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Note on Income Tax (Amendment) Ordinance, 2022



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NOTE ON INCOME TAX (AMENDMENT) ORDINANCE, 2022

INTRODUCTION

The Federal Cabinet, on March 1, 2022 approved a Promotion Package for Industry (PPI) providing tax incentives for:

- investment in new and existing industrial undertakings;
- revival of sick units; and
- investment in industries by overseas Pakistanis and resident Pakistanis (having declared foreign assets).

To give effect to the PPI, the President of Pakistan is expected to promulgate the Income Tax (Amendment) Ordinance, 2022 ('Amendment Ordinance') for amendments in the Income Tax Ordinance, 2001.

As the Presidential Ordinance has an effect for a period of 120 days, it is expected that the amendments made through the Amendment Ordinance will be given permanent effect through the forthcoming Finance Bill, 2022.

The incentive package is envisaged to generate employment and to boost economic activity by incentivizing capital investment into various industrial sectors.

This note has been prepared on the basis of text of the Amendment Ordinance, which is publicly available, copy of which is enclosed with this note for ease of reference.

This note can also be accessed on the link <https://www.pwc.com.pk/en/tax-memorandum.html>

SCHEME FOR TAX IMMUNITY OF EQUITY INVESTMENT IN INDUSTRIAL UNDERTAKINGS

Under the scheme, tax immunity has been provided for investment in industrial undertakings, by making payment of tax at 5 percent of those funds which have not been declared in any of the returns of income upto tax year 2021 (filed by the December 31, 2021).

The scheme provides for immunity if equity investment is made in:

- (i) a new company for establishing and operating new industrial undertaking; or
- (ii) an existing company being an industrial undertaking for the purpose of expansion and modernization.

Following are the salient features of the scheme:

I. Exclusions - Persons, funds and investments not eligible for the scheme

Persons ineligible to avail scheme

- (a) Holders of public office [as defined in the Voluntary Declaration of Domestic Assets Act, 2018; their spouses and dependent children;
- (b) Public company as defined in clause (47) of section 2 of the Income Tax Ordinance, 2001;
- (c) Person who has filed a declaration under the Voluntary Declaration of Domestic Assets Act, 2018; the Foreign Assets (Declaration and Repatriation) Act, 2018, or the Assets Declaration Act, 2019;
- (d) Person who has been declared a bank loan defaulter by a bank or a financial institution within the last three years;
- (e) Director of a company who has been declared a bank loan defaulter by a bank or a financial institution within the last three years;

Ineligible funds

- (f) Proceeds of crime, corruption, money laundering and terror financing
- (g) Amount which is subject of any departmental or court proceedings
- (h) Investment made through borrowed funds and investment in land.
- (i) Funds below the minimum threshold of Rs 50 million.

Ineligible sectors

- (j) Investments made in following sectors, namely:
 - arms and ammunitions;
 - explosives;
 - sugar;
 - cigarettes;
 - aerated beverages;
 - flour mills;
 - vegetable ghee; and
 - cooking oil manufacturing excluding extraction units.

II. Conditions for declaration

- (a) The declaration under this section is to be made by filing a statement in the form and manner as specified by the Board through a notification in the official Gazette. Declaration under this section must be filed by September 30, 2022.
- (b) Payment of an amount equal to five (5) percent of the funds declared must be made along with filing of the aforesaid statement.

New undertaking

- (c) Funds declared in the statement (not below the minimum amount of Rs 50 million) shall be deposited in rupees in a dedicated bank account in Pakistan as equity of the newly formed company, incorporated under the Companies Act, 2017 (XIX of 2017), before the filing of the statement and such funds shall only be used for purchase or import of plant and machinery through letter of credit or for construction of building and structure for the industrial undertaking.
- (d) The new industrial undertaking should not be established by the splitting up or reconstruction or reconstitution of an undertaking already in existence or by transfer of machinery or plant from an existing industrial undertaking established in Pakistan.
- (e) The new industrial undertaking in which such investment is made shall commence commercial production by June 30, 2024 and a certificate to that effect, duly issued by Engineering Development Board, is submitted to the Commissioner along with the return filed for tax year 2024.

Existing undertaking

- (f) In case of investment in an existing company being an industrial undertaking, such company shall open a dedicated bank account to deposit the funds declared (not below Rs. 50 million) before filing of the statement and such funds shall only be used for expansion and modernization by way of purchase or import of plant and machinery including IT hardware through letter of credit, or software and IT services or for construction of building and structure for the manufacturing premises of the existing industrial undertaking. The term 'modernization' includes acquisition or upgradation of IT hardware, software, and IT services.

- (g) The expansion and modernization shall be completed by June 30, 2024, and a certificate to that effect, duly issued by the Engineering Development Board, is submitted to the Commissioner along with the return filed for tax year 2024.

III. Validity of Declaration

The declaration filed under this section shall not be valid if:

- (a) the newly formed industrial undertaking company fails to prove commercial production;
- (b) there is change in ownership of industrial undertaking company prior to the June 30, 2026;
or
- (c) the newly formed industrial undertaking company disposes of any of its assets prior to June 30, 2026.

Similar conditions for the validity of declaration shall be applicable in case of investment in an existing company being an industrial undertaking for the purpose of balancing and modernization.

IV. Overriding Effect and Confidentiality

The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force. All confidentiality provisions of the Income Tax Ordinance, 2001, National Accountability Ordinance, 1999, the Federal Investigation Agency Act, 1974 and the Right of Access to Information Act, 2017 shall apply to declarations made under this section, except for disclosure of information to any authority exercising its powers under the Income Tax Ordinance, 2001; Sales Tax Act, 1990; Federal Excise Act, 2005 and Customs Act, 1969 for the purpose of enabling such authority to exercise its powers under these laws. It is worth mentioning here that unlike the previous schemes, there is no provision for imposition of fine / for imprisonment of any person in breach of confidentiality provisions.

V. Misrepresentation / Suppression of Facts

This section restricts the protection and concession under this section if the same is made by way of 'misrepresentation' or 'suppression of facts'. The law has not defined both the terms. This requires practical interpretation of these terms. Nevertheless, if an invalid declaration is made due to the reasons described in I. and III. above or by way of misrepresentation or suppression of facts, such declaration shall be void as if it had never been made and all the provisions of the Income Tax Ordinance, 2001 shall apply accordingly. However, the Commissioner shall not take any action under this section without providing the declarant an opportunity of being heard.

VI. Effect of declaration and incorporation in books

Where tax has been paid in respect of the funds declared, the declarant shall be immune from probe about the source of funds / investment under section 111 of the Income Tax Ordinance, 2001. Moreover, the declarant shall be entitled to incorporate the funds / investment in his wealth statement, financial statements or books of accounts, as the case may be.

VII. No refund or adjustment of tax paid under the scheme

The declarant shall not be allowed to claim any refund or adjustment against any other tax liability of the amount of tax paid under this section in consequence of such declaration.

CARRY FORWARD OF BUSINESS LOSSES OF SICK INDUSTRIAL UNITS

Through a newly inserted section 59C, provisions regarding adjustment / carry forward of business losses of a 'sick industrial unit' have been introduced.

It is provided that where a company acquires (under a 'scheme of acquisition') majority share capital of another company (being a 'sick industrial unit' as defined below), the acquiring company shall be entitled to adjust loss for the latest tax year and brought forward assessed business losses (excluding capital loss) of the acquired company against 'income from business' for a period of three years, **subject to the following conditions:**

- (a) there is continued ownership for five years starting from the June 30, 2023 and there is no change in share capital of the acquiring company;
- (b) the assets of the acquired company shall not be sold upto the June 30, 2026; and
- (c) the acquired company continues the same business till the June 30, 2026.

Acquiring company is required to revive the acquired / sick industrial unit by tax year 2026. A sick industrial unit (acquired company) shall be deemed to be revived if the said company attains maximum production capacity that was obtained before the industrial unit went sick provided that the acquired company produces a certificate to the effect that it stands revived, duly issued by Engineering Development Board, along with the return of income filed for tax year 2026.

The loss of the acquired company shall be adjusted against income of the acquiring company under the head "income from business" as per below formula:

$(A/100) \times B$ where

A is the percentage share capital held by the acquiring company of the acquired company; and

B is the loss of the acquired company as referred above.

In case the losses surrendered by the acquired company are not adjusted against income of the acquiring company in the said three tax years, the acquired company shall carry forward the unadjusted losses in accordance with section 57.

"Sick industrial unit" has been defined to mean a company being an industrial undertaking, which –

- (a) has accumulated losses, for a continuous period of three years prior to the July 1, 2022, equal to or exceeding its entire capital and reserves at the time of acquisition, as the case may be; or
- (b) has defaulted towards repayment of outstanding debts owing to banking companies or non-banking financial institutions for a consecutive period of three years immediately before acquisition, as the case may be; or
- (c) has been declared as such by the Federal Government in a notification published in the official Gazette.

It has been clarified that this section shall not apply to any scheme of amalgamation or merger as it is applicable only in case of a scheme of acquisition. It has also been clarified that if the acquiring company fails to revive the sick industrial unit by tax year 2026, it shall offer to tax the amount of profit on which taxes have not been paid due to set off of losses surrendered by the acquired company in tax year 2027.

TAX CREDIT FOR FOREIGN INVESTMENT BY PAKISTANI CITIZENS FOR INDUSTRIAL PROMOTION

To encourage industrial promotion through foreign investment, a new one-time tax credit is introduced for:

- (a) Pakistani citizens who are either non-residents for more than five years; or
- (b) resident individuals having declared their foreign assets in the respective wealth statement and foreign income and asset statement as of December 31, 2021.

The tax credit is available, if these taxpayers:

- (a) incorporate a new company on or after March 1, 2022;
- (b) set up an industrial undertaking in Pakistan by investing in an equity of not less than Rs. 50 million from foreign funds remitted in Pakistan through proper banking channel as per the procedure to be prescribed by the State Bank of Pakistan, at any time upto December 31, 2022; and
- (c) commence commercial production before June 30, 2024.

Upon fulfilment of the above conditions, this one-time tax credit shall be provided against the tax liability of the company to the extent of one hundred percent of the amount remitted (and credited in the bank account of such company) for the tax year in which commercial production commences. Where the benefit of the tax credit is not attained due to the fact that no tax is payable in the tax year in which the commercial production commenced or tax payable is less than the amount of credit, it can be carried forward for five tax years.

It is clarified that the company or industrial undertaking should not be established by splitting up or reconstitution of a company or an industrial undertaking already in existence or by transfer of machinery or plant from an industrial undertaking established at any time before March 1, 2022.

The Commissioner Inland Revenue is, however, empowered to re-compute the tax payable in case any discrepancy in the fulfilment of conditions attached to the tax credit is found.