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Tax on Windfall Gains of Bank

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Introduction

Section 99D of the Income Tax Ordinance, 2001 empowers the Federal Government to impose an additional tax on company operating in a specified sector or sectors, not exceeding 50% of windfall income, profit or gains arising due to economic factors for any of the last three years preceding the tax year tax year 2023 and onwards.

Definition

The term "windfall profits tax" is elucidated in Black's Law Dictionary as a tax imposed on a business or industry following a sudden increase in profits.

Section 99D Procedures

Section 99D stipulates that the Federal Government, through notification in the official gazette, will delineate the sectors to which this section applies, the criteria for windfall income, profits/gains, and relevant economic factors. These factors encompass, but are not limited to, international price fluctuations impacting commodity prices in Pakistan, sector-specific fluctuations, and differences in income, profits, or gains due to foreign currency fluctuations.

Moreover, it is mandated in section 99D that the Federal Government must present such notifications to the National Assembly within ninety days of issuance or by June 30 of the financial year, whichever occurs first. This provision aims to safeguard against challenges to this tax on the basis that it is not included in the charging provisions.

Corresponding Amendments

Corresponding amendments were made to apply these provisions to insurance companies (Fourth Schedule), Oil & Gas Exploration (Fifth Schedule), and Banking companies (Seventh Schedule).

FBR's Directive - S.R.O.1588 (I)/2023

On 21 November 2023, Federal Board of Revenue (FBR) issued S.R.O.1588 (I)/2023, specifying banking companies as the sector for the purpose of section 99D of the Ordinance. Banks are obligated to pay 40% additional tax on windfall income, profits, and gains arising during calendar years 2021 and 2022 (tax years 2022 and 2023) by November 30, 2023. The deadline is extendable up to fifteen days upon application and approval of the Commissioner.

Formula for Computation

Through this SRO, Windfall income, profits, and gains are computed using a provided formula. Specific parameters include tax years (TY), calendar years (CY), arithmetic means (AM), and foreign exchange income (Fx Income) for the relevant years.

Illustrations I and II elucidate application of formula to a bank's foreign exchange income, demonstrating calculation of windfall income, profits, and gains, along with resulting additional tax under section 99D at 40% rate. The illustrations also underscore provisions for handling negative windfall income and exclusion of losses from calculation.

The formula is utilized to calculate windfall income, profits, and gains for two tax years 2022 and 2023. In simpler terms, the formula compares current year's foreign exchange income with average income from previous years, with adjustments for specific years involved, aiding in determining the tax implication.

Formula Application Steps

Windfall Income for 2022 (Calendar Year 2021):

Take the foreign exchange income for 2021 (Fx Income 2021) subtract the average foreign exchange income from the years 2015 to 2020 (AM2022). This average is calculated by adding up the foreign exchange



income for each of those years and then dividing it by 6 (the number of years).

Windfall Income for 2023 (Calendar Year 2022)

Take the foreign exchange income for 2022 (Fx Income 2022) subtract the average foreign exchange income from the years 2016 to 2021, excluding the windfall income from 2021 (AM2023). This average is calculated similarly to AM2022 but excludes the windfall income from the calculation.

Important Notes

TY stands for Tax Year, and CY stands for Calendar Year.

AM2022 is the average foreign exchange income from 2015 to 2020.

AM2023 is the average foreign exchange income from 2016 to 2021, excluding the windfall income from 2021.

Fx Income 2015 to Fx Income 2022 are the foreign exchange incomes for the respective years, as disclosed in financial statements or notes.

In simpler terms, this formula is a way of figuring out windfall income by comparing the foreign exchange income of the current year with the average income from the previous years, with adjustments for the specific years involved.

Interpretational Aspects

The validity of this SRO shall be subject to test in shape of placement of same before National Assembly, primarily due to the existing political circumstances in Pakistan. Notwithstanding this aspect, many tax experts / litigators shall argue that the imposition of this additional tax is only justifiable for years after tax year 2023 as there are various judgments of superior courts with regards to past and close transaction.

Having said that there are no recovery procedures narrated in said notification in case if the taxpayers do not pay the said tax, meaning thereby we consider that there may be further amendments round the corner.

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