;
 - Electronic version of records mentioned above
 - Such other records as may be specified by the Board.

Provided that the persons paying retail tax shall keep such record as may be specified by the Board.

- The Board may also require a registered person or class of registered persons to declare and use only as many number of business bank accounts as may be specified by the Board in such notification to make or receive payments on account of purchase and sale transactions for the purpose of the Sales Tax Act, 1990 or rules made thereunder and to make payment of due tax from such accounts only.
- The Board may specify to keep such other records for the sales tax law purposes.
- The Board may specify to use such electronic fiscal cash registers as are approved by the Board.
- The registered person shall keep the aforesaid record at his business premises or registered office in English or Urdu language
- The registered persons, whose accounts are subject to audit under the Companies Act, 2017, shall be required to submit a copy of the annual audited accounts, along with a certificate by the auditors certifying the payment of due tax by the registered person.

2.2 Tax invoices [Sec 23]

- A registered person making a taxable supply shall issue a serially numbered tax invoice at the time of supply of goods containing the following particulars in Urdu or English language, namely:
 - i. name, address and registration number of the supplier;
 - ii. name, address and registration, number of the recipient and NIC or NTN of the unregistered person, as the case may be, excluding supplies made by a retailer where the transaction value inclusive of sales tax amount does not exceed rupees one hundred thousand, if sale is being made to an ordinary consumer

Explanation—For the purpose of this clause, ordinary consumer means a person who is buying goods for his own consumption and not for the purpose of resale or processing:

Provided that the condition of NIC or NTN shall be effective from 1st August, 2019

- i. date of issue of invoice;
 - ii. description including count, denier and construction in case of textile yarn and fabric and quantity of goods;
 - iii. value exclusive of tax;
 - iv. amount of sales tax; and
 - v. value inclusive of tax:
- No person other than a registered person or a person paying retail tax shall issue an invoice under this section. Moreover, not more than one tax invoice shall be issued for a taxable supply.
 - The Board through notification in the official Gazette, may require any person or class of persons to integrate their electronic invoicing system with the Board's Computerized System for real time reporting of sales in such mode and manner and from such date as may be specified therein.
 - Licensed integrator shall integrate electronic invoicing system of registered persons in such mode and manner as may be prescribed.
 - With effect from July 1, 2025, all corporate registered persons, and from August 1, 2025, all non-corporate registered persons, shall be required to integrate their hardware and software systems with the Board's computerized system through a licensed integrator or PRAL, and shall generate and transmit electronic invoices accordingly.
 - Debit/credit notes must also be generated digitally.
 - Where any goods are transported or supplied, the registered person shall ensure the generation and linkage of the tax invoice with the e-Bilty generated under section 40C of this Act and section 83C of the Customs Act, 1969.

- A registered person making a taxable supply shall, subject to such conditions, restrictions and limitations as the Board may, by notification in the official Gazette, specify to issue electronic invoices
- The sales tax registered person may also issue sales tax invoice electronically to its buyers. The sales tax rules prescribe the procedure for issuance of sales tax invoice electronically.
- The Board may specify modified invoices for different persons along with the manner and procedure for regulating the issuance and authentication of the invoices.

2.3 Retention of record and documents for six years [Sec 24]

A person shall retain the record and documents for a period of six years after the end of the tax period to which such record or documents relate or till the final decision in any proceedings including proceedings for assessment, appeal, revision, reference, petition and any proceedings before an alternative Dispute Resolution Committee.

3 MISCELLANEOUS

3.1 Audit of sales tax affairs [Sec 25]

- The Commissioner on the basis of reasons to be recorded in writing, may direct the officer of Inland Revenue not below the rank of Assistant Commissioner to conduct audit of sales tax affairs of any registered person and issue a notice to such registered person intimating him regarding audit of sales tax affairs.

Explanation: For the removal of doubt, it is declared that the powers of the Commissioner to direct conduct of audit and to issue a notice under this sub-section are independent of the powers of the Board under section 72B and nothing contained in section 72B restricts the powers of the Commissioner to direct conduct of audit and to issue notice under this sub-section.

- The Commissioner shall communicate the reasons to the registered person whose audit is to be conducted through the notice.
- Commissioner **may not** provide an opportunity of hearing before issuance of notice for audit.
- The reasons for audit selection shall be based on scrutiny of the available records including sales tax and federal excise returns, income tax returns and withholding statements, financial statements or third party information.
- The reasons shall not include the mere verification of input tax, output tax, refund claim and compliance of legal provisions without identifying risk factors that require such verification.
- Subsequent to the issuance of notice, the officer of Inland Revenue, may call for any record or documents including record maintained under this Act, the rules made thereunder or any other law for the time being in force for conducting audit of the sales tax affairs of the person.
- Where such record or documents have been kept on electronic data, the registered person shall allow authorize officer of Inland Revenue access to the use of machine and software on which such data is kept and the officer of Inland Revenue may obtain duly attested hard copies of such information or data from the registered person.
- The officer of Inland Revenue shall not call for record or documents of the registered person after expiry of six years from the end of the financial year to which they relate.
- The officer of Inland Revenue may require the registered person to attend his office in person or through an authorized representative. The registered person shall produce such accounts, documents or any evidence as the officer of Inland Revenue may consider necessary.
- The officer of Inland Revenue not below the rank of Assistant Commissioner may conduct or cause to be conducted such enquiry and obtain such information from any third party as he considers appropriate.
- The officer of Inland Revenue not below the rank of Assistant Commissioner shall conduct audit of the sales tax affairs to verify the correctness or otherwise of the declared tax liability, output tax, input tax claimed, tax paid, refund claimed, stocks consumed or available for ascertaining compliance or otherwise with the provisions of this Act and the rules made thereunder on the basis of the record and evidence obtained.
- The officer of Inland Revenue may conduct audit proceedings electronically through video links, or any other facility as may be prescribed by the Board.
- After completion of the audit, the officer of Inland Revenue may, if required pass an order under section 11E (assessment/recovery of tax), after providing an opportunity of being heard to the registered person.
- Where a registered person fails to produce before the officer of Inland Revenue, any accounts, documents or records required to be maintained under this Act or the rules made thereunder or any other relevant document electronically kept record, electronic machine or any other evidence that may be required by the officer of Inland Revenue for the purpose of audit. The officer of Inland Revenue may proceed to make best judgment assessment under section 11D of this Act.

- Notwithstanding the penalties prescribed in section 33, if a registered person wishes to deposit the amount of tax short paid or amount of tax evaded along with default surcharge voluntarily, whenever it comes to his notice, before receipt of notice of audit, no penalty shall be recovered from him.
- If a registered person wishes to deposit the amount of tax short paid or amount of tax evaded along with default surcharge during the audit, or at any time before issuance of show cause notice under section 11E, he may deposit the evaded amount of tax, default surcharge under section 34, and twenty five percent of the penalty payable under section 33.
- If a registered person wishes to deposit the amount of tax short paid or amount of tax evaded along with default surcharge after issuance of show cause notice under section 11E, he shall deposit the evaded amount of tax, default surcharge under section 34, and full amount of the penalty payable under section 33 and thereafter, the show cause notice, shall stand abated.

3.2 Drawing of samples [Sec 25A]

- An authorized officer of Inland Revenue, if consider it necessary, may take a sample of any goods or raw materials, for the purpose of:
 - i. determining the liability to sales tax of a registered person; or
 - ii. for the purpose of establishing value of goods; or
 - iii. for any other reason.
- The sample drawn shall be a minimum quantity of goods or raw materials sufficient to enable a proper examination or analysis to be made.
- At the time of taking the sample the person in possession of the goods shall be informed and given the opportunity to sign the representative samples, so drawn, and take corresponding sample for his own record.
- Any sample taken as above shall be taken against a proper receipt a copy each of which shall be kept in the record by the registered person and the large Tax payers unit or Regional Tax Officer, as the case may be.

3.3 Transaction between associates [Sec 25AA]

The Commissioner or an officer of Inland Revenue may, in respect of any transaction between persons who are associates, determine the transfer price of taxable supplies between the persons as is necessary to reflect the fair market value of supplies in an arm's length transaction.

The Board may, by notification in official gazette, prescribe rules for carrying out the purpose of above section.