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**Name:**

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**Semester: Autumn 2026**

# ALLAMA IQBAL OPEN UNIVERSITY, ISLAMABAD

**Course: Business Taxation (456) • Level: ADC/AD**

**Semester: Autumn 2026**

**Assignment No. 1 (Units 1–4)**

**Total Marks: 100 • Pass Marks: 50**

## SOLVED ASSIGNMENT GUIDE

***(For Study & Reference)***

*Note: This guide is prepared for study and reference purposes. Students are advised to read the relevant units of the course book, understand the concepts, and then write the assignment in their own words. Copying this guide word for word is not recommended.*

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## Question 1: Definitions under the Income Tax Ordinance, 2001 (20 Marks)

*Keeping this in view, define the following terms with reference to the Income Tax Ordinance 2001: (a) Depreciable Asset (b) Total Income (c) Turnover (d) Tax Year (e) Public Company (f) Person (g) Royalty*

### Introduction

Section 2 of the Income Tax Ordinance, 2001 is the interpretation clause of the Ordinance. It defines the important expressions used throughout the law, because in taxation the exact statutory meaning of a word decides who is taxed, on what amount, and at what rate. A word in a tax statute does not necessarily carry its ordinary dictionary meaning; the definition given in section 2 controls, unless the context otherwise requires. The seven terms asked in this question — depreciable asset, total income, turnover, tax year, public company, person and royalty — are among the most frequently used expressions in the Ordinance. Each of them is connected with a charging, computation or administrative provision elsewhere in the law:




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depreciable asset with the depreciation allowance under section 22, total income with the computation of tax under section 9 and section 10, turnover with minimum tax under section 113, tax year with assessment and filing periods, public company with the rates of tax in Division II of Part I of the First Schedule, person with the unit of assessment, and royalty with the head 'Income from Other Sources' and with withholding or tax. This answer defines each term in the language of the Ordinance and then explains its practical significance, so that the student can see not only what the term means but also why the legislature bothered to define it.

## (a) Depreciable Asset — Section 2(15A) read with Section 22

The Ordinance defines a 'depreciable asset' as a tangible asset, not being an intangible asset, that has an expected useful life of more than one year and that is likely to lose its value due to use, wear and tear, decay or obsolescence, and that is used wholly or partly in the production of income chargeable to tax. Four conditions are built into this short definition. First, the asset must be tangible, that is, it must have physical existence — plant, machinery, a building used as factory premises, furniture, vehicles and office equipment are examples. Secondly, it must have an expected useful life of more than one year; a tool that is consumed within a single season is a revenue expense, not a depreciable asset. Thirdly, its value must decline through use, passage of time or technical obsolescence. Fourthly, it must be used in earning taxable income, because depreciation under section 22 is an allowance against business income and is granted only for assets used for the purposes of business or profession during the tax year. The written down value of the asset is computed under section 22 by taking its cost, adding additions and deducting disposals and the depreciation already allowed, and the prescribed rates in Part I of

the Third Schedule are applied to that written down value. Initial allowance under section 23 may also be available on eligible plant and machinery in the year it is first put to use. A depreciable asset must be distinguished from an intangible asset such as goodwill, a patent or a copyright, which is dealt with separately through amortisation under section 24.

### (b) Total Income — Sections 9, 10 and 11

'Total income' means the amount computed under section 10 of the Ordinance: it is the sum of a person's income under all the heads of income — salary (section 12), income from property (section 15), income from business (section 18), capital gains (section 37) and income from other sources (section 39) — for a tax year, reduced by the total of any deductible allowances for that year, such as the deductible allowance for Zakat paid under section 60 and for certain donations and contributions under sections 60 to 64 read with Part X of Chapter III. The concept works in three steps. First, income is classified and computed head by head, because each head has its own rules of computation, exemptions and deductions; this aggregate is often described as the gross total income. Secondly, the losses of one head are set off against the income of another head in accordance with sections 56 to 59. Thirdly, the deductible allowances are subtracted, and what remains is the total income. Total income must further be distinguished from taxable income under section 11: total income becomes taxable income after excluding income that is exempt from tax and income that is subject to final tax or a separate block of income. Tax is finally charged on taxable income at the rates given in the First Schedule, and tax credits for charitable donations, investment in shares and similar items are then allowed against the tax so computed. In short, total income is the central measuring figure of the whole Ordinance — the bridge between the five heads of income and the tax actually payable.

### (c) Turnover — Section 2(69) read with Section 113

'Turnover' is defined widely in the Ordinance and, in relation to a person for a tax year, broadly means: the gross receipts from the sale of goods; the gross fees for the rendering of services; a commission agent's total receivables in respect of the goods supplied or services rendered on behalf of the principal; the gross receipts from the execution of contracts; and other receipts declared by the Federal Board of Revenue. The most important practical use of the concept is section 113, which imposes a minimum tax on the turnover of companies and, in specified cases, of other persons: where the tax payable on taxable income is less than the prescribed percentage of turnover, the person pays tax on the basis of turnover instead. The logic is that a business with a very large volume of sales should contribute a minimum amount of tax even if it declares low profits or a loss. Turnover is therefore a gross figure, taken before deducting the cost of sales or business expenses, and this is exactly why disputes about its scope are common — taxpayers argue that a particular receipt is not part of turnover, while the department reads the definition expansively. Turnover is also relevant to the registration and audit thresholds in the Ordinance and to the withholding provisions, where the gross value of supplies, services and contracts determines the tax to be collected under sections 150 to 153.

### (d) Tax Year — Section 2(68) and Section 74

A 'tax year' is defined in section 2(68) by reference to section 74. Under section 74, the tax year is the period of twelve months ending on 30 June, and it is denoted by the calendar year in which 30 June falls: thus the period from 1 July 2025 to 30 June 2026 is 'Tax Year 2026'. This is called the normal tax year, and it applies to the great majority of taxpayers, including salaried persons and most businesses. In special cases a 'special tax year' may be adopted: a person

may, with the approval of the Commissioner, use a twelve-month period ending on a date other than 30 June — for example, the calendar year ending on 31 December, which banks, insurance companies and many multinational branches follow — while the Commissioner may require a person who changes his accounting year to use a 'transitional tax year' for the intervening period. The concept matters because almost every obligation in the Ordinance is tied to the tax year: income is aggregated for a tax year, the return of income under section 114 is filed for a tax year, advance tax under section 147 is paid during a tax year, assessments, audits, limitation periods for amendment under section 122 and the levy of default surcharge all run by reference to it. Confusing the tax year with the financial year of the Government or with the taxpayer's own accounting year is a common student error; the Ordinance deliberately links all three through sections 2(68) and 74.

### (e) Public Company — Section 2(49)

A 'public company' is defined in section 2(49) to mean: (i) a company in which not less than fifty per cent of the shares are held by the Federal Government; or (ii) a company in which not less than fifty per cent of the shares are held by a Provincial Government; or (iii) a company in which not less than fifty per cent of the shares are held by a local authority; or (iv) a public company as defined in the Companies Act, 2017, in which any of the above, singly or jointly, hold shares; or (v) a company listed on any registered stock exchange in Pakistan, whose shares are available for subscription or purchase by the public. The practical importance of the definition lies mainly in the rates of tax: Division II of Part I of the First Schedule taxes companies, and listed (public) companies have historically been charged at a slightly lower rate than unlisted companies in order to encourage listing, documentation and wider shareholding.

The definition is also relevant to provisions dealing with the distribution of profits, group relief and the treatment of dividends, because a company whose shares are genuinely available to the public is subjected to stricter disclosure and governance requirements and is, in return, given a measure of fiscal recognition. It should be noted that the definition in the Ordinance is wider than the company-law definition alone, because it expressly brings in government-held companies and stock-exchange-listed companies even where the technical company-law test might be debated.

### (f) Person — Section 2(46) and Section 80

'Person' is defined in section 2(46) simply as a person as defined in section 80, and section 80 provides that a person includes: (a) an individual; (b) a company or association of persons incorporated, formed, organised or established in Pakistan or elsewhere; (c) an association of persons established in Pakistan or elsewhere; (d) the Federal Government, a Provincial Government or a local authority in Pakistan; and (e) a foreign government, a political sub-division of a foreign government, or a public international organisation. The definition is deliberately much wider than the ordinary meaning of 'person' as a human being. Its purpose is to fix the unit of assessment: every person is a separate taxable entity that must obtain a National Tax Number, file a return, and be assessed on its own total income. A company is a person separate from its shareholders, which is why the company pays tax on its profits and the shareholder pays tax again on dividends, subject to the withholding and credit mechanism. An association of persons (AOP) — for example, a partnership firm — is likewise a separate person, distinct from its members, although the members are also taxed on their shares of profit where the Ordinance so provides. Government bodies and even foreign governments and

international organisations are included so that, unless a specific exemption in the Second Schedule protects them, income accruing to them in Pakistan can be brought within the charge of tax.

### (g) Royalty — Section 2(54)

'Royalty' is defined in section 2(54) as any amount paid or payable, otherwise than on account of the full cost price of a product, as consideration for: (a) the use of, or right to use, any patent, invention, design or model, secret process or formula, trademark, motion picture film, audio or video tape or disc, or other similar property or right; (b) the use of, or right to use, any industrial, commercial or scientific equipment; (c) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill; (d) the rendering of any assistance ancillary to the matters in (a) to (c); or (e) the use of, or right to use, a copyright in a literary, artistic or scientific work, including a cinematograph film. The essential idea is payment for the use of an intangible right or of know-how, not payment for the outright purchase of goods: if a Pakistani publisher pays a foreign author for the right to print his book, the payment is royalty; if he simply buys printed books for resale, it is not. Royalty is taxed under the head 'Income from Other Sources' (sections 39 and 40) in the hands of the recipient; royalty paid to a non-resident is subject to withholding of tax under section 152, and reduced rates are frequently provided in Pakistan's double taxation treaties, under which royalty is one of the standard articles. The wide definition, especially the limbs covering information and ancillary assistance, is designed to prevent taxpayers from escaping tax by labelling what is really a royalty as fees for services.

### Conclusion

To conclude, the definitions in section 2 are not academic decoration; they are operative provisions that decide real tax liabilities. A depreciable asset earns depreciation because it satisfies the tests of tangibility, a life of more than one year and use in producing taxable income; total income is the computed aggregate of the five heads after deductible allowances; turnover is the gross base on which minimum tax under section 113 is measured; the tax year fixes the twelve-month frame for all assessments; a public company is identified mainly by government holding or stock-exchange listing and enjoys the rate treatment given to listed companies; a person is the wide statutory unit of assessment under section 80; and royalty is the consideration for the use of intangible rights and know-how, taxed under other sources and withheld upon when paid abroad. A student who masters these definitions with their section references can handle most computation and theory questions in this course, because almost every later provision of the Ordinance uses one or more of these expressions.

## Question 2: Income from Salary — Components and Tax Treatment (20 Marks)

*The Income Tax Ordinance 2001 divides income into five major heads: salary, property, business, capital gains and other sources. Explain the components of salary & their taxation treatment as per the provisions of the Income Tax Ordinance 2001.*

### Introduction

Salary is the first and, for the largest number of Pakistan's taxpayers, the most important head of income. Sections 12 to 14 of the Income Tax Ordinance, 2001 deal with it. Section 12(1)

provides that any salary received or due from an employer, whether paid or payable, is charged to tax under the head 'Income from Salary'. Section 12(2) then gives an inclusive list of what salary means, and it is far wider than the cash that reaches the employee's bank account every month: it covers every amount, allowance, perquisite and benefit in kind received in connection with employment. The underlying principle is that an employee is taxed on the full economic reward of his employment, whether it is received in cash or in kind, while genuine reimbursements and a few specifically exempt items listed in the Second Schedule are left out. Salary is taxed on a due or receipt basis, whichever is earlier, in the tax year in which it becomes due or is received. This answer explains each component of salary — pay, allowances, perquisites, profits in lieu of salary and retirement benefits — and its exact treatment, and ends with the mechanics of deduction of tax at source by the employer under section 149.

## Basic Salary and Wages

Basic salary is the core of the pay package and is fully taxable without any exemption. It includes wages, overtime payments, fees, commission and bonuses received from the employer, because section 12(2) expressly includes any pay, wages or other remuneration provided in connection with employment, and any bonus, commission or similar amount. Arrears of salary are taxed in the year of receipt if they were not charged to tax earlier; however, section 12(7) gives relief where arrears are received in a year and, because of their bunching, the employee is placed in a higher slab — in such a case the employee may elect, by notice to the Commissioner, to be taxed at the rate that would have applied if the arrears had been received in the year to which they relate. Advance salary is taxed in the year of receipt on the receipt basis. Salary due but not received is equally taxable on the due basis, so an

employer cannot defer an employee's tax merely by delaying payment. One important boundary rule should be remembered: salary is chargeable under this head only where an employer–employee relationship exists; remuneration received by a partner from his firm, or by a director who is not an employee, is not salary but is taxed under business or other sources, as the case may be.

## Allowances Received from the Employer

Allowances are cash amounts paid over and above basic salary to meet particular needs, and the general rule is that every allowance is fully taxable unless a specific exemption applies. House rent allowance, conveyance allowance, utilities allowance, entertainment allowance, dearness allowance, cost of living allowance and overtime allowance are all added in full to taxable salary; there is no general exemption for house rent allowance in Pakistan of the kind found in some other countries. Three qualifications deserve special mention. First, medical allowance is exempt up to ten per cent of the basic salary under Part I of the Second Schedule, but only where the employer does not also provide free medical treatment, hospitalisation or reimbursement of medical expenses; if such a facility is provided, the allowance loses its exemption and becomes fully taxable, while the value of the facility itself remains exempt. Secondly, an allowance granted to meet personal expenses at the place of duty or an entertainment allowance in the hands of a government employee has a small historic exemption, but for private-sector employees allowances are taxable in full. Thirdly, any sum paid by the employer to discharge an employee's personal obligation — for example, the employer directly paying the employee's domestic servant, driver or personal utility bills — is

treated as salary of the employee, because economically it is the employee's own income applied at his direction.

## Perquisites and Benefits in Kind

Perquisites are benefits in kind provided by the employer, and section 13 values them so that they can be taxed as salary. The most common perquisite is the motor vehicle provided for official and personal use: where a vehicle is provided partly for official and partly for personal purposes, five to ten per cent of the cost of the vehicle (or its fair value where the vehicle is leased) is added to the employee's salary for the year — ten per cent where the use is wholly or partly personal as prescribed by the rules, and five per cent where the vehicle is used exclusively for official purposes. Accommodation provided by the employer is valued at the higher of forty-five per cent of the basic salary or the actual rent that would be payable for comparable accommodation, as prescribed; where the employer instead pays rent directly to a landlord on the employee's behalf, the amount paid is the perquisite. Other taxable perquisites include the services of a domestic servant, gardener, watchman or driver paid by the employer; gas, electricity, water, telephone and other utilities provided free; free or concessional passage for travel; the benefit of an interest-free loan or a loan at a concessional rate from the employer, valued by reference to the benchmark (KIBOR-based) rate under section 13; and any other amenity, service, right or privilege, other than telephone and mobile phone facilities, which are specifically excluded. The valuation rules ensure that two employees with the same cash salary but very different benefits in kind do not bear the same tax.

## Profits in Lieu of Salary and Retirement Benefits

Section 12(2) also includes any ‘profit in lieu of salary’, which covers amounts received in connection with the termination of employment or the modification of its terms: compensation for loss of office, golden handshake payments and amounts received from an unapproved provident or other fund to the extent they represent the employer’s contribution and interest on it are taxable under this head. Retirement benefits receive concessional treatment in order to encourage long-term saving. Pension received from a former employer is exempt under Part I of the Second Schedule in the cases specified there, including pension received by a citizen of Pakistan from a former employer in Pakistan, subject to the conditions of the clause. Gratuity received on retirement or death is exempt where it is received under an approved gratuity scheme or from the Government, and for other approved cases up to the limits prescribed. The accumulated balance of a recognised provident fund is exempt to the extent provided in Part I of the Second Schedule, broadly where the employee has completed the required years of continuous service, while the annual accretion — the employer’s contribution in excess of ten per cent of salary and interest in excess of the prescribed rate — is taxed as salary year by year. Commutation of pension is similarly exempt where the pension itself would be exempt. These concessions show a consistent policy: current consumption from employment is taxed fully, while genuine retirement provision is protected.

## Exemptions, Reductions and Deduction of Tax at Source

A salaried person’s final liability is computed by applying the rates in Division I of Part I of the First Schedule — the slab schedule reproduced at the end of this assignment booklet for Tax Year 2025-26, under which no tax is charged up to Rs 600,000 and progressive rates of 5, 15, 25

per cent and above apply thereafter. Certain salaried taxpayers enjoy specific reductions, for example the reduction in liability available to full-time teachers and researchers and to senior citizens in the cases and to the extent provided in Part III of the Second Schedule. The distinctive administrative feature of this head is section 149: the employer must deduct tax at source from salary payments, computed on the employee's estimated average rate for the year, deposit it in the Government treasury within the prescribed time, issue a certificate of deduction to the employee and file the prescribed statements. This deduction is adjustable, not final: if more tax has been deducted than is finally payable, the employee claims a refund by filing his return, and if less has been deducted, he pays the balance. The salaried taxpayer therefore normally meets his liability month by month through his employer, which is why salary is the most successfully documented head of income in Pakistan.

## Conclusion

To conclude, 'salary' under sections 12 to 14 is a comprehensive concept. It includes basic pay, wages, overtime, bonus and commission; all cash allowances, which are fully taxable except for the conditional ten per cent medical allowance exemption; perquisites valued under section 13, such as the company car, accommodation, servants, utilities and concessional loans; and profits in lieu of salary on the termination of employment. Against this wide charge, the Ordinance grants targeted relief for genuine retirement provision — pension, approved gratuity and recognised provident fund accumulations — and relief for arrears under section 12(7). Tax is charged at the progressive slab rates for salaried individuals and is collected mainly by the employer's adjustable deduction under section 149. The student should remember the

organising idea: whatever an employee receives because of his employment, in cash or in kind, is salary, unless the Ordinance expressly exempts it.

## Question 3: Tax Liability of Mr. Hakim, a Salaried Person (20 Marks)

*Calculate the tax liability of Mr. Hakim, a salaried person, from the following records: (Tax rates are given at the end). Basic salary Rs. 65,000 per month; utilities allowance Rs. 12,000 per month; overtime Rs. 10,000 per month; medical allowance Rs. 4,000 per month; conveyance facility provided for personal & official use, cost of vehicle Rs. 30,00,000; reimbursement of personal medical expenses Rs. 30,000 per year; contribution to the provident fund Rs. 10,000 per year; Zakat paid Rs. 10,000 per year; shares purchased in the IPO Rs. 55,000 (total); donation to a hospital Rs. 5,000 (annual).*

### Introduction and Working Notes

Mr. Hakim is a salaried individual, so his income is computed under sections 12 and 13 of the Income Tax Ordinance, 2001 and taxed at the slab rates for salaried persons given at the end of the booklet for Tax Year 2025-26. Five working notes govern the computation. (1) Basic salary, utilities allowance and overtime are fully taxable cash receipts from employment; annual amounts are obtained by multiplying the monthly figures by twelve. (2) Medical allowance is exempt up to ten per cent of basic salary only where the employer does not provide free medical treatment or reimbursement; here the employer separately reimburses Mr. Hakim's personal medical expenses of Rs. 30,000, so the condition for the exemption fails and the medical allowance of Rs. 48,000 is fully taxable, while the reimbursement itself, being the value of a medical facility provided by the employer, is exempt and is not added. (3) The car provided

for official and personal use is a perquisite under section 13 valued at ten per cent of the cost of the vehicle: 10% × Rs. 3,000,000 = Rs. 300,000 per year. (4) Zakat paid of Rs. 10,000 is a deductible allowance under section 60 and is subtracted to arrive at taxable income. (5) The investment in IPO shares (Rs. 55,000) and the contribution to the recognised provident fund (Rs. 10,000) attract tax credit under section 62, and the donation to a hospital (Rs. 5,000) attracts tax credit under section 61, in each case at the taxpayer's average rate of tax, subject to the statutory ceilings, all of which are satisfied here as shown below.

## Step 1: Computation of Total and Taxable Income

| Particulars | Working | Amount (Rs.) |
|---|---|---|
| Basic salary | 65,000 × 12 | 780,000 |
| Utilities allowance | 12,000 × 12 | 144,000 |
| Overtime | 10,000 × 12 | 120,000 |
| Medical allowance (fully taxable — see Note 2) | 4,000 × 12 | 48,000 |
| Perquisite: car for official & personal use | 10% × 3,000,000 | 300,000 |
| Reimbursement of medical expenses | Exempt (medical facility) | Nil |
| Total income from salary**Total income from salary** | | 1,392,000****1,392,000** |
| Less: Deductible allowance — Zakat paid (section 60) | | (10,000) |
| Taxable income**Taxable income** | | 1,382,000****1,382,000** |

Cross-check of the total: Rs. 780,000 + Rs. 144,000 + Rs. 120,000 + Rs. 48,000 + Rs. 300,000 = Rs. 1,392,000. Deducting Zakat of Rs. 10,000 gives taxable income of Rs. 1,382,000. Mr. Hakim has no income under any other head in the data given, so his taxable income for the year is Rs. 1,382,000.

### Step 2: Tax on Taxable Income

Applying the schedule of rates for Tax Year 2025-26 printed at the end of the booklet: taxable income of Rs. 1,382,000 falls in the third slab (exceeding Rs. 1,200,000 but not exceeding Rs. 2,200,000), where the tax is Rs. 30,000 plus 15 per cent of the amount exceeding Rs. 1,200,000. The excess is Rs. 1,382,000 − Rs. 1,200,000 = Rs. 182,000, and 15 per cent of Rs. 182,000 is Rs. 27,300. Tax before credits is therefore Rs. 30,000 + Rs. 27,300 = Rs. 57,300. The average rate of tax, which is needed for the tax credits under sections 61 and 62, is Rs. 57,300 ÷ Rs. 1,382,000 × 100 = 4.1462 per cent.

### Step 3: Tax Credits under Sections 61 and 62

Section 61 grants a credit for donations to approved charitable institutions, universities, hospitals and similar bodies. The qualifying amount is the lower of the donation actually paid and thirty per cent of taxable income; thirty per cent of Rs. 1,382,000 is Rs. 414,600, so the whole donation of Rs. 5,000 to the hospital qualifies, giving a credit of Rs. 5,000 × 4.1462% = Rs. 207. Section 62 grants a credit for investment in shares and for contributions to an approved provident fund. For the IPO shares, the qualifying amount is the lowest of the cost of investment (Rs. 55,000), twenty per cent of taxable income (Rs. 276,400) and the prescribed monetary ceiling; the whole Rs. 55,000 therefore qualifies, giving a credit of Rs. 55,000 ×

4.1462% = Rs. 2,280. For the provident fund contribution of Rs. 10,000, the credit is Rs. 10,000 × 4.1462% = Rs. 415. Total tax credits are Rs. 207 + Rs. 2,280 + Rs. 415 = Rs. 2,902.

| Item | Qualifying amount (Rs.) | Credit @ 4.1462% (Rs.) |
|---|---|---|
| Donation to hospital (section 61) | 5,000 | 207 |
| Shares purchased in IPO (section 62) | 55,000 | 2,280 |
| Contribution to provident fund (section 62) | 10,000 | 415 |
| Total tax credits**Total tax credits | | 2,902**2,902 |

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## Step 4: Net Tax Payable

| Particulars | Amount (Rs.) |
|---|---|
| Tax on taxable income of Rs. 1,382,000 | 57,300 |
| Less: Tax credits (sections 61 and 62) | (2,902) |
| Net tax liability of Mr. Hakim**Net tax liability of Mr. Hakim | 54,398**54,398 |

The net tax liability of Mr. Hakim for the tax year is therefore Rs. 54,398. In practice this amount would be compared with the tax already deducted by his employer from his salary under section 149: if the employer has deducted more than Rs. 54,398 during the year, Mr. Hakim is entitled to a refund of the excess on filing his return; if less has been deducted, the balance of Rs. 54,398 minus the amount already deducted is payable with the return.

### Conclusion

To conclude, the computation follows the standard four-step method for a salaried taxpayer: aggregate every cash and in-kind receipt from employment (Rs. 1,392,000), deduct the deductible allowance for Zakat to reach taxable income (Rs. 1,382,000), apply the printed slab schedule to obtain tax before credits (Rs. 57,300), and finally allow the tax credits for the hospital donation, the IPO investment and the provident fund contribution at the average rate of 4.1462 per cent (Rs. 2,902). The two points on which this question turns are the loss of the medical-allowance exemption because medical reimbursement is also provided, and the valuation of the mixed-use car at ten per cent of its cost. The final tax liability of Mr. Hakim is Rs. 54,398, and all figures cross-check: the components add to the total income, the slab arithmetic is exact, and the credits are each computed on qualifying amounts that lie within their statutory ceilings.

## Question 4: Capital Gains and Income from Other Sources (20 Marks)

*Describe the concept and taxation treatment of capital gains and income from other sources under the Income Tax Ordinance 2001.*

### Introduction

Capital gains and income from other sources are the fourth and fifth heads of income under the Income Tax Ordinance, 2001, dealt with in sections 37 to 38 and sections 39 to 43 respectively. They are natural companions in a single question. The capital gains head taxes the profit that arises not from a regular trade but from the disposal of a capital asset — a gain that accrues because an asset has appreciated in value while it was held. The ‘other sources’ head is the

residuary head: it catches every kind of income that is chargeable to tax but does not fall under salary, property, business or capital gains. Together the two heads ensure that the charging net of section 9 has no gaps: every receipt that is income in nature is taxed somewhere, either under a specific head or under the residuary head. This answer explains the concept and treatment of each head in turn — the meaning of a capital asset, the computation of the gain, the rates and holding-period rules, the set-off of capital losses, and then the scope, inclusions and deductions of income from other sources — before drawing the two together in a brief comparison.

## Capital Gains: Concept and Charge — Section 37

Section 37(1) provides that a gain arising on the disposal of a capital asset by a person in a tax year is chargeable to tax under the head 'Capital Gains'. A 'capital asset' is defined in section 2(9) very widely as property of any kind held by a person, whether or not connected with a business, but excluding: stock-in-trade, consumable stores and raw materials held for business purposes; movable property held for personal use (with important exceptions such as jewellery, paintings and similar valuable articles, which remain capital assets); agricultural land in Pakistan in the cases excluded by the definition; and certain specified shares and certificates. The exclusion of stock-in-trade is the key boundary: profit on selling an asset that the taxpayer trades in is business income, while profit on selling an asset that he held as an investment or for use is a capital gain. A 'disposal' is equally wide and includes a sale, exchange, transfer under a compulsory acquisition, and the redemption or relinquishment of an asset. A gain arises only on disposal: a mere rise in the market value of an asset that is still held creates no taxable gain, which is why capital gains tax is sometimes described as a tax on realised appreciation. Capital

gains must also be distinguished from income from property and business by the intention and regularity tests applied by the courts — a single, isolated realisation normally produces a capital gain, while a planned series of purchases and sales may amount to an adventure in the nature of trade taxed as business income.

## Computation of the Gain — Section 37(2) to (4) and Section 38

The gain is computed under section 37 by deducting from the consideration received on disposal: (a) the cost of acquiring the asset; and (b) any expenditure wholly and exclusively incurred in connection with the disposal, such as brokerage, commission and legal charges on transfer. Where the consideration received is less than the cost, the result is a capital loss, which is dealt with under the set-off rules discussed below. Section 38 contains special rules, including the treatment of assets that were depreciable assets: where a depreciable business asset is sold, the gain up to the depreciation allowed is in substance recaptured through the business computation, and only the excess over original cost can be a capital gain. Special computation regimes apply to the two most important classes of assets. For securities (listed shares and similar instruments), the First Schedule prescribes rates by reference to the holding period and the date of acquisition, with gains on securities acquired on or after 1 July 2024 generally taxed at a flat rate, and the collection mechanism operating through the National Clearing Company under section 37A. For immovable property, the First Schedule similarly prescribes rates that depend on the holding period, collected at the time of registration or transfer under section 236C, with longer holding periods historically attracting lower rates in order to discourage speculation and reward genuine long-term holding. The student should

note the policy pattern: the law does not tax all capital gains at the taxpayer's ordinary slab rate, but largely through separate, final or presumptive rate blocks given in the First Schedule.

## Exemptions, Losses and Collection of Capital Gains Tax

Certain capital gains are exempt or excluded, for example gains protected by Part I of the Second Schedule and gains on assets that fall outside the definition of a capital asset, such as most personal effects and specified agricultural land. Capital losses are ring-fenced: under sections 58 and 59 a capital loss can be set off only against capital gains, not against salary, business or other income, and an unabsorbed capital loss of the year may be carried forward for set-off against capital gains of the following years up to the limit prescribed by section 59 (six years), subject to the conditions of that section. Collection is largely transaction-based, which makes this head highly documented: tax is withheld on the sale of immovable property (section 236C), on the purchase of property by the buyer in specified cases (section 236K, an advance tax adjustable against the buyer's liability), and on securities through the capital-gains collection system administered with the stock exchange and the clearing company. Gains of non-residents on Pakistani assets are equally chargeable, because the gain accrues or arises in Pakistan, and double taxation treaties generally preserve Pakistan's right to tax gains on immovable property and substantial shareholdings situated here. The result is a head that is conceptually simple — consideration minus cost — but administratively detailed, because the asset class, the holding period and the mode of disposal all affect the final charge.

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## Income from Other Sources: Concept and Inclusions — Sections 39 and 40

Section 39(1) provides that income of every kind received by a person in a tax year, if it is not chargeable to tax under any other head, is chargeable under 'Income from Other Sources'. Section 39(2) and section 40 then name the principal inclusions. They include: dividends (also separately defined and, where applicable, taxed at the special rates in the First Schedule with withholding under section 150); profit on debt, such as interest on bank deposits, government securities and loans (with withholding under section 151); ground rent; rent received for the sub-lease of a house or building and rent for plant, machinery or equipment let out where it is not business income; royalty, as defined in section 2(54); income from providing any facility of any name or form against any amount, prize money and winnings from lotteries, crossword puzzles, races and card games in the cases specified; any profit from the provision of a finance or loan-related arrangement; annuity and pension-type receipts not taxed as salary; and any other income that is income in the ordinary sense but fits nowhere else. Two classic illustrations show the residuary character of the head: interest earned by a salaried employee on his bank deposit is 'other sources', because it is not salary, while the same interest earned by a money-lending business would be business income. The head therefore performs a sweeping-up function, and the courts have consistently read it widely, holding that a receipt need not be specifically named if it bears the character of income and is not exempt.

## Deductions and Treatment under Other Sources — Sections 40 and 41

Against income from other sources, section 41 allows a deduction for any expenditure wholly and exclusively incurred by the taxpayer for the purpose of earning that income, other than expenditure of a capital nature; the classic example is interest paid on money borrowed to

purchase the shares or securities that produce dividend or profit on debt, and collection charges actually incurred. No deduction is allowed for personal or domestic expenses, and no deduction can exceed the character permitted by the section — in particular, no deduction is allowed against income that is subjected to a separate block or final tax treatment, such as dividend and most profit on debt, because those incomes are taxed at the rates in the First Schedule on the gross amount, with the withholding tax treated as final tax in the cases specified. Tax treatment under this head is therefore of two kinds. Some items, notably dividend and profit on debt, are largely taxed through withholding at special rates (sections 150 and 151) and in many cases that withholding is the final tax. Other items, such as ground rent, sub-lease rent and royalty received by a resident, are aggregated with the taxpayer's other income and taxed at the normal applicable rates, with any tax withheld treated as adjustable. Losses under this head follow the general set-off rules of sections 56 to 59, except that no loss can be computed against a final-tax item. The head is assessed, like the others, on the basis of the tax year, and the receipts are generally taxed on a receipt basis except where a specific provision directs otherwise.

## Conclusion

To conclude, capital gains tax under sections 37 and 38 is a tax on realised appreciation of capital assets, computed as consideration minus cost and disposal expenses, charged largely at the special holding-period-based rates of the First Schedule, with capital losses ring-fenced against capital gains only and carried forward under section 59. Income from other sources under sections 39 to 41 is the residuary head that taxes every income receipt not covered elsewhere — dividend, profit on debt, royalty, ground rent, sub-lease rent, prizes and similar

items — allowing only revenue expenditure wholly and exclusively incurred to earn the income, and taxing many of its items finally through withholding. The two heads complete the five-head structure of the Ordinance: the first four heads tax identified streams of income, while these two make sure that neither the occasional profit on an asset nor the odd, unnamed receipt escapes the charge to tax.

## Question 5: Income Tax Return — Who Must File, Requirements of a Valid Return and Penalty for Non-Filing (20 Marks)

*What is an income tax return? Who is required to file the income tax return? What are the requirements of a valid return of income? Also, write down the penalty for non-filing of the income tax return.*

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### Introduction: What is an Income Tax Return?

An income tax return is the prescribed statement which a taxpayer files with the Federal Board of Revenue (FBR), through the Commissioner, declaring for a tax year his total income, taxable income, the tax payable by him, the tax already paid or deducted at source, and the refund, if any, claimed by him. Under Pakistan's system of universal self-assessment, the return is far more than a formality: under section 120, a complete return of income filed under section 114 is taken to be an assessment order itself on the day it is furnished, so the taxpayer in substance assesses himself, and the department's role is to verify, audit and, where necessary, amend that self-assessment. The return is filed electronically through the FBR's online system (IRIS) in the form prescribed by the Board under the Income Tax Rules, 2002, and for individuals it is accompanied by a wealth statement under section 116, a reconciliation of wealth, and, where

applicable, a foreign income and assets statement under section 116A. The normal due date for individuals and associations of persons is 30 September following the end of the tax year, and for companies 31 December (or 30 September for companies with a June year end in the cases specified), unless the Board extends the date. This answer states, in turn, who is required to file, what makes a return valid, and what penalty and other consequences follow from non-filing.

## Who is Required to File a Return? — Section 114

Section 114(1) lists the persons who must furnish a return of income for a tax year. The principal categories are as follows:

- Every company, for every tax year, whether or not it has taxable income.
- Every person (other than a company) whose taxable income for the year exceeds the maximum amount that is not chargeable to tax under the Ordinance — for individuals, broadly, taxable income above Rs. 600,000 under the current First Schedule threshold.
- Any person who has been charged to tax in any of the two preceding tax years, who claims a loss carried forward, or who owns immovable property of the prescribed area or a motor vehicle as specified in section 114.
- Any person who holds a commercial or industrial electricity connection, or whose annual utility bills or other specified expenditure crosses the thresholds notified under section 114, and any person registered for sales tax or federal excise or holding the specified licences and memberships mentioned in the section, including a business or professional chamber, market committee, professional body and similar persons listed there.

- Every resident person deriving income from a foreign source above the prescribed limit, every person who is required to furnish a wealth statement, non-profit organisations, welfare institutions and trusts within the terms of section 114, and any other person whom the Commissioner calls upon by notice under section 114(4) to file a return, even if his income is below the taxable limit.
- Every person whose income is exempt or subject to final tax in the cases covered by section 114, where the section requires a return notwithstanding the exemption or final discharge — a return obligation depends on the section, not merely on whether tax is finally payable.

Two practical points follow. First, the duty to file is wider than the duty to pay: a person may owe no tax at all and still be legally bound to file, for example a company with a loss. Secondly, filing also controls the taxpayer's status on the Active Taxpayers List (ATL): only a person who files by the due date (or the extended date) is treated as a 'filer' for the higher withholding rates that apply to non-filers throughout the Ordinance, so the return is the gateway document of the entire tax system.

## Requirements of a Valid Return — Sections 114(2) to (6) and 118

A return that is defective is treated as an invalid return, which is almost as dangerous as filing no return at all, so section 114 prescribes the conditions of validity carefully. A valid return must satisfy the following requirements.

- It must be in the prescribed form and be verified in the prescribed manner (section 114(2)): the return is filed electronically on IRIS, verified by the taxpayer's own IRIS credentials/PIN,

and, where the taxpayer is a company or an AOP, signed and verified by the principal officer or the authorised representative in accordance with section 172 on representatives.

- It must be duly filled in, complete and correct in all material particulars: all heads of income, exempt income, foreign income, tax deducted at source and taxes paid must be declared, and the return must be accompanied by the documentary evidence of tax payment and deduction prescribed, including the certificates of collection and deduction and the paid challans (PSIDs).
- It must be accompanied by payment of the tax payable: under section 114(6) and section 137, a return is not valid/treated as furnished unless the tax payable on the basis of the return has been paid before or at the time of filing; the unpaid balance attracts default surcharge under section 205.
- It must be accompanied, where applicable, by the wealth statement under section 116 together with the wealth reconciliation statement explaining the increase or decrease in net wealth during the year, and by audited accounts/financial statements in the case of companies and persons required to maintain audited accounts, as required by the prescribed form and the Rules.
- It must be filed within the time allowed by section 118 (the schedule of due dates) or within the period allowed in response to a notice under section 114(4); a return filed for a tax year must also quote the taxpayer's National Tax Number/registration number correctly so that IRIS can accept and process it.
- If a return furnished is found to be incomplete or defective, the Commissioner may, under section 114 read with the assessment provisions, serve a notice calling upon the taxpayer to

remove the defect within the time allowed; failure to remove it renders the return invalid, and it is treated as if it had never been filed.

A taxpayer who discovers an omission or wrong statement in a valid return may file a revised return under section 114(6A) within the period and on the conditions laid down — broadly within five years of the original filing, with the approval of the Commissioner where required — but a revised return cannot be used to cure the consequences of an invalid return after the department has acted upon the default. Accuracy at the first filing is therefore the safe course.

## Penalty and Other Consequences of Non-Filing

Non-filing is punished on four levels: a monetary penalty, default surcharge and compensatory consequences, prosecution in serious cases, and adverse withholding and 'non-filer' treatment across the tax system. The principal penalty is in the Table in section 182 of the Ordinance. Where a person fails to furnish a return of income as required under section 114 by the due date, he is liable to a penalty equal to 0.1 per cent of the taxable income for each day of default, subject to the minimum penalty prescribed in that Table — a minimum of Rs. 40,000 for an individual (with higher minimum amounts prescribed for other classes of persons, notably companies) — and subject also to the maximum limits laid down in the Table as amended from time to time by the Finance Acts; where the taxable income is nil or the person has sustained a loss, the prescribed minimum penalty applies. In addition, late filing means exclusion from the Active Taxpayers List for the year until the return is filed and the prescribed late-filing surcharge for ATL inclusion is paid under section 182A; while a person remains a non-filer, the Ordinance subjects many of his transactions — banking, purchase of property and

vehicles, dividends, and other payments listed in the withholding regime — to substantially higher rates of withholding tax, which is often a heavier practical burden than the penalty itself. Further, where a person fails to file in response to a notice under section 114(4), or wilfully fails to file with the intention of evading tax, prosecution may be launched under Chapter XXII (notably section 191A and the related offence provisions), punishable with fine and imprisonment as prescribed, and the Commissioner may proceed to make a best judgment assessment under section 121 on the basis of available material. Penalties are levied only after giving the taxpayer an opportunity of being heard under section 182(2), and an order imposing a penalty is appealable like other orders under the Ordinance.

## Conclusion

To conclude, the income tax return under section 114 is the taxpayer's self-assessment for the tax year: it declares his income, tax, payments and refund, and under section 120 it is itself treated as the assessment order. Every company, every individual whose taxable income exceeds the non-taxable limit (Rs. 600,000), persons charged to tax earlier, property and vehicle owners, utility-threshold persons, foreign-source earners and any person called upon by notice must file it. A return is valid only if it is in the prescribed form, duly verified, complete, accompanied by proof of taxes paid and deducted, by the wealth statement where required, and by payment of the tax payable, and is filed within the time allowed by section 118. Non-filing attracts the penalty in the Table in section 182 — 0.1 per cent of taxable income per day of default subject to the prescribed minimum (Rs. 40,000 for individuals) and maximum — besides default surcharge, exclusion from the Active Taxpayers List under section 182A, higher withholding as a non-filer, best judgment assessment under section 121 and, in wilful cases,

prosecution. Filing a complete and correct return on time is therefore both a legal duty and a clear financial advantage.

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