Basic Concepts of Tax on Income
Our Vision

To be a modern, progressive, effective, autonomous and credible organization for optimizing revenue by providing quality service and promoting compliance with tax and related laws.

Our Mission

Enhance the capability of the tax system to collect due taxes through application of modern techniques, providing taxpayer assistance and by creating a motivated, satisfied, dedicated and professional workforce.

Our Values

- Integrity
- Professionalism
- Teamwork
- Courtesy
- Fairness
- Transparency
- Responsiveness

For assistance and information on tax matters
Please contact our help line center through
Toll Free Telephone 0800-00-227 and following numbers:
Telephone 051-111-227-227 or 051-111-227-228
Fax 051-9205593
E-mail helpline@fbr.gov.pk
or
Visit our tax facilitation center (located in all major cities) or any Regional Tax Office
or
Introduction

This brochure provides information on the basic concepts of tax on income.

We have used plain language to explain most common tax situations. If you need more help after reading this brochure, feel free to contact us for further details or information.

Comments and suggestions
We welcome your valuable input about this brochure for future editions.
You can e-mail us at memberfate@fbr.gov.pk
or
You can write to us at the following address:
Member, Facilitation And Taxpayer’s Education,
Federal Board of Revenue,
Constitution Avenue,
Islamabad
Basic concepts of taxation

The Federal levy, **tax**, on income (Income Tax) is governed by the Income Tax Ordinance, 2001 and Income Tax Rules, 2002. It is an annual charge on income. This includes **taxable income**, **income subject to separate charge** and **income subject to final tax** of a **person** for a **tax year**, and also includes global income of the **resident** person, even if it has already been taxed outside of Pakistan.

In this brochure from now onwards **taxable income** refers to as **taxable income** excluding **separate block of income** subject to fixed tax and income subject to final tax.

“Taxable Income” means **total income** reduced by:

- **Donations qualifying for straight deductions**; and

- Following **deductible** allowances:
  - Zakat paid under the Zakat and Ushr Ordinance, 1980; (Zakat paid on a debt, the profit of which is chargeable to tax under the head “Income from Other Sources” is not deductible from total income. Such Zakat is an admissible deduction against profit on debt);
  - Workers Welfare Fund paid under the Workers Welfare Fund Ordinance, 1971 (applies to certain specified industrial establishments); and
  - Worker’s Participation Fund paid under the Companies Profit (Worker’s Participation) Act, 1968 (applies to companies only).

“Total Income” is the aggregate of income chargeable to tax under each **head of income**.

“Head of Income” – Under the Income Tax Ordinance, 2001, all income are broadly divided into following five heads of income:

- Salary;
- Income from property;
- Income from business;
- Capital gains; and
- Income from other sources

[like dividend, royalty, profit on debt, rent from sub-lease of land or building, income from lease of any building together with plant machinery, prize on bonds, winnings from a raffle, lottery or crossword puzzle, or profit on loan, advance, deposit or gift (subject to certain conditions)].

Different set of rules apply for determination of income chargeable to tax under each head of income. These are briefly explained later in this brochure.

Generally, income under a head of income is the total of the amounts derived as reduced by the admissible deductions against such income, if any. Expenditures attributable to exempt income, **income subject to separate charge**, **income subject to final tax** (and **separate block of income**) are not deductible against income chargeable to tax as **total income/taxable income**.

Chargeable income under each head of income is further dependent on the residential status of a taxpayer. In case of **resident**, it is both **Pakistan source income** and **foreign source income**, while in case of **non-resident** it is restricted to **Pakistan source** income only.

“Resident”

- **An association of persons** is resident for a **tax year** if the control and management of its affairs is situated wholly or partly in Pakistan at any time in that year;
- **A company** is resident for a **tax year** if –
  - it is incorporated or formed by or under any law in force in Pakistan;
  - the control and management of its affairs is situated wholly in Pakistan at any time in the year; or
  - it is a Provincial Government or a local Government in Pakistan.
- An individual is resident for a **tax year** if he/she –
- is present in Pakistan for a period of, or periods amounting in aggregate to, 183 days or more in the tax year; or
- is an employee or official of the Federal Government or a Provincial Government posted abroad in the tax year.

In order to compute the number of days an individual is present in Pakistan in a tax year, the following rules apply:

- A part of a day that an individual is present in Pakistan (including the day of arrival in, and the day of departure from Pakistan) counts as a whole day of presence; However, a day or part of a day where an individual is in Pakistan solely by reason of being in transit between two different places outside Pakistan does not count as a day present in Pakistan.
- Following days in which an individual is wholly or partly present in Pakistan count as a whole day of presence:
  - a public holiday;
  - a day of leave, including sick leave;
  - a day that the individual's activity in Pakistan is interrupted because of a strike, lock-out or delay in receipt of supplies; or
  - a holiday spent by the individual in Pakistan before, during or after any activity in Pakistan.

“Non-Resident” – An association of persons, a company and an individual are non-resident for a tax year if they are not resident for that year.

“Pakistan source income” is defined in section 101 of the Income Tax Ordinance, 2001, which caters for incomes under different heads and situations. Some of the common Pakistan source incomes are as under:
- Salary received or receivable from any employment exercised in Pakistan wherever paid;
- Salary paid by, or on behalf of, the Federal Government, a Provincial Government, or a local Government in Pakistan, wherever the employment is exercised;
- Dividend paid by resident company;
- Profit on debt paid by a resident person;
- Property or rental income from the lease of immovable property in Pakistan;
- Pension or annuity paid or payable by a resident or permanent establishment of a non-resident;

“Foreign source income” is any income, which is not a Pakistan source income.

“Person” means:
- An individual;
- A company or association of persons incorporated, formed, organized or established in Pakistan or elsewhere;
- The Federal Government, a foreign government, a political subdivision of a foreign government, or public international organization

“Company” means –
- A company as defined in the Companies Ordinance, 1984 (XLVII of 1984);
- A body corporate formed by or under any law in force in Pakistan;
- A modaraba;
- A body incorporated by or under the law of a country outside Pakistan relating to incorporation of companies;
- An amendment has been made through Finance Act, 2013 to enlarge the scope of definition of a Company. Now as per Income Tax Ordinance, 2001 a company includes:
  i) a co-operative society, a finance society or any other society;
  ii) a non-profit organization;
  iii) a trust, an entity or a body of persons established or constituted by or under any law for the time being in force.
- A foreign association, whether incorporated or not, which the Board has, by general or special order, declared to be a company for the purposes of this Ordinance;
- A Provincial Government;
- A Local Government in Pakistan;
- A Small Company

“Association of persons” includes a firm (the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all), a Hindu undivided family, any artificial juridical person and any body of persons formed under a foreign law, but does not include a company.

“Tax Year” is a period of twelve months ending on 30th day of June i.e. the financial year and is denoted by the calendar year in which the said date falls. For example, tax year for the period of twelve months from July 01, 2010 to June 30, 2011 shall be denoted by calendar year 2011 and the period of twelve months from July 01, 2011 to June 30, 2012 shall be denoted by calendar year 2012. It is called Normal Taxyear.
Tax year includes **special tax year**, which means any period of twelve months and is denoted by the calendar year relevant to the normal tax year in which closing date of the special tax year falls. For example, tax year for the period of twelve months from January 01, 2010 to December 31, 2010 shall be denoted by calendar year 2011 and the period of twelve months from October 01, 2010 to September 30, 2011 shall be denoted by calendar year 2012.

A person or class of persons may shift from Normal to Special Tax year or vice versa subject to the conditions specified under section 74 of the Income Tax Ordinance, 2001.

**Income subject to a separate charge**, which do not form part of total income or taxable income and are subject to tax on the basis of gross income, e.g.:-

- Dividend;
- Royalty of non-resident;
- Fee for technical services of non-resident;
- Shipping income of non-resident; and
- Air transport income of non-resident.

For further details, please refer to our brochure **“Income subject to separate charge, final tax and fixed tax regimes of Income Tax”**.

**Income subject to Final Tax**, which are subject to collection or deduction of tax at source and such tax collected or deducted at source is treated as final tax liability in respect of such income e.g.:

- Income arising from business on account of:
  - Sale of Imported of goods;
  - Execution of contracts by non-residents
  - Insurance and re-insurance premiums received by non-residents
  - Any other amounts received by a non-resident (profit on debt)
  - Supply of goods (other than by manufacturers);
  - Execution of contracts by a Resident
  - Services of stitching, dying, printing, embroidery, washing, sizing and weaving
  - Media services by non-residents
  - Export realization (goods)
  - Commission / discount on petroleum products
  - Brokerage and commission;
  - Plying of goods transport vehicles; and
  - Natural Gas Consumption (CNG Stations).
- Income arising from other sources on account of:
  - Profit on debt; (except derived by a company) and
  - Prizes and winnings.

For further details, please refer to our brochure **“Income subject to separate charge, final tax and fixed tax regimes of Income Tax”**.

“**Separate block of income**” are those, which are chargeable to tax under the respective head of income (salary, business, capital gains and other sources) but for the purposes of calculation of tax such incomes are excluded from the taxable income and tax thereon is calculated and charged at varying rates depending on the nature of each such income e.g.:-

- Income arising from salary in respect of:
  - Retirement or termination benefits of an employee;
  - Arrears of salary of an employee; and
  - Flying and submarine allowance of certain employees.
- Income; (except self-hiring see “self-hiring” on next pages)
- Business income:
  - From services rendered outside Pakistan;
  - From construction contracts executed out-side Pakistan;
  - Of certain manufacturers of cooking oil or vegetable ghee or both; and
  - Of resident from shipping business.
• Capital gains from:
  - Sale of securities; and
  - Sale of shares or assets by a private limited company to Private Equity and Venture Capital Fund.

For further details, please refer to our brochure “Income subject to separate charge, final tax and fixed tax regimes of Income Tax”.

“Tax” is the amount computed by applying the applicable rate of tax, on taxable income, income subject to a separate charge, income subject to final tax and separate block of income subject to fixed tax.

“Income tax” payable on taxable income is:
- Gross income tax (calculated on taxable income by applying applicable rate of income tax); as reduced by the following:-
- Reductions in tax liability (refer to our brochure Tax Reductions, Rebates and Credits); minus
- Foreign tax credit (refer to our brochure Tax Reductions, Rebates and Credits); minus
- Tax credits on donations, investments etc. (refer to our brochure Tax Reductions, Rebates and Credits); minus
- Tax credit on exempt share from association of persons (refer to our brochure Tax Reductions, Rebates and Credits).

To arrive at the net income tax payable or refundable, income tax payable determined as above is reduced by:
- Advance tax already paid; and
- Adjustable tax paid through deduction at source. (If it is not final tax liability paid through deduction)

For further details refer to our brochures “Collection and Deduction of Tax at Source” and “Income subject to separate charge, final tax and fixed tax regimes of Income Tax”.

Agricultural Income is chargeable to tax (Agricultural Income Tax) separately by the respective Provincial Governments and hence is specifically declared exempt from levy of tax under the Income Tax Ordinance, 2001. Accordingly such income does not form part of total income / taxable income.

“Agricultural income” is defined broadly to include direct and indirect income from land situated in Pakistan used for agriculture purposes. Rental income for the use of cultivated land and rent of a building on or in the vicinity of cultivated land occupied by the cultivator or by the receiver of rental income from cultivated land are some of the examples of indirect agriculture income. Income from fruit or vegetable farming etc. and Sale of trees is exempt in the hands of grower as Agriculture income. However, Income from sale of trees/vegetables or agri-produce are taxable in the hands of non-growers e.g “Arthis”.

Some Important Provisions of Law which a Taxpayer should know

Obligations as a withholding agent – refer to our brochure “Collection and Deduction of Tax at Source”

Inadmissible deductions against income chargeable to tax:
- Payment for purchases or of salary, rent, brokerage or commission, profit on debt, payment to non-resident, payment for services or fee from which tax is required to be deducted and paid to state but is not deducted or paid.
- Fine or penalty paid for the violation of any law, rule or regulation;
- Personal expenditures like residential expenses, education, etc.;
- Salary paid exceeding Rs. 15,000 per month other than by a crossed cheque or direct transfer of funds to the employee’s bank account;
- Expenditure of a capital nature on Depreciable Asset except depreciation and amortization on certain specified tangible Depreciable Assets and intangible assets;
Expenditure exceeding Rs. 10,000 incurred and paid otherwise than by a crossed cheque drawn on a bank or by crossed bank draft or crossed pay order or any other crossed banking instrument showing transfer of amount from the business bank account of the taxpayer.

However, this does not apply to the following:

- Where expenditures under a single account head in aggregate does not exceed Rs.50,000;
- Expenditures on account of –
  - Utility bills;
  - Freight charges;
  - Travel fare;
  - Postage;
  - Payment of taxes, duties, fee, fines or any other statutory obligation; and
  - Purchase of agricultural produce directly from the growers of such produce.

Crossed banking instrument includes online transfer of payment from the business account of the payer to the business account of payee as well as payments through credit card, subject to the condition that such transactions are verifiable from the bank statements of the respective payer and the payee.

Apportionment of expenditures – Where expenditure relates to –

- The derivation of income from more than one heads of income;
- Derivation of income comprising of taxable income and/or income subject to separate charge and/or income subject to final tax and/or separate block of income; or
- The derivation of income chargeable to tax under a head of income and to some other purpose,

the expenditure has to apportioned on any reasonable basis taking account the relative nature and size of the activities to which the amount relates. Rule 13 of the Income Tax Rules, 2002 specifies how to apportion such common expenditures.

Obligations to furnish income tax declarations – refer to our brochure “Obligation to file Income Tax Declarations”. Tax having been deducted at source does not absolve from filing a tax declaration or a tax return.

Loan, advance, deposit or gift received from another person otherwise than:

- By a crossed cheque drawn on a bank; or
- Through a banking transaction from a person holding a National Tax Number Certificate;

is treated as income chargeable to tax under the head “income from other sources”.

The purpose is to document the transactions of loan, advance, deposit or gift reflected in the books of account, wealth statement or reconciliation of wealth. The following transactions, however, are excluded:

- Loan, advance or deposit received from a banking company or an institution notified under the Companies Ordinance, 1984 by the Federal Government in the official gazette as a ‘financial institution’; or
- Advance payment for the sale of goods or supply of services.

Self-hiring – When an employee gives on rent any building (house/flat/apartment etc.) owned by him or any of his/her family members to the employer and the employer provides the same against the employee’s entitlement for a rent-free accommodation or housing, it results into:

- Provision of a perquisite (rent free accommodation or housing) by the employer to the employee chargeable as income from “salary”; and
- Receipt of rent of land or building by the employee or any of his/her family members,
as the case may be, chargeable as income from “property” in the hands of the owner.

**Recouped expenditure or loss** is the income of the **tax year** in which it is received in cash or in kind and chargeable under the head of income where deduction for such expenditure or loss was allowed in computing the chargeable income of an earlier year.

**Double derivations and double deductions**-
Any amount chargeable to tax on the basis of being receivable shall not be again chargeable on the basis that it is received or vice versa. Similarly any expenditure deductible on the basis of being payable shall not be again deductible on the basis that it is paid or vice versa.
Facilitation and Taxpayer Education Material available on our website www.fbr.gov.pk

Income Tax:
- Income Tax Ordinance, 2001;
- Income Tax Rules, 2002;
- Income Tax Notifications (SRO’s issued by the Federal Government);
- Income Tax Circulars (Clarifications issued by the Federal Board of Revenue);
- Income Tax Forms (Registration form, return forms, withholding tax statements, tax deposit form);
- Computer Software (Withholding tax statements);
- Avoidance of Double Tax Treaties with other countries;
- Publications and brochures

Sales Tax
- Sales Tax Act, 1990;
- Sales Tax Rules, 2006;
- Sales Tax Special Procedure Rules, 2007;
- Sales Tax Special Procedure (Withholding) Rules, 2007
- Sales Tax Notifications (SRO’s issued by the Federal Government);
- Sales Tax General Orders;
- Sales Tax Circulars/Rulings (Clarifications issued by the Federal Board of Revenue);
- Sales Tax Forms (Registration form, return forms, tax deposit form);
- Computer Software (Refund claim);
- Publications and brochures

Federal Excise Duty
- Federal Excise Act, 2005;
- Federal Excise Rules, 2005;
- Federal Excise Notifications (SRO’s issued by the Federal Government);
- Federal Excise General Orders;
- Federal Excise Circulars/Rulings (Clarifications issued by the Federal Board of Revenue);
- Federal Excise Forms (Return forms);
- Publications and brochures

On line information services:
- Registration (Income Tax, Sales Tax and Federal Excise Duty);
- Registration Application Status (Income Tax and Sales Tax);
- Registered Taxpayers Verification (Income Tax and Sales Tax);
- Active taxpayers list;

F A T E
“Facilitation and Tax Education“
is the key to Voluntary Compliance
and
Voluntary Compliance is the key to
“Better Revenues”