

## TAX INSIGHTS - # 02 - APRIL, 2023

Welcome to our latest newsletter, packed with insightful updates and important information on Income Tax and Sales Tax in Pakistan. In this edition, we bring you the latest developments and changes in fiscal laws and regulations that will impact businesses and individuals. From the judgment of the Lahore High Court on section 7E to updates on Sales Tax, we aim to keep you well-informed and up-to-date. Additionally, we provide comprehensive summaries of key notifications and rules issued by tax authorities, such as the Federal Board of Revenue, Sindh Revenue Board, Balochistan Revenue Authority, and Khyber Pakhtunkhwa Revenue Authority. Stay ahead of the curve with our newsletter to ensure compliance with the ever-evolving tax landscape in Pakistan.



### INCOME TAX

#### 1. JUDGEMENT OF THE LAHORE HIGH COURT IN W.P NO. 52559 OF 2022 ON SECTION 7E (DEEMED INCOME).

##### **BRIEF FACTS OF THE CASE:**

Section 7E was inserted in the Income Tax Ordinance, 2001 ("ITO") through Finance Act, 2022. According to this section, resident persons shall be treated to have derived income chargeable to tax at the rate of 5% of fair value of certain capital assets situated in Pakistan held on the last day of tax year. The rate of tax on deemed income under section 7E is 20% which is applicable for tax year 2022 and onwards.

The provisions of section 7E were challenged in writ petitions before the High Courts. The Lahore High Court has disposed of various petitions through its judgment dated 06' April' 2023. This judgment examines

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Federal Legislator's competence to levy income tax on immoveable property through fiction of law by using phrase "A person shall be treated to have derived, as income chargeable to tax", on capital assets owned by resident person.

### **ARGUMENTS MADE BY THE PETITIONERS**

The following grounds were taken and argued by the petitioners:

1. The Section 7E of the ITO is *ultra vires* the Federal Legislator's field of competence as listed under Entry 47 and 50 of the Fourth Schedule to the Constitution of Islamic Republic of Pakistan 1973 (the "Constitution").
2. After the 18<sup>th</sup> Constitutional Amendment, taxation of immoveable property has been excluded from Entry 50, and therefore, taxation of income as envisaged in Entry 47 cannot be deemed for immoveable property.
3. The Federal Legislator cannot target immovable property alone, while taxing capital value of assets under the Constitution, which allows taxation on the value of assets of every description.
4. Only a receipt or a benefit received can be deemed as income for the purpose of taxation under the Entry 47. Moreover, it was further argued that a legal fiction of deeming income has been employed to overcome the impediment in the Constitution, which is not permissible.
5. The fair market value is determined under Section 68 based on DC rates, meant for one time levy at the time of a transaction of immovable property. Fair market value is the expected saleable price at a relevant point of time, which being uncertain is speculative gain (not actually received), therefore, cannot be a yardstick to deem it as income and tax.
6. The capital gain on immoveable property cannot be taxed by the Federal Legislature under Entry 50, after the 18<sup>th</sup> constitutional amendment.

### **ARGUMENTS MADE BY THE RESPONDENTS**

The Counsel for the Respondents made the following arguments:

1. The provisions of Section 7E derives legislative competence from the Entry 47, wherein the word "income" used in the Entry is to be given widest possible meaning.
2. The legislature having competence to tax can impose it in any legislative instrument, be it Finance Act or the Ordinance of 2001 and that income includes deeming income as is defined under Section 2(29) of the Ordinance of 2001.
3. It was also argued that the definition of income under Section 2(29) of the ITO includes deeming income. Placing reliance on the Elahi Cotton Mills judgment, it was argued that anything can be deemed as income by invoking the fiction of law.
4. The object of taxing immovable property is to discourage accumulation of wealth, for encouraging investment in industry and other productive economic activities.
5. The incidence of tax, under the impugned Section 7E, is the value of immovable property, even if we ignore the deeming phrase used in Section 7E of the Ordinance of 2001. The impugned provisions can be read down to harmonize it with the competence available under Entry 50, which allows taxation on Capital Value of Assets and the term assets includes immovable property.

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## DECISION SUMMERY

The Court considered the arguments raised by the counsels from both sides and after much-sought deliberation, the petitions were allowed by holding that:

- (i) To treat the market value of immovable property as income under Entry 47 is beyond the competence of Federal Legislator, hence is declared *ultra vires*.
- (ii) The provisions of Section 7E are read down to save the taxation on Capital Value of Assets, which is within competence of Federal Legislature under Entry 50.
- (iii) The Entry 50 for taxing Capital Value of Assets requires that the assets should be valued as a whole and taxed inseparably. Curative legislation is expected to bring the provisions, of Section 7E, within the spirit of taxing Capital Value of Assets, and to harmonies it with other provisions of the Ordinance of 2001.
- (iv) Exclusion of persons under clauses (i), (iii) and (iv) of Section 7E(2)(d), is discriminatory, offending the Article 25 of the Constitution, therefore, are declared *ultra vires*. However, the legislature is expected to remove the pointed out expropriatory and confiscatory aspects in the provisions of Section 7E.

## SALES TAX

### 2. Tier-1 Retailers - Integration with FBR's POS System

The FBR has issued Sales Tax General Order No. 10 of 2023 on 10' April' 2023. The order required certain Tier-1 retailers specified in the Order to integrate with the FBR. Failure to comply with the Order will result in disallowance of input tax claim.

### 3. Revised Minimum Value of Supply for Locally Produced Steel Goods

On 20' April' 2023, FBR issued a notification through S.R.O 501(1)/2023, which re-fixed the minimum value of supply for locally produced steel goods. This revision was made for the purpose of calculating sales tax on ad valorem basis at the rate of 18%. The rates are tabulate as under;

Sr. No.	Goods	Value (Rs.)
1.	Steel bars and other long profiles	225,000
2.	Steel Billets	195,000
3.	Steel Ingots/bala	180,000
4.	Ship plates	172,000
5.	Other re-rollable iron & steel scrap	160,880
6.	Re-meltable iron & steel scrap (72.04)	155,000

If the value of supply of aforementioned products exceeds the fixed value, sales tax will be charged based on the higher value.

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### The ISLAMABAD CAPITAL TERRITORY SALES TAX ON SERVICES

#### 4. The Islamabad Capital Territory (Place of Provision of Services) Rules, 2023

The FBR has notified the Islamabad Capital Territory (Place of Provision of Services Rules), 2023 through S.R.O. No.494(I)/2023 dated 14' April' 2023. These rules establish principles for determining place of provision of certain services for the purpose of sales tax chargeable under the Islamabad Capital Territory (Tax on Services) Ordinance, 2001. The rules apply to services of advertisement, advertising agents, insurance and reinsurance, insurance agents and insurance brokers, franchise services, electric power transmission services, intellectual property and services relating to transportation or carriage of goods by road or through pipeline or conduit. Moreover, rules also provide for apportionment of input tax claim in case the place of provision of a service transaction is determined to be in more than one province.

These rules shall be effective from 01' July' 2023 in case of electric power transmission services. For other specified services, the rules are effective from 01' May' 2023.

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### SINDH SALES TAX ON SERVICES

#### 5. Sindh Place of Provision of Services, Rules, 2023

The SRB has notified the Sindh Place of Provision of Services Rules, 2023 through notification No. SRB-3-4/21/2023, on 12' April' 2023, for determination of place of provision of services for the purpose of sales tax chargeable under the Sindh Sales Tax on Services Act, 2013 in respect of certain services. The services include Advertising, Advertising Agents, Insurance and Reinsurance, Insurance Agents and Insurance Brokers, Franchise Services and Intellectual Property Services, Transportation or Carriage of Goods. The rule also provides for apportionment of input tax claim if a service is determined to have been provided in more than one province.

These rules will be applicable throughout the province of Sindh and will take effect from 01' May' 2023.

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#### 6. Limitations on Reporting of Debit/Credit Notes in Monthly Sales Tax Return on SRB Web Portal

On 06' April' 2023, the SRB issued Notification No. SRB/Sr. Member/Ops/KTBA/Portal/2023/90407, allowing taxpayers who encounter difficulties in filing debit/credit notes in their sales tax return with the SRB to enter them in the following month's return. This is due to the system correction taking some time.

#### 7. Change in Prescribed Fee for Attested Duplicate copy of Documents

The Sindh Revenue Board has revised the fee for attested duplicate copy of certain documents. In this regard, a notification SRB-3-4/24/2023 dated 27' April' 2023 amending its previous notification No. 3-4/5/2013 dated 17' June' 2013 has been issued. The copying fee has been revised to Rs. 1,000 per document or Rs. 250 per page, whichever is higher. The documents in question include notices, orders, show cause notices, assessment orders, orders-in-original, orders-in-appeal, and orders-in-revision related to registered individuals.

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### BALUCHISTAN SALES TAX ON SERVICES

#### 8. Sales Tax Exemption for Toll Manufacturing Services in Balochistan

The Balochistan Revenue Authority has exempted Toll Manufacturing services (Tariff Heading 9816.0000) from whole of sales tax payable under Balochistan Sales Tax on Services Act, 2015 with immediate effect. In this regard, a Notification No. BRA/HQ/22-23/29 has been issued on 14' April' 2023.

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### KHYBER PAKHTUNKHWA SALES TAX ON SERVICES

#### 9. Clarification on Exemption from Sales Tax on Services in Erstwhile FATA and PATA

The Khyber Pakhtunkhwa Revenue Authority (KPRA) has issued its circular No: KPRA/Dir/Rev-2023/2937-41 on 07' April' 2023, to clarify the exemption from sales tax on services available to erstwhile Federally or Provincially Administered Tribal Areas (FATA and PATA).

According to the circular, sales tax exemption is available, as per already laid down criteria, to service providers who are bona fide residents of these areas, having service providing businesses located in these areas, and provide services for consumption exclusively within these areas. The circular explains that services consumed within the territory means that the services originate and terminate within these areas. Circular also states that all previous clarification letters regarding tax exemptions will be suspended/cancelled and fresh applications will be decided on a case-to-case basis as per the directions of the provincial government. Moreover, the concerned departments must first verify the letters about tax exemption from KPRA before processing the request of persons claiming tax exemptions.

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