

small business
by two or more
persons

UCO
Taxbook 3



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About

This document contains basic tax provisions applicable on small business carried on by **Partnership, Private Limited Company and Limited Liability Partnership** with changes incorporated through Finance Act 2020 and supplementary amendments made through Tax Laws (Amendment) Ordinance, 2021 and Tax Laws (Second Amendment) Ordinance, 2021.

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Preface

For the year 2020-21 the federal budget was presented on 12th June, 2020 and formally approved by the National Assembly after the assent of the President of Pakistan on June 30, 2020. Afterwards, supplementary amendments have been introduced vide Tax Laws (Amendment) Ordinance, 2021 [the First Amendment Ordinance] and Tax Laws (Second Amendment) Ordinance, 2021 [the Second Amendment Ordinance] which were assented by the President of Pakistan on February 12, 2021 and March 22, 2021 respectively and have become effective immediately. Hence provisions including in this commentary have been duly enacted and updated till March 22, 2021.

This UCO Tax book series 2020 Second Edition has been issued for the convenience and guidance of different category of tax payers and sharing required information which is of their interest and relevance. These booklets start with a brief applicability of taxation on respective tax payers along with changes brought through Finance Act 2020 and supplementary amendments through the First Amendment Ordinance and the Second Amendment Ordinance. For ease of readers' understanding UCO tax books 2020 Second Edition have been developed for each of the following classes of taxpayers:

UCO Taxbook 1

for Resident and
Non-Resident Individuals
not doing business

UCO Taxbook 2

for Small Business
by single person

UCO Taxbook 3

for Small Business
by two or more persons

UCO Taxbook 4

for Not for Profit
Organizations based
in Pakistan

UCO Tax Card is for
applicable withholding
tax on above classes of
taxpayers.

The UCO Taxbook-3
is for small businesses
by two or more persons
and is divided into
following categories:

- A** Partnership
- B** Private Limited Company
& Limited Liability Partnership

UCO TaxBook series 2020 Second Edition

can also be accessed through our website

www.usmanico.com

and Firm's all social media pages.



Karachi- ___ April 2021

Section A

a

Partnership



A-1 SCOPE: This category is in respect of Partnership / Association of Persons (AOP) who own and run small businesses in Pakistan.

A-2 TAX LIABILITY: AOP who is deriving income from business of more than Rs. 400,000 is liable to pay income tax. The following income are classified as income from business:

- Profits and gains of any business carried on during the tax year;
- Income derived by any trade, professional or similar association from sale of goods or provision of services to members;
- Income on hire or lease of tangible moveable property;
- Fair market value of any benefit or perquisite derived in the course of or by virtue of any past, present or prospective business relationship;
- Profit on debt where person's business is to derive such income.

There are certain deductions which are allowed and which are not allowed from business income. The relevant provisions are elaborated in **Section C** of this textbook.

Changes brought by Finance Act 2020

No changes have been made in the existing definition of income from business.

Method of accounting of business income:

AOP may apply cash or accrual basis of accounting for calculating taxable income under the head "Income from Business".

A person may apply to the Commissioner for change in the method of accounting. Commissioner may approve such change, only if he is satisfied that the change is necessary to reflect the person's business income.

Changes brought by Finance Act 2020

No changes have been made in the existing provisions for method of accounting of business income.

Tax Rates: AOP's business income is taxable at slab rates. These slab rates are applicable on taxability of business income above Rs. 400,000 which are as follows:

S.No.	Taxable Amount	Tax Rate
1	Up to Rs. 400,000	0%
2	Exceeds Rs.400,000 but does not exceeds Rs. 600,000	5% of the amount exceeding Rs 400,000
3	Exceeds Rs. 600,000 but does not exceeds Rs. 1,200,000	Rs. 10,000 + 10% of amount exceeding Rs 600,000
4	Exceeds Rs.1,200,000 but does not exceeds Rs.2,400,000	Rs. 70,000 + 15% of amount exceeding Rs 1,200,000
5	Exceeds Rs. 2,400,000 but does not exceeds Rs. 3,000,000	Rs. 250,000 + 20% of amount exceeding Rs 2,400,000
6	Exceeds Rs.3,000,000 but does not exceeds Rs.4,000,000	Rs. 370,000 + 25% of amount exceeding Rs 3,000,000
7	Exceeds Rs.4,000,000 but does not exceeds Rs.6,000,000	Rs. 620,000 + 30% of amount exceeding Rs 4,000,000
8	Exceeds Rs. 6,000,000	Rs. 1,220,000 + 35% of amount exceeding Rs 6,000,000

A-3 TAX CREDIT: There are certain tax credits allowed to sole proprietor in respect of calculation of net tax liability which are as follows:

Donation:

AOP is allowed a tax credit in respect of donations given to approved educational institutions / hospitals or Non-Profit Organization (NPO). Maximum limit of donation was 30% of taxable income in case of availing tax credit. However, through changes brought by Finance Act 2020, this limit has been further reduced to 15%, if donation is made to an associate of the donor. Moreover, following further changes have been introduced by the **Second Amendment Ordinance:**

- (a) besides donations, voluntary contributions or subscription are also allowed to calculate tax credit; and
- (b) donations, voluntary contributions or subscription given to persons eligible for tax credit under section 100C are also eligible for tax credit.

Further, donation given to institutions/ foundations/societies/Boards appearing in clause (61) of Second Schedule of the Ordinance is allowed as straight deduction from total income. Following changes brought by Finance Act 2020:

- Some new institutions have been added in clause (61).
- A limit of 15% of taxable income is introduced in case of donation by an associate to the institutions appearing in clause (61).
- Straight deduction from total income will only be allowed if donation is paid by crossed cheque drawn on a bank.

Through changes made by the Second Amendment Ordinance, this concept of straight deduction from total income has been withdrawn and clause (61) is omitted. A new i.e. Thirteenth Schedule has been introduced listing the organizations to which donations, voluntary contributions or subscription will be allowed as tax credit.

Investment in shares: AOP is entitled to claim tax credit in respect of investments in:

- new shares of public listed company where AOP is the original allottee of the shares;
- shares acquired from Privatization Commission of Pakistan; and
- sukus of public listed company where AOP is the original allottee of the sukus;

Investment in insurance: AOP is entitled to tax credit in respect of:

- life insurance premium paid on a policy of life insurance company;
- health insurance premium or contribution paid to insurance company.

Salary paid to fresh graduates: AOP is entitled to tax credit in respect of annual salary paid to fresh graduates from university or institutes recognized by HEC in the tax year in which such graduates are hired. Through changes made by the Second Amendment Ordinance, this tax credit has now been withdrawn.

Coal mining projects, export of software and IT & IT enabled services

Through changes made by the Second Amendment Ordinance, a new tax credit has been introduced through section 65F, whereby AOP will be allowed 100% tax credit if engaged in following:

- coal mining project in Sindh supplying coal to power generation projects
- startup certified by Pakistan Software Export Board
- export of software, IT services or IT enabled services

The above tax credit will be available subject to the fulfillment of following conditions:

- tax return has been filed;
- tax required to be deducted or collected has been deducted or collected and paid;
- withholding tax statements for immediately preceding tax year have been filed;
- sales tax returns have been filed.

Green field industrial undertaking and industrial undertaking engaged in manufacture of dedicated equipment for renewable energy

Through changes made by the Second Amendment Ordinance, a new tax credit has been introduced through section 65G, whereby AOP will be allowed 25% tax credit if he establishes:

- green field industrial undertaking as defined in the Income Tax Ordinance which is engaged in manufacturing process or ship building.
- Industrial undertaking by June 30, 2023 engaged in the manufacturing of dedicated plant, machinery and equipment for generation of renewable energy.

This tax credit is allowed for a period of five years from the date such industrial undertaking is setup.

A-4 MECHANISM FOR PAYMENT OF TAX

For payment of tax by AOP, a mechanism is provided in the Ordinance whereby AOP is required to pay tax on business income in advance on quarterly basis. Any remaining tax liability on business income will be payable at the time of filing of return.

Quarterly Advance Tax: AOP having income charged to tax during the latest tax year (other than income falling under final taxation), is required to determine and pay the amount of advance tax due for a quarter. Amount of advance tax for a quarter shall be computed on turnover basis according to the following formula:

Advance tax for a quarter= (A x B/C) - D
Where

A – Turnover for the quarter. If turnover for the quarter is unknown, turnover will be computed as follows:

Turnover of latest tax year x 110% x 25%

B – Tax assessed for the latest tax year;

C – Turnover for the latest tax year; and

D – taxes paid during the quarter (other than final taxes)

AOP is required to estimate the tax payable on taxable income for the year before the due date of second installment of advance tax. In case, estimate of tax payable is likely to be more than the tax payable on turnover basis, AOP shall furnish to the Commissioner the said estimate and pay the advance tax as per the estimate.

If at any time before the last installment is due, AOP estimates that tax payable by it for the relevant tax year is less than that it is required to pay as per above formula, taxpayer may furnish estimate to the Commissioner and pay the amount as per the estimate after deducting the amount of tax already paid in equal installments. However, in such case, estimate shall contain quarter wise turnover along with the reason of decline in estimated turnover, documentary evidences of estimated expenses which resulted in lower advance tax and estimated computation of taxable income. Further, if the Commissioner is not satisfied with the furnished estimate or evidences, he may reject the estimate and require the taxpayer to pay advance tax as per the above formula.

Advance tax shall be payable by the following timelines:

- (a) For September quarter, on or before 25th of September;
- (b) For December quarter, on or before 25th of December;
- (c) For March quarter, on or before 25th of March; and
- (d) For June quarter, on or before 15th of June.

Advance tax paid will be adjustable from tax payable for the tax year at the time of filing of return.

A-5 REPORTING OBLIGATIONS TO TAX AUTHORITIES

AOP is required to file Annual Income Tax Return if it falls in any of the category as mentioned in

Annexure-I for the purposes of filing of Annual Tax Return by 30th September each year.

In case of non-compliance certain penalties will be imposed along with consequences of not appearing in Active Taxpayers' List (ATL). Please refer **Annexure-II** for ATL definition.

A-6 WITHHOLDING AGENT'S OBLIGATIONS

Withholding agent is a person who is required to deduct tax when making payments for the purpose of business. Presently, AOP having turnover of Rs. 50 million or more in any of the preceding tax years was a withholding agent in respect of payment for goods, services and contracts. However, this limit is enhanced to Rs. 100 million through Finance Act 2020, and now AOP with Rs. 100 million turnover in a preceding tax year will be considered as withholding agents in respect of payment for goods, services and contracts. They will be liable to deduct tax as per applicable tax rates on all purchases made through each vendor in a tax year as per following limits:

For goods: Rs. 75,000 per vendor

For services: Rs. 30,000 per vendor

Please refer **UCO Tax Card** for detailed withholding tax obligations and withholding tax rates on various transactions.

Changes brought by Finance Act 2020

Payment to 'toll manufacturer' is classified as sale of goods and thus subject to withholding tax as applicable for sale of goods.

Payment obligation for tax withheld:

All taxes deducted from the payments to vendors are required to be deposited in government treasury within 7 days.

Reporting obligation as withholding agent:

Through changes made through Finance Act, 2020, withholding agents are required to file withholding tax statement quarterly by 20th day of following month after each quarter end. Earlier, it is required to be filed biannually.

In case no tax is deducted or paid nil statement will be filed.

A-7 WITHDRAWAL OF CERTAIN EXEMPTIONS

Through changes made by the Second Amendment Ordinance, exemption available to AOP on fee for technical services rendered outside Pakistan to a foreign enterprise under an agreement has been withdrawn.

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Section B

Private Limited Company and Limited Liability Partnership



B-1 SCOPE: This category is in respect of Private Limited Companies incorporated under Companies Act 2017 and Limited Liability Partnership (LLP) registered as body corporate under Limited Liability Partnership Act, 2017. Both these entities are engaged in small businesses. The scope of this document is restricted to those private limited companies and LLPs which fall under the definition of a small company as per Income Tax Ordinance. A company is considered as a small company if it fulfills all of the following conditions:

- has paid up capital plus undistributed reserves not exceeding Rs. 50 million;
- has employees not exceeding 250 at any time during the year;
- has annual turnover not exceeding Rs. 250 million; and
- is not formed by splitting up or reconstitution of existing company.

B-2 TAX LIABILITY: Private Limited Company and LLP deriving income from business is liable to pay income tax. The following income are classified as income from business:

- (a) Profits and gains of any business carried on during the tax year;
- (b) Income derived by any trade, professional or similar association from sale of goods or provision of services to members;
- (c) Income on hire or lease of tangible moveable property;
- (d) Fair market value of any benefit or perquisite derived in the course of or by virtue of any past, present or prospective business relationship;
- (e) Management fee derived by management company;
- (f) Profit on debt where person's business is to derive such income.

There are certain deductions which are allowed and which are not allowed from business income.

The relevant provisions are elaborated in **Section C** of this Taxbook.

Changes brought by Finance Act 2020

No changes have been made in the existing definition of income from business.

Method of accounting of business income:

Private Limited Company and LLP shall apply accrual basis of accounting for calculating taxable income under the head "Income from Business".

Changes brought by Finance Act 2020

No changes have been made in the existing provisions for method of accounting of business income.

Tax Rates: Tax rate for Private Limited Company and LLP is 23% for tax year 2020, being a small company, which will be reduced by 1% each tax year till tax year 2023 and will remain constant afterwards.

Changes brought by Finance Act 2020

No changes have been made in the existing tax rates.

B-3 TAX CREDIT: There are certain tax credits allowed to Private Limited Company and LLP in respect of calculation of net tax liability which are as follows:

Donation: Private Limited Company and LLP is allowed a tax credit in respect of donations given to approved educational institutions / hospitals or Non-Profit Organization (NPO). Maximum limit of donation was 20% of taxable income in case of availing tax credit. However, through changes brought by Finance Act 2020, this limit has been further reduced to 10%, if donation is made to an associate of the donor. Moreover, following further **changes have been introduced by the Second Amendment Ordinance:**

- (a) besides donations, voluntary contributions or subscription are also allowed to calculate tax credit; and
- (b) donations, voluntary contributions or subscription given to persons eligible for tax credit under section 100C are also eligible for tax credit.

Further, donation given to institutions/foundations/societies /Boards appearing in clause (61) of Second Schedule of the Ordinance is allowed as straight deduction from total income. Following **changes brought by Finance Act 2020:**

- Some new institutions have been added in clause (61).
- A limit of 10% of taxable income is introduced in case of donation by an associate to the institutions appearing in clause (61).
- Straight deduction from total income will only be allowed if donation is paid by crossed cheque drawn on a bank.

Through **changes made by the Second Amendment Ordinance**, this concept of straight deduction from total income has been withdrawn and clause (61) is omitted. A new i.e. Thirteenth Schedule has been introduced listing the organizations to which donations, voluntary contributions or subscription will be allowed as tax credit.

Employment generation: Where Private Limited Company and LLP is formed for establishing and operating a new manufacturing unit, and sets up a new manufacturing unit between July 1, 2015 to June 30, 2019, it will be entitled to tax credit.

Salary paid to fresh graduates: Private Limited Company and LLP is entitled to tax credit in respect of annual salary paid to fresh graduates from university or institutes recognized by HEC in the tax year in which such graduates are hired. Through changes made by the Second Amendment Ordinance, this tax credit has now been withdrawn.

Newly established industrial undertaking: Where Private Limited Company and LLP is formed for establishing and operating a new industrial undertaking, and sets up a new industrial undertaking between July 1, 2011 to June 30, 2021, it will be entitled to tax credit. Through changes made by the Second Amendment Ordinance, this tax credit has now been withdrawn. However, existing beneficiaries continue to avail tax credit subject to the conditions mentioned under the section before omission.

Industrial undertaking established before July 1, 2011: Where Private Limited Company and LLP sets up in Pakistan before July 1, 2011, invest in purchase of plant and machinery or expansion in plant and machinery or undertaking a new project, through at least 70% new equity raised through shares, it will be entitled to tax credit.

Coal mining projects, export of software and IT & IT enabled services

Through changes made by the Second Amendment Ordinance, a new tax credit has been introduced through section 65F, whereby Private Limited Company and LLP will be allowed 100% tax credit if it is engaged in following:

- coal mining project in Sindh supplying coal to power generation projects
- startup certified by Pakistan Software Export Board
- export of software, IT services or IT enabled services

The above tax credit will be available subject to the fulfillment of following conditions:

- tax return has been filed;
- tax required to be deducted or collected has been deducted or collected and paid;
- withholding tax statements for immediately preceding tax year have been filed;
- sales tax returns have been filed.

Green field industrial undertaking and industrial undertaking engaged in manufacture of dedicated equipment for renewable energy

Through changes made by the Second Amendment Ordinance, a new tax credit has been introduced through section 65G, whereby Private Limited Company and LLP will be allowed 25% tax credit if it establishes:

- green field industrial undertaking as defined in the Income Tax Ordinance which is engaged in manufacturing process or ship building.
- Industrial undertaking by June 30, 2023 engaged in the manufacturing of dedicated plant, machinery and equipment for generation of renewable energy.

This tax credit is allowed for a period of five years from the date such industrial undertaking is setup.

B-4 MECHANISM FOR PAYMENT OF TAX

For payment of tax by Private Limited Company and LLP, a mechanism is provided in the Ordinance whereby Private Company is required to pay tax on business income in advance on quarterly basis. Any remaining tax liability on business income will be payable at the time of filing of return.

Quarterly Advance Tax: Private Limited Company and LLP, having income charged to tax during the latest tax year (other than income falling under final taxation), is required to determine and pay the amount of advance tax due for a quarter. Amount of advance tax for a quarter shall be computed on turnover basis according to the following formula:

Advance tax for a quarter= (A x B/C) - D

Where

A – Turnover for the quarter. If turnover for the quarter is unknown, turnover will be computed as follows:

Turnover of latest tax year x 110% x 25%

B – Tax assessed for the latest tax year;

C – Turnover for the latest tax year; and

D – taxes paid during the quarter (other than final taxes)

Private Limited Company and LLP is required to estimate the tax payable on taxable income for the year before the due date of second installment of advance tax. In case, estimate of tax payable is likely to be more than the tax payable on turnover basis, Private Limited Company and LLP shall furnish to the Commissioner the said estimate and pay the advance tax as per the estimate.

If at any time before the last installment is due, Private Limited Company and LLP estimates that tax payable by it for the relevant tax year is less than that it is required to pay as per above formula, taxpayer may furnish estimate to the Commissioner and pay the amount as per the estimate after deducting the amount of tax already paid in equal installments. However, in such case, estimate shall contain quarter wise turnover along with the reason of decline in estimated turnover, documentary evidences of estimated expenses which resulted in lower advance tax and estimated computation of taxable income. Further, if the Commissioner is not satisfied with the furnished estimate or evidences, he may reject the estimate and require the taxpayer to pay advance tax as per the above formula.

Advance tax shall be payable by the following timelines:

- (a) For September quarter, on or before 25th of September;
- (b) For December quarter, on or before 25th of December;
- (c) For March quarter, on or before 25th of March; and
- (d) For June quarter, on or before 15th of June.

Advance tax paid will be adjustable from tax payable for the tax year at the time of filing of return.

B-5 REPORTING OBLIGATIONS TO TAX AUTHORITIES

Private Limited Company and LLP are required to file Annual Tax Return without exception.

Please refer **Annexure-I** regarding the conditions in detail, whereby the persons are required to file return of income and exceptions thereto.

Annual Income Tax return requires details of income earned and taxes paid in advance during the year. Annual Income Tax return is required to be submitted online through FBR portal by the following timelines:

- (a) Where, tax year of Private Company & LLP is ending between January to June, 31st December next following the end of tax year.
- (b) Where, tax year of Private Company & LLP is ending between July to December, 30th September next following the end of tax year.

In case of non-compliance certain penalties will be imposed along with consequences of not appearing in Active Taxpayers' List (ATL). Please refer **Annexure-II** for ATL definition.

B-6 WITHHOLDING AGENT'S OBLIGATIONS

Withholding agent is a person who is required to deduct tax when making payments for the purpose of business. Private Limited Company and LLP (being companies) are withholding agent without exception and is liable to deduct tax as per applicable tax rates on all purchases made through each vendor in a tax year as per following limits:

For goods: Rs. 75,000 per vendor
For services: Rs. 30,000 per vendor

Please refer **UCO Tax Card** for detailed withholding tax obligations and withholding tax rates on various transactions.

Changes brought by Finance Act 2020

Payment to 'toll manufacturer' is classified as sale of goods and thus subject to withholding tax as applicable for sale of goods.

Payment obligation for tax withheld:

All taxes deducted from the payments to vendors are required to be deposited in government treasury within 7 days.

Reporting obligation as withholding agent:

Through changes made through Finance Act, 2020, withholding agents are required to file withholding tax statement quarterly by 20th day of following month after each quarter end. Earlier, it is required to be filed biannually.

In case no tax is deducted or paid nil statement will be filed.

B-7 WITHDRAWAL OF CERTAIN EXEMPTIONS

Through changes made by the Second Amendment Ordinance, following exemptions / reductions in tax rate / tax liability available to Private Limited Company and LLP have been withdrawn:

- (a) No exemption on dividend income, if Private Limited Company and LLP are eligible for group relief during the tax year.
- (b) No exemption on royalty, commission or fee for technical services rendered outside Pakistan for a foreign enterprise under an agreement.
- (c) No reduction of tax rate to the Private Limited Company and LLP setting up an industrial undertaking between July 1, 2014 and June 30, 2017 for a period of five years. However, existing beneficiaries continue to avail tax reduction subject to the conditions mentioned under the clause before omission.
- (d) No reduction in tax liability of Private Limited Company and LLP deriving income from film making.

Section C

C

General Provisions in Respect of AOP, Private Limited Company and Limited Liability Partnership

For the purpose of computation of taxable business income, certain provisions are similar and applicable to AOP, Private Company and LLP. These provisions are mentioned under the following headings:

1. Deductions allowed against business income
2. Deductions not allowed against business income
3. Set off of losses
4. Unexplained income / assets
5. Taxation on builders and developers

Moreover, this section will also discuss briefly certain exemptions / reduction in tax rates or liabilities that were allowed to AOP, Private Limited Company and LLP, which have now been withdrawn by the [Second Amendment Ordinance](#).

1- Deductions allowed against business income

For the purpose of calculating taxable income the following expenditures are allowed as deduction against business income, if these are incurred wholly and exclusively for business purposes:

(a) Entertainment expenditures under the following conditions that are directly related to business and are in accordance with customs and norms of businesses in Pakistan:

- Expenditure incurred outside Pakistan in connection with business transaction;
- Expenditure incurred outside Pakistan and allocated as head office expenditure;
- Incurred in Pakistan on entertainment of foreign customers and suppliers;
- Incurred on entertainment of customers and clients and persons business premises;
- Incurred on entertainment at meetings of shareholders, agents, directors or employees; or
- Incurred on entertainment at the opening of branches.

(b) Contributions to recognized / approved provident, pension, superannuation or gratuity fund;

(c) Following cash expenditures are allowed for deduction against business income:

- Cash expenditure under a single account head that is not exceeding Rs. 250,000. Previously,

this limit was Rs. 50,000.

- Single cash expenditure transaction not exceeding Rs. 25,000. Previously, this limit was Rs. 10,000.
- Utilities paid in cash
- Freight charges paid in cash
- Travel fare paid in cash
- Taxes, duties, fee or statutory obligations paid in cash
- Salary paid in cash not exceeding Rs. 25,000. Previously, this limit was Rs. 15,000.

(d) Certain specific deductions discussed briefly in below paragraphs:

(i) Depreciation of assets

Taxpayer is allowed depreciation deduction in respect of owned business assets that have a normal useful life of more than one year; and that are used in business during the tax year. Rates of depreciation of certain assets that are relevant to small businesses are as under:

SNo.	Taxable Amount	Rate
1	Building	10%
2	Furniture (including fittings), plant and machinery, motor vehicles, technical or professional books	15%
3	Computer hardware (including printer), monitor and allied items, machinery and equipment used in the manufacture of IT products	30%

Full year depreciation was allowed during the tax year in which an asset is purchased and no depreciation was allowed in the year of disposal. Through changes made by Finance Act 2020, now depreciation deduction is restricted to 50% in the year of purchase and 50% of depreciation will be allowed in the year of disposal. This amendment is applicable on the assets which will be purchased on or after July 1, 2020.

(ii) Initial allowance

Initial allowance is allowed for the 'eligible depreciable asset' used by the person for the first time or the tax year in which commercial production is commenced, whichever is later.

Initial allowance is allowed at the rate of 25% on eligible depreciable assets used by the person.

'Eligible depreciable asset' means a depreciable asset other than:

- Road transport vehicle plying for hire;
- Furniture, including fittings;
- Plant and machinery that has been previously used in Pakistan.

(iii) Amortization of intangibles

Taxpayer is allowed amortization deduction in respect of intangibles that are wholly or partly used in deriving business income during the tax year and that has a normal useful life of exceeding one year as per given formula

Where intangible is not used for the whole tax year in deriving business income, amortization shall be allowed in proportion to the number of days intangible is used for deriving business income during the tax year.

An intangible that does not have ascertainable useful life, shall be treated as if it has normal useful life of 25 years. This change was brought through Finance Act 2019, as earlier the limit was of 10 years.

(iv) Pre-commencement expenditure

Amortization in respect of pre-commencement expenditure is allowed at the rate of 20% on straight line basis.

Pre-commencement expenditure shall not include expenditure incurred in acquiring land or the expenditure that is depreciated or amortized.

(v) Scientific research expenditure

Scientific research expenditure incurred in Pakistan in a tax year wholly and exclusively for the purpose of business are allowed as deduction from business income.

(vi) Employee training and facilities

Expenditure incurred during a tax year (other than capital nature) in respect of following are allowed as deduction from business income:

- educational institution or hospital established in Pakistan for the benefit of person's employees and their dependents;
- institute in Pakistan established for the training of industrial workers that is recognized, aided or run by Government; or
- training of any citizen of Pakistan in connection with scheme approved by FBR.

(vii) Profit on debt, finance cost and lease rentals

Any profit on debt, finance cost and lease rentals incurred during the tax year on any debt or asset which has been used for the purpose of business is allowed as deduction from business income.

Through changes made by Finance Act 2020, deduction on account of lease rentals of passenger transport vehicle, not plying for hire, is now restricted to the extent of principal amount Rs. 2.5 million.

(viii) Bad debts

Deduction for bad debt during a tax year is allowed under the following conditions:

- The amount of business income was already taxed in previous years;
- The debt was actually written off in the accounts; and
- There are reasonable grounds to believe that the debt is irrecoverable.

2- Deductions not allowed against business income

Following deductions are not allowed, which are listed below:

- (a) Any cess, rate or tax paid or payable on the profits and gains of business;
- (b) Taxes deducted at source;
- (c) Any expenditure on which taxpayer is required to withhold tax, however failed to withhold such tax;
- (d) Commission expense exceeding 0.2% of gross supplies of certain products where the person to whom commission is paid is not appearing in ATL;
- (e) Entertainment expenditure in excess of limits explained above under "Deductions Allowed Against Business Income";

- (f) Contributions to unrecognized / unapproved provident, pension, superannuation or gratuity fund;
- (g) Any fine or penalty paid or payable by the person for violating any law, rule or regulation;
- (h) Personal expenditures;
- (i) Any cash expenditure, except that are allowed and explained in “Deductions Allowed Against Business Income”;
- (j) Capital expenditure;
- (k) Through changes made by Finance Act 2020, utility expense in excess of prescribed limits and in violation of prescribed conditions;
- (l) Sale promotion expense exceeding 10% of turnover in respect of pharmaceutical manufacturer;
- (m) Through changes made by Finance Act 2020, expenditure attributable to sales made to persons not registered under Sales Tax Act, 1990 by an industrial undertaking will not be allowed. However disallowance shall not exceed 10% of total deductions claimed by such industrial undertaking

3- Set off Losses

Business loss suffered during a tax year can be set off against income chargeable to tax under any other head of income (except Salary and Income from Property). The remaining business loss can be carried forward to set off against business income only upto 6 tax years.

Set off of unabsorbed depreciation and amortization losses are restricted upto 50% of such losses in a tax year against the balanced income from business after setting off business loss. However, the said restriction of 50% will not apply when the taxable income for the year is less than Rs. 10 million.

Changes brought by Finance Act 2020

No changes have been made in the existing provisions of set off of losses.

4- Unexplained Income and Asset

Previously all the unexplained /concealed income or expenditure for which unsatisfactory explanation was provided to the Commissioner, were treated as Income from other sources.

However, through changes brought by Finance Act 2020, now the taxability of such income shall be in the following manner:

Description	Head of Income
Unexplained assets (Investments, money, amount credited in the Accounts)	Income from other sources
Concealed income	Income from Business

5- Taxation of Builders Developers

Builders are the persons registered with FBR as builder and engaged in construction and sale of residential or commercial buildings.

Developers are the persons registered with FBR as developer and engaged in development of land in the form of plots.

Through changes made by Finance Act 2020, a fixed tax scheme has been introduced for builders and developers whereby builders and developers who opt for the scheme will be taxed on the basis of project area in respect of their income from sale of building or plot from tax year 2020 and onwards. Moreover, definition of “industrial undertaking” is extended to include builders and developers for the purpose of importing plant and machinery to be utilized in construction of buildings and lands. Previously, similar fixed tax regime was also provided in the law but that was restricted to the projects that were approved during tax year 2017 only.

Salient features of the scheme are as under:

- (i) The tax paid under the scheme will be final tax.
- (ii) The scheme will apply to the “new projects” that are started between April 17, 2020 and December 31, 2020, to be completed by September 30, 2022, and also to the “existing projects” to be completed by September 30, 2022.
- (iii) Builders and developers opting to be taxed under the scheme are required to apply the option online through FBR portal by December 31, 2020 or 30 days of start of project whichever is earlier.

(iv) Being covered under the definition of industrial undertaking, builders and developers who opt for the scheme will be entitled to claim exemption from tax deduction on import of plant and machinery that will be used in their projects.

(v) No question will be asked about the source of amount from the investor who invested in “new project” and from first purchaser of building or units of building and also from purchaser of plot. However, this immunity will be subject to certain conditions.

(vi) Builder or developer can incorporate profits and gains from the project upto ten times of tax paid. However, in case of profits in excess of ten times of tax paid, builder or developer is required to pay tax on the excess amount of profit at normal tax rates (i.e. 29% for Private Limited Company and LLP and slab rates for AOP).

(vii) Exemption of tax on dividend paid by builder or developer from profits arising on their projects.

(viii) Exemption from obligation to withhold tax on:

- purchase of building material except steel and cement.
- Plumbing, electrification, shuttering and other similar services provided by non-corporate service providers.

(ix) Exemption from tax on capital gain to resident individual on sale of constructed residential property where land area of house does not exceed 500 sq yds and of flat does not exceed 4000 sq yds, and the property has been used for personal accommodation.

(x) 90% reduction in tax rates, in case of low cost projects developed or approved by Naya Pakistan Housing and Development Authority or under the Ehsaas program.

6- Withdrawal of certain exemptions

Through changes made by the Second Amendment Ordinance, following exemptions / reductions in tax rates or liabilities that were available to AOP, Private Limited Company and LLP have been withdrawn:

(a) No exemption on income from Sukuk issued by “The Second Pakistan International Sukuk Company Limited” and “The Third Pakistan International Sukuk Company Limited”.

(b) No exemption on profit on debt payable by industrial undertaking on foreign borrowing under loan agreement from approved foreign financial institution or on foreign borrowing in respect of purchase of plant and machinery outside Pakistan.

(c) No exemption on profit on debt derived on bonds issued by Pakistan Mortgage Refinance Company to refinance residential housing market.

(d) No exemption on distribution of collective investment schemes, mutual funds, National Investment (Unit) Trust, REIT scheme or Private Equity and Venture Capital Fund.

(e) No exemption on capital gain derived by transfer of bonds issued by Pakistan Mortgage Refinance Company to refinance residential housing market.

(f) No exemption on capital gain derived from an industrial undertaking set up in Export Processing Zone.

(g) No exemption on profits and gains derived from industrial undertaking set up in Larkano Industrial Estate between July 1, 2008 and June 30, 2013, for a period of ten years. However, existing beneficiaries continue to avail the exemption subject to the conditions mentioned under the clause before omission.

(h) No exemption on profits and gains from a fruit processing or preservation unit setup in Baluchistan, Malakand Division, Gilgit-Baltistan and FATA between July 1, 2014 and June 30, 2017, for a period of five years. However, existing beneficiaries continue to avail the exemption subject to the conditions mentioned under the clause before omission.

(i) No exemption on profits and gains from an industrial undertaking set up by December 31, 2016 or between March 1, 2019 and June 30, 2023, which is engaged in the manufacture of dedicated plant, machinery and equipment for generation of renewable energy, for a period of five years. However, a new tax credit has been introduced in lieu of omission of exemption which is mentioned in A-3 and B-3 above

(j) No exemption on profits and gains from an industrial undertaking set up between July 1, 2015 and June 30, 2016, which is engaged in operating warehouse and cold chain facilities for storage of agricultural produce, for a period of three years. However, existing beneficiaries continue to avail the exemption subject to the conditions mentioned under the clause before omission.

- (k) No exemption on profits and gains from an industrial undertaking set up between July 1, 2015 and June 30, 2017, which is engaged in establishing and operating halal meat production unit, for a period of four years. However, existing beneficiaries continue to avail the exemption subject to the conditions mentioned under the clause before omission.
- (l) No exemption on profits and gains from an industrial undertaking set up in Khyber Pakhtunkhwa and Baluchistan between July 1, 2015 and June 30, 2018, for a period of five years. However, existing beneficiaries continue to avail the exemption subject to the conditions mentioned under the clause before omission.
- (m) No exemption on profits and gains from an industrial undertaking set up between July 1, 2015 and June 30, 2017, which is engaged in the manufacture of cellular mobile phones, for a period of five years. However, existing beneficiaries continue to avail the exemption subject to the conditions mentioned under the clause before omission.
- (n) No exemption on profits and gains from green field industrial undertaking set up by July 1, 2019, for a period of five years. However, a new tax credit has been introduced in lieu of omission of exemption which is mentioned in A-3 and B-3 above.
- (o) No exemption on profits and gains from electric power generation project to the persons who enter into agreement or to whom letter of intent is issued by Federal Government or Provincial Government for setting up power generation project after June 30, 2021.
- (p) No exemption on profits and gains from coal mining project in Sindh, supplying coal to power generation projects. However, a new tax credit has been introduced in lieu of omission of exemption which is mentioned in A-3 and B-3 above.
- (q) No exemption on income from export of software, IT services or IT enabled services. However, a new tax credit has been introduced in lieu of omission of exemption which is mentioned in A-3 and B-3 above.
- (r) No exemption on profits and gains derived by LNG terminal operator and terminal owners.
- (s) No exemption on income of startup as defined under the Income Tax Ordinance which is certified by Pakistan Software Export Board. However, a new tax credit has been introduced in lieu of omission of exemption which is mentioned in A-3 and B-3 above.
- (t) No exemption on any income to the residents of Tribal Areas forming part of provinces of Khyber Pakhtunkhwa and Baluchistan under Article 246 of the Constitution of Pakistan.
- (u) No reduction in tax rates on import of hybrid cars.
- (v) Industrial undertaking set up in Export Processing Zone was earlier allowed to carry forward business losses to an infinite period. This facility has been withdrawn and now such industrial undertaking will be allowed to carry forward business losses for a period of six tax years.

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Section

D

Sales Tax Provisions

In this section brief aspects of Federal Sales Taxes and Provincial Sales Taxes are discussed for understanding of small business owners.

FEDERAL SALES TAX

Applicability: Every person engaged in making taxable supplies in Pakistan, including zero-rated supplies, falling in any of the following categories is required to be registered under the Sales Tax Act, 1990 (STA).

- (a) manufacturer who is not running a cottage industry;
- (b) retailer who is required to pay sales tax under STA, excluding such retailer required to pay sales tax through electricity bill;
- (c) importer;
- (d) exporter who intends to obtain sales tax refund against his zero-rated supplies;
- (e) wholesaler, dealer or distributor;
- (f) person who is required to be registered under any other Federal or Provincial law for the purpose of any duty or tax collected or paid as if it were a levy of sales tax under STA.

Cottage Industry

Persons engaged in cottage industry are not required to be registered under Sales Tax Act 1990.

Under Sales Tax Act, 1990, a cottage industry is defined as a manufacturing concern which fulfills each of the following conditions:

- (a) does not have industrial gas or electricity connections;
- (b) is located in a residential area;
- (c) does not have total labour force of more than 10 workers; and
- (d) annual turnover from all supplies does not exceed Rs. 3 million.

Taxability: Sales tax shall be charged, levied or paid on the value of:

- (a) taxable supplies made by a registered person in the course of or in furtherance of taxable activity carried on by him;

- (b) goods imported in to Pakistan.

General rate of sales tax is 17%. However, following goods are taxable at the rate of 0% which are called zero-rated supplies means a taxable supply which is charged to tax at the rate of zero per cent under the Act:

- (a) goods exported;
- (b) goods specified in Fifth Schedule of STA;
- (c) supply of stores and provisions for consumption aboard a conveyance proceeding to a destination outside Pakistan as specified in section 24 of Customs Act, 1969;
- (d) such other goods as the Federal Government may specify.

There are certain goods on which applicable sales tax rate is applied on retail price. These goods are mentioned in Third Schedule of STA.

Goods fall under zero-rated supplies are given in Fifth Schedule.

Certain goods are exempt from sales tax as specified under Sixth Schedule.

There are certain goods on which reduced rate is applied that may be upto 1%. These goods are specified under Eighth Schedule of STA.

Further tax of 3% (in addition to applicable sales tax rate) will be applied on taxable supplies made to persons who are required to register under STA but who have not obtained registration.

In case of import, registration and supply of SIM card and cell phones, sales tax on basis of value of cell phones will apply as mentioned in Ninth Schedule.

In case of supply of bricks, sales tax on fixed basis as per the region or area of supply will apply as mentioned in Tenth Schedule.

Withholding tax rates and applicability is given in Eleventh Schedule.

Minimum Value Addition Tax (Min VAT) shall be charged at 3% (in addition to applicable sales tax) on import of goods, subject to the conditions and exceptions mentioned in Twelfth Schedule.

Reporting obligation: Every registered person is required to file monthly sales tax return by 18th day of following month. In case of no sales tax activity during the reporting period nil statement will be filed.

Mechanism for payment of sales tax: For payment of sales tax, mechanism is provided in the Rules to the STA, whereby every registered person is required to pay sales tax charged on taxable supplies as reduced by sales tax paid on purchases made, on monthly basis by 15th day of following month.

PROVINCIAL SALES TAX

Applicability: Provincial taxes are applicable on services provided by registered persons from their registered offices or places of businesses in their respective provinces.

Taxability: The provincial taxes are levied without any minimum threshold of sales/revenue and are payable to provincial governments under their respective Provincial Sales Tax Acts (PSTAs). Taxable services are defined under Second Schedule of each of the Provincial Act (i.e. Sindh, Punjab, Baluchistan and KPK Acts).

Provincial Acts	Rate of Sales Tax
Sindh Sales Tax Act	13%
Punjab Sales Tax Act	16%
KPK Sales Tax Act	15%
Baluchistan Sales Tax Act	15%

There are certain exemptions and reduced rates of sales tax that are specified under the Second Schedules, notifications and Rules of the respective Acts.

Withholding tax rates and applicability is given in special procedure withholding rules of the respective PSTAs.

Reporting obligation: Every registered person is required to file monthly sales tax return by 18th day of following month. In case of no sales tax activity during the reporting period nil statement will be filed.

Mechanism for payment of sales tax: For payment of provincial sales tax, mechanism is provided in the Rules to the respective PSTAs, whereby every registered person is required to pay sales tax charged on taxable services as reduced by sales tax paid on purchases made, on monthly basis by 15th day of following month.



Section

E

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Administrative Provisions Relevant to AOP, Private Limited Company and LLP

There are certain changes brought by Finance Act 2020 in administrative provisions which are of relevance to AOP, Private Limited Company and LLP, are as follows:

Taxpayer's Profile

Taxpayer earning business income or income subject to final taxation is required to submit taxpayer's profile, in the prescribed manner, which shall state:

The relevant particulars of –

- Bank accounts
- Utility connections
- Business premises including all manufacturing, storage or retails outlets operated or leased by the taxpayer
- Types of businesses
- Other details as may be prescribed by the FBR

A taxpayer's profile shall be furnished as per the following timelines:

- On or before 31 December 2020, in case a person is registered with FBR before 30 September 2020;
- Within 90 days of registration, in case a person is registered with FBR after 30 September 2020.

If a tax payer fails to furnish or update taxpayer's profile, the person's name will be excluded from ATL. Moreover, such person shall pay a penalty of Rs. 2,500 for each day of default subject to minimum penalty of Rs.10,000. However, such person shall be included in ATL upon filing of profile and on payment of surcharge as follows:

S.No.	Person	Surcharge Amount
1	Company	20,000
2	AOP	10,000

ONLINE INTEGRATION OF BUSINESS

A new concept of "integrated enterprise" for online integration of businesses have been introduced whereby a person is integrated with FBR through approved fiscal electronic device and software and fulfills prescribed obligations and requirements for

integration. Draft rules for such integration were already proposed by FBR in April 2020 for certain service sectors.

Assessment

Returns filed by the tax payer shall be deemed to be assessed by the Commissioner after it has been processed through automated system within 6 months of filing of return for adjustments for arriving at correct amount of taxable income, total income and tax payable. However, no adjustments shall be made without system generated notice. Such notice is required to be responded within 30 days of issuance of notice and in case of failure to respond, the adjustments proposed in the notice will be made in the return.

Amendment of assessment on audit

The Commissioner is empowered to amend an assessment on any matter identified in the audit whether or not the same represents definite information.

Agreed Assessment

In case a show-cause notice issued by the Commissioner, taxpayer has been given right to file offer of settlement to Assessment Oversight Committee (Committee), at the same time reply to the notice as well.

Committee will dispose of the matter through consensus and communicate its decision to the taxpayer. If taxpayer accepts the decision of the Committee, he will be required to deposit the amount of tax payable along with default surcharge and penalty as per the decision of Committee, and in this case taxpayer has no right to appeal on the agreed assessment.

Appeal before Commissioner Appeals

Prescribed fee for filing appeal before Commissioner Appeals has been increased as follows:

S.No.	Person	Increase in Fee
1	AOP	
	- In case of assessment	From Rs.1000 to Rs. 2,500
	- Other than assessment	From Rs. 200 to Rs. 1,000
2	Company	From Rs. 1,000 to Rs. 5,000

Commissioner Appeal is required to specify the amount of tax upheld in the order passed.

Appeal before Appellate Tribunal Inland Revenue (ATIR)

Prescribed fee for filing appeal before ATIR has been increased as follows:

S.No.	Person	Increase in Fee
1	AOP	From Rs. 2,000 to Rs. 2,500
2	Company	From Rs. 2,000 to Rs. 5,000

Audit proceedings through video link

If a tax payer does not furnish return or documents, or he furnishes incomplete record or books of accounts or is unable to provide sufficient explanation regarding defects in records, documents and books of accounts, the Commissioner may initiate audit proceeding through video link.

Exemption certificate to industrial / commercial consumer of electricity

If advance tax liability for the entire year is discharged by industrial / commercial consumer of electricity, such consumer will be entitled to obtain exemption certificate on deduction of advance tax on electricity bills.

Omission of requirement of withholding tax / collection of advance tax

- No collection of advance tax by educational institutions where taxpayer appears on ATL.
- No withholding of tax from any balance withdrawn from pension fund.
- No collection of advance tax on payments for functions and gatherings.
- No collection of advance tax for remittance of educational expense.
- No collection of advance tax in respect of general insurance premium and life insurance premium paid.
- No collection of advance tax on locally produced edible oil by manufacturer of cooking oil or vegetable ghee.
- No collection of advance tax on cable operators and other electronic media.



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Section **F**

Annexure - I

Requirement to file Annual Tax Return in case of small business by two or more persons

Partnership (AOP)	<p>AOP is required to file return on income if business income for the tax year exceeds Rs. 400,000 or any of the following conditions are fulfilled:</p> <ul style="list-style-type: none"> (a) Has been charged to tax in any of the two preceding tax years (b) Claims a carried forward loss (c) Owns immovable property of land area above 500 sq yards in areas falling within municipal limits or in cantonment Islamabad Capital Territory (d) Owns flat more than 2000 sqft (e) Owns motor vehicle of 1000cc (f) Has obtained NTN (g) Holds commercial electricity connection where the annual bill exceeds Rs. 500,000 (h) For residents, member of any Chamber or a professional body (i) Resident having foreign income of USD 10,000 or more or foreign assets valuing USD 100,000 or more (j) Income subject to final taxation
Company (Private Limited Company and LLP)	All are required to file return on income without any condition.

Annexure - II

Active Taxpayers' List (ATL)

If a person fails to file return of income by the due date or within the time extended by the Commissioner or FBR, such person shall not be included in the ATL. In this way anyone who is not in ATL will need to face following consequences:

- (a) 100% additional payment of withholding tax
- (b) Through the information gathered from the withholding agents, will be subject to provisional Assessment on the basis of imputed income.

However such person shall be included in ATL on filing return after due date and on payment of default surcharge of Rs. 1,000.

Disclaimer:

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