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Finance Supplementary (Second Amendment) Bill, 2019

January 24, 2019

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Chartered Accountants
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A. F. FERGUSON & CO.

FINANCE SUPPLEMENTARY (SECOND AMENDMENT) BILL, 2019

This Memorandum gives a brief overview of significant amendments proposed through the Finance Supplementary (Second Amendment) Bill, 2019 which has been laid down before the National Assembly on January 23, 2019.

The amendments proposed through the Bill will be effective from the date of assent given by the President except for certain amendments in the Customs Act, 1969 which will be effective from March 31, 2019 and certain other amendments in the Income Tax Ordinance, 2001 which will be effective from July 1, 2019.

This memorandum can also be accessed on https://www.pwc.com.pk/en/tax-memorandum.html

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OVERVIEW OF ECONOMIC PACKAGE

Notwithstanding any political connotation, all the realistic analyses of Pakistan's economy reveal that at the time of assumption of power, the present incumbent government inherited fractured, disoriented, trade based, import led and consumption driven economic state of affairs. There are huge current account and fiscal deficits with clear erosion of state writ to collect due taxes.

There was a serious need to provide a direction for the future course of economy. This was expected as the first correction made after assumption of power. Nevertheless, it would be unfair to term the steps undertaken today on January 23, 2019 as 'Mini Budget'. This is effectively an 'Economic Package' to change the direction of the economy from trade and consumption based state towards industrialization, export promotion, ease of doing business and import substitution.

Unlike generally discussed fiscal measures, the subjects to be taken seriously in this package are the adjustments in the duty structure, other facilities for the import of raw materials and other items for the promotion and sustenance of domestic industry. In the past, cascading duty structures were not properly monitored to provide conducive environment for the local industry. Pakistan, in the present state of affairs, requires connected and integrated industrialization using small and medium scale industry. In the past, this sector which provides employment and support to large population was highly discriminated against and neglected from all angles especially through fiscal policies.

As indicated by the Finance Minister, government has taken bold decisions to expand the business at the cost of reduction in collection of taxes which were hurting overall business friendly environment. This includes abolition of super tax, abolition of tax on undistributed profits, resumption of group relief to a certain extent and other such measures. There appears to be a clear realization that present tax collection base is not sustainable for the country, however the better prescription for the government is administrative action and not collecting more taxes from the people who are already burdened by paying taxes. There are pertinent measures in this direction in this package.

Pakistan is faced with the menace of presumptive / final tax regime. This ill which started in 1992 has eroded the tax base and documentation of economy. There had been a policy of gradually reducing the presumptive / final tax regime. In the present package, primary principles on this ground have been compromised for commercial importers. This step needs re-examination at the time of budget for the year 2019. The problem is two pronged; however, there can be some solution to this ugly heritage.

In 2018-2019, Pakistan's economy is at the cross road of correction or further deterioration. There are very limited choices. There are clear signals from all angles that documentation of economy is inevitable. This step, in the present state of affairs at times, unnerves the business community, in principle, for the reason that administrative actions and powers are at times abused against common businessman. Nevertheless, there are minimal choices for the government. They have to move towards documentation in a very structured way keeping in view the ground realities and the prevalent culture that has pervaded due to wrong policies of governments in the last forty years. This correction cannot be made in one day. It is therefore advised that a clear road map with transparent and smooth transition be provided for this process.

On overall basis, it can be concluded that this package, in general, is a step in the right direction.

INCOME TAX

TAX ON UNDISTRIBUTED PROFITS

Undistributed reserves were taxed in tax years 2015 and 2016. This was replaced by a tax on undistributed profits in the tax year 2017. Presently, such tax is payable for tax year 2017 and onwards at the rate of 5% of the whole profits, if distribution (including by way of bonus shares) is less than 20% of after tax profits.

This tax has now been abolished from tax year 2020 and onwards as the Finance Supplementary (Second Amendment) Bill, 2019 now proposes to restrict this levy upto tax year 2019.

INTER-CORPORATE DIVIDEND IN GROUP COMPANIES

The Finance Minister in his speech stated the desire of the Government to promote holding company and group structures. One of the major impediment in the creation of such group structure is dual taxation of inter corporate dividends within the group. In 2016, a regressive step was undertaken by way of elimination of exemption from tax on inter corporate dividend. In this Supplementary Bill, the concept of group relief has been re-introduced however that does not fulfil what has been stated in the Speech.

In the Finance Bill, a new regime has been introduced to exempt inter corporate dividend in case of companies availing group relief. Resultantly, this exemption will be available only:

(i) where there is a surrender of losses in that Tax Year, and
(ii) to the extent of percentage holding of parent company in the subsidiary company.

We consider that the term 'to the extent of the percentage holding' requires explanation as the same can be misinterpreted.

The aforesaid amendment needs to be re-examined and it is suggested that the original position prior to 2016 be reinstated as the purpose of exemption on inter-corporate dividend was to promote formation of group companies and not limited to the cases where group were formed merely for loss utilisation.

TAXATION OF BANKING COMPANIES

Reduced rate of tax for certain advances

Under the existing regime, all income of banking companies is subject to uniform rate of tax of 35%. It is now proposed that 'income' from advances to the following will be subject to reduced rate of 20% for tax years 2020 to 2023:

a) Micro and small enterprises
b) Low cost housing finance
c) Farm credit

The above terms are defined as per State Bank of Pakistan's Prudential Regulations. With regard to farm credit and low cost housing finance, advances would not qualify for the above concessional rate and the same is subject to submission of details of advances along with gross and net margin earned from such advances.

The above concessional rate is available on 'additional advances', which term has been defined as advances in addition to average amount of advances to the above sectors for tax year 2019.

A new clause in Second Schedule has been proposed to exempt the above income from Super Tax for tax years 2020 to 2023. This proposal needs to be suitably placed as the provisions of Seventh Schedule, being in the nature of special provisions, state that the exemptions in Second schedule are not applicable to Banking companies. Also, the proposed concession refers to tax years up to and including tax year 2023 whereas the imposition of Super Tax at present is restricted to 2021.

Super Tax

The phase wise reduction in rate of Super Tax for Banking companies as was introduced through Finance Act, 2018 has been reversed. The existing and proposed rates of Super Tax for respective years are as under:

Tax Year	Existing Rate (%)	Proposed Rate (%)
2018	0	4
2019	4	4
2020	3	4
2021	2	4

The reinstatement of super tax for tax year 2018 needs to be reconsidered. In all such cases, deemed assessments have already been finalized and vested rights accrued for the nil rate introduced by Finance Act 2018.

SUPER TAX – PERSONS OTHER THAN BANKS

In the case of persons (other than banking companies) having taxable income of Rs 500 Million or above, the rate of super tax of 1 per cent for tax year 2020 is proposed to be reduced to 0 per cent.

PROVISIONAL ASSESSMENT FOR UNDECLARED OFFSHORE ASSETS

The process of provisional assessment which was earlier limited to assets which could have been impounded has been extended to undeclared offshore assets of any person. This extension has been made in order to encompass the right of provisional assessment on assets which could not have been impounded by the Government of Pakistan on account of being held outside Pakistan.

This amendment has been apparently made to avoid unnecessary delay in the recovery of taxes due from the offshore assets which have been discovered by Government of Pakistan.

ADVANCE TAX ON BANKING TRANSACTIONS

Advance tax on cash withdrawal and certain banking transactions is proposed to be withdrawn for Filers. Collection of advance tax on such transactions from 'Non-Filers' would remain unchanged at 0.6 per cent.

The provisions relating to advance tax collection on cash withdrawals are proposed to be inapplicable on filers as well as non-filers with respect to a Pak Rupee Account if the deposits in the account are made solely from foreign remittances credited directly into such account.

RESTRICTION ON PURCHASE OF CERTAIN ASSETS BY NON-FILERS

Through Finance Act, 2018 restrictions were introduced on non-filers from purchasing of immovable property and motor vehicles. The said restrictions were relaxed through Finance Supplementary Act 2018 for purchase of motor cycles, rickshaw, agricultural tractor and any other motor vehicle having engine capacity of less than 200 cc.

It is now proposed to extend the above relaxation to locally manufactured motor vehicle having engine capacity not exceeding 1,300 cc. As regards other vehicles, the concession earlier given is now made restricted to locally manufactured vehicles only.

Another relaxation was also given through Finance Supplementary Act, 2018 for NICOP and POC holders in respect of purchase of immovable properties and vehicles, subject to certain conditions including that with regard to financing of such assets from money brought from outside Pakistan through normal banking channels. It is now proposed that non-resident Pakistani Citizens holding international passports will also be excluded from such restrictions.

RESTORATION OF PRESUMPTIVE TAX REGIME FOR COMMERCIAL IMPORTERS

Through Finance Act, 2018 a very major shift had been made in the tax policy measures whereby the right to be taxed under presumptive regime has been abolished for commercial importers. Such importers were taxable on net income arising from such import transactions, and the tax collected at the import stage has been treated as minimum tax liability in this respect. The minimum tax payable under this clause was 5% of the import value as increased by customs duty, sales tax and federal excise duty.

Now the bill proposes to restore the position prior to Finance Act, 2018 and the commercial importers will be taxed under final tax regime. There is a need to re-examine this amendment with reference to the documentation of economy.

SPECIAL PROCEDURE FOR SMALL TRADERS AND SHOPKEEPERS

In order to address the grievances genuinely portrayed by small traders and shopkeepers, such as abuse of personal interaction, harassment by concerned jurisdiction, delayed appellate procedures and complicated manner of computation of income and requirements of books of accounts to ascertain taxable income, the bill seeks to empower the Federal Government to prescribe taxation scheme for such small traders and shopkeepers.

For that purpose, an enabling provision is proposed to be inserted, whereby the Federal Government may prescribe special procedures for the scope and payment of tax, filing of return and assessment in respect of small traders and shopkeepers, in such cities or territories, as may be specified. As per the speech of the Finance Minister, this scheme will be initially implemented in Islamabad Capital Territory.

WITHHOLDING STATEMENTS

The requirement to file monthly withholding statements has been replaced with bi-annual statements. The Commissioner is however empowered to ask any taxpayer to file a withholding statement. This amendment will be applicable immediately upon passing of Finance Act.

The Banking Companies have also been absolved from requirement of furnishing certain particulars of customers in relation to withholding tax statements in respect of cash withdrawals and profit on debt. This amendment has been proposed in consequence of an earlier amendment in Rules whereby special statements were prescribed for the said withholding taxes.

CARRY FORWARD OF CAPITAL LOSSES ON DISPOSAL OF LISTED SECURITIES

Under the present regime, loss on disposal of listed and other securities (covered under section 37A of the Income Tax Ordinance, 2001) which is not fully set-off against capital gains is not allowed to be carried forward to subsequent tax year. It is proposed that any unadjusted capital losses for tax year 2019 and onwards can be carried forward for set-off against capital gains on such securities up to a maximum of three tax years.

COMMISSION INCOME OF STOCK BROKERS

Under the provisions of section 233A, advance tax is collected by Stock Exchange from its members on purchase and sale of shares in lieu of tax on commission income earned by such members. The said withholding tax was adjustable against their income. It is now proposed that such advance tax collection will not be made from February 1, 2019 and onwards.

As a consequence of the above amendment, the general provisions applicable on brokerage and commission income under section 233 will become applicable whereby the tax is collected on brokerage and commission amount as against the existing manner of collecting the tax on whole transaction value. The tax now deductible on brokerage and commission income will be final tax.

RENEWABLE ENERGY PROJECTS

Exemption available to industrial undertakings engaged in renewable project is extended to such undertakings which are set up between March 1, 2019 to June 30, 2023 for a period of five years.

AUCTION OF FRANCHISE RIGHTS

There was a dire need to address the concerns of Sports league franchisees in relation to advance tax collection on auction of franchise rights especially when there is no or low profitability from such activities in initial years. The amendment has therefore been proposed to exempt from advance tax collection primarily in respect of PSL. However, the same will also apply in respect of auction of franchise rights in participating teams in a national or international league organised by any board or other organisation established by the Government in Pakistan for the purposes of controlling, regulating or encouraging major games and sports recognised by Government. This exemption will apply from July 1, 2019.

ADVANCE TAX ON IMPORT OF MOBILE PHONE

Advance tax at the time of import of mobile phone is proposed to be collected as per the rates tabulated below:

S. No.	C & F Value of mobile Phone (in US Dollars)	Tax (in Rupees)	
		Filer	Non-Filer
1	Up to 30	70	
2	From 31 to 100	730	
3	From 101 to 200	930	
4	From 201 to 350	970	
5	From 351 to 500	3,000	
6	Above 500	5,200	

The proposed rates for Filer and Non-filer should ideally be different as is apparent from the heading. A correction is required in this respect.

ADVANCE TAX ON PURCHASE, REGISTRATION AND TRANSFER OF MOTOR VEHICLES

Advance tax for 'Non-Filers' is proposed to be increased as per the engine capacity of motor vehicle as tabulated below:

S. No.	Engine capacity	Existing Rates (Rupees)	Proposed Rates (Rupees)
1	upto 850cc	10,000	15,000
2	851cc to 1,000cc	25,000	37,500
3	1,001cc to 1,300cc	40,000	60,000
4	1,301cc to 1,600cc	100,000	150,000
5	1,601cc to 1,800cc	150,000	225,000
6	1,801cc to 2,000cc	200,000	300,000
7	2,001cc to 2,500cc	300,000	450,000
8	2,501cc to 3,000cc	400,000	600,000
9	Above 3,000cc	450,000	675,000

ADVANCE TAX ON FUNCTIONS AND GATHERINGS

Adjustable advance tax for marriage function in a marriage hall, marquee or a community place with total function area of less than 500 square yards or in case of multi-story premises with function area of less than 500 square yards on each floor is proposed to be collected at higher of 5 per cent of bill ad valorem or Rs. 5,000.

Presently, the advance tax to be collected for marriage functions in larger cities is higher of 5 per cent of bill ad valorem or Rs. 20,000 and for those in smaller cities, the advance tax to be collected is higher of 5 per cent of bill ad valorem or Rs. 10,000.

FEDERAL GOVERNMENT, PROVINCIAL GOVERNMENT AND LOCAL GOVERNMENT INCOME

By way of a special provision, income from sale of spectrum license by Pakistan Telecommunication Authority (PTA) is treated as income of the Federal Government and not that of PTA for the purposes of taxation under the Ordinance.

The Finance bill now proposes to include the income from renewal of spectrum and licenses to be the income of Federal Government and not the PTA. Consequentially, now the income of the Federal Government both from the sale of spectrum licenses and renewal of spectrum and licenses is exempt from tax.

DIRECTORATE OF TRANSFER PRICING

Through Finance Act, 2017 a separate Directorate for Transfer Pricing was proposed to be established for conducting transfer pricing audits. It is now proposed to be abolished.

SALES TAX

PAYMENT OF REFUND THROUGH PROMISSORY NOTE

A totally new concept of clearance of refunds available to taxpayers has been introduced by way of introduction of a tradeable, negotiable instrument to be issued for the amount of Sales Tax refunds due. Now, the persons entitled to refunds can opt for acquiring a sovereign negotiable instruments in the form of promissory notes issued by the Government of Pakistan, instead of cash.

Salient features of such instruments will be as under:

- The notes will be transferable in the manner provided;
- Maturity period will be three years from the date of issuance;
- These will be traded freely in the country's secondary market;
- The notes shall bear annual simple profit at 10 percent;
- These shall be redeemable after the period of maturity;
- These shall be accepted by banks as collateral; and
- These shall not be subject to compulsory deduction of zakat.

SIXTH SCHEDULE - EXEMPTIONS

Following changes are proposed to be made in the Sixth Schedule:

a) Exemption on import or supply of items with dedicated use of renewable source of energy like solar and wind has been proposed to be restricted up to June 30, 2023. The exemption was previously available without any time restriction.

b) Exemption from sales tax on import or supply of appliances for colostomy has been proposed to be restricted for such appliances and items required for ostomy procedures as specified in Chapter 99 of the First Schedule to the Customs Act, 1969.

c) Exemption from sales tax on import or supply of colostomy and urostomy bags has been proposed to be withdrawn.

d) A new entry is proposed for exemption from sales tax on import of plant and machinery, excluding consumer durable goods and office equipment as imported by Greenfield industries to manufacture taxable goods, during their construction and installation period, subject to certain conditions and issuance of exemption certificate by the Commissioner Inland Revenue.

e) Exemption for machinery, equipment and spares meant for initial installation, balancing, modernization, replacement or expansion of project for power generation through renewable energy sources like solar, wind, micro-hydel bio energy, ocean, waste to energy and hydrogen cell etc. has been proposed to be restricted upto June 30, 2023.

f) Exemption on various systems and items for dedicated use with renewable source of energy like solar, wind, geothermal, etc. is now proposed to be restricted up to June 30, 2023.

NINTH SCHEDULE

Rates of sales tax on import or local supply of cellular mobile phones have been rationalized by proposing substitution of Serial No 2 in the following manner:

S. No	Description / Specification of goods	Sales tax on import or local supply	Sales tax (chargeable at the time of registration of IMEI Number by CMOs)
2	Cellular mobile phones or satellite phones to be charged on the basis of import value per set, or equivalent value in rupees in case of supply by the manufacturer, at the rate as indicated against each category:--		
	A. Not exceeding US $ 30	Rs. 150	Rs. 150
	B. Exceeding US $ 30 but not exceeding US $ 100	Rs. 1,470	Rs. 1,470
	C. Exceeding US $ 100 but not exceeding US $ 200	Rs. 1,870	Rs. 1,870
	D. Exceeding US $ 200 but not exceeding US $ 350	Rs. 1,930	Rs. 1,930
	E. Exceeding US $ 350 but not exceeding US $ 500	Rs. 6,000	Rs. 6,000
	F. Exceeding US $ 500	Rs. 10,300	Rs. 10,300

FEDERAL EXCISE DUTY

INCREASE OF DUTY ON IMPORTED MOTOR VEHICLES

The rate of excise duty on imported motor cars, SUVs and other motor vehicles principally designed for the transport of persons (other than those of headings 87.02), including station wagons and racing cars has been proposed to be increased as under:

- For vehicles having cylinder capacity of 1800 cc but not exceeding 3000 cc, the duty is proposed to be increased from 20% to 25%.

- For vehicles having capacity of 3000 cc or above, the duty is proposed to be increased from 20% to 30%.

LEVY ON LOCALLY MANUFACTURED MOTOR VEHICLES

Excise duty of 10% has been proposed to be levied on locally manufactured or assembled motor cars, SUVs and other motor vehicles of cylinder capacity of 1800 cc or above, principally designed for transport of persons (other than those of headings 87.02), including station wagons and racing cars of cylinder capacity of 1800 cc or above.

LEVY ON SMART PHONES

Through the Finance Act 2018, a new levy was imposed on smart phones valuing in excess of Rs. 10,000. This is payable at Rs 1,000, Rs 3,000 and Rs 5,000 depending on their import values in Rupee terms.

It is now proposed to impose the levy on the basis of C&F value in terms of US Dollars instead of Rupees.

Mobile handset levy on smart phones of different categories is proposed to be abolished up to USD 100 C&F value (earlier for Rs 10,000 including duties and taxes). While the maximum levy is enhanced to Rs 7,000 from Rs 5,000 as under:

Mobile phones – C&F value	*Revised rate per set (PKR)*
Above USD 100 & upto USD 200	500
Above USD 200 & upto USD 350	1,500
Above USD 350 & upto USD 500	3,500
Above USD 500	7,000

CUSTOMS DUTY

REDUCTION OF DUTY ON IMPORT OF INPUTS / RAW MATERIALS OF INDUSTRIAL SECTOR

It is proposed to reduce incidence of customs duty on certain raw materials / inputs, if imported by following industrial sectors, subject to certain prescribed conditions;

- Footwear;
- Tanners;
- Leather;
- Gloves;
- Furniture;
- Ceramics;
- Diapers / Sanitary Napkins;
- Home Appliance;
- Infant Formula;
- Chemical Manufacturing; and
- Other items falling under PCT 3812.3900, if imported by PVC / plastic manufacturers.

Above reduction is proposed to be effective from March 31, 2019.

ZERO RATING OF CUSTOM DUTY

Currently, import of Newsprint in rolls or sheets [PCT Code - 4801.0000] is subject to reduced rate of customs duty of 5%. It is proposed to further reduce the rate to 0%.

REDUCTION OF DUTY ON PLASTIC MOULDING COMPOUND

Currently, import of Polymers of ethylene, in primary forms (PCT Code - 3901.0000) and Polymers of propylene or of other olefins, in primary forms (PCT Code - 3902.0000) is subject to reduced rate of customs duty of 5%. It is now proposed to further reduce the rate to 3%.

EXEMPTION OF DUTY TO ITEMS FOR OSTOMY USE

The scope of exemption provided for Ostomy items is proposed to be extended.