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INCOME TAX ORDINANCE, 2001.

Section 107 deals with Agreements for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income imposed by this Ordinance and under the corresponding laws in force in a foreign country.

The Federal Government is competent to make provisions by Gazette notification to implement such agreements,

These agreements have overriding effect and no provision of the Ordinance will have effect in so far as these agreements and notified provisions for implementation provide for—

(a) Relief from the payable tax.
(b) Determination of Pakistan-source income.
(c) Determination of income in the hands of non-residents, including permanent establishments in Pakistan.
(d) Determination of income of resident persons having special relationship with non-residents.
(e) Exchange of information for the prevention of fiscal evasion or avoidance of taxes on income between treaty partners.

1980 UN MODEL CONVENTION

Article 3.2 states- “As regards the application of the Convention by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the law of that State Concerning the taxes to which the Convention applies.”

1969 VIENNA CONVENTION
on the Law of Treaties

Article 31(1) states-“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.” Therefore, not only the text itself, but preamble, annexes, correspondence and related other agreements are to be considered in making interpretation.

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INCOME TAX RULES, 2002
Mutual Agreement Procedure.

Rule 19D.- An aggrieved Pakistani national residing abroad or a resident taxpayer may make an application to the Competent Authority (FBR) in the prescribed form for taking up his matter with the Competent Authority of the relevant tax treaty partner who would endeavour to resolve it through consultative measures.

However, the taxpayer can withdraw from the mutual agreement procedure and pursue his right of appeal under the normal course, if the terms and conditions of the impending resolution are not satisfactory to him.

Note: The same procedure would apply for an application received in Pakistan through the Competent Authority of the other treaty partner.

1980 UN MODEL CONVENTION
Mutual Agreement Procedure

Article 25 states-- "1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the Competent Authority of the Contracting State of which he is a resident."
"3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as the interpretation or application of the Convention."

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INCOME TAX ORDINANCE, 2001
Exemptions from tax

Section 44 provides for exemptions under international agreements. Its sub-section (1) states—(1) Any Pakistan-source income which Pakistan is not permitted to tax under a tax treaty shall be exempt from tax under this Ordinance.

Sub-section (3) states that any income received by a person (not being a citizen of Pakistan) engaged as a contractor, consultant or expert on a project in Pakistan shall be exempt from tax under this Ordinance to the extent provided for in a bilateral or multilateral technical assistance agreement between the Federal Government and a foreign government or public international organization.

Section 53 provides for exemptions and tax concessions in the Second Schedule to the Ordinance. The income or classes of income, or persons or classes of persons specified in the Second Schedule may be exempted from tax, taxed at lower rates, allowed reduction in tax liability or exempted from the operation of any provision of this Ordinance.

1980 UN MODEL CONVENTION
Exemption method

Article 23A provides that where a resident of a Contracting State derives income which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall exempt such income from tax.

However, where income derived by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax, on the remaining income of such resident, take into account the exempted income.

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INCOME TAX ORDINANCE, 2001
PAKISTAN-SOURCE BUSINESS INCOME

Section 101(3) states that Business Income of a non-resident person is to be treated as Pakistan-source income to the extent it is directly or indirectly attributable to-

(a) Permanent establishment in Pakistan of the non-resident.

(b) Sales of goods merchandise of the kind sold by the person through a permanent establishment in Pakistan.

© Other business activities of the kind as those effected by a non-resident through a permanent establishment in Pakistan.

(d) Any business connection in Pakistan.

WHERE business of a non-resident comprises rendering of independent services (including professional and services of entertainers and sports persons) any remuneration

paid by a resident person or borne by permanent establishment is also treated as business income in Pakistan.

1980 UN MODEL CONVENTION
BUSINESS PROFITS

Article 7, among other provisions, states that the profits derived from the sales of goods or merchandise of the kind sold by the person through a permanent establishment or other business activities of the kind as those effected by a non-resident through a permanent establishment SHALL NOT BE TAXABLE if the enterprise demonstrates that such sales or business activities have been carried out for reasons other than obtaining a benefit under the Convention.

Likewise, no profits shall be attributed to a permanent establishment by reason of the mere purchase by the permanent establishment of the goods or merchandise for the enterprise.

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INCOME TAX ORDINANCE, 2001.
Permanent Establishment

Section 2 (41) defines "permanent establishment" to mean a fixed place of business through which the business is wholly or partly carried on-including:

(a) a place of management, branch, office, factory, workshop, premises, warehouse, permanent sales exhibition or outlet and a liaison office where contracts (not being purchase-contracts) are negotiated;

(b) a mine, oil or gas well, quarry or any other place of extracting natural resources;

c) an agricultural, pastoral or forestry property;

(d) a building site, a construction, assembly or installation project together with supervisory activities continuing for more than 90 days in a 12-month period;

(e) the furnishing of consultancy or other services through employees/personnel;

(f) an agent (not being of independent status) habitually exercising an authority to conclude contracts or habitually maintaining stock-in-trade or other merchandise for delivery on behalf of the other person; and

(g) any substantial equipment, other asset or property capable of giving rise to income.

1980 UN MODEL CONVENTION
Permanent Establishment

Article 5 provides more or less the same definition as in the Income Tax Ordinance, except as follows:

(a) Para 3(a) provides for a period of more than 6 months and not 90 days for the activities to continue in respect of a building site, a construction, assembly or installation project.

(b) Para 3(b) provides for an aggregate period of 6 months within a 12-month period for furnishing of services for the same or a connected project.
© The term "Permanent establishment" does not include (i) use of facilities for stock or storage and display of goods only (ii) solely for purchase of goods, etc. and (iii) activity of preparatory or auxiliary character.
(d) Agents of independent status would include a broker and a general commission agent, acting in ordinary course of their business with many enterprises. 0o0

INCOME TAX ORDINANCE, 2001
Royalties

Rule 18 of the Income Tax Rules, 2002, deals with income from royalties and states that the income of a non-resident person by way or royalty received from a resident person or a permanent establishment in Pakistan of a non-resident person shall be determined in the light of agreements made before or after 08 March,1980, by allowing certain expenditures incurred in Pakistan or outside Pakistan in earning royalty which would not exceed 10 per cent of the gross amount of royalty.
However, this provision does not apply where royalty is covered u/s 169 of the Income Tax Ordinance and the tax thereon (presently 15% unless fixed at a lower rate under a tax treaty) is treated as a final tax. Besides, any royalty relating to a permanent establishment is treated as income from Business u/s 6(4) of the Ordinance.
The term "royalty" has been defined in section 2(54) of the Ordinance which, in short, may be taken to mean any amount paid or payable, as consideration for the use of or right to use any patent, invention, design, model, secret formula or process, trade mark, copyright (including films or video tapes) and receipt or right to receive any visual images or sounds in connection with television, radio or internet broadcasting or for the supply of any technical, industrial, commercial or scientific knowledge, experience or skill; or for the use of any industrial, commercial or scientific equipment; for the supply of any assistance for these properties or rights and the disposal of any property or right so mentioned.

1980 UN MODEL CONVENTION
Article 12 Royalties

As a general rule, the Convention treats royalties as taxable in the recipient's country of residence. The payer's country is entitled to only a limited taxation right by way of charging tax at an amount not exceeding the agreed percentage of the gross amount of royalties, mostly through withholding taxes.
It is further provided that where the recipient of royalties is not a beneficial owner or the royalties are attributable to a permanent establishment or a fixed base maintained by the recipient in the payer's country, full taxation will be allowed to the source country, but the taxpayer would be entitled to deduction of relevant expenditures as are applicable to Business Profits and Independent Personal Services.

INCOME TAX ORDINANCE, 2001
Fees for technical services

Rule 19 of the Income Tax Rules, 2002, states that, except where fee for technical services is treated as a final tax u/s 169 of the Ordinance, deductions will be allowed, according to the agreements, for the expenditure admissible u/s 40 being “Income from other sources” generally applying maximum total deduction @ 20% of the gross mount of such fees.
If the tax rate is not settled in the relevant tax treaty, normal tax @ 15% will be levied on gross amount of the fee for technical services u/s 6 of the Ordinance, which is the final tax.

The term “fee for technical services” has been defined in section 2 (23) of the Ordinance to mean any consideration, whether periodical or lump sum, for the rendering of any managerial, technical or consultancy services, including the services of technical or other personnel (not being salary income)but excluding consideration for services rendered in relation to a construction, assembly or like project undertaken by the recipient.
Under section 101(12) of the Ordinance, income from technical fee is treated as Pakistan-source income, if it is borne by a permanent establishment of a non-resident or paid by a resident for services utilized in Pakistan.

1980 UN MODEL CONVENTION

This convention does not specifically deal with taxation of fee for technical services but leaves it to the Contracting States to arrive at mutual agreements to cover such incomes.

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INCOME TAX ORDINANCE, 2001
Independent services

Section 101 (4) provides that where the business of a non-resident person comprises the rendering of independent services (including professional services and the services of entertainers and sports persons) any remuneration derived by that person which is paid by a resident person or borne by a permanent establishment of that non-resident person will be taxed in Pakistan.

1980 UN MODEL CONVENTION
Independent personal services

Article 14 contains provisions similar to the provisions made in section 101(4) of the Ordinance, except that the period of non-resident's stay is 183 days (in the aggregate) or more in a fiscal year. Besides, the term "professional services" specifically includes independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

CAPITAL GAINS

Section 101(5) of the Income Tax Ordinance treats gains on disposal of assets or properties used in deriving business income by a non-resident person or his permanent establishment in Pakistan and from rendering independent services as Pakistan-source income.

1980 UN MODEL CONVENTION
(Capital Gains)

Article 13***, inter alia,*** provides that gains derived from the alienation of immovable property situated in a Contracting State may be taxed in that State. (Such tax in Pakistan is treated as a Provincial subject).
Gains from the alienation of movable property belonging to business of a permanent establishment or pertaining to a fixed base of a non-resident for performing independent personal services may be taxed in that State (as done in Pakistan).

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INCOME TAX ORDINNCE, 2001
DIVIDENDS

Section 101 (6) provides that a dividend paid by a resident company shall be treated as Pakistan-source income. Resident company is one which is incorporated or formed by or under any law in force in Pakistan and the control and management of its affairs is situated wholly in Pakistan at any time in the year.
As regards tax on dividends, section 5 of the Ordinance imposes tax at the prescribed rate (presently 10%) on the gross amount of dividend received by any person from any company. Similarly, advance or loan given to a shareholder of a private company is also treated as dividend by virtue of its broad definition given in section 2 (19) of the Ordinance.

1980 UN MODEL CONVENTION
DIVIDENDS

Article 10 provides that dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident.

Where the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed a certain agreed percentage of the gross amount of the dividends.
In all other cases, percentage of tax can be established through bilateral negotiations.

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INCOME TAX ORDINNCE, 2001
Salary income for dependant personal services

Section 101(1) provides that Salary shall be Pakistan–source income to the extent to which it is received from any employment exercised in Pakistan (wherever paid) or is paid by our Governments in Pakistan, wherever the employment is exercised.
For this purpose, an individual who is not present in Pakistan for 183 days, in the aggregate, in a tax year, is treated as a non-resident person u/s 81(2) of the Ordinance.
Dependant personal services need to be distinguished from Independent Services which are not treated as "Salary" but are taken as Business Income of a non-resident rendering independent services (including professional and services of entertainers and sports persons) for which remunerations are paid by a resident person or borne by a permanent establishment of the non-resident in Pakistan.

1980 UN MODEL CONVENTION
Dependant Personal Services

Article 15, *inter alia*, provides that salaries, wages, etc. of a non-resident shall be taxed only if the employment is exercised and remuneration is derived in that Contracting State. However, remuneration derived by a

resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first mentioned State if (a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned and (b) the remuneration is paid by or on behalf of any employer who is not a resident of the other State and (c) the remuneration is not borne by a permanent establishment or fixed base which the employer has in the other State.

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Shipping and Air Transport Income of non-residents.

Section 7 of the Income Tax Ordinance, 2001, provides for taxation on the business of operating ships or aircrafts by the owner or charterer in respect of-

(a) gross amount (whether in or out of Pakistan) for the carriage of passengers, livestock, mail or goods embarked in Pakistan; and

(b) gross amount received/receivable in Pakistan for carriage of passengers, livestock, mail or goods embarked outside Pakistan.

The following rates of tax have been prescribed:-

(i) 8% in case of shipping income (gross amount)

(ii) 3% in case of air transport income (gross amount)

UN MODEL CONVENTION
(Article 8 Alternate A & B)

Main criteria: Profits are taxable only in the contracting state where the place of effective management of the enterprise operating ships or aircrafts in international traffic is situated;

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The activities arising from such operations in the other contacting state are more than casual.

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INCOME TAX ORDINANCE, 2001

Independent services

Section 101 (4) provides that where the business of a non-resident person comprises the rendering of independent services (including professional services and the services of entertainers and sports persons) any remuneration derived by that person which is paid by a resident person or borne by a permanent establishment of that non-resident person will be taxed in Pakistan.

1980 UN MODEL CONVENTION

Independent personal services

Article 14 contains provisions similar to the provisions made in section 101(4) of the Ordinance, except that the period of non-resident's stay is 183 days (in the aggregate) or more in a fiscal year. Besides, the term "professional services" specifically includes independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

CAPITAL GAINS

Section 101(5) of the Income Tax Ordinance treats gains on disposal of assets or properties used in deriving business income by a non-resident person or his permanent establishment in Pakistan and from rendering independent services as Pakistan-source income.

1980 UN MODEL CONVENTION

(Capital Gains)

Article 13, ***inter alia***, provides that gains derived from the alienation of immovable property situated in a Contracting State may be taxed in that State. (Such tax in Pakistan is treated as a Provincial subject).
Gains from the alienation of movable property belonging to business of a permanent establishment or pertaining to a fixed base of a non-resident for performing independent personal services may be taxed in that State (as done in Pakistan).

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INCOME TAX ORDINNCE, 2001
DIVIDENDS

Section 101 (6) provides that a dividend paid by a resident company shall be treated as Pakistan-source income. Resident company is one which is incorporated or formed by or under any law in force in Pakistan and the control and management of its affairs is situated wholly in Pakistan at any time in the year.
As regards tax on dividends, section 5 of the Ordinance imposes tax at the prescribed rate (presently 10%) on the gross amount of dividend received by shareholder of a any person from any company. Similarly, advance or loan given to a private company is also treated as dividend by virtue of its broad definition given in section 2 (19) of the Ordinance.

1980 UN MODEL CONVENTION
DIVIDENDS

Article 10 provides that dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident.

Where the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed a certain agreed percentage of the gross amount of the dividends.
In all other cases, percentage of tax can be established through bilateral negotiations.

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INCOME TAX ORDINANCE, 2001
PROFIT ON DEBT

Section 101 (7) states that profit on debt shall be Pakistan-source income if it is borne by a permanent establishment of a non-resident person or paid by a resident person.

“Profit on debt” whether payable or receivable, is defined in section 2(46) to mean—

(a) any profit, yield, interest, discount, premium or other amount owing under a debt, other than a return on capital, or

(b) any service fee or other charge in respect of a debt, including any fee or charge incurred in respect of a credit facility which has not been utilized.

Section 152(2) requires every person paying an amount (profit on debt) to a non-resident to deduct tax @ 30% of the gross amount of such payment. However, this provision will not apply if the Commissioner accords approval that it is taxable to a permanent establishment in Pakistan of a non-resident person. It will also not apply where the amount is payable by a person who is liable to pay tax on that amount s representative of the non-resident person.

UN MODEL CONVENTION
Interest

Article 11 provides that Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. However, such Interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the Interest the tax so charged shall not exceed the mutually agreed percentage of the gross amount of the Interest.

Note: Where debt-claim in respect of which the interest is paid is effectively connected with the permanent establishment, fixed base for independent personal services or business activities for not obtaining any benefit under the Convention, the above provisions will not apply.

INCOME TAX RULES, 2002
Foreign Income Tax

Rule 15 made u/s 102 and 103 of the Ordinance provides relief to the resident person from international double taxation but any penalty, fine, interest, etc. is not treated as a foreign tax.

However, withholding taxes imposed on dividends, salary and gross receipts of non-resident persons as final tax are treated as substantially equivalent to the income tax imposed under the Income Tax Ordinance, 2001.

Section 102 of the Ordinance provides exemption to the foreign source salary of resident individuals if they have paid foreign income tax or tax was withheld at source and paid to the revenue authority of the foreign country.

Section 103 of the Ordinance states that where a taxpayer resident in Pakistan has paid foreign income tax, he shall be allowed a tax credit equal to or lesser of—
(a) foreign tax paid, or
(b) Pakistan tax payable in respect of that income.
This will be done by applying average rate of Pakistan income tax applicable to the taxpayer against his net foreign source income.

Foreign tax credit u/s 103 is allowed first before any other tax credit admissible u/s 147 (advance tax paid) or section 168 (credit for tax collected or deducted in Pakistan) is applied.

Rule 16 requires the resident person to submit an application with return of income, accompanied by supporting documents, to claim credit for foreign tax. However, Commissioner is authorized to accept secondary evidence of tax deductions abroad.

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INCOME TAX RULES, 2002

Transfer Pricing

Chapter VI of the Income Tax Rules applies for the purposes of section 108 (Transactions between associates).
It mainly provides for the exercise of the Commissioner's power to distribute, apportion or allocate income, expenditure or tax credit, between associates in respect of transactions not made according to the arm's length principle.
Such transactions cover sales, assignments, leases, licenses, loans, contributions and rights to use property or performance of services.

Among other provisions, the Commissioner is to be guided by international standards, case law and guidelines issued by various tax-related internationally recognized organizations.

He may also use any method consistent with the comparable uncontrolled transactions, if other methods viz (a) comparable uncontrolled price method (b) re-sale price method (c) cost plus method or (d) profit-split method would not readily determine the arm's length result.

UN MODEL CONVENTION

Associated Enterprises

Article 9 states that where conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

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