CHAPTER 16

INCOME TAX - HOW DO I KNOW WHAT NEEDS TO BE DONE?

116 DISCLAIMER

The contents of this Chapter are not intended to be a complete summary of the Income Tax law, nor is it intended to give an advice in any particular matter. This Chapter only intends to provide an overview of the prevailing Income Tax law. Readers are advised not to take decisions based on this Chapter alone – it is recommended that professional advice be sought on any income tax matter.

117 WHAT IS INCOME TAX?

Income tax, as the name implies, is a tax on income earned by Businesses operating in Pakistan. Income Tax is one of the major sources of income for the government with which various expenditures get incurred for the betterment and welfare of public.

Because the government has provided the infrastructure and the necessary opportunity to its people to pursue business opportunities, a certain portion of the income earned by Businesses is required to be paid to the government as compensation – this is the basic rationale for paying income tax. Keeping in mind this perspective, you will see in the following sections that income tax is paid whenever income is earned by a Business or an individual.

118 LAWS GOVERNING INCOME TAX

Income Tax laws in Pakistan have evolved over a long period of time. At present, the main sources of Income Tax regulations are:

- Income Tax Ordinance, 2001.
- Income Tax Rules, 2002.
- Statutory Regulatory Orders (SROs)
- Federal & Provincial Budgets.

SROs are announced by the government as and when an amendment is required to Income Tax regulations which can happen through out the year. Annual Budgets are announced once a year which is normally in May – June and are effective from July 1st till June 30th of the next year.

119 TO WHOM DO INCOME TAX REGULATIONS APPLY?

Income Tax regulations are applicable to both Businesses and individuals, i.e., to all those who are earning income. Here, in this Chapter, we shall focus on how these income tax regulations apply to Businesses.

Every Business should prepare Accounts for each year of its activities, on the basis of which, an Income Tax Return is filed with the Tax Authorities. The Return includes calculation of income tax payable based on the Business's profits or losses shown in the Accounts.

An important distinction must be remembered here. You will recall from Chapter 4 where we discussed that the Owners of a Business are different from the Business which they own. In Income Tax, this distinction is also very important. Every Business whether being run as a Sole Proprietor, Partnership or as a Company is subject to income tax laws as a separate legal person. Then, the Owners of the Business are also subjected to Income Tax laws based on the income which they have derived from the same Business. What this means is that the Business and its Owners are subjected to income tax laws separately.

120 INCOME TAX TERMINOLOGY MADE SIMPLE

Before we go in more detail, an understanding of key terms used in context of Income Tax is very important. These are briefly explained below:

Tax	Tax includes any payment of tax, penalty, fee or any amount payable under Income Tax Ordinance.
Taxable Income	Taxable income is the total income for the year after deducting allowable expenses and deductible allowances.
Withholding Tax	It is the amount of tax collected or deducted at source from where an income is being generated.
Assessment	Assessment means determination of taxable income and tax liability or refund by the Income Tax department.
Advance tax	Advance tax is the method by which government collects taxes in advance from Businesses.
Deductible Allowances	These are allowances which are deductible while calculating taxable profits.

121 HOW TO APPLY FOR A NATIONAL TAX NUMBER?

Every Business is issued a National Tax Number which is a unique number for that Business. All taxes for and on behalf of that Business are deposited under this Number so that a complete and accurate tax record is maintained.

The National Tax Number is issued once to a Business, normally at the time that a Business starts its operations. It is the responsibility of every Business to apply for its National Tax Number – the following sections will briefly explain the procedures.

121.1 Partnership Firm

The following documents are required:

- Application Form IT-B duly completed and signed.
- Attested copy of the Partnership Deed.
- Attested copies of National Identity cards of each Partner.
- Separate application Forms (IT-B) for each partner duly filled in and signed.

121.2 Sole Proprietor

The following documents are required:

- Application Form IT-B duly completed and signed.
- Attested copy of the National Identity card of the Owner.

121.3 Limited Company

The following documents are required:

- Application Form IT-A duly completed and signed.
- Attested copy of the incorporation certificate.
- Attested copies of National Identity cards of all Directors.
- Separate application Form IT-B for each Director duly filled in and signed, in cases where Directors do not have their own NTN.

Specimens of Form IT-A and IT-B are attached as Appendix 16-01 and 16-02 to this Chapter respectively.

Another important point to bear in mind is that the representatives of the tax department may also choose to visit the Business's office to ensure that the Business seeking a National Tax Number does indeed exist.

122 INCOME TAX LAW – BRIEF OVERVIEW

Income Tax law is not just about collecting tax – income tax law provides a comprehensive framework under which Businesses are required to operate.

Income Tax is not collected once a year only. The Law has been made such that tax is collected at various times and depends on the nature of activities being pursued by a Business. In most cases, responsibility is on Businesses to ensure that compliance with tax laws is adhered to at all times.

In the following sections, we have given a summary of the more common procedures that a Business is expected to encounter during its normal operations.

123 WHAT IS A TAX YEAR?

The income tax year starts from July 1st to June 30th of the next year. The income tax law requires every Business to prepare its Accounts for every twelve month period to coincide with normal tax year. However, there are exceptions given to certain types of Businesses, e.g., sugar sector Businesses can have their year closing on September 30th instead.

The following general rule will be useful to determine what deadlines are applicable to each type of Business as well as to the Owner of that Business:

Legal Form	Year Ending	Business Returns	Personal Returns
Sole proprietors	June 30th annually	September 30th	September 30th
Partnerships	June 30th annually	September 30th	September 30th
Companies	June 30th annually	December 31st	September 30th

However, the following year closing dates can also be adopted by certain types of Businesses irrespective of the Legal Form of the Business:

Type of Business	Year Ending	Business Returns
Sugar	September 30th annually	September 30th of next year
Rice Exporting	December 31st annually	September 30th of next year
Shawl Manufacturers	March 31st annually	December 31st of current year

The only last thing left with respect to Tax Year is when a new Business is started – in such a case, the following rule applies:

If a Business starts during a year, the income tax return will be filed for the number of months till 30th June, e.g., if a Business has started on 1st March, 05 then the Accounts are closed on 30th June, 05, i.e. the return is prepared for only 4 months of operations.

124 WHAT IS INCOME TAX CYCLE?

As we have discussed, Income Tax law is not just about filing your annual tax return and depositing tax. It is a set of rules and guidelines which affects the everyday working of a Business.

The Income tax cycle will be discussed under the following four main sub-sections:

- Payments for goods, services and rent.
- Receipts from customers.
- Advance tax.
- Salaries paid to employees.

The basic purpose of income tax regulations is two folds:

- Tax should be paid to government whenever income arises; &
- Cash transactions should be minimized, i.e., transaction should get done through Bank Accounts so that a trail is maintained on What is Paid? & Who has paid?

The income tax implications of tax on salaries have already been discussed in Chapter 12 so it shall not be repeated here.

The other sub-sections are discussed in more detail below:

124.1 PAYMENTS FOR GOODS, SERVICES & RENT

Where payments against each account head are expected to exceed Rs. 25,000 on an annual basis, every individual payment under the respective head in excess of Rs. 10,000 should be made through a crossed cheque. (There are, however, some pre-defined account heads in law for which this rule does not apply e.g. Freight, Travel, Postage, Utilities and Payments of taxes, duties, fees, fines etc.)

Where payments are made, the following rule will be applicable insofar as deduction of withholding taxes is concerned:

Type of Payment	Tax Rate	On Payments Exceeding
Local purchases	3.5%	Rs. 25,000
Services	6.0%	Rs. 10,000

Rent:

In case of non-corporate taxpayers:

S. NO.	Gross Amount of Rent	RATE OF TAX
	Where gross amount of rent;	
1	does not exceed Rs. 150,000	NIL
2	exceeds Rs. 150,000 but does not exceed Rs. 400,000	5% of gross amount exceeding Rs. 150,000
3	exceeds Rs. 400,000 but does not exceed Rs. 1,000,000	Rs. 12,500 plus 7.5% of the gross amount exceeding Rs. 400,000
4	exceeds Rs. 1,000,000	Rs. 57,500 plus 10% of the gross amount exceeding Rs. 1,000,000

In case of corporate taxpayers:

S. NO.	Gross Amount of Rent	RATE OF TAX
	Where gross amount of rent;	
1	does not exceed Rs. 400,000	5% of gross amount of rent
2	exceeds Rs. 400,000 but does not exceed Rs. 1,000,000	Rs. 20,000 plus 7.5% of the gross amount exceeding Rs. 400,000
3	exceeds Rs. 1,000,000	Rs. 65,000 plus 10% of the gross amount exceeding Rs. 1,000,000

The important thing to note is that withholding tax is deducted on the basis of payments and not invoices. Therefore, if a Business has purchased goods on 1/4/05 against which payment was made on 29/4/05, withholding tax will be deducted on 29/4/05.

However, please also note that the Income Tax department may also issue an Exemption Certificate (please refer to section 9.1.1 below) to certain Businesses. This means that where a Business has been given such a Certificate, no withholding tax may get deducted from payments made to that Business.

EXAMPLE # 16.1 Withholding Tax on Payment For Goods
On 2/9/05, Hussain Khaddar purchased 20 bags of 20/s yarn from Resham Textile costing Rs. 10,000. Further purchases were made from the same supplier costing Rs. 14,000, Rs. 30,000 and Rs. 15,000 on 4/9/05, 10/9/05 and 20/9/05 respectively. We can assume that all these dates represent payment dates.

Based on this example, withholding tax will be calculated as follows:

No withholding tax will be calculated and deducted on purchases made on 2/9/05 and 4/9/05 as the total purchases did not exceed Rs. 25,000. Withholding tax will be calculated on Rs. 30,000 on 10/9/05 and on 15,000 on 20/9/05.

Date		Withholding tax
		Rs.
10/9/05	Rs. 30,000 @ 3.5%	1,050
20/9/05	Rs. 15,000 @ 3.5%	525

EXAMPLE # 16.2 Payments For Goods, Services & Rent
Hanif Auto Engineering pays rent of Rs. 20,000 per month for a godown.

Withholding tax		
		Rs.
Per month rent	A	20,000
Annual rent	B=A*12	240,000
Applicable rate (Non corporate tax payer)		5%
Exempted amount	C	150,000
Taxable amount	D=B-C	90,000
Amount of tax	E=D*5%	4,500

Withholding tax will be deducted @ 5% on the amount of rent exceeding Rs. 150,000 on an annual basis.

Where a Business is not deducting withholding tax on payments on the basis of an Exemption Certificate, the following shall be ensured:

- Exemption Certificate should be in the name of the Business to whom payment is being made. Exemption Certificate shall be valid unless commissioner of Income Tax revokes it.
- Exemption Certificate should be valid, i.e. such a Certificate should not have

expired. Where it is expired, the Certificate can also be renewed.

- Exemption Certificates are specific to section numbers in the Income Tax law. Therefore, Businesses should ensure that Exemption Certificates are in respect of the section of Income Tax law under which payments are being made.

Once tax has been deducted and withheld from a payment, the amount of tax should be deposited with the government within 7 days from the end of each fortnight. This is done by way of completing and filing a tax challan. The specimen of a tax challan is shown in Appendix 16-03. One copy of the tax challan is retained by the paying Business and the other copy is given to the supplier whose tax was deducted.

124.1.1 Exemption certificates

To get an Exemption Certificate, a Business has to file an Application before Commissioner of Income Tax, setting out the reasons on the basis of which an Exemption Certificate may be issued.

124.2 Receipts from customers

Receipts from customers are an exact opposite of payments to suppliers but the underlying principles are the same, i.e. customers will deduct withholding tax before making payments.

Businesses also need to ensure that all tax challans and deduction certificates mentioned above have also been obtained from their customers – these will be very useful when it comes to filing the Business's income tax returns.

124.3 Advance tax

Advance Tax is the method by which government collects taxes in advance from Businesses. The basis of determining the amount of Advance Tax is the tax which was paid in the prior year.

The following types of Businesses are required to pay Advance Tax:

- Businesses operating as sole proprietors or as partnerships where the last assessed income was more than Rs. 200,000.
- Every Business operating as a Company.

However, there are exceptions, i.e. there are certain Businesses who may not be required to pay Advance Tax. A Business operating as a company which has just started its operations will have to pay Advance Tax on the basis of estimated future profit of a tax year. In this Chapter we shall not discuss the specific procedures for such estimation; readers are advised to seek Professional help in this regard.

124.3.1 How is advance tax calculated?

Advance tax is paid in 4 quarterly installments in a calendar year and it is calculated as follows:

(A/4) – B

"A"is the tax assessed for the latest tax year or latest assessment year.

"B" is tax that has already been paid in the quarter other than the tax on salary, on property rent and the final tax.

EXAMPLE # 16.3 Advance Tax
Hussain Khaddar & Looms (Pvt) Limited's last income was assessed at Rs. 250,000/- in the year 2003/04. Advance Tax payments for each of the four calendar quarter need to be calculated.

Advance Tax to pay will be calculated by using the formula:

(A/4) – B

Where

A= 250,000

B= Nil

By applying these amounts, Advance Tax will be (250,000/4 – Nil) = Rs. 62,500/-.

124.3.2 When is advance tax paid?

Advance tax is paid on a calendar quarter basis, as follows:

Period	Deadline
1st July to 30th September	15th September
1st October to 31st December	15th December
1st January to 31st March	15th March
1st April to 30th June	15th June

Continuing with Example 16.3, Advance Tax for the first quarter, i.e. 1st July till 30th September will be paid by 15th September.

124.3.3 CONSEQUENCES OF NON-PAYMENT

Tax Authorities have imposed penalties on Businesses that delay or do not pay Advance Tax. Penalties will be calculated on the following basis:

1st Default	Not paid within 1½ month from the date of assessment order	5% of amount of tax in default
2nd Default	Not paid within further 1 month	An additional penalty of 20% of amount of tax in default
3rd Default	Not paid within further 1 month	An additional penalty of 25% of amount of tax in default
4th Default	Not paid within further 1 month	An additional penalty of 50% of amount of tax in default

Additional tax for non-payment of Advance Tax shall also be charged at 12% per annum in addition to applicable penalties as mentioned above.

EXAMPLE # 16.4
Consequences of Non-Payment of Advance Tax
Continuing from Example 16.3, suppose that Hussain Khaddar & Looms (Pvt) Limited did not pay the advance tax on 15th September and received the assessment order on 16th September. Hussain Khaddar & Looms (Pvt) Limited paid the amount of advance tax after 3 months from receiving the assessment order, i.e. on 16th December.

Penalties and additional tax will be calculated as follows:

Period	Additional Tax @ 12% p.a.	Penalty	Total Amount Payable
After 1½ month	62,500*12%*1.5/12=938	63,438*5%=3,172	63,438+3,172=66,610
After 2½ month	66,610*12%*1/12=666	67,276*20%=13,455	67,276+13,455=80,731

124.4 SALARIES PAID TO EMPLOYEES

We have already covered the various regulations and guidelines pertaining to salaries in Chapter 12.

125 ARRIVING AT TAXABLE PROFITS

So far, in this Handbook, we have covered the concept of Accounting profit while we have also made brief mention of "Taxable Profits" in various sections. From a tax view point, it is taxable profits that are more important because income tax payable is based on taxable profits. However, you also need to appreciate that Taxable Profits are derived from Accounting Profits.

In the following sections, we will describe some of the more common circumstances which lead to differences between Accounting and Taxable Profits.

125.1 ADMISSIBLE EXPENSES AND ALLOWANCES / DEDUCTIONS ALLOWED

A Business, during any twelve month period, will incur various types of expenditures some of which may be for the Business and some of which may not be. Under Income Tax law, only those expenses which are specifically incurred for the purposes of the Business will be accepted by the Tax department as bona fide Business expenses.

If a Business has made some non-Business related expenditure, the consequence is that such expenses will be "disallowed" by the tax department with the consequence that taxable profits will be higher and hence the tax to pay will also increase.

125.2 TAX DEPRECIATION

The rationale behind Tax Depreciation is same as that of Accounting depreciation. However, in order to unify the spreading the cost of the asset over its estimated useful life, the tax department has standardized the depreciation rates for all types of Businesses – you will recall that, from an Accounting view point, Businesses are free to choose deprecation rates on their own. Tax depreciation is allowed as an expense to Businesses and is calculated on the following basis:

Name of Assets	Rate on WDV
Buildings	10 %
Furniture and fittings	15 %
Plant & Machinery	15 %
Computer & Allied Equipments	30 %
Technical or professional books	15 %
Motor vehicles	15 %

The method of calculation is exactly same as that has been described for Accounting depreciation – however, you should note that tax depreciation shall be calculated only on Reducing Balance basis (and not on Straight Line basis).

125.3 INITIAL ALLOWANCES

Initial Allowances are like tax depreciation but a more expedite way to allow the depreciation as an expense. The rationale behind initial allowance is that it is given to encourage Owners to invest more in upgrading, modernizing, replacing and expanding their Businesses.

Initial Allowance is available on the following Assets:

Name of Assets	Initial Allowance
Buildings (All Types)	50%
Plant & Machinery (if not previously used in Pakistan)	50%
Computer & Allied Equipments	50%
Technical or professional books	50%

To be entitled to receive Initial Allowance, an asset should be used for the first time in Pakistan in a tax year.

125.4 Bad & doubtful debts

Accounting requires Businesses to make provision against balances owed by customers where there are reasonable doubts on the ability of the customer to make payment. However, Income Tax law does not recognize such provisions as expenses.

For bad and doubtful debts owed by customers, the Income Tax law will only accept them as an expense where there is reasonable evidence that the customer is unable to pay.

125.5 Unpaid trading liability

Unpaid trading liability is that expense which has been recorded in Accounts as an expense which has been incurred but not paid. Income Tax law requires that where such a provision for expenses has been made and three years have lapsed since the provision was initially made, the same will no longer be treated by the Income Tax department as an expense.

This is done by reversing such provisions so that it becomes “Income” for the Business. The impact will be that taxable profits will be higher and hence tax to pay will also correspondingly increase.

125.6 Operating & finance leases

Income Tax law does not make a distinction between an operating and a finance lease. The tax treatment for leases is that all rentals (which, in case of finance leases, also include principal repayments and mark up) are allowed as an expense.

You will recall the table on the next page from Chapter 8 which describes the different features of the two types of leases.

	Operating Lease	Finance Lease
1	Assets are not recorded.	Assets are recorded.
2	Depreciation is not charged.	Depreciation is charged as an expense.
3	Lease rentals are charged as expense.	Only mark up is charged as an expense.
4	No liability for finance lease is shown.	Liability for repayment of finance lease is shown.

However, as explained before, from Income Tax view point, both types of leases are treated in a similar manner, i.e.:

	Operating Lease	Finance Lease
1	Assets are not recorded.	Assets recorded in Accounts are not recognized.
2	Depreciation is not charged.	Depreciation charged in Accounts is not allowed and no tax depreciation or initial allowance is given.
3	Lease rentals are charged as expense.	Total rental is allowed as an expense (similar to an Operating Lease).
4	No liability for finance lease is shown.	Liability for finance lease shown is not recognized.

Therefore, in order to arrive at Taxable Profits, the following adjustments are required to be made for Finance Leases:

- Depreciation/Amortization of finance leases is added back to Accounting Profit.
- Since mark up has already been charged in calculating Accounting Profits, a further deduction is made for principal repayments.

Because principal repayments under Finance Leases are also allowed as an expense, this is the reason why finance leases are a more lucrative financing option as compared to bank financing.

125.7 TAX RATES FOR BUSINESS INDIVIDUALS AND FIRMS

Following are the income tax rates for Individuals and Businesses which are operating under the legal form of a Sole Proprietorship or a Partnership – please note that these tax rates are not applicable to salaries and to agriculture income.

S. NO.	TAXABLE INCOME	RATE OF TAX
1	Where taxable income does not exceed Rs. 100,000	0%
2	Where taxable income exceeds Rs. 100,000 but does not exceed Rs. 110,000	0.50%
3	Where taxable income exceeds Rs. 110,000 but does not exceed Rs. 125,000	1.00%
4	Where taxable income exceeds Rs. 125,000 but does not exceed Rs. 150,000	2.00%
5	Where taxable income exceeds Rs. 150,000 but does not exceed Rs. 175,000	3.00%
6	Where taxable income exceeds Rs. 175,000 but does not exceed Rs. 200,000	4.00%
7	Where taxable income exceeds Rs. 200,000 but does not exceed Rs. 300,000	5.00%
8	Where taxable income exceeds Rs. 300,000 but does not exceed Rs. 400,000	7.50%
9	Where taxable income exceeds Rs. 400,000 but does not exceed Rs. 500,000	10.00%
10	Where taxable income exceeds Rs. 500,000 but does not exceed Rs. 600,000	12.50%
11	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 800,000	15.00%
12	Where taxable income exceeds Rs. 800,000 but does not exceed Rs. 1,000,000	17.50%
13	Where taxable income exceeds Rs. 1,000,000 but does not exceed Rs. 1,300,000	21.00%
14	Where taxable income exceeds Rs. 1,300,000	25.00%

In case of a business woman, no tax shall be charged if her taxable income does not exceed Rs. 125,000.

125.8 TAX RATES WHEN INCOME INCLUDES AGRICULTURAL INCOME

The income, derived by individuals and Businesses, which is Agriculture income (which is defined as being that income from agricultural activities) shall be exempted from the tax.

125.9 TAX RATES FOR SALARIED INDIVIDUAL

For those individuals whose source of income is salary from an employment (which is defined as that income which is equal to or is more than 50% of the total income), the following income tax rates are applicable:

S. NO.	TAXABLE INCOME	RATE OF TAX
1	Where taxable income does not exceed Rs. 180,000	0%
2	Where taxable income exceeds Rs. 180,000 but does not exceed Rs. 250,000	0.50%
3	Where taxable income exceeds Rs. 250,000 but does not exceed Rs. 350,000	0.75%
4	Where taxable income exceeds Rs. 350,000 but does not exceed Rs. 400,000	1.50%
5	Where taxable income exceeds Rs. 400,000 but does not exceed Rs. 450,000	2.50%
6	Where taxable income exceeds Rs. 450,000 but does not exceed Rs. 550,000	3.50%
7	Where taxable income exceeds Rs. 550,000 but does not exceed Rs. 650,000	4.50%
8	Where taxable income exceeds Rs. 650,000 but does not exceed Rs. 750,000	6.00%
9	Where taxable income exceeds Rs. 750,000 but does not exceed Rs. 900,000	7.50%
10	Where taxable income exceeds Rs. 900,000 but does not exceed Rs. 1,050,000	9.00%
11	Where taxable income exceeds Rs. 1,050,000 but does not exceed Rs. 1,200,000	10.00%
12	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,450,000	11.00%
13	Where taxable income exceeds Rs. 1,450,000 but does not exceed Rs. 1,700,000	12.50%
14	Where taxable income exceeds Rs. 1,700,000 but does not exceed Rs. 1,950,000	14.00%
15	Where taxable income exceeds Rs. 1,950,000 but does not exceed Rs. 2,250,000	15.00%
16	Where taxable income exceeds Rs. 2,250,000 but does not exceed Rs. 2,850,000	16.00%
17	Where taxable income exceeds Rs. 2,850,000 but does not exceed Rs. 3,550,000	17.50%
18	Where taxable income exceeds Rs. 3,550,000 but does not exceed Rs. 4,550,000	18.50%
19	Where taxable income exceeds Rs. 4,550,000 but does not exceed Rs. 8,650,000	19.00%
20	Where the taxable income exceeds Rs. 8,650,000	20.00%

In case of a salaried woman, no tax shall be charged if her taxable income does not exceed Rs. 240,000.

Marginal Tax Relief:

Where the total income of a taxpayer marginally exceeds the maximum limit of a slab in the table, the income tax payable shall be the tax payable on the maximum of that slab plus an amount equal to;

S. NO.	TAXABLE INCOME	RATE OF TAX
1	Where total income does not exceed Rs. 500,000	20% of amount by which total income exceeds the said limit
2	Where total income does not exceed Rs. 1,050,000	30% of amount by which total income exceeds in each slab
3	Where total income does not exceed Rs. 2,000,000	40% of amount by which total income exceeds in each slab
4	Where total income does not exceed Rs. 4,450,000	50% of amount by which total income exceeds in each slab
5	Where total income exceed Rs. 4,450,000	60% of amount by which total income exceeds in each slab

Tax Rates for Companies

For Businesses which operate as Companies (here, Companies are defined as those which are incorporated under Companies Ordinance, 1984 – please refer to Chapter 2), the following income tax rates are applicable:

TAX YEAR	BANKING COMPANY	PUBLIC COMPANY (OTHER THAN A BANKING COMPANY)	PRIVATE COMPANY (OTHER THAN A BANKING COMPANY)
2005 On wards	35%	35%	35%

TAX YEAR	TURNOVER/SALES	SMALL COMPANY
2005 & On wards	Turnover does not exceed Rs. 250 million	20%
	Turnover exceed Rs. 250 million but does not exceed Rs. 350 million	25%
	Turnover exceed Rs. 350 million but does not exceed Rs. 500 million	30%
	Turnover exceed Rs. 500 million	35%

Tax Rates for Retailers

A Retailer, operating as a Sole Proprietor or as an Association of Persons, will be pay income tax at 0.5% of the turnover exceeding Rs. 5,000,000 in a year.

If the turnover of a Retailer exceed exceeds Rs. 10,000,000 in a year, income tax at 0.75% of the turnover exceeding Rs. 10,000,000 plus Rs. 50,000 shall be paid.

125.10 CALCULATION OF TAXABLE PROFITS

In the foregoing sections, we have covered some of the commonly encountered reasons for the differences between Accounting Profits and Taxable Profits. We will now use the following examples to illustrate how taxable profits and calculation of income tax payable is derived from Accounting Profits.

EXAMPLE # 16.5
Taxable Profits & Tax Payable
Accounts for Hussain Khaddar (Private) Limited have been prepared till June 30th, 2006. The Income Tax Return for 2005/06 financial year is required to be filed with the Income Tax department. We will use the Accounts which were prepared in Chapter 14 for Hussain Khaddar (Private) Limited.

	2006 Rupees	2006 Rupees
Profit before taxation		1.472.950
Add:		
Accounting Depreciation	203.807	
Financial Charges on leased assets	12.715	
Amortization on Finance Lease	225.000	
Accounting gain on Disposal	35.096	
Reduction in inventory	2.500	479.118
		1.952.068
Less:		
Tax gain on Disposal	(40.586)	
Lease Rentals Paid	(40.700)	
Tax Depreciation	(651.764)	(733.050)
TAXABLE INCOME / (LOSS)		1.219.018
COMPUTATION OF TAX PAYABLE		
Income Tax @ 35% of Taxable Income		
1.219.018*35%		426.656

Tax depreciation has been calculated as follows:

Asset	WDV (Rs.)	Depreciation Rate	Depreciation (Rs.)
Factory Building	2,100,000	10%	210,000
Machinery	2,945,096	15%	441,764
			651,764

Note: For the purpose of tax depreciation in this example, we ignored the initial allowance.

EXAMPLE # 16.6

Taxable Profits & Tax Payable

Accounts for Hanif Auto Engineering have been prepared till June 30th, 2006. The Income Tax Return for 2005/06 financial year is required to be filed with the Income Tax department. We will use the Accounts which were prepared in Chapter 14 for Hanif Auto Engineering.

HANIF AUTO ENGINEERING

CALCULATION OF THE TAXABLE INCOME AND TAX PAYABLE
FOR THE PERIOD ENDED JUNE 30, 2006

	June 2006 Rupees	June 2006 Rupees
Loss before taxation		779
Add:		
Bad Debt Expense	6,000	
Inventory Loss	5,000	
Accounting Depreciation	66,800	77,800
		78,579
Less:		
Tax Depreciation		(47,500)
TAXABLE INCOME / (LOSS)		31,079

COMPUTATION OF TAX PAYABLE

Tax @ 0.5% of Taxable Income		
	31,079*0.5%	155

Tax depreciation has been calculated as follows:

Asset	WDV (Rs.)	Depreciation Rate	Depreciation (Rs.)
Tools and Machinery	150,000	15%	22,500
WorkShop Shed	100,000	10%	10,000
Machinery	100,000	15%	15,000
			47,500

125.11 ASSESSMENT

Assessment is the term used to refer to finalization of tax liability of Business for any financial year. The normal procedure adopted in this context is that a Business files its Income Tax return along with a computation of tax liability. The tax department then scrutinizes the information to its entire satisfaction which may include asking the representatives of the Business to attend meetings, submit its Books of Accounts and any other information which the Tax department may also ask for.

The end result of all these efforts is that the tax department will issue an Assessment Order which determines the tax liability that has been calculated by the Tax department which may be same or different from what the Business had originally presented.

The impact of all these efforts is that a lot of time and effort gets spent in discussing and presenting the case to the tax department. In the end, where the Business does not agree with the tax liability determined by the tax department, the Business has the right to lodge an appeal which can then take further time and effort.

In order to simplify the assessment procedures for Businesses, government has introduced a Universal Self Assessment Scheme (explained in section 12) – the objective of this scheme is to simplify the Assessment proceedings by reducing burden on Businesses.

125.12 ACCOUNTING ENTRIES

After provision for income tax has been calculated, it is now time to make Accounting entries relating to income tax in the Books of Accounts.

The following example will illustrate this:

EXAMPLE # 16.7 Provision for Income Tax
Hussain Khaddar's provision for income tax has been worked out as Rs. 426,656 in Example 16.5. The Accounting entries will be as follows:

GENERAL LEDGER							
TAXATION EXPENSE ACCOUNT GL-80							
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				30/6/06	GL-81	Provision for Taxation Account	426,656

GENERAL LEDGER							
PROVISION FOR TAXATION ACCOUNT GL-81							
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
30/6/06	GL-80	Taxation Expense Account	426,656				

EXAMPLE # 16.8
Provision for Income Tax
Hanif Auto Engineering's provision for income tax has been worked out as Rs. 155 in Example 16.6. The Accounting entries will be as follows:

GENERAL LEDGER							
TAXATION EXPENSE ACCOUNT							GL-80
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				30/6/06	GL-81	Provision for Taxation Account	155

GENERAL LEDGER							
PROVISION FOR TAXATION ACCOUNT							GL-81
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
30/6/06	GL-80	Taxation Expense Account	155				

125.13 BALANCE TAX TO PAY

After a Business's tax liability has been determined for a year of operations, the amount of tax determined now needs to be paid over to the tax authorities. But, you will also recall from our earlier discussion that a Business will also have paid some income tax in advance during the year – all such taxes already paid in advance will be deducted from the tax liability, and the balance tax will be payable to the tax authorities at the time that the annual tax return is filed by the Business.

Some common examples of taxes paid in advance by a Business are, Advance Tax & Withholding Tax deducted by customers.

Besides these, there are various other circumstances where similar taxes will also have been paid in advance, e.g., on:

- Mobile phones
- Telephone

- Electricity

Every Business should keep a record of such advance taxes paid because these, in aggregate, will be used to reduce the amount of tax that is payable.

The following example will illustrate this:

EXAMPLE # 16.9		
Balance Tax to Pay		
For this example, we assume that Hussain Khaddar paid income tax in the following cases:		
Rs. 500 while making payments for mobile & PTCL bill		
Rs.11,500 was deducted by various customers as withholding tax		
The balance tax liability will be calculated as follows:		
	Rs.	Rs.
Tax Liability calculated as in Example 16.5		426,656
Less:		
Tax paid with mobile and telephone bills	(500)	
Withholding tax deducted by customers	(11,500)	
		12,000
Balance Tax To Pay		414,656

126 UNIVERSAL SELF ASSESSMENT SCHEME

The salient features of the scheme are as under:

- The Tax department will not determine the tax liability of Businesses. The latter will now declare their taxable income and tax liability which will be accepted by the Tax department.
- Income Tax return shall be accepted without any conditions.
- Filing of income tax return itself will be an assessment order and eligibility for refund will be on the basis of the Income Tax return filed by the Business.
- A certain percentage of returns filed shall be selected for tax audit on the basis of risk assessment to verify the accuracy and correctness of your income tax return.

The Universal Self Assessment Scheme in its true sense is available to all Businesses irrespective of quantum, status, location or size. This is the first such experience in this part of the world. Implementation of this Scheme in the manner it is envisaged will take away the discretionary powers of the tax collectors and place great responsibility and obligation on Businesses to honestly declare their correct income and tax liability.

127 REFUNDS

A Business may be entitled to receive refund of Income Tax in any given year depending on the level of taxable profits, and depending on the magnitude of withholding and advance tax that has been paid by the Business in that same year.

In situations where withholding tax and advance tax exceed tax liability, Business will be entitled to receive a refund from the Tax department.

127.1 APPLICATION PROCEDURE

Where a Business has refund due to it, the Commissioner of Income Tax will examine the refund mentioned in the return and will determine and order the refund as he thinks fit. After this order, Business will file the Application claiming the refund.

Specimen of Application for Refund of Tax is attached as Appendix 16-04 to this Chapter.

127.2 TIME LIMIT

Time limit for the refund is within two years of determining the refund by the Commissioner or actually tax deducted or paid, whichever is later.

127.3 DELAY IN REFUND BY TAX DEPARTMENT

Businesses are entitled to receive interest at 12% per annum on the amount of refund which has been determined and claimed but is still not paid.

128 PENALTIES

Income Tax laws have set out stringent guidelines to ensure that correct amount of taxes is paid and that too on time. Where there are non-compliances with such regulations, the tax department is authorized to impose penalties. The type and amount of penalties are described below:

Default	Rate of Penalty
Failure to file any return of income	0.1% of tax payable per day minimum Rs. 500 and maximum 25% of tax payable
Failure to pay any tax (Other than a penalty)	
In the case of first default	5% of the amount of tax in default
In the case of second default additional penalty	20% of the amount of tax in default
In the case of third default additional penalty	25% of the amount of tax in default
In the case of fourth and subsequent default additional penalty	50% of the amount of tax in default Total penalty in default shall not exceed 100% of such amount
Concealment of income or furnishing of inaccurate particulars of income	Amount equal to tax sought to be evaded by concealment or furnishing of inaccurate particulars
Failure to maintain records	
In the case of first default	Rs. 2,000
In the case of second default	Rs. 5,000
In the case of third and subsequent default	Rs. 10,000
Non compliance of notice issued for filing of wealth statement or obtaining information or evidence	
In the case of first default	Rs. 2,000
In the case of second default	Rs. 5,000
In the case of third and subsequent default	Rs. 10,000
Making of false or misleading statement	
Statement or omission was made knowingly	200% of tax short fall
In other cases	25% of tax short fall
Failure to give notice of discontinuance of business	Not exceeding Rs. 10,000
Failure to give notice by liquidator of his appointment	Not exceeding Rs. 10,000
Penalty for obstruction	Not exceeding Rs. 10,000

129 SMALL COMPANY

The Federal Budget for 2007 has introduced the concept of a Small Company for tax purposes. It appears that this concept has been introduced to remove the burden on small Businesses which do not necessarily have the expertise to comply with Income Tax regulations.

A Small Company has been defined as a company that has been incorporated on or after 1st July 2007 under the Companies Ordinance, and:

- Has paid up capital plus undistributed reserves not exceeding twenty five million rupees (Rs 25 million).
- Has employees not exceeding two hundred and fifty (250) any time during the year.
- Has annual turnover not exceeding two hundred million rupees (Rs 200 million).
- Is not formed by splitting up or reconstitution of business already in existence.

Where a Company meets these conditions, it will have the benefit of reduced tax rate of 20% of taxable profit if its turnover does not exceed Rs. 250 million.

APPENDIX

APPENDIX 16-01 FORM IT-A

Form : IT-A

Application for the Issuance of National Tax Number (NTN)
(For Registered Firms and Companies)
(PLEASE USE CAPITAL LETTERS TO FILL IN)

Category (please tick one): ☐ Registered Firm ☐ Company

Name of Business:

Business Address:

Business Telephone Number: ____________ Business Fax: ____________

Principal Business Activity: ☐ Manufacturer ☐ Importer ☐ Exporter ☐ Distributor ☐ Wholesaler ☐ Retailer ☐ Services ☐ Others (Please Specify)

Nature of Business ____________

Company Type: ☐ Public Ltd. ☐ Private Ltd. ☐ Non-Resident Company ☐ Others ____________ *(If yes, please specify)*

Reg./Inc. No: ____________ Date of Reg./Inc.: ____________

Status: ☐ Resident ☐ Non-Resident Old NTN (if any) : ____________

PARTICULARS OF PARTNERS / DIRECTORS

1. Name: ____________
   NTN *(if any)*: ____________ *(Please attach attested copy of NIC)*
2. Name: ____________
   NTN *(if any)*: ____________ *(Please attach attested copy of NIC)*
3. Name: ____________
   NTN *(if any)*: ____________ *(Please attach attested copy of NIC)*
4. Name: ____________
   NTN *(if any)*: ____________ *(Please attach attested copy of NIC)*
5. Name: ____________
   NTN *(if any)*: ____________ *(Please attach attested copy of NIC)*
6. Name: ____________
   NTN *(if any)*: ____________ *(Please attach attested copy of NIC)*

I, the undersigned solemnly declare that to the best of my knowledge and belief the information given above is correct and complete.

Date: ____________ ____________ Office Seal ____________ Name & Signature of the applicant / Authorised person

Note:- Please ensure that all relevant and necessary information is filled in correctly. Photocopies of NICs and business registration documents duly attested by a class-I gazetted officer or an officer of the bank should be attached. Photocopies of NICs (or passport in case of foreign national) of all partners/members should also be attached. In case any director/partner does not possess NTN, their applications should also be accompanied/attached. Incomplete applications shall not be processed resulting in delay in issuance of NTN certificate.

Send to:

Islamabad : INCHARGE NTN Cell, CDA Block II Old CBR Building, Melody, G-6, Islamabad.

Lahore : INCHARGE NTN Cell,TFC, Ground Floor, Income Tax Building, Nabha Road, Lahore.

Karachi : INCHARGE NTN Cell, TFC, Ground Floor, Income Tax Building, Shahrah-e-Kamal Ataturk, Karachi.

APPENDIX 16-02 FORM IT-B

Application for the Issuance of National Tax Number (NTN)

(For Individuals, AOPs, HUFs, URFs)

(PLEASE USE CAPITAL LETTERS TO FILL IN)

Category (Please Tick one): ☐ Salaried Individual ☐ Business Individual ☐ Others - Individual ☐ AOP ☐ HUF ☐ URF

Name of Applicant:

Residential Address:

Name of Business:

Business Address:

Phone: (Res) ________ Business Telephone ________ Business Fax: ________

Principal Business Activity: ☐ Manufacturer ☐ Importer ☐ Exporter ☐ Distributor ☐ Wholesaler ☐ Retailer ☐ Services ☐ Others ☐ (Please Specify)

Nature of Business ________

Old N.I.C. No. ☐☐☐ - ☐☐☐ - ☐☐☐☐☐☐ (Please attach attested copy of national identify card)

New N.I.C No: (Please attach attested copy of national identify card)

Old NTN (if any): ☐☐ - ☐☐☐ - ☐☐☐☐☐☐

Nationality: ☐ Pakistani ☐ Non-Pakistani

Status: ☐ Resident ☐ Non-Resident

Passport Number ________ Country of Origin ________ *(For foreign nationals only, attach photocopy)*

NTN of Employer:

Name of Employer:

Address of Employer:

PARTICULARS OF PARTNERS / DIRECTORS / MEMBERS

1. Name: ________
   NTN *(if any)*: ☐☐☐☐☐☐☐☐☐☐☐☐☐ ☐☐☐☐ - ☐☐☐ - ☐☐☐☐☐☐
   (Please attach attested copy of NIC)
2. Name: ________
   NTN *(if any)*: ☐☐☐☐☐☐☐☐☐☐☐☐☐ ☐☐☐☐ - ☐☐☐ - ☐☐☐☐☐☐
   (Please attach attested copy of NIC)
3. Name: ________
   NTN *(if any)*: ☐☐☐☐☐☐☐☐☐☐☐☐☐ ☐☐☐☐ - ☐☐☐ - ☐☐☐☐☐☐
   (Please attach attested copy of NIC)
4. Name: ________
   NTN *(if any)*: ☐☐☐☐☐☐☐☐☐☐☐☐☐ ☐☐☐☐ - ☐☐☐ - ☐☐☐☐☐☐
   (Please attach attested copy of NIC)
5. Name: ________
   NTN *(if any)*: ☐☐☐☐☐☐☐☐☐☐☐☐☐ ☐☐☐☐ - ☐☐☐ - ☐☐☐☐☐☐
   (Please attach attested copy of NIC)
6. Name: ________
   NTN *(if any)*: ☐☐☐☐☐☐☐☐☐☐☐☐☐ ☐☐☐☐ - ☐☐☐ - ☐☐☐☐☐☐

I, the undersigned solemnly declare that to the best of my knowledge and belief the information given above is correct and complete.

Date: ________

____
Name & Signature of the applicant / Authorised person

Note:- Please ensure that all relevant and necessary information is filled in correctly. Photocopy of NIC duly attested by a class-I gazetted officer or an officer of the bank should be attached. In case of AOP, HUF, URF, Photocopies of NICs of all partners/members should also be attached. In case any member/partner of an AOP, HUF, URF does not possess NTN, their applications should also be accompanied/attached. Incomplete applications shall not be processed resulting in delay in issuance of NTN certificate.

APPENDIX 16-03 TAX PAYMENT CHALLAN

CBR PAKISTAN — Central Board of Revenue, Revenue Division, Government of Pakistan

INCOME TAX DEPARTMENT
TAX PAYMENT RECEIPT

IT-31 (Rev-II)
ORIGINAL for Department

Notes 1) Tax payments should be rounded to Rupees 2) Payment Sections and codes are printed overleaf

Name of LTU/ MTU/ RTO ______ **LTU/MTU/RTO Code** ☐☐ **Tax Year** ______

Nature of Tax Payment ☐ Current Demand ☐ Arrear Demand ☐ With Return **Salary Month** ☐☐
☐ Deduction at Source ☐ Advance Payment ☐ Misc./ Others *(only for payment u/s 149)*

Payment Section ______ (Section) ______ (Description of Payment Section) **Payment Section Code** ☐☐
Account Head (NAM) ______

Taxpayer's Particulars (To be filled for payments other than Withholding Taxes) *(To be filled in by the bank)*

NTN ______ CNIC / Reg./ Inc. No. ______
Taxpayer's Name ______ Status (*) ______
Business Name ______
Address ______

FOR WITHHOLDING TAXES ONLY

NTN/ FTN of Withholding agent ______ CNIC/ Reg./ Inc. No. (where applicable) ______
Name of withholding agent ______

Details of taxpayers provided in electronic form : ☐ Yes ☐ No
(Enter maximum of 10-taxpayers in one challan, no limit if provided electronically)

Sr.	NTN/ CNIC	Status (*)	Taxpayer's/Business Name & Address	Amount against which tax is being Withheld	Tax Amount
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
9.					
10					
			TOTAL		

Amount of tax in words : ______ Rs. ______

Mode of payment ☐ Cash ☐ *Refund Adjustment (by Department only)*
☐ Cheque/ Pay Order/ etc. No. ______ Date : ______
Bank ______ Branch ______ **Signature of Depositor**

	Treasury Challan No. & Date	Bank Stamp & Branch Code
For use of Computer Section of Dept.	*To be endorsed by the Treasury Officer of Authorized Bank*	

(*) Status **PUB** => Public Company, **PVT** => Pvt. Ltd. Company, **SCOY** = > Small Company, **AOP** => AOP, **IND** => Individual

APPENDIX 16-04 APPLICATION FOR REFUND OF TAX

APPLICATION FOR REFUND OF TAX
Tax Year

The Taxation Officer of Income Tax
Lahore.

I, -------------------------------, on behalf of --------------------------------of ---------------
hereby declares:

(a) That total income of the ---------------------------------- computed in accordance with the provisions of the Income Tax Ordinance, 2001, for the year ending on the 30th June------ is Rs. ---------------.
(b) That the total tax chargeable in respect of such total income is Rs.---------------.

(c) That the total amount of tax paid / deducted is Rs. -----------------be allowed to our company.

I, therefore, request that a refund of Rs. ---------------------may be allowed to our company.

SIGNATURE:
____

NAME:

NTN: | | |-| | |-| | | | | | | |-| |

ADDRESS:

I, hereby declare that I am non-resident and that what is stated in this application is correct.

SIGNATURE: __________________________

Date: NAME:

Notes:

1. The application should be accompanied by a return of total income in the prescribed form unless it has already been filed.
2. The application for refund should be made to the Income Tax Officer for the Circle in which the applicant is assessable otherwise to the Income Tax Officer for the circle in which the applicant resides.
3. Where the application is made in respect of interest on securities, the application should be accompanied by the certificate prescribed under section 51.
4. A non-resident person should make his application for refund to the Income Tax Officer, Exemption refunds Circle If his total income is made up of income wholly taxed at source or from Dividends or both and, in other cases, to the Income Tax Officer of the circle in which the greater part of his income arises. If the non-resident tax payer is assessed through a statutory agent, the application for refund should be made to the Income Tax Officer who has jurisdiction over the statutory agent.