

Q 1: Understanding the legal terms in taxation provides a way forward for determining the tax liability of a person. Keeping this in view, define the following terms with reference to Income Tax Ordinance 2001:

(20)

- | | | |
|----------------------------|-------------------|-------------|
| a) Capital Asset | b) Income | c) Turnover |
| d) Industrial Undertaking | e) Public Company | f) Royalty |
| g) Intangible | h) Tax Year | i) Company |
| j) Permanent Establishment | | |

ANSWER:

a) Capital Asset

A capital asset is property that is expected to generate value over a long period of time. Capital assets form the productive base of an organization. Examples of capital assets are buildings, computer equipment, machinery, and vehicles. In asset-intensive industries, companies tend to invest a large part of their funds in capital assets.

A capital asset has the following characteristics:

- It has an expected useful life of more than one year
- Its acquisition cost exceeds a company-designated minimum amount, known as the capitalization limit
- It is not expected to be sold as a normal part of business operations, as would be the case for inventory
- It tends not to be easily convertible into cash

Capital assets are defined differently when viewed from a tax perspective. For tax purposes, a capital asset is all property held by a taxpayer, with the exceptions of inventory and accounts receivable.

b) Income

Income is money that an individual or business receives in exchange for providing a good or service or through investing capital. Income is consumed to fuel day-to-day expenditures. Most people age 65 and under receive the majority of their income from a salary or wages earned from a job. Investments, pensions and Social Security are primary sources of income for retirees. In businesses, income can refer to a company's remaining revenues after all expenses and taxes have been paid. In this case, it is also known as "earnings". Most forms of income are subject to taxation.

c) Turnover

Turnover is an accounting term that calculates how quickly a business collects cash from accounts receivable or how fast the company sells its inventory. In the investment industry, turnover represents the percentage of a portfolio that is sold in a particular month or year. A quick turnover rate generates more commissions for trades placed by a broker.

d) Industrial Undertaking

An industrial undertaking which is engaged or is proposed to be engaged in the manufacture or production of parts, components, sub-assemblies, tooling or intermediates, or the rendering of services and the undertaking supplies or renders or proposes to supply or render not less than 50 per cent of its production.

As per the government definition an industrial undertaking in which the investment in fixed assets in plant and machinery whether held on ownership terms on lease or on hire purchase does not exceed Rs. 10 million, can be categorized as small scale undertaking. To encourage the growth of small scale industries in Pakistan, Government has reserved certain products for manufacture in the small scale sector in areas where there is techno-economic justification for such an approach. Large/Medium units can, however, manufacture such reserved items provided they undertake to export 50% or more of their production.

e) Public Company

"Public company" means –

- (a) A company in which not less than fifty per cent of the shares are held by the Federal Government;
- (b) 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 23[] at the end of that year; or
- (c) A unit trust whose units are widely available to the public and any other public trust;

f) Royalty

A royalty shall be Pakistan-source income if it is:

- (a) Paid by a resident person, except where the royalty is payable in respect of any right, property, or information used, or services utilized for the purposes of a business carried on by the resident outside Pakistan through a permanent establishment; or
- (b) Borne by a permanent establishment in Pakistan of a non-resident person.

g) Intangible

Intangible□ means any patent, invention, design or model, secret formula or process, copyright 1[, trade mark, scientific or technical knowledge, computer software, motion picture film, export quotas, franchise, license, 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).

h) Tax Year

Tax year means the tax year as defined in sub-section (1) of section 74 and, in relation to a person, includes a special year or a transitional year that the person is permitted to use under section 74;

i) Company

"Company" means –

- (i) A company as defined in the Companies Ordinance, 1984 (XLVII of 1984);
- (ii) A body corporate formed by or under any law in force in Pakistan;
- (iii) A modaraba;
- (iv) A body incorporated by or under the law of a country outside Pakistan relating to incorporation of companies;
- (v) A trust, a co-operative society or a finance society 86[or any other society established or constituted by or under any law for the time being in force];
- (vi) A foreign association, whether incorporated or not, which the Central Board of Revenue has, by general or special order, declared to be a company for the purposes of this Ordinance;
- (vii) A Provincial Government; or
- (viii) A local authority in Pakistan;

j) Permanent Establishment

"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, 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;
- (c) A building site, a construction, assembly or installation project or supervisory activities connected with such site or project;
- (d) The furnishing of services, including consultancy services, by any person through employees or other personnel engaged by the person for such purpose, but only where activities of that nature continue for the same or a connected project within Pakistan for a period or periods aggregating more than ninety 20[days] within any twelve-month period;
- (e) A person acting in Pakistan on behalf of the person (hereinafter referred to as the "agent" 21 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;
 - (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;

Q 2: The Income Tax Ordinance 2001 divides income into five major head: salary, property, business, capital gains and other sources. Explain your understanding of the income from property as per the provision of the Income Tax Ordinance 2001. In your opinion what type of deduction should be allowed from salary income? (20)

ANSWER: Income from property

(1) The rent received or receivable by a person 1[for] a tax year, other than rent exempt from tax under this Ordinance, shall be chargeable to tax in that year under the head –Income from Property.

(2) Subject to sub-section (3), –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.

(3) This section shall not apply to any rent received or receivable by any person in respect of the lease of a building together with plant and machinery and such rent shall be chargeable to tax under the head –Income from Other Sources.

2[(3A) Where any amount is included in rent received or receivable by any person for the provision of amenities, utilities or any other service connected with the renting of the building, such amount shall be chargeable to tax under the head –Income from Other Sources.]

(4) Subject to sub-section (5), where the rent received or receivable by a person is less than the fair market rent for the property, the person shall be treated as having derived the fair market rent for the period the property is let on rent in the tax year.

(5) Sub-section (4) shall not apply where the fair market rent is included in the income of the lessee chargeable to tax under the head –Salary.

[15A. Deductions in computing income chargeable under the head –Income from Property.—

(1) 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:-

(a) 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;

(b) Any premium paid or payable by the person in the year to insure the building against the risk of damage or destruction;

(c) any local rate, tax, charge 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;

(d) Any ground rent paid or payable by the person in the year in respect of the property;

(e) 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;

(f) 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;

(g) Where the property is subject to mortgage or other capital charge, the amount of profit or interest paid on such mortgage or charge;

(h) Any expenditure (not exceeding six 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 for the purpose of collecting the rent due in respect of the property;

(i) 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

(j) 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

- (i) 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;
- (ii) 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
- (iii) 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.

My Opinion on Types of Deduction from Salary Income

Although many people consider there should be 0 tax on salary income. But income tax has always been making a significant impact on any country's economy. Very high or low income tax does not necessarily mean to aid economy of any country. An optimum income tax rate depending upon country's economic, social goals is necessary in order to realize the real benefits of income tax. I would like to support my views on this topic in following paragraphs.

Income tax is a key driver for any country to grow and provide sufficient facilities to its citizens. If there is no income tax in the country then it is very difficult to fund the systems like army, police, industry and agriculture, which are backbones for any country's economic growth. For example without having police in the society it is almost impossible to protect citizens and provide necessary security for the industries from stealing their products. In absence of police, various industries will have to hire their own security, which will negatively impact on the industries performance since they have to spend lot of money on the security. Same thing with the army; in absence of army it is impossible to protect the people from outside enemies in case of war or terror attacks. Thus in order to have smooth functioning of all the systems mentioned above there must of some income tax posed on countries citizens all over the world. However, imposing higher taxes does not necessarily mean strong economic growth. If there is very high income tax imposed on people then many people would not like to work.

But it is also important for the government to provide some subsidies on the income from specific products for example, solar panels, wind turbines in order reduce negative impact on earth's environment and also stimulate economy by importing and exporting these products.

Overall, income tax plays paramount role on any country's economy. But very high or low tax rate does not enhance the economy, an optimum income tax rate is essential for country's potential growth.

Accordingly there should be minimum tax on salary income, however allowances may be nominally liable to be imposed tax.

Q 3: Calculate the tax liability for the tax year 2016 of Mr. Azam, a disable person from the following record. From the following records: (Tax rates are given at the end). (20)

No.	Item	Amount (Rs.)
1.	Basic Salary	30,000 per month
2.	House rent allowance	6,000 per month
3.	Utilities allowance	8,000 per year
4.	Medical allowance	10,000 per year
5.	Conveyance facility is provided to Mr. Azam for personal & official use.	Cost of vehicle is 700,000
6.	Reimbursement of children education expenses	12,000 per year
7.	Contribution to provident fund	7,000 per year
8.	Zakat paid	10,000 per year
9.	Shares of BD Ltd. purchased	Rs. 16,000
10.	Donation to a Govt. school	Rs. 3500

Solution:

Mr. Aslam
Tax year ended on: 30-06-2015
Personal status: individual (Disabled Person)
Residential status: Resident

Computation of Taxable Income and Tax Liability

	Rs.	Rs.
Income from Salary:		
Basic Salary (30,000 × 12)		360,000
House Rent allowance (6000 × 12)		72,000
Utilities allowance		8,000
(a) Medical allowance (8,000)		
(b) (10% of basic salary) (36,000)		36,000
Whichever is higher (a) or (b)		35,000
Conveyance facility		35,000
Reimbursement of children		Nil
Provident fund (15,000)		
(1/10 th of the basic salary) (36,000)		15,000
(whichever is lower (a) or (b))		
Total income		518,000
Less: zakat paid		5,000
Total taxable income		513,000
Computation of tax liability at 500000:		2000
(13,000 @ 5%)		650
Tax payable income		2650

Q 4: Suppose you are running a small business. The FBR sends you a notice to pay your tax liability. Under the Income Tax Ordinance 2001, how would you calculate your income from business on which the tax will be payable.

(20)

Answer:

Mr. Zaheer

Tax year: 2016
Tax year ended on: 30.6.2016
Personal Status: Individual
Residential Status: Resident

		Rs.
Income from business:		
Income from Business (Sales in business - (depreciation expenses - cost of sales - interest expenses - salaries expenses)		784000
Income from Capital gain:		
Capital gain on sale of shares of public company after 1 year of purchase	100000	
Less: exempt upto 25% of such gain	<u>25000</u>	75000
Income from other source:		
Income from other source		140000
Total income		999000
Less: Zakat paid 10000		
Less: Donation to a school 15000		
Total Taxable Income		974000
Commutation of Tax: Tax rate on 7,50,000	17500	

Tax on @10% on 2,24,000	22400	
Gross Tax		39900

Paid challan of Rs. 39,900 is attached herewith.

Q 5: There are certain types of incomes on which no tax is payable under the Income Tax Ordinance 2001. You are required to list down at least twenty (20) such types of income which exempt from tax. (20)

ANSWER: Incomes Exempted from Tax

Income Tax Ordinance 2001 provides a list of incomes which either have been exempted fully from tax or some concession has been provided on such incomes. Section 53 of the Ordinance authorizes the federal government to specify the incomes or clauses of incomes, persons, clauses of persons which shall either be exempt from tax or whose tax liability shall be reduced. Some of the items are enlisted below:

1. AGRICULTURAL INCOME
2. PENSION
3. ASSOCIATION OF PERSON
4. Income of Trust, Welfare Institutions or Non-Profit Organizations
5. Amount of Gratuity or Commutation of Pension
6. Compensatory Allowance
7. Foreign Source Income of Certain Resident Individuals
8. Foreign-source income of short-term resident individuals
9. Foreign-source income of returning expatriates
10. Income of a Pakistani Working on a Foreign Ship
11. Salary from British Council
12. Exemption for Diplomats and Representative of United Nations
13. Officials of the Foreign Government
14. Allowances attached to Honors, Awards, etc.
15. Scholarships
16. Income of Governments
17. Income from Micro Finance Banks
18. Foreign government officials
19. President's honours
20. Support payments under an agreement to live apart
21. Exemption for Diplomats and Representatives of United Nations
22. AWARDS
23. PROFIT ON DEBT TO ATTRACT FOREIGN FUNDING
24. Income of Educational Institutes
25. Profit on debts
