

**LEX MUNDI**  
PUBLICATION



**TAX PRACTICE GROUP**  
**Multi-Jurisdictional Survey**

**TAX DESK BOOK**

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**Introduction**

**1. Please give a brief overview of the types of taxes imposed in your jurisdiction (i.e., direct and indirect taxes and their components.)**

The law governing taxation in Pakistan is the Income Tax Ordinance, 2001 (“ITO”), which imposes various kinds of direct and indirect tax. The following are the various kinds of tax imposed under the ITO:

Income tax, which includes tax on

- salary income
- income from property
- income from business
- capital gains
- income from other sources

Withholding tax, which includes tax on

- Dividends
- Profit on debt

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- Payments to non-residents
- Payment for goods & services
- Export proceeds
- Rental payments
- Prizes & winnings
- Pension fund withdrawals

Advance tax, which includes tax on

- Imports
- Cash withdrawals from banks
- Purchase of motor vehicles
- Brokerage & commission
- Electricity consumption
- Telephone bills

## **INCOME TAXES – AS APPLIED TO BUSINESS ENTITIES AND INDIVIDUALS**

### **Calculation of Income/ Profit Taxes**

#### **2. How is the taxable base determined?**

All capitalized terms used hereunder but not defined shall have the meaning attributed to them in the ITO.

Under section 9 of the ITO, the taxable income of a person for a year shall be the total income of the person for the year reduced (but not below) zero by the total of any deductible allowance such as zakat, worker's welfare fund and worker's participation fund as stated in Part IX, Chapter III of the ITO.

Under the ITO, the total income of a person for a tax year shall be the sum of the person's income under each of the heads of income for the year. For purposes of the imposition of tax and computation of total income, all income shall be classified under the following heads; namely Salary; Income from Property; Income from Business; Capital Gains and Income from Other Sources

Pursuant to section 11(5) of the ITO, the income of a resident person under a head of income shall be computed by taking into account amounts that are Pakistan-source income and amounts that are foreign-source income. The income of a non-resident person under a head of income shall be computed taking into account only amounts that are Pakistan-source income.

### 3. What revenues are included?

Under section 18 of the ITO, the following incomes of a person for a tax year, other than income exempt from tax under the ITO, shall be chargeable to tax under the head, “Income from Business”:

- the profits and gains of any business carried on 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;
- any income from the hire or lease of tangible moveable property;
- the fair market value of any benefit or pre-requisite, 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;
- and any management fee derived by a management company (including a modarba [management company]).

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.”

Furthermore, any profit and gains arising from the speculation business for a tax year computed in accordance with the ITO shall be included in the person’s income chargeable to tax under the head “Income from Business” for that year.

### 4. What deductions are allowed?

Zakat, worker’s welfare fund and worker’s participation fund are deductible allowances from the taxable income of a person.

There are different kinds of deductions provided for in the ITO, as follows:

(i) A deduction shall be allowed for any expenditure incurred by the person in the year wholly and exclusively for the purposes of business. A person shall be allowed a deduction for the depreciation of the person’s depreciable assets used in the person’s business in the tax year.

(ii) A person who places an eligible depreciable asset into service in Pakistan for the first time in a tax year shall be allowed a deduction provided the asset is used by the person for his business for the first time or the tax year in which commercial production is commenced, whichever is later

(iii) A person shall be allowed an amortization deduction in a tax year for the cost of the person’s intangibles:

- that are wholly or partly used by the person in the tax year deriving income from business chargeable to tax; and
- that have a normal useful life exceeding one year

(iv) A person shall be allowed a deduction for any pre-commencement expenditure in accordance with the ITO. The total deductions allowed 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.

(v) 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.

(vi) 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 dependants;
- any institute in Pakistan established for the training of industrial workers recognized, aided, or run by the government; or
- the training of any person, being a citizen of Pakistan

(vii) Deductions shall be allowed for profit on debt, financial costs and lease payments. A person may be allowed a deduction for a bad debt in a tax year if certain conditions under the ITO are satisfied.

The ITO also makes provision for deduction by banking companies, not exceeding 3% of the income of a tax year, arising out of consumer loans for creation of a reserve to off-set bad debts arising out of such loans.

## 5. What are the major expenses that are not deductible?

Section 21 of the ITO provides for deductions which are not allowed. 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;
- any salary, rent, brokerage or commission, profit on debt, payment to non-resident, payment for services or fee paid by the person from which the person is required to deduct tax under the ITO;
- any entertainment expenditure in excess of such limits or in violation of such conditions as may prescribed;
- any contribution made by the person to a fund that is not a recognized provident fund;
- 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 profit on debt, brokerage, commission, salary or other remuneration paid by an association of persons to a member of the association;
- any expenditure for a transaction, paid or payable under a single account head which, in aggregate exceeds fifty thousand rupees, made other than by a crossed cheque drawn on a bank or by crossed banking instrument showing transfer of amount from the business bank account of the taxpayer;
- any salary paid or payable exceeding fifteen thousand rupees per month other than by a crossed cheque or direct transfer of funds to the employee's bank account.

## 6. What are the applicable federal rates?

Please note that there are no different rates which apply in Pakistan. The ITO extends to the whole of Pakistan.

## 7. What are the applicable state and/ or other local rates?

Please refer to the response to question no. 6 above.

## 8. What are the applicable capital gains rates and base, if different and concessional tax treatment in case of business re-organization such as amalgamation, slump sale, demerger, etc?

Subject to the ITO, 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 under the ITO, shall be chargeable to tax in that year under the head "Capital Gains". The gain arising on the disposal of a capital asset by a person shall be computed in accordance with the following formula, namely:–

A – B where :

A is the consideration received by the person on disposal of the asset; and

B is the cost of the asset.

The ITO provides for set-off of business loss consequent to amalgamation, and states that the assessed loss (excluding capital loss) for the tax year, other than brought forward and capital loss, of the amalgamating company or companies shall be set off against business profits and gains of the amalgamated company, and vice versa, in the year of amalgamation and where the loss is not adjusted against the profits and gains for the tax year the unadjusted loss shall be carried forward for adjustment upto a period of six tax years succeeding the year of amalgamation.

## 9. How are operating losses handled?

Section 56 of the ITO provides that where a person sustains a loss for any tax year under any head of income, the person shall be entitled to have the amount of the loss set off against the person's income, if any, chargeable to tax under any other head of income for the year. Furthermore where a person sustains a loss under a head of income for a tax year that cannot be set off, the person shall not be permitted to carry the loss forward to the next tax year.

Where, in a tax year, a person sustains a loss under the head "Income from Business" and a loss under another head of income, the loss under the head "Income from Business" shall be set off last.

## 10. How are capital losses handled?

Section 59(1) of the ITO provides that where a person sustains a loss for a tax year under the head "Capital Gains", the loss shall not be set off against the person's income, if any, chargeable under any other head of income for the year, but shall be ca

## Territorial Rules

### 11. What are the residence rules?

Under the ITO, salary shall be Pakistan-source income to the extent to which the salary is received from any employment exercised in Pakistan, wherever paid, or is paid by or on behalf of the government, wherever the employment is exercised. Business income of a resident person shall be Pakistan-source income to the extent to which the income is derived from any business carried on in Pakistan. Business income of a non-resident person shall be Pakistan-source income to the extent to which it is attributable to –

- a permanent establishment of the non-resident person in Pakistan;
- sales in Pakistan of goods merchandise of the same or similar kind as those sold by the person through a permanent establishment in Pakistan;
- other business activities carried on in Pakistan of the same or similar kind as those effected by the non-resident through a permanent establishment in Pakistan, or
- any business connection in Pakistan.

The ITO also stipulates various types and sources of income which shall be considered to be Pakistan-source income, e.g. dividend paid by a resident company, profit on debt paid by a resident person, any gain arising on the disposal of shares in a

resident company, etc. An amount shall be foreign-source income to the extent to which it is not Pakistan-source income.

## **12. Is worldwide income taxed?**

Yes. However, 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 in respect of foreign-source salary if tax has been withheld from the salary by the individual's employer and paid to the revenue authority of the foreign country in which the employment was exercised. For details on tax credits on other foreign-source income, please refer to the answer to Question 18.

## **13. Tax credits - Are there tax credits relating to legal dispositions other than provisions in Double Taxation Treaties, on the possibility of deducting taxes paid abroad, or any others?**

Yes. Where a resident taxpayer derives foreign source income chargeable to tax under the ITO in respect of which the taxpayer has paid foreign income tax, the taxpayer shall be allowed a tax credit of an amount equal to the lesser of –

- the foreign income tax paid; or
- the Pakistan tax payable in respect of the income (In this case, the Pakistan tax payable 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.)

The aforementioned 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.

## **Withholding Taxes**

### **14. What are the rates on dividends for withholding taxes?**

Under the ITO, the rate of withholding tax imposed on dividends is 10%.

### **15. What are the rates on royalties for withholding taxes?**

Under the ITO, the rate of withholding tax imposed on royalties paid to non-residents is 15% of the gross amount of such royalties.

**16. What are the rates on interest for withholding taxes?**

Under the ITO, the rate of withholding tax imposed on profit on debt is 10%.

**17. What are the rates of withholding tax on profits realized by a foreign corporation?**

Under the ITO, the rate of tax imposed on dividend received from a resident company is 10%.

**18. Please list any other rates on withholding taxes that we should be aware of.**

The ITO imposes various other withholding taxes, including:

- Payment of fee for technical services to non-residents: 15%
- General payments to non-residents (unless otherwise provided for): 30%
- Export proceeds: 1%

The ITO also imposes withholding tax on rental payments, and the rates for such tax depend on the gross amount of rent paid.

**Tax Returns and Compliance****19. What is the taxable reporting period?**

The ITO requires persons chargeable to tax there under to file returns of income for each tax year, which has been defined under the ITO as a period of twelve months ending on the 30th day of June, denoted by the calendar year in which the said date falls.

**20. What are the due dates for the filing of tax returns?**

A return of income under the ITO for any person other than a company shall be furnished on or before the thirtieth day of September next following the end of the tax year to which the return relates.

A return of income of a company shall be furnished –

- in the case of a company with a tax year ending any time between the first day of January and the thirtieth day of June, on or before the thirty-first day of December next following the end of the tax year to which the return relates; or
- in any other case, on or before the thirtieth day of September next following the end of the tax year to which the return relates.

## 21. What are the key compliance requirements?

Under the ITO, the following persons are required to furnish a return of income for a tax year, namely:–

- (a) every company;
- (b) every person (other than a company) whose taxable income for the year exceeds the maximum amount that is not chargeable to tax under this Ordinance for the year;
- (c) any non-profit organization as defined in the ITO; and
- (d) any welfare institution approved under the ITO;
- (e) any person not covered above, who,-
  - has been charged to tax in respect of any of the two preceding tax years;
  - claims a loss carried forward under the ITO for a tax year;
  - owns immovable property with a land area of two hundred and fifty 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.

A return of income -

- (a) shall be in the prescribed form and shall be accompanied by such annexures, statements or documents as may be prescribed;
- (b) 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
- (c) shall be signed by the person, being an individual, or the person's representative where applicable.

The tax payable by a taxpayer on the taxable income of the taxpayer for a tax year shall be due on the due date for furnishing the taxpayer's return of income for that year.

Every resident taxpayer filing a return of income for any tax year whose last declared or assessed income or the declared income for the year is five hundred thousand rupees or more shall furnish a wealth statement for that year along with such return. Such wealth statement shall be submitted in the prescribed form and verified in the prescribed manner.

The ITO requires that any person discontinuing a business shall give the commissioner of income tax a notice in writing to that effect within fifteen days of the discontinuance. The person discontinuing a business shall 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 the ITO.

The ITO states that every taxpayer shall maintain in Pakistan such accounts, documents and records as may be prescribed. The Income Tax Rules, 2001 state that every taxpayer deriving income chargeable to tax under the ITO as income from business shall maintain proper books of account, documents and records with respect to, inter alia -

- (a) all sums of money received and expended by the taxpayer and the matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases of goods and all services provided and obtained by the taxpayer;
- (c) all assets of the taxpayer;
- (d) all liabilities of the taxpayer.

**22. Are there any other requirements that we should be aware of regarding tax returns and compliance?**

Please refer to the answer to Question 21.

**INDIRECT TAXES**

**23. Are there any indirect taxes in your jurisdiction?**

Yes.

**24. How does it operate? Is it a VAT or a sales tax?**

The Sales Tax Act, 1990 (“STA”) imposes sales tax at the rate of sixteen per cent of the value of--

- taxable supplies made by a registered person in the course or furtherance of any taxable activity carried on by him; and
- goods imported into Pakistan.

**25. How is the taxable base determined?**

Under the STA, the liability to pay sales tax shall be:

- in the case of supply of goods, of the person making the supply, and
- in the case of goods imported into Pakistan, of the person importing the goods.

**26. What are the applicable rates?**

The rate of sales tax applicable to goods chargeable to the same under the STA is sixteen percent.

**27. Are there any exemptions?**

Yes. The Sixth Schedule to the STA sets out numerous classes of goods the supply and/or import of which is exempt from sales tax.

**28. Are there any other taxes such as debit or financial transactions taxes enforced in you jurisdiction?**

The Stamp Act, 1899 imposes stamp duty on various types of instruments, including but not limited to share transfer deeds, contracts, conveyances, debentures, and bonds. The Customs Act, 1969 levies custom duty on goods imported into Pakistan, goods brought from any foreign country to any customs station, and without payment of duty there, transshipped or transported for, or thence carried to, and imported at any other customs-station, and goods brought in bond from one customs station to another.

The Federal Excise Act, 2005 imposes duty on goods produced, manufactured or imported into Pakistan, inter alia, and services provided or rendered in Pakistan.

**PARAFISCAL CONTRIBUTIONS****29. Are there any parafiscal contributions (i.e. social security, science and/or technology)?**

Certain types of employers are required to make contributions in respect of old-age benefits for their employees under the Employees' Old-Age Benefits Act, 1976 ("EOBA"). Also, industrial establishments are required to make contributions to the Workers' Welfare Fund constituted under the Workers' Welfare Fund Ordinance, 1971 ("WWFO").

**30. How do they operate?**

Under the EOBA, persons who are insured there under are entitled to avail benefits such as old-age pension (on retirement), invalidity pension (in case of permanent disability), old-age grants and survivor's pension. A contribution equal to five percent of an employee's salary has to be paid by employers to the Employees' Old-Age Benefits Institution.

Under the EOBA, an "employer", in relation to an industry or establishment, means any person who employs any employee, and includes,-

- (i) in the case of an individual, an heir, successor, administrator or assign;
- (ii) a person who has ultimate control over the affairs of an industry or establishment, or where the affairs of an industry or establishment are entrusted to any other person (whether called a managing agent, managing director, manager, superintendent, secretary or by any other name), such other person.

For the purposes of the EOBA, "establishment" means-

- (i) an establishment to which the West of Pakistan and Establishments Ordinance, 1969 applies, and includes clubs, hostels, organisations and messes not maintained for profit or gain and establishment, including hospitals, for the treatment or care of sick, infirm, destitute or mentally unfit persons ;
- (ii) a construction industry as defined in the West Pakistan Industrial and Commercial Employment (Standing Orders) Ordinance, 1968
- ( iii ) a factory as defined in the Factories Act, 1934 (XXV of 1934);
- (iv) a mine as defined in the Mines Act, 1923(IV of 1923) ;
- (v) a road transport service as defined in the Road Transport Workers Ordinance, 1961 (XXVIII of 1961) and includes any class of industries or establishments which the Federal Government may, by notification in the official Gazette, declare to be establishments.

An "industry" means any business, trade, undertaking, manufacture or calling of employers, and includes any calling, service, employment, handicraft industrial occupation or avocation of workmen.

The EOBA defines an insured person as an employee who is or was in insurable employment, which means employment of a person under a contract of service or apprenticeship, whether written or oral, express or implied and in respect of which contributions are payable under the EOBA.

Under the WWFO, every industrial establishment to which the WWFO applies is required to pay to the Welfare Fund established under the WWFO a sum equal to two percent of so much of its total income. Every such establishment is required to pay the amount due from it to the income-tax officer having jurisdiction over the establishment.

### **31. How is the taxable base determined?**

Please refer to the answer to Question 30.

**32. What are the applicable rates?**

Please refer to the answer to Question 30.

**33. Are there any exemptions?**

Please note that the EOBA and WWFO apply to certain classes of establishments and industries as noted in the answer to Question 36. Also, the EOBA does not apply to:

- persons in the service of the state, including members of the armed forces, police force and railway servants;
- persons in the service of the local council, a municipal committee, a cantonment board or any other local authority ;
- persons who are employed in services or installations connected with or incidental to the Armed Forces of Pakistan including an ordinance factory maintained by the Federal Government or Railway Administration ;
- persons in service of Water & Power Development Authority ;
- persons in the service of a bank or a banking company ;
- person in the service of statutory bodies other than those employed in or in connection with the affairs of a factory or a mine;
- members of the employer's family, [that is to say, the husband or wife and the dependent children of the employer] living in his house, in respect of their work for him.

**INHERITANCE AND GIFT TAXES****34. Are there inheritance taxes, gift taxes or any other taxes like Wealth Tax, etc.?**

No

**35. If you answered yes to the question above, please describe what triggers the requirement for the tax, what the rate of tax is, and what is included in the taxable base.**

Please refer to the answer to Question 34.

**OTHER MATTERS****36. Are there any tax incentives granted for various matters such as research and development, investment in certain industries/ areas, etc.?**

Yes

**37. If so, please indicate if there are any of the following: anti-deferral regimes; transfer pricing provisions; tax avoidance measures like legislated General Anti-Avoidance Rules, etc.; controlled foreign companies regulations; thin capitalization rules**

The ITO imposes various anti-avoidance mechanisms. Under the ITO, the Commissioner of Income Tax may, in respect of any transaction between persons who are associates, distribute, apportion or allocate income, deductions or tax credits between the persons as is necessary to reflect the income that the persons would have realised in an arm's length transaction.

For the purposes of determining liability to tax under the ITO, the Commissioner may

–

- recharacterise a transaction or an element of a transaction that was entered into as part of a tax avoidance scheme;
- disregard a transaction that does not have substantial economic effect; or
- recharacterise a transaction where the form of the transaction does not reflect the substance.

“Tax avoidance scheme” means any transaction where one of the main purposes of a person in entering into the transaction is the avoidance or reduction of any person's liability to tax under the ITO.

Where, in any tax year, salary is paid by a private company to an employee of the company for services rendered by the employee in an earlier tax year and the salary has not been included in the employee's salary chargeable to tax in that earlier year, the Commissioner may, if there are reasonable grounds to believe that payment of the salary was deferred, include the amount in the employee's income under the head “Salary” in that earlier year.

Where –

- (a) any amount is credited in a person's books of account;
  - (b) a person has made any investment or is the owner of any money or valuable article; or
  - (c) a person has incurred any expenditure,
- and the person offers no explanation about the nature and source of the amount credited or the investment, money, valuable article, or funds from which the expenditure was made or the explanation offered by the person is not, in the Commissioner's opinion, satisfactory, the amount credited, value of the investment,



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money, value of the article, or amount of expenditure shall be included in the person's income chargeable to tax under head "Income from Other Sources" to the extent it is not adequately explained.

Where the owner of any security disposes of the security and thereafter re-acquires the security and the result of the transaction is that any income payable in respect of the security is receivable by any person other than the owner, the income shall be treated, for all purposes of the ITO, as the income of the owner and not of the other person. For these purposes, "security" includes bonds, certificates, debentures, stocks and shares.

**38. List the countries in which there are tax treaties. This could impact the withholding taxes on various distributions and to the extent possible, please itemize them below. Please include the impact upon withholding on compensation, interest, dividends or other distributions for each country listed.**

Where an agreement is entered into by the Government of Pakistan with the government of a foreign country for the avoidance of double taxation and prevention of fiscal evasion, the agreement shall have effect in so far as it provides for:

- a) relief from the tax payable under the ITO;
- b) the determination of Pakistan-source income of non-resident persons;
- c) where all the operations of a business are not carried on within Pakistan, the determination of the income attributable to operations carried on within and outside Pakistan, or the income chargeable to tax in Pakistan in the hands of non-resident persons, including their agents, branches, and permanent establishments in Pakistan;
- d) the determination of the income to be attributed to any resident person having a special relationship with a non-resident person; and
- e) the exchange of information for the prevention of fiscal evasion or avoidance of taxes on income chargeable under the Income Tax Ordinance 2001, and under the corresponding laws in force in that other country.

The Government of Pakistan has entered into full scope double taxation treaties with the following countries:

- 1 Austria
- 2 Azerbaijan
- 3 Bangladesh
- 4 Belgium
- 5 Belarus

- 6 Bosnia & Herzegovina
- 7 Canada
- 8 China
- 9 Denmark
- 10 Egypt
- 11 Finland
- 12 France
- 13 Germany
- 14 Hungary
- 15 Indonesia
- 16 Iran
- 17 Ireland
- 18 Italy
- 19 Japan
- 20 Jordan
- 21 Kazakhstan
- 22 Korea
- 23 Kuwait
- 24 Libya
- 25 Lebanon
- 26 Malaysia
- 27 Malta
- 28 Mauritius
- 29 Netherlands
- 30 Nigeria
- 31 Norway
- 32 Oman
- 33 Philippines
- 34 Poland
- 35 Portugal
- 36 Qatar
- 37 Romania
- 38 Singapore
- 39 South Africa
- 40 Sri Lanka
- 41 Sweden
- 42 Switzerland
- 43 Saudi Arabia
- 44 Syria
- 45 Tajikistan
- 46 Thailand
- 47 Tunisia
- 48 Turkey
- 49 Turkmenistan
- 50 United Arab Emirates



- 51 United Kingdom
- 52 United States of America
- 53 Uzbekistan
- 54 Yemen
- 55 Vietnam

For further details on the impact of the aforementioned treaties on various withholding taxes, please refer to:

<http://www.fbr.gov.pk/newdt/TaxTreaties/Double%20Taxation/Default.asp>