Government of Pakistan
Revenue Division
Federal Board of Revenue
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C.No. 1(28)R&S/2019 Islamabad, the 20th August, 2019.

Circular No. 13/2019
(Income Tax)

Subject: **EXPLANATION OF THE SECTION 109A OF INCOME TAX ORDINANCE 2001.**

A new section 109A has been introduced by Finance Act, 2018, which is effective from 1st July, 2018. Return for tax year 2019 will be the first year when provision of this section will become applicable. This section states that taxable income of resident person shall include income attributable to a "Controlled Foreign Company (CFC)".

2. In ordinary sense, income of a foreign company owned by a Pakistani resident is 'taxable' in Pakistan only when such income is 'received' from that non-resident entity. Section 109A(1) of the Ordinance is a deeming provision which essentially creates legal fiction resulting in following exceptions;

(a) Corporate veil is pierced and income of a 'company' is deemed to be the income of controlling entity; and

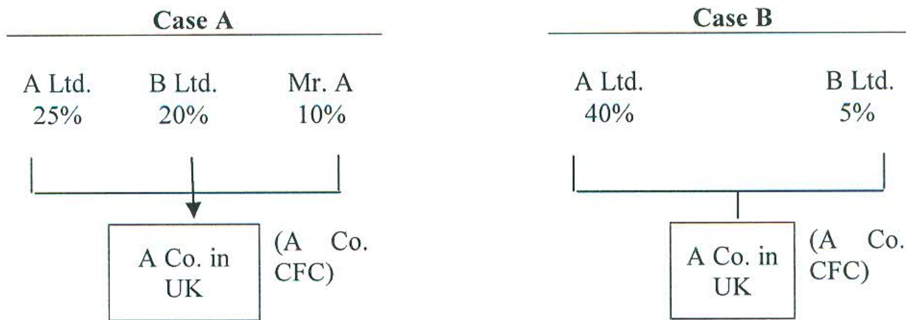
(b) Income is taxed in the year it is 'earned' not when it is actually 'received'. This is the consequence of the first action because when corporate veil is pierced the income becomes taxable when earned.

3. **What is a CFC**: In order to determine that a foreign company is a Controlled Foreign Company (CFC) either of the two conditions regarding control of the resident over foreign company has to be fulfilled:-

i) more than fifty percent of the capital or voting rights of the non-resident company are held, directly or indirectly, by one or more persons resident in Pakistan; or
ii) more than forty percent of the capital of the or voting rights of the non-resident company are held, directly or indirectly, by a single resident person in Pakistan.

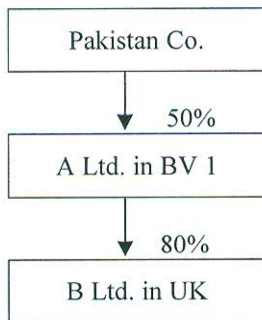
This can be illustrated as under:

Table A



[in both examples the A Co. in UK shall be treated as CFC of the residents of Pakistan]

Table B



[Both A and B are CFCs]

However, a foreign entity which fulfills either of the above condition, cannot be treated as a CFC if:-

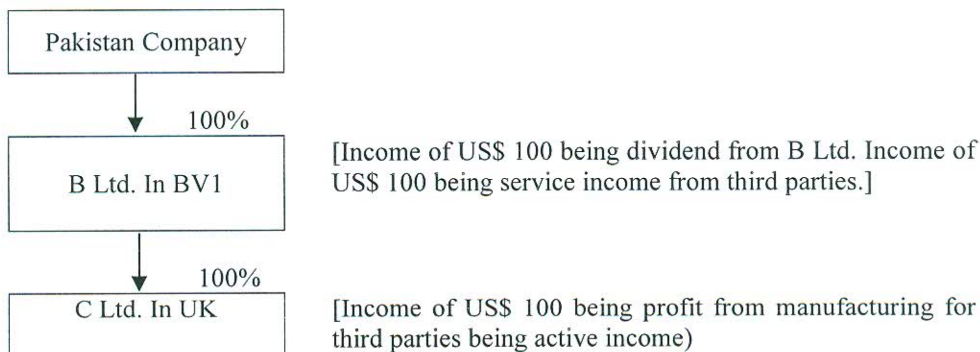
i) the shares of the company are traded on any stock exchange recognized by law of the country or jurisdiction of which the non-resident company is resident for tax purposes;
ii) the non-resident company derives active business income as defined under sub-section (3) of section 109A; and
iii) tax paid, after taking into account any foreign tax credits available to the non-resident company, on the income derived or accrued, during a foreign tax year, by the non-resident company to any tax authority outside Pakistan is less than sixty percent of the tax payable on the said income under this Ordinance.

4. The concept of Active Business Income:

"Active Income" for the purpose of exclusion from CFC regime requires simultaneous fulfillment of two conditions:-

i) cumulative income from dividend, interest, property, capital gains, royalty, annuity payment, supply of goods or services to an associate, sale or licensing of intangibles and management, holding or investment in securities and financial assets is less than 20% of the total income of the said company; and
ii) principal source of the company is under the head "income from business" in the country or jurisdiction of which it is a resident.

Table C



[The dividend income of B Ltd is 50% of the total income of the company hence exceeds threshold of more than 20% passive income therefore it constitute CFC. Whereas 100% income of C Ltd is from business (Active Income) it cannot be treated as CFC.

5. Direct and Indirect Control:

The term 'direct control' refers to direct ownership of capital or voting rights in the foreign entity. However the term 'indirect control' is very wide in its connotation. It includes indirect control by a company through subsidiary companies in which the resident person holds capital or voting rights but also includes other companies in which the resident person exercises control through ownership of capital or voting rights.

Example I:

Mr. A owns 30% shares in A Ltd (a non-resident company) and also owns 30% shares in B Ltd. (another non-resident company) which in turn owns 70% capital of A Ltd. In this case A Ltd shall be treated as CFC of Mr.A through indirect control.