

Alternative Corporate Tax

23 December 2014

By: Muhammad Raza

Agenda

Section 1	Introduction to ACT
Section 2	International examples
Section 3	Effect of non-obstante clause
Section 4	Effective year & retrospective application
Section 5	Taxpayers covered by ACT
Section 6	Exclusions
Section 7	Computational aspects
Section 8	Carry forward of ACT
Section 9	FBR's computational examples
Section 10	Issues emanating from ACT
	Q & A

Introduction to ACT

- A new section 113C titled as “Alternative Corporate Tax” has been introduced through Finance Act, 2014, which starts with a “**non-obstante clause**” i.e. Notwithstanding anything contained in this Ordinance (Income Tax Ordinance, 2001)
- Applicable for **tax year 2014 and onwards**
- Tax payable by a “Company” will be **higher** of the “**Corporate Tax**” (generally includes minimum and final taxes apart from certain exceptions) or “**Alternative Corporate Tax**” (**17% of Accounting Income** subject to certain adjustments and exclusions)
- Rationale for introduction of ACT was explained in the “Salient features” of Budget documents “*to discourage **perpetual declaration of losses or very low income** using tax avoidance means by Companies*”.
- The Finance Minister in his Budget Speech also mentioned that “*ACT is being introduced for corporate cases where taxable income is **usually far less than accounting income due to careful tax planning to avail all possible avenues of tax avoidance technically.***”

International examples

- ***India***

18.5% of book profits of the Company (termed as adjusted accounting profits).

- ***Argentina***

Applicable at 1% of the value of fixed and current assets.

- ***Mexico***

17.5% of Flat Tax Base computed on the basis of certain cash inflows and outflows

- ***Austria***

Minimum amounts of tax have been prescribed for certain types of companies.

- ***Mauritius***

7.5% of book profits or 10% of dividends, whichever is higher.

Except for Mauritius, in all the above cases, adjustment is allowed for next 10 years.

Effect of non-obstante clause

- The provisions of section 113C **only** have an overriding effect over other provisions of the Income Tax Ordinance, 2001
- In case of **any conflict** between the provisions of section 113C and any other provision of the Income Tax Ordinance, 2001, the provisions of section 113C will prevail
- If, however, there is a conflict between section 113C and any other provision of a **Special Statute**, the provisions of section 113C will remain subservient to the provisions of such Special Statute. Much would, however, depend upon the language of such Special Statute and the nature of conflict.
- The provisions of section 113C are in the nature of “**Self Contained code**”. Other provisions of the Income Tax Ordinance cannot be applied automatically except to the extent permitted by Section 113C itself.

Effective year & retrospective application

- Specifically mentioned to be applicable for **tax year 2014 and onwards**.
- **Not a one-time levy** but also intended to be applicable for subsequent tax years.
- Companies following **Special Tax Years** already ended before introduction of section 113C are affected by this levy.
- Even for Companies following June 30 as their year-end are also affected by this law as all advance tax payments were already made in accordance with normal provisions.
- ACT, thus, has a **retrospective effect** for tax year 2014 by way of expressed language and not by way of any intendment.
- **Constitutional validity** of the retrospective application is **to be decided by the Courts**. It is, however, generally believed that a retrospective law is valid if made through expressed legislation.

Taxpayers covered by ACT

- ACT is **only** applicable on a “**Company**” and as such, all other categories of taxpayers, such as **Individuals** and **Association of Persons** are **not covered**.
- Unlike section 113, ACT is also applicable on **non-resident companies**.
- Section 113C itself does not define the term “Company” and, therefore, the term has to be construed as per **section 80** to include the following.
 - (a) Locally incorporated Companies, body corporates, Small Companies
 - (b) Modarabas
 - (c) Foreign companies
 - (d) Co-operative societies, Finance societies and other societies
 - (e) Non-profit organisations
 - (f) Trust, an entity or body of persons established or constituted by any law
 - (g) Foreign associations declared by FBR as a Companies
 - (h) Provincial Governments
 - (i) Local Governments in Pakistan

Companies not covered by ACT

- ACT is specified to be **non applicable** on Taxpayers chargeable to tax in accordance with the following provisions of Income Tax Ordinance, 2001
 - (a) Fourth Schedule (**Insurance** Companies)
 - (b) Fifth Schedule (**Mining** Companies)
 - (c) Seventh Schedule (**Banking** Companies)
- By implication, ACT is also **not applicable** on following companies:
 - (i) **Companies setting up an Industrial Undertaking between July 1, 2014 to June 30, 2017** and subject to certain conditions, eligible for a reduced tax rate of 20% for a period of five years
 - (ii) **Non-profit organisations** and certain trusts and welfare institutions eligible for 100% tax credit under section 100C
 - (iii) Companies eligible for **100% tax credit under section 65D** not having any other income
 - (iv) **Companies not deriving any income other than exempt or certain incomes subject to final taxation or Capital Gains under section 37A**
 - (v) Non-resident companies not having any presence in Pakistan

Computation of ACT

- ACT is defined as the tax at a rate of **17%** of a sum equal to “Accounting Income” as reduced by certain specific adjustments.
- “Accounting Income” is defined as the **accounting profit before tax for the tax year, as disclosed in the financial statements**, excluding share from the associate recognised under equity method of accounting.
- Following amounts are also **excluded from accounting income** for computing ACT.
 - (a) exempt income
 - (b) income subject to tax under section 37A (capital gains on securities)
 - (c) income subject to final taxation under section 148(7) – Imports, Section 150 (Dividends), Section 153(3) – Resident Suppliers and Contractors, Section 154 (Exports), Section 156 (Prizes & winnings) and section 233(3) – Brokerage and Commission

Computation of ACT

- (d) income subject to tax credit under sections 65D and 65E (equity investment in certain Industrial Undertakings)
 - (e) income subject to tax credit under section 100C (NPOs and certain trusts & welfare institutions); and
 - (f) income of the Company subject to reduced rate of tax under newly inserted clause 18A of Part II of the Second Schedule
-
- The sum equal to accounting income less any amount to be excluded therefrom (as mentioned in (a) to (f) above) is to be treated as **“Taxable income”** for the purposes of section 113C.
 - For the purposes of determining the “Accounting Income”, expenses are required to be **apportioned** between the “excluded amounts” and the balance accounting income (being treated as “taxable income”). FBR’s Circular suggests the apportionment on turnover basis.
 - The Commissioner is empowered to make adjustments and proceed to compute accounting income **as per historical accounting pattern** after providing an opportunity of being heard.
 - Tax credit under **section 65B** (on investment in BMR Plant & Machinery) is allowed against ACT.

Corporate Tax

Defined as total tax payable by the Company, **including-**

- (a) tax payable on account of **minimum tax** (e.g. Minimum tax on turnover under section 113, Minimum tax on builders under section 113A, Minimum tax on land developers under section 113B, minimum tax under section 148(8) on importers of edible oil and packing material, minimum tax under clauses 56B, to 56G for certain persons opting to be taxed under normal tax regime)
- (b) **final taxes** payable under any provision of the Ordinance but **not including** those mentioned in **Section 8** (FTS and royalty of non-resident persons not having Permanent Establishments in Pakistan, incomes of non-resident shipping & airlines, dividend income)

Following taxes are **excluded**:

- **Section 161** (tax recovered from payer due to default in withholding tax compliance)
- **Section 162** (tax recovered from the recipient due to withholding tax non-compliance of payer)
- Default Surcharge or penalty
- ACT payable under section 113C

Carry forward of ACT

- The excess of Alternative Corporate Tax paid over the Corporate Tax payable for the tax year is to be carried forward and adjusted against the tax payable **under Division II of Part I of the First Schedule** for following year.
- If the excess tax is not wholly adjusted the unadjusted amount is to be carried forward to the following tax year and so on, however, the excess cannot be carried forward to more than ten tax years immediately succeeding the tax year for which the excess was first computed.
- The entitlement to carry forward minimum tax under section 113 will remain unaffected by ACT.
- If Corporate Tax or ACT is enhanced or reduced as a result of any amendment or as a result of any order, the excess amount to be carried forward will be adjusted accordingly.

FBR's computational examples

Example 1 – Explanation of carried forward minimum tax & ACT

Corporate Tax (excluding minimum tax)	(A)	Rs 100
Minimum tax under section 113	(B)	Rs 140
ACT	(C)	Rs 200
Corporate Tax under section 113C	(D=A+B)	Rs 140
Excess amount of ACT over Corporate Tax carried forward for next ten tax years	(C-D)	60
Excess amount of Minimum tax carried forward for next five years	(B-A)	40

FBR's computational examples

Example 2 – Apportionment of expenses

Export Sales – FTR	20
Contract receipts – FTR	30
Dividend receipts – FTR	10
Exempt income	10
Business income	130
Total receipts	200

Total expenses	50
Accounting Income as per accounts	150
Taxable Income	25

FBR's computational examples

Example 2 – Apportionment of expenses

Computation of Accounting Income for ACT calculation

Total receipts in the accounts	(A)	200
Total receipts to be excluded under section 113C(8)	(B)	70
Total receipts pertaining to accounting income for ACT	(C)	130

Apportionment of Expenses for ACT

Percentage of receipts of accounting income	(D=C/A)	65%
Expenses to be apportioned (65% of total expenses)	(E)	32.5
Accounting income for ACT	(C-E)	97.5

FBR's computational examples

Example 2 – Apportionment of expenses

Computation of tax liability

Tax liability under ACT @ 17.5% of Accounting Income	(A)	16.575
Corporate tax @ 34% of Taxable Income	(B)	8.5
Final Tax liability on exports, contracts & dividends	(C)	3
Total Tax payable	(A+C)	19.575

Certain observations in the above example

- All expenses between final tax and normal income have been apportioned on receipts basis
- Final taxes have been added over and above ACT whereas the same should have been made part of Corporate Taxes (other than dividend related tax)

FBR's computational examples

Example 3 – Brought forward of tax losses

Taxable income for the year	200
Brought forward losses	(300)
Taxable income / loss after losses	(100)
Accounting Income as per section 113C	250

Computation of tax liability

Corporate Tax @ 34% of Taxable Income	0
Tax liability under ACT @ 17% of 250	42.5
Tax liability (higher of above)	42.5

Issues emanating from ACT

- **Discriminatory to Corporate Sector** which is documented and subject to Corporate Regulatory requirements whereas other taxpayers such as sole proprietors and AOPs are not subject to ACT regime. The possibility of extending ACT to other taxpayers cannot be ruled out.
- The provision **penalises the so-called low tax / no tax paying companies** by ignoring the overall contribution to the economic development and **omitting to take into account the effect of contribution to the Exchequer** by way of other indirect taxes, such as Sales Tax, Provincial Sales Tax, FED and Customs Duty, etc.
- The **rationale for 17% of accounting profit** is not known and there is no surety if the rate of ACT will remain static in future years depending upon the revenue pressures.
- **Arbitrary powers of the Commissioner** to determine the accounting profit especially with regard to the unclear terms “**historical accounting pattern**” and “**profit before tax for the tax year as disclosed in the financial statements.**”

Issues emanating from ACT

- Lack of clarity on the **basis of computing** excluded items such as exempt income.
- No rationale for **apportionment of all expenses** especially when there are identifiable direct expenses and the Company is liable to WWF and WPPF.
- Treatment of **non-taxable items** (such as capital receipts / gain on sale of immovable property held for more than 2 years / 25% of capital gains on long term assets).
- **No tax credit other than section 65B** will be allowed against ACT, such as Charitable donations (under section 61), sales to registered persons (section 65A) and enlistment (65C).
- Likely to have an impact for **small companies** entitled to be taxed at a reduced rate of 25% under normal basis.

Issues emanating from ACT

- Companies having brought forward tax losses and unabsorbed depreciation may also be affected by ACT, which is only applicable on **accounting profit for the tax year without any impact of brought forward losses** and unabsorbed depreciation
- Following classes of income and persons (otherwise covered by FTR) have not been excluded from Accounting Income:
 - (a) Import of ships by ship breakers
 - (b) **Non-resident contractors opting for taxation under FTR**
 - (c) Commission / discount of petrol pump operators
 - (d) Income of a CNG station
 - (e) Shipping business qualifying for reduced rate on tonnage basis as final tax
 - (f) Income from services rendered and construction contracts outside Pakistan subject to tax at 1% of gross receipts
- **Adjustment of ACT** against taxes payable under the above categories is not provided

Issues emanating from ACT

- No **consequential amendment** has been made in **section 147** thereby creating an ambiguity as regards the payment of ACT by way of advance tax
- Likely **mismatch** between the income taxable under FTR (generally on receipt basis) with the corresponding amounts disclosed in financial statements (on accrual basis)
- Application of ACT on companies opted for **group taxation** as single fiscal unit
- Treatment of remittance of after tax profits by branches of non-resident companies deemed as dividend requires clarity as the same does not form part of accounting income before tax

Questions & Answers