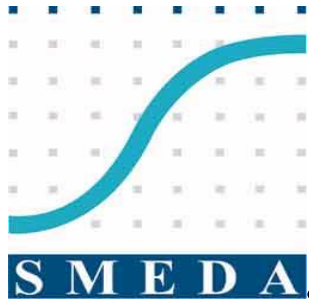


Procedure for Income Tax (For an AOP)



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Government of Pakistan**

Revised on June 9, 2006

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INTRODUCTION OF SMEDA

The Small and Medium Enterprise Development Authority (SMEDA) was established with the objective to provide fresh impetus to the economy through the launch of an aggressive SME development strategy.

Since its inception in October 1998, SMEDA had adopted a sectoral SME development approach. A few priority sectors were selected on the criterion of SME presence. In depth research was conducted and comprehensive development plans were formulated after identification of impediments and retardants. The all-encompassing sectoral development strategy involved overhauling of the regulatory environment by taking into consideration other important aspects including finance, marketing, technology and human resource development.

SMEDA has so far successfully formulated strategies for sectors, including fruits and vegetables, marble and granite, gems and jewellery, marine fisheries, leather and footwear, textiles, surgical instruments, transport and dairy. Whereas the task of SME development at a broader scale still requires more coverage and enhanced reach in terms of SMEDA's areas of operation.

Along with the sectoral focus a broad spectrum of services are now being offered to the SMEs by SMEDA, which are driven by factors like enhanced interaction amongst the stakeholders, need based sectoral research, over the counter support systems, exclusive business development facilities, training and development for SMEs and information dissemination through wide range of publications.

2-ROLE OF LEGAL SERVICES CELL

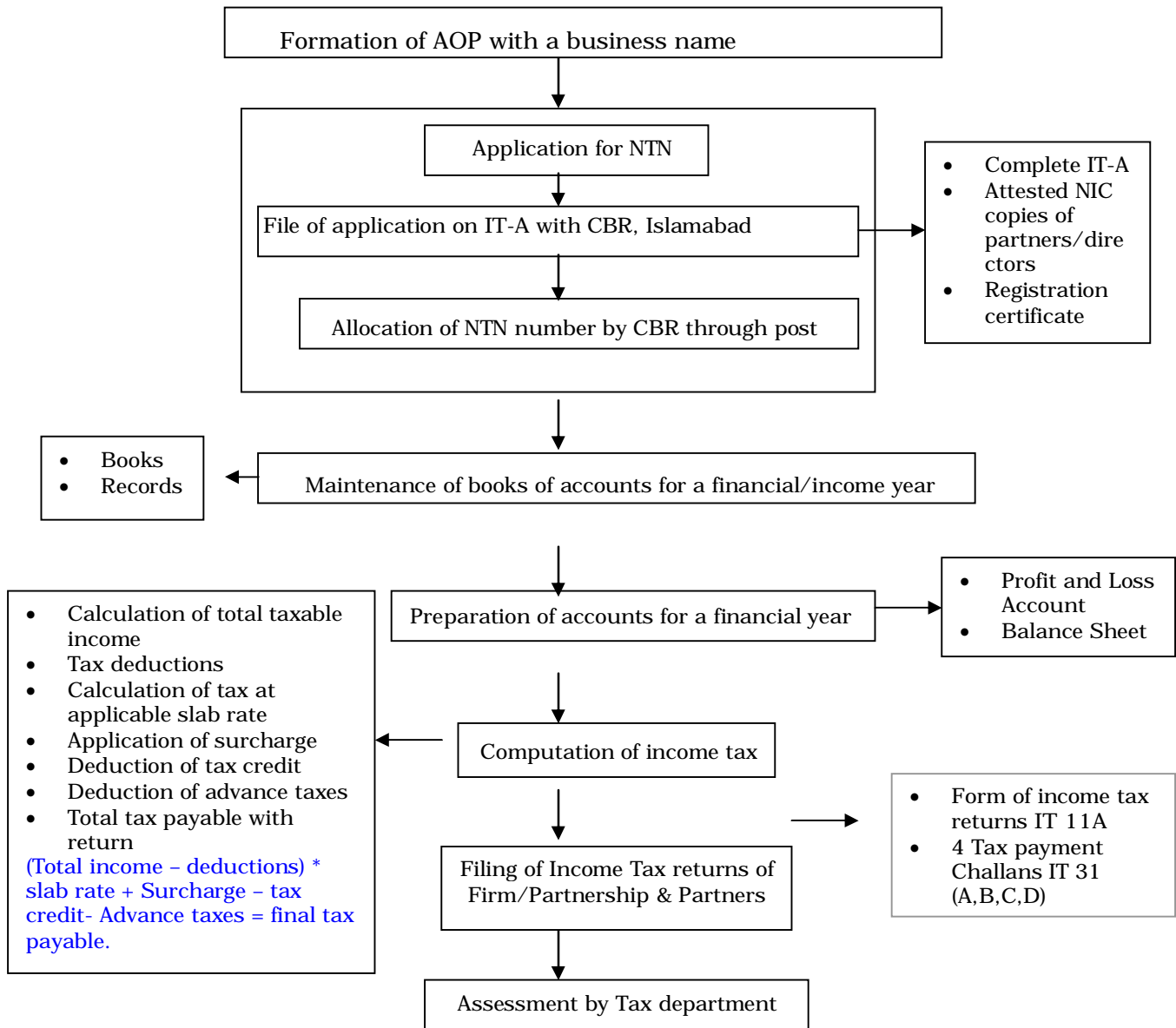
The Legal Services Cell [LSC] is a part of Business Development Division of SMEDA and plays a key role in providing an overall facilitation and support to SMEs. The LSC provides guidance based on field realities pertaining to SMEs in Pakistan and other parts of the world.

LSC believes that information dissemination among the SMEs on the existing regulatory environment is of paramount importance and it can play a pivotal role in their sustainable development.

In order to facilitate SMEs at the Micro Level LSC has developed user-friendly systems, which provide them detail description of the Laws, and Regulations including the process and steps required for compliance.

The purpose of this document is to provide SMEs with information pertaining to computation of Income and other requirements by AOPs under the Income Tax Ordinance, 2001. Companies / individuals interested in enhancing their understanding about the procedures can also use the document and documentation required to comply with registration procedure. For convenience of the readers a process flow chart and sample of various forms are also included.

FLOW CHART¹



¹ The definitions of the terms are given on the next page

DEFINITIONS

- **ASSESSEE:** Every firm/partnership or association of persons which is liable to pay income tax or liable to file returns of total income under the Income Tax Ordinance, 1979.
- **FIRM:** Means the relation between persons who have agreed to share profits of a business carried on by all or any of them acting for all.
- **NIC:** National Identity Card.
- **NTN:** National Tax Number
- **AOP:** Association of persons includes a firm, a Hindu undivided family, any artificial juridical person and any body of persons formed under a foreign law, but does not include a company and a professional firm prohibited from incorporating by any law or the rules of the body regulating the profession.
- **HUF:** Hindu undivided family
- **FINANCIAL YEAR:** From June to July next year. Filing of returns due on September 30.

Association of Persons (AOP)

Under the Income Tax Ordinance 2001, specific principles of taxation for calculating the income of an AOP have been provided. As per the definition given in the Ordinance, following are included in the definition of an AOP:

- A firm, whether registered or not
- A Hindu Undivided Family, and
- Any body of persons formed under a foreign law

An AOP gets the benefit of lower rates of income tax than companies. Their income is charged to tax according to the same ration according to which income tax is charged on the income of individuals. There is no requirement in law for registration of an AOP.

Principles of Taxation of AOP

Under the Income tax Ordinance, an AOP is liable to be taxed separately from its members and where the association has paid the tax, the amount received by the member of the association in the capacity as a member out of the income of the association shall be exempt from tax.

NATIONAL TAX NUMBER (NTN)

Every AOP is assigned a national tax number. The reason for having a NTN by the AOP is that it cannot file for returns if it does not have the NTN. And so AOPs who do not have the NTN have to file an application for it. This application form can be obtained from Income tax offices and can also be obtained online from <http://www.cbr.gov.pk/NewNTN/ntndownload.htm> .

The documentation required to obtain the NTN for Firms and association of persons are:

- Complete application form for the issuance of NTN.
- Photo copies of NICs or passports in case of foreigners, of all the partners / Associates.
- Incorporation or the registration certificate, if any.
- Application for NTN by individual partners / associates in case they do not have NTN.

Class-1 gazetted officer or an officer of the state owned bank should attest all documents.

MAINTAINANCE OF BOOK OF ACCOUNTS

It is most important for an AOP to maintain its books of accounts and accounting records as mentioned. For this purpose, the following accounting records must be kept:

Books

- Vouchers (Receipt and payment vouchers, journal vouchers)
- General Ledger (Individual accounts)
- Cash Book
- Bank Book
- Computerised accounting software (if applicable)

Records

- Records of sales (Sales invoices)
- Records of purchases (Purchase orders & bills of vendors)
- Records of stocks/ inventory (in case of manufacturing concern, production records)
- Records of utility bills
- Supporting documents for expenses (Cash memos of expenses etc)

The preparation, maintenance and possession of these accounts are important for an AOP to calculate its annual profit/income. The tax authorities assess the total income of an AOP on the basis of particulars given in the tax return. The particulars furnished in the tax return are taken from the books of accounts. In case there is any difference in the tax returns and the books of accounts, the firm will have to face penalties or the income tax authorities may take ex-parte decision/ assessment, which might prove more costly to the AOP.

There are certain kind of penalties which can be imposed on AOP upon non-compliance of the income tax regulations, which are defined from section 182 to section 189 of the Ordinance.

PREPARATION OF ACCOUNTS

The AOP is required to prepare accounts once at the end of every financial year in order to arrive at the profit/income, which it has earned. This profit/income is required for computing the income tax liability/ refund, which will be mentioned in the annual income tax returns. Following set of accounts are required to be prepared by the firm/partnership:

- Profit and Loss Account
- Balance Sheet

There may be difference between the tax calculated by an AOP and the tax calculated by the tax department. This difference may be due to change in depreciation² rates, lease rentals or any other differences as stated in the 1ST schedule of Income Tax Ordinance.

COMPUTATION OF INCOME TAX

Subject to the provisions of the Ordinance, computation of income of an AOP shall be in accordance with the method of accounting regularly employed by it either on accrual or cash basis.

Computation of Total Taxable Income:

In order to compute the income of an AOP for the year in which it is assessable, following steps will be taken under the following sections of the income tax ordinance 1979:

1. Section 18 (S18): Calculation of income from business or profession (subject to deductions, which are allowable under section 20, 22, 23, 24, 25, 26, 27, 2829³). This income is derived from Profit & Loss Account of the AOP.
2. Section 39 (S39): Income from other sources such as dividends; interest, royalties and fee for technical services; ground rent; income from renting out machinery, plant or furniture belonging to the assessee, etc.). Deductions such as: Zakat paid, depreciation of plant, machinery of building used to derive income, initial allowance for plant or machinery under sec. 23, any expenditure paid to derive income section 40 shall be allowed while computing the income under this head.

² Depreciation: It is a measure of the wearing out, consumption or other losses in the value of the "Fixed Asset" arising from its usage, passage of the time or obsolescence.

³ Deductions Allowed under Income from business: The deductions that could be made under this head are: expenditure in earning income, depreciation on depreciable assets i. machinery, plant etc., initial allowance, intangibles, pre-commencement expenditure, scientific research expenditure, employee training facilities, profit on debt etc.

3. Section 37 (S37) (if applicable): Capital Gain arising on the disposal of capital assets. etc. Deductions are available under section 38.
4. Sections 15 (S15) (if applicable): Income from house property (subject to deductions, which are allowable under section 17⁴). Any rent received or receivable by an AOP in a tax year other than exempted rent shall be chargeable to tax.

In order to calculate the total taxable income, all the above mentioned sections will be summed up as below:

$$S18 + S 39 + (37 + S 15) \text{ If Applicable} = \text{Total taxable Income}$$

TAXES ON EXPORTERS

The tax on exporters is levied according to First Schedule Part III Division IV under section 154 of Income Tax Ordinance, 2001.

According to Section 154, an authorised foreign exchange dealer, banking company, an Export Processing Zone Authority, a direct exporter and an export house shall deduct tax at the rate specified in Division IV of Part III of First Schedule at the time of making payment to the exporter or commission agent or to the individual as the case may be. The tax deducted is taken as final tax payment. Following is a schedule outlining tax rates on exports and various industrial sectors.

Schedule 7	Percentage of Tax	Description of Industrial Sectors
Part -I	0.75% of the proceeds of exports	Engineering goods including electrical goods, jewelry, pharmaceuticals, wooden furniture, doors and windows, cutlery, ceramic tiles and wares, horticulture products, durries, vegetables fresh fruits, cut flowers and processed poultry meet etc.
Part -II	1% of the proceeds of exports	Export of goods manufactured in Pakistan, Leather and textile made ups specified under heading no. 90.18 of the first schedule to the Customs Act, sports goods, toilet linen including terry towels, other articles of leather under PCT heading 42.05 and hand knitted carpets and rugs under PCT heading 57.01, Men and boys and women overcoat, jackets knitted or crocheted under headings 61.01, and 61.02 respectively, Men and boys suits, jackets, trousers, shirts, knitted or crocheted under heading 61.03, Men and boys shirts knitted or crocheted under heading 61.05, Women and girls blouses, shirts knitted or crocheted under heading 61.06, T-

⁴ Deduction Permissible under Section 17: The deductions permissible under section 20 are; repairs, Insurance premium, any local rate, charges or cess, ground rent, interest on borrowed capital, e.t.c. for the property purposes.

		shirts knitted or crocheted under heading 61.09, Tracksuits, swimwear knitted or crocheted under heading 61.12, Blankets, wool, cotton and MMF under headings 63.01, 2000, 3000, 4000, Bed lined, table linen and kitchen linen under heading 63.02, Refined / treated salt, Ground batteries, Granite blocks and slabs, heat insulating bricks magnesite refractory etc.
Part -III	1.25% of the proceeds of export	All goods not covered under part I, II, AND IV of this schedule, and goods manufactured in Pakistan namely, Rice, Rice bran, wheat bran, Lamb skin, goods not covered by other provisions of this schedule namely: leather and leather articles, textile and textile articles, carpets, surgical goods etc. and such other goods as may be notified by the Central Board of Revenue.
Part -IV	1.50% of the proceeds of export	Raw cotton, cotton yarn and such other goods as may be notified by the Central Board of Revenue.

Deductions from total taxable income:

After calculating the total income, various deductions have to be made in order to arrive at the total taxable income. The detail of which along with examples is given below:

- Section 20 (S20) : Includes deductions such as expenditure in earning income.
- Section 22 (S22) : Includes deductions such as depreciation on depreciable assets e.t.c.
- Section 23 (S23) : Includes deductions such as initial allowance on plant and machinery e.t.c
- Section 24 (S24) : Includes deductions such as amortization on intangibles e.t.c.
- Section 25 (S25): Pre-commencement expenditure.⁵
- Section 27 (S26): expenditure on scientific research.⁶
- Section 28 (S28): expenditure on employees training facilities
- Section 29 (S29): profit on debt
- Exemptions from total income under Schedule II

⁵ Business Losses: The business losses can arise due to loss in the interest on securities, income from house property, income from non-speculative business, income from other sources and income from speculative business.

⁶ Capital Loss: Any loss arising out of the transfer of a capital asset is termed as capital loss.

After deducting the above-mentioned deductions, an AOP will arrive at the total taxable income. Tax liability will be calculated on the basis of the following slabs:

Slab applicable to AOP:

Total Income	Rates of Income Tax
Up to Rs. 100,000	Nil
Exceeding Rs. 100,000 but not exceeding Rs. 150,000	7.5% of the amount exceeding Rs. 100,000
Rs. 150,001 to Rs. 300,000	Rs. 3,750 + 12.5% of the amount exceeding Rs. 150,000
Rs. 300,001 to Rs. 400,000	Rs. 22,500 + 20% of the amount exceeding Rs. 300,000
Rs. 400,001 to Rs. 700,000	Rs. 42,500 + 25% of the amount exceeding Rs. 400,000
Where the total income exceeds RS. 700,000	Rs. 117,500 + 35% of the amount exceeding Rs. 700,000

Deductions of various Advance Taxes from Tax Liability:

After computing the total taxable income of the business concern, the various advance taxes, which were paid in advance to the government, during the year, will be deducted from the income tax liability.

Examples of more frequently deductible advance taxes as per various sections of the income tax ordinance are given below:

- Section 147

Includes advance tax to be paid by the taxpayer deriving income other than “Capital Gains”, “Income from Property”, dividends etc on quarterly basis.

- Section 148

It is advance tax collected by the Custom Collectorate @ 6% on imports.

- Section 150

It is advance tax paid on dividends at the rates stated above.

- Section 151

This is the tax deducted on saving certificates or on debt at the rates stated above.

- Section 153

Includes tax on sale of goods and rendering of services at the rates mentioned above.

- Section 233 (If Applicable)

Includes advance tax deducted on brokerage or commission as per rates given above.

- Section 235

Tax collected on commercial or industrial electricity bills.

- Section 236

Advance tax deducted on telephone bills.

- $S147 + S148 + S151 + S153 + S235 + S236 + S233$ (If Applicable)= Advance Taxes

Formula for calculation of final tax liability

After completing the above mentioned procedures, the total income tax liability of an AOP can be summarized as follows:

Step 1:

$$\text{Total Taxable Income} = S18 + S39 + (37 + S15) \text{ If Applicable}$$

Step 2:

Deductions = $S20 + S23 + S23 + S24 + S25 + S26 + S27 + 28 + 29$ + exemptions in 2nd schedule)

So the total taxable income can be calculated from the following formula:

$$\text{Total Taxable Income} = S18 + S39 + (37 + S15) \text{ If Applicable} - S20 + S23 + S23 + S24 + S25 + S26 + S27 + 28 + 29 + \text{exemptions}$$

Step 3: Tax liability shall be calculated on the rates given above.

Step 4:

- Addition of surcharge
- Deduction of available Tax credits, If any.

Step 5:

- Adjustment of Tax deducted in advance as stated above.

After completing the first three steps, deduct amounts mentioned in step five

Step 6:

After completing the above mentioned steps, the AOP will arrive at its final tax liability.

So the final formula for calculation of income tax liability is:

Total Tax Liability = S18 + S39 + (S15 + S37) If Applicable – deductions as noted above- tax credit, if available – advance tax paid.

After the above-mentioned procedure the AOP will arrive at the income tax liability/ refund.

In case of liability, the amount of tax liability has to be deposited in the government treasury through State Bank of Pakistan or designated branches of National Bank of Pakistan on Tax payment Challan IT 31 (A,B,C,D) of which 4 copies are to be prepared. The distribution of the copies is as under:

- Two copies of the tax payment challan be kept by the respective bank.
- One copy to be attached with the Annual Income Tax return IT-11 A.
- The firm, for its official use will retain the fourth copy.

In case of refund, a firm can contact the Income Tax department to get the refund of tax.⁷

FILING OF ANNUAL INCOME TAX RETURN

After preparation and completion of annual income-tax return, it will be deposited along with a copy of tax payment challan, with the respective income tax department (income tax return form can be downloaded at www.cbr.gov.pk):

- In the case of an AOP with a tax year ending any time between the first day of January and the thirtieth day of June, on or before the thirty first day of December next following the end of the tax year to which the return relates; or
- In any other case on or before of Sept 30th of the respective year.

A detail of income tax offices in major cities is given in Annexure I. Acknowledgement on prescribed form will be taken from the income tax authority at the time of deposit of the said documents. A return of income tax can now be filed electronically on www.cbr.gov.pk .

Under section 165, an AOP has to provide the Income Tax authorities, a statement regarding payment of salary to its employees and tax deducted on there salaries, on a quarterly or six monthly basis.

To file the income tax returns, a taxpayer needs to furnish the following documents to the income tax authorities:

1. Form of return of total income under Income Tax Ordinance, 2001
2. Tax payment challans (IT 31 A, B, C, D).
3. Statement U/S 115(4) - Statement of receipts / incomes subject to final taxation
4. Copies of:
 - a) Audited financial statements (income statement and balance sheet) alongwith auditors' and directors' reports thereon.

- b) Charts of depreciation/amortization as admissible under the Income Tax Ordinance, 2001
- 5. Evidence of payment of Tax deducted/collected at source, Advance tax paid U/S 147, Expenditure on personal medical service, Zakat, Tax paid with return U/S 137
- 6. Photocopies of tax payment challans in case of adjustment of advanced taxes deducted under the Ordinance.

Please refer to Section 169 of Income Tax Ordinance, 2001 for details of cases that do not require furnishing return of income.

15. ASSESSMENT

After completing the above-mentioned procedure, the taxpayer will submit the return to income tax department and the return filed to the Income Tax Commissioner shall be considered as an assessment order by the Commissioner the day the return is filed.

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However, according to section 122 the Commissioner may amend the assessment order within period of five years by making alterations or additions to the return as he conceives necessary.

ANNEXURE I

ADDRESSES OF INCOME TAX OFFICES IN MAJOR CITIES

Income Tax Offices in Lahore:
Address: Income Tax Building,
Syed Mauj Darya Road, Lahore.
Fax number: 042-9211857

Income Tax Office, Gujranwala
Address: Income Tax Department,
GT Road, Gujranwala
Fax Number: 0431- 291401

Income Tax Offices in Karachi:
Address: Income Tax Office,
Sharah-e- Kamal Attaturk, Karachi.
Fax number: 021-2628624

Income Tax Office, Sialkot
Address: Income Tax Department,
Katchehry Road, Sialkot
Fax Number: 0432-267296

Income Tax Office, Northern Region
Islamabad
Address: House no.110-H,
Lukman Hakeem Road,
Sector G-6/3, Islamabad.
Fax Number: 051-9204904

Income Tax Office, Peshawar
Address: Income Tax Department,
Jamrud Road, Peshawar
Fax Number: 091-9216140

Income Tax Office, Islamabad
Address: Buland Markaz, Blue area
Islamabad
Fax Number: 051 -9203670

Income Tax Office, Multan
Address: Income Tax Department,
57-B, Sher Shah Road, Multan
Fax Number: 061-585219

Income Tax Office, Rawalpindi
Address: 12 Mayo Road
Fax Number: 051-9270422

Income Tax Office, Faisalabad
Address: Income Tax Department,
Opposite Allied Hospital, Sargodha
Road
Fax Number: 041- 761433