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Memorandum on the Finance Act, 2021

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AMENDMENTS ENACTED BY FINANCE ACT, 2021 VIS-À-VIS THOSE PROPOSED IN FINANCE BILL, 2021

The Federal Government presented Finance Bill 2021 in the National Assembly on June 12, 2021. After the debate in the Senate and National Assembly, the Government has passed Finance Act, 2021 which contains those proposals of Finance Bill which were eventually approved with certain modifications and certain subsequent amendments made in the Bill during the above process. The amendments made in the fiscal laws by the Finance Act, 2021 are made effective from July 1, 2021.

This Memorandum summarises certain major amendments made by the Finance Act, 2021.

INCOME TAX

Concealment of income and powers to arrest

The Finance Bill proposed a definition of this term 'concealment of income' which has been further amended by the Act to include claiming of any income or receipt as exempt which is otherwise taxable. However, all the actions including this new category would only be considered as concealment if it is proved that the taxpayer has knowingly and wilfully committed the acts.

The Bill proposed certain additional powers for the tax authorities to arrest and prosecute taxpayers involved in concealment of income, before adjudication. The Finance Act has retained the power of arrest; however, certain safeguards have been provided to dispel the impression of this provision being potentially used for harassment. The arrest can now only be made on the basis of material evidence obtained through third party audit or assessment under the relevant provisions of the Income Tax Ordinance and subject to a finding recorded by an Officer to the effect that an offence of concealment of income arose resulting in non-payment of tax exceeding certain limits. For filers, such limit is prescribed at Rs 100 million and for non-filers, the threshold has been kept at Rs 25 million. The arrest will, however, only be made after approval of the Committee of Finance Minister, Chairman FBR and other Senior officials.

Capital Gains Tax rate on immovable properties enhanced

As against the original proposal of taxing capital gains on immovable properties sold within a holding period of four years upto Rs 5 million at 5% and at normal rates for gains exceeding Rs 5 million, the final amendment in Finance Act has enhanced the tax rates as under:

Amount of Capital Gains	Old Rate	New Rate
Upto Rs 5 million	2.5%	3.5%
Exceeding Rs 5 million but not exceeding Rs 10 million	5%	7.5%
Exceeding Rs 10 million but not exceeding Rs 15 million	7.5%	10%
Exceeding Rs 15 million	10%	15%

Capital gains for the purpose of applicability of above tax rates would be reduced based on holding period as under:

S. No.	Holding period	Gain
1.	Where the holding period of an immovable property does not exceed one year	A = Consideration minus cost
2.	Where the holding period of an immovable property exceeds one year but does not exceed two years	A x ¾
3.	Where the holding period of an immovable property exceeds two years but does not exceed three years	A x ½
4.	Where the holding period of an immovable property exceeds three years but does not exceed four years	A x ¼
5.	Where the holding period of an immovable property exceeds four years	Zero

The Finance Act has not adopted following amendments proposed in Finance Bill:

(i) Taxation of depreciable immovable property on its disposal for an amount exceeding its cost; and

(ii) Explanation for taxation of persons habitually engaged in transaction of sale and purchase of property, under the head of 'Business income'

Criterion for determining residential status of individual

Through the Finance Act, 2019, the definition of a resident individual was broadened to include an individual who stays in Pakistan for at least 120 days during the tax year and who was also present in Pakistan for an aggregate of 365 days or more during the preceding 4 years.

The above-referred criterion for determining the residential status of an individual has now been withdrawn through the Act. This means that an individual's residential status will now only be determined on the sole basis of his physical stay in Pakistan for at least 183 days during that particular tax year.

Taxation of resident persons' interest income

The Finance Bill proposed that in case of non-corporate persons, interest income in excess of Rs 5 million be subjected to normal tax as applicable on such persons. On the other hand, Corporate persons remained subjected to tax on their interest income at the applicable corporate tax rate, subject to deductions and allowances.

The Act has inserted a new clause whereby the tax payable by all persons including corporate persons (other than banking and insurance companies) will be subject to a final tax @ 15% on their interest income from government securities. By virtue of this clause, where a non-corporate person will be deriving interest income from government securities in excess of Rs 5 million, his income will not be subject to normal rate and 15% tax thereon will be final. Similarly, all corporate persons (other than banking and insurance companies) will also be able to avail the benefit of final taxation at 15% on their income as against the standard corporate tax rate of 29%.

Taxation of interest income for resident persons is summarised as under:

	Interest Income from			
	Other than Government Securities		Government Securities	
	Individual	Company (other than bank)	Individual	Company (other than bank and insurance company)
Withholding	15%	15%	15%	15%
Taxability				
- Upto Rs. 5 m	15%	29%	15%	15%
- Above Rs. 5 m	Applicable rate *	29%	15%	15%

* *Where interest income exceeds Rs. 5 million, the entire interest income would be subject to tax at applicable rate.*

Reduction in tax for women enterprises

A new concept of woman enterprise has been introduced which will apply on a 'startup' established on or after July 1, 2021 as sole proprietorship or an AOP (having all female members) or a company whose 100% shareholding is with females. The tax payable on business income of such women enterprises will be reduced by 25%. The benefit of this reduction will not be available to a business that is formed by the transfer or reconstitution or splitting up of an existing business.

Advance Tax collection from distributors & retailers

The Bill proposed to expand the list of sectors whose distributors and retailers will be subject to collection of advance tax. The Act has retained this proposal with an amendment to the proposed list. The final amendment will impact Pharmaceutical, poultry and animal feed, edible oil & ghee, auto-parts, tyres, varnishes, chemicals, cosmetics and IT equipment.

Dividend from REIT

Dividend income from REIT will be subject to 15% final withholding tax as against the earlier rate of 25%.

Minimum Tax

The proposal of reduction in minimum tax rates (from 1.5% to 1.25% and certain other sectors for whom varied rates are prescribed) has been approved by the Finance Act; however, the rate of tax for flour mills has been kept at 0.25%.

Reduced withholding tax rate (3%) for non-resident Oilfield Services

For payments to non-residents on account of oilfield services, a reduced rate of 3% has been prescribed.

Architectural services subject to reduced (3%) withholding tax

The list of services provided by resident persons subject to 3% withholding income tax has been expanded to include Architectural services. Earlier, the Bill proposed to include telecommunication, warehousing, oilfield, collateral management and travel & tour services in the aforesaid list, which have also been approved by the Act.

Reduction in withholding tax rate on execution of contracts

The withholding income tax rate on payments for execution of contracts by resident persons is reduced from 7% to 6.5% in case of corporate persons and from 7.5% to 7% in case of non-corporate persons.

International Buying Houses

Under this newly introduced concept, persons acting as buying offices, buyer's agents or representatives of international buyers for facilitating exports from Pakistan, who are registered as liaison office or companies with SECP have been exempted in respect of:

a) Amounts remitted in Pakistan through banking channels in foreign currency received by such buying houses from their non-resident principals to meet expenses in Pakistan; and

b) Salary income of non-resident and non-Pakistani experts engaged by such buying houses.

In order to qualify as a buying house, the persons should be acting as cost centres with the sole purpose to bring export orders to Pakistan on behalf of their principals and do not enter into any local business transactions in Pakistan and their expenses are remitted to Pakistan.

Exemption from withholding tax on import stage

The Bill proposed to exempt certain imports from collection of withholding tax, such as temporary imports by athletes, re-importation of earlier exported goods, persons authorised under Export Facilitation Scheme 2021 (draft rules recently issued), Newspapers, journals and periodicals, printed books, motor vehicles upto 850cc in CBU condition. All such proposals have been accepted through Finance Act with an increase in engine capacity of imported vehicle from 850 cc to 1,000 cc. Further, the list also now includes blind talking mobile phones imported by blind individuals.

Builders & developers

Under the earlier introduced special area based taxation and other related concessions for builders and developers, they were inter alia allowed to incorporated 10 times of tax paid on such basis in their books of account and any income in excess of such limit was to be taxed at normal rate. The Finance Act has prescribed a special reduced rate of 20% for such excess income instead of normal higher rate.

Small & Medium Manufacturing Enterprises

Through the Finance Bill, a special tax regime was proposed for SME manufacturing sector having turnover upto Rs 250 million. Under the regime, reduced tax rates are prescribed depending upon the threshold of turnover and taxable income of SMEs. The Finance Act has approved this regime with certain additional provisions as under:

a) Export proceeds of SMEs to be subject to reduced rate of 0.25% (for turnover upto Rs 100 million) and 0.5% (for turnover not exceeding Rs 250 million)

b) Minimum tax on turnover basis exempted

c) Withholding tax on local supplies to be adjustable and not minimum tax

Taxation of Banking Companies

The Finance Act amended the Seveth Schedule to the effect that the taxable income of banking companies attributable to investment in Federal Government Securities will be subjected to following tax rates effective from tax year 2022 (i.e. accounting year ending December 31, 2021):

Assets to Deposit Ratio as of year end	Tax rate
upto 40%	40%
exceeding 40% but not exceeding 50%	37.5%
exceeding 50%	35%

FBR through its Circular No. 2 of 2021-2022 (issued on July 1, 2021) has clarified the above ratio as 'advances to deposit ratio' instead of 'Assets to Deposit ratio'.

Tax holiday for Refineries

The Finance Bill proposed to prescribe the commencement date of the 10 years' tax holiday to be the date of commencement of commercial production in the case of new refinery and from the date of completion of upgradation, modernisation or expansion project of an existing refinery.

The Finance Act removed the restriction of 100,000 barrels per day for qualification of an existing refiner's modernisation or expansion projects. Furthermore, the exemption has been made available for a period of 20 years beginning from date of commencement of commercial production in the case of new refinery and for 10 years from date of completion of upgradation, modernisation or expansion project of an existing refinery.

The tax holiday is, however, restricted to only those Refineries whose products fulfil Euro 5 standards.

National Power Parks Management Company Limited (NPPMCL)

A new exemption clause was proposed through Finance Bill to provide a tax holiday on income of NPPMCL from the date of change in ownership owing to privatisation besides exemption from minimum tax and protection to tax credit claim under section 65D for equity-based investments.

The Finance Act has extended the above exemption from the date of commencement of operations by NPPMCL besides making certain protective amendments relating to tax credit under section 65D.

Exemption of medical benefits & provision of certain free or subsidised products retained

The proposal to delete the exemption on salaried persons regarding their medical allowances upto certain limit and reimbursements for actual medical expenses has been withdrawn and not adopted in the Finance Act. As a result of this, these benefits will continue to remain exempt subject to same limitations and conditions.

Similarly, the proposal to omit the exemption clause relating to free or subsidized food provided by hotels and restaurants to their employees, free or subsidized education by educational institutions to their employees' children, free or subsidized medical treatment by hospitals for their employees, etc. has also been withdrawn. Consequently, there is no change in exemption provisions relating to such perquisites.

Exemption of payments and transfers out of Provident Funds

In respect of the below-referred exemptions available under the Ordinance, the Bill proposed to restrict the exemption and payments representing profit on debt exceeding Rs. 500,000, were proposed to be taxed @ 10% as a separate block of income:

(a) Payment received from provident fund to which Provident Funds Act, 1925 applies;

(b) The accumulated balance due and becoming payable to employees participating in recognised provident funds; and

(c) Any withdrawal of accumulated balance from an approved pension fund that represents transfer of balance of approved provident fund to the said approved pension fund under the Voluntary Pension System Rules, 2005.

The Finance Act has not adopted the above-referred proposal of Finance Bill. As a result, the above exemptions continue to remain available.

Exchange Traded Fund

Unit of Exchange Traded Fund has been clarified to be 'security' for the purposes of section 37A, and the resident persons (other than company) investing in such fund are to be allowed tax credit thereon.

Business bank account

Every taxpayer engaged in business is required to declare his business bank account in his profile by October 1, 2021. Those not declaring bank account would be penalised with Rs. 10,000 for each day of default which would be computed at later of submission of application for tax registration or the date of opening of business bank account. Minimum penalty has been prescribed at Rs. 100,000.

SALES TAX

Online Market Place

The following amendments relating to 'online market place' were proposed in the Bill:

(i) Definition of online market place was proposed to be introduced as under: **"online market place"** includes an electronic interface such as a market place, e-commerce platform, portal or similar means which facilitate sale of goods, including third party sale, in any of the following manner, namely:

(a) by controlling the terms and conditions of the sale;

(b) authorising the charge to the customers in respect of the payment for the supply; or

(c) ordering or delivering the goods.";

(ii) Definition of Tier-1 / retailer was proposed to be expanded to include the following:

- a retailer operating an online market place supplying goods through e-commerce platform, whether or not the goods are owned by him; and

- a retailer who has acquired point of sale for accepting payment through debit or credit cards from banking companies or any other digital payment service provider authorized by State Bank of Pakistan.

(iii) Section 3(3) was proposed to be amended to impose liability to pay sales tax (in the case of supply of goods through online market place), of the person running online market place, whether or not the goods are owned by him.

Through Finance Act, 2021:

(i) Amendment made in definition of Tier-1 retailers relating to online market place has been withdrawn. Consequently, amendment proposed in section 3(3) has also been withdrawn.

(ii) Online market place (as defined above) has been required to withhold sales tax @ 2% on value of supplies made by persons, other than active taxpayers.

As a result of the above, those selling goods as owner of taxable supplies remain liable to charge and pay sales tax applicable on these supplies. However, online market place, through which such sales would take place, are required to withhold sales tax on supplies made by such persons. While making amendment in the Eleventh Schedule to give effect to withholding of sales tax @ 2% corresponding amendment has not been made in section 3(7) to give legal effect to withholding of sales tax from payment against supplies made by retailers. As a result, it appears that online market place would be liable to withhold sales tax @ 2% only on supplies made by them as owner of goods, and not on supplies made by others.

Steel Sector

The Finance Bill proposed to withdraw FED regime on Steel Sector with a replacement of normal sales tax. The Finance Act has made certain amendments to ensure that Steel Sector remains subject to sales tax on similar basis as was previously undertaken under FED regime.

Restriction on input tax for Tier – 1 retailers

For those Tier -1 retailers who does not integrate their retail outlets with the FBR's computerised system for real time reporting of sales through Point of Sale machines, their claim of input tax for a tax period will now be reduced by 60%. Earlier this limit was prescribed as 15%.

Reduction in sales tax rate for integrated retail outlets

The sales tax rate on supplies as made from retail outlets as are integrated with FBR's computerised system for real-time reporting of sales is further reduced from 12% to 10%.

Common identifier number

The proposal to introduce a common identifier number has been withdrawn.

Conversion from exemption to Zero rating

Following items have been included in the list of zero rating which were earlier exempted from sales tax:

a) Import or supply of milk; and

b) Import or supply of fat filled milk excluding those sold in retail packaging under a brand name or a trademark

Exemptions from sales tax

The proposal to delete the exemption relating to eggs, cereals and other products of milling industry and preparations suitable for infants put up for retail sale has been withdrawn. As a result, these items will continue to remain exempt from sales tax.

Certain additions have been made to the list of exempt items, which include local supply of wheat barn and import of POS machines for installation at retail outlets. Exemption available to suppliers of manufacturers of marble and granite, and crushed stone has been withdrawn.

Restorative of zero rating

Zero rating on supply of ships and related machinery and equipment, proposed through Finance Bill to be withdrawn, has been retained.

Reduced rate of Sales Tax

The Finance Bill's proposal to withdraw reduced sales tax rate on certain items has not been adopted in the Act and as a result, such items will continue to be subjected to reduced rates, such as certain dairy products, plant & machinery not manufactured locally, silver & gold in unworked condition, articles of jewellery and precious stones, etc.

Rate of sales tax applicable on articles of jewellery or parts thereof, of precious material or of metal clad with precious metal, has been amended. The applicable rate of sales tax is 1.5% of value of gold plus 2% of value of diamond used therein, plus 3% of making charges.

Furthermore, the proposed reduction of sales tax rate at 12.5% on supply of locally manufactured / assembled cars upto 850 cc has been enacted by the Act with a modification to increase the capacity to 1,000 cc.

Goods supplied from FATA / PATA

In order to reinforce the claim of sales tax, goods supplied from FATA / PATA to the taxable areas have been included in the Eighth Schedule whereby such goods will be subject to reduced rate of sales tax at 16%.

Sales tax withholding on lead batteries

As against the proposal of Finance Bill to introduce 100% sales tax withholding on purchase of reclaimed lead or used batteries, the Act has reduced the rate to 75% and extended the scope of withholding to specific kinds of lead batteries.

FEDERAL EXCISE DUTY

EXCISE DUTY ON GOODS

Locally Manufactured Vehicles

The Bill proposed withdrawal of excise duty on locally manufactured vehicles with cylinder capacity of up to 850cc.

In the Act, such relief has been extended to locally manufactured vehicles of cylinder capacity up to 1,000 cc and thus, these have been zero rated for the purposes of excise duty.

Furthermore, the following reductions in rates of duty has been made in respect of locally manufactured vehicles:

Vehicles	Existing Rate	New Rate
- with cylinder capacity from 1001 cc to 2000cc	5% *ad val.*	2.5% *ad val.*
- with cylinder capacity of 2001cc or above	7.5% *ad val.*	5% *ad val.*

EXCISE DUTY ON SERVICES

Telecommunication Sector

The Bill proposed to levy a new charge of duty in respect of mobile phone calls exceeding 3 minutes in duration, and also on internet and SMS services.

Now, whilst the proposed duty on internet and SMS services has been withdrawn, a new levy at a flat rate of Re. 0.75 in respect of mobile phone calls exceeding 5 minutes in duration has been imposed.

CUSTOMS DUTY

Retailing included in Smuggling

The proposal regarding the amendment of definition of smuggling to include retailing has been approved.

Definition of Owner

The Bill proposed a definition for the term 'owner' to include any person who is for the time being entitled, either as owner or agent for the owner to the possession of goods. This proposal has been withdrawn.

Reduction in proposed penalties

The Finance Bill proposed certain penalties for persons contravening the requirements of placement of invoice and packaging list inside the import container or consignment, which started from Rs 100,000 for the first time till outright confiscation of goods and blockage of WEBOC user ID for one year in case of such offence for the fourth time. The Act has retained these penalties for the first three offences with a reduction in amounts of penalty and omitted the action regarding blockage of WEBOC user ID in fourth time offence. A committee to be formed by FBR will examine the issues relating to this matter.

Confiscation of smuggled goods

As against the proposal of not releasing a conveyance against the redemption fee if apprehended for a third time to carry smuggled goods, the Act has made an amendment whereby a conveyance found carrying smuggled goods in false cavities or being used exclusively or wholly for transportation of offending goods is seized for a third time it shall not be released against redemption fee.

Amendments in First and Fifth Schedules

Finance Act has amended the First Schedule to increase customs duty on certain tariff lines of following sectors:

(i) Chemicals and allied industries
(ii) Textiles

By virtue of amendment in the Fifth Schedule, the rate of duty on certain items imported by shoe, carpet and welding industry have been reduced to 5%, 0% and 10% respectively, subject to certain conditions.

Concessions for Hybrid Vehicles

Certain conditional concessions have also been introduced for import of hybrid vehicles under the Auto Industry Development Exports Policy.