CHAPTER 13

FOREIGN SOURCE INCOME

How a **resident** is taxed on **foreign-source income**: separate computation, the **foreign tax credit** (s.103), **foreign losses** (s.104), and the exemptions for **short-term residents** (s.50), **returning expatriates** (s.51) and **foreign salary** (s.102). Law: ITO 2001 · tax year 2027.

CHAPTER ROADMAP

1	Taxation of foreign income	resident person
2	Computation of income	separate
3	Foreign tax credit	s.103
4	Foreign losses	s.104
5	Short-term residents	s.50
6	Returning expatriates · foreign salary	ss.51 · 102

PRINCIPLE A **resident** is taxed on **worldwide** income (Pakistan-source and foreign-source); a **non-resident** only on Pakistan-source income (Chapter 4). Foreign business income is therefore chargeable in Pakistan like any other.

1 COMPUTING FOREIGN-SOURCE INCOME

kept separate

1 SEPARATE FROM PAKISTAN INCOME

Foreign-source income is computed **separately**. Expenses of earning it are deductible **only against foreign income** — and Pakistan expenses only against Pakistan income.

2 SEPARATE FOR EACH HEAD

Foreign income is computed **head by head**: foreign other-sources income separately from foreign business income, and **speculation business is a separate head**.

3 SAME PRINCIPLES

Foreign **business** income follows the same computation principles as Pakistan business income.

4 NO CROSS SET-OFF

Foreign losses are not adjustable against Pakistan-source income.

2 FOREIGN TAX CREDIT

section 103

THE CREDIT

The **lesser of** (a) the **foreign income tax paid** (including foreign withholding) and (b) the **Pakistan tax payable on that income**.

PAKISTAN TAX ON FOREIGN INCOME

Average rate × net foreign-source income. Average rate = Pakistan income tax **before credits ÷ taxable income**. Net foreign income = foreign income less deductions exclusively or reasonably (s.67) attributable to it.

EACH HEAD SEPARATELY

If foreign income arises under more than one head, apply the credit **head by head**; speculation is its own head.

CONDITIONS

Allowed only if the foreign tax is **paid within two years after the end of the tax year** in which the income was derived. Unused credit is **not refunded, carried forward or carried back**. Order of credits: foreign tax credit first.

3 WORKED EXAMPLE

fresh numbers · tax year 2027

Non-salaried individual	Case A: foreign tax 120,000	Case B: foreign tax 300,000
Pakistan-source income	3,000,000	3,000,000
Foreign other-sources income	1,000,000	1,000,000
Taxable income	4,000,000	4,000,000
Gross tax: 650,000 + 40% × (4,000,000 − 3,200,000)	970,000	970,000
Average rate 970,000 ÷ 4,000,000	24.25%	24.25%
Pakistan tax on foreign income: 1,000,000 × 24.25%	242,500	242,500
Credit = lower of foreign tax and 242,500	**120,000**	**242,500** (57,500 lapses)
Net tax payable	**850,000**	**727,500**

4 FOREIGN LOSSES

section 104

WHERE IT CAN BE USED

Deductible expenditure on foreign income is deductible **only against that foreign income**. An excess is a **foreign loss** of that head.

CARRY FORWARD

To the following year, against **foreign income of the same head**; **no more than six tax years**; **earliest year first**. Speculation foreign income is a separate head for set-off and apportionment.

5 EXEMPTIONS FOR FOREIGN-SOURCE INCOME

sections 50, 51, 102

SHORT-TERM RESIDENT · s.50

Foreign-source income is **exempt** for an individual who is resident **solely because of employment** and present in Pakistan for **not more than three years**. **Not** exempt: income from a **business established in Pakistan**, or foreign income **brought into or received in Pakistan**.

RETURNING CITIZEN · s.51

A **citizen not resident in any of the four preceding tax years**: foreign-source income is exempt in the year he becomes resident **and the next year**. A citizen who **leaves Pakistan and stays abroad** for the rest of the year: foreign **salary** earned there is exempt.

FOREIGN SALARY · s.102

A resident's foreign-source **salary** is exempt **if foreign income tax has been paid** — withheld by the foreign employer and paid to that country's revenue authority.

OTHER EXEMPTIONS

Diplomats and UN officials, foreign government officials and international agreements (Chapter 11).

EXAMPLE

Worked situation: a man returns after five years abroad. If he is a **Pakistani citizen**, s.51 exempts his foreign income in the year of return and the next; only his Pakistan salary is taxed. If he is a **foreign national**, s.50 applies: foreign income is taxed only to the extent it is **received in Pakistan**.

6 EXAM FOCUS · MCQ TRAPS

what examiners test

1 Separate computation
Foreign expenses are deductible **only against foreign income**.

2 Foreign losses
Never against Pakistan income; **six years**; same head; speculation separate.

3 Credit amount
Lower of foreign tax paid and Pakistan tax on that income.

4 Average rate
Tax **before credit** ÷ taxable income — then × net foreign income.

5 Two-year rule
Foreign tax must be paid within **two years** after the end of the tax year of the income.

6 Excess credit
Lapses: no refund, carry forward or carry back.

7 Section 51
Only **citizens**; not resident in the **four** preceding years; exempt for **two** years.

8 Sections 50 and 102
s.50: **three years**, lost if brought into Pakistan; s.102: foreign tax **must have been paid**.

CLASSIFY IT · EXEMPT OR TAXABLE?

1	Foreign salary of a resident, foreign tax withheld	EXEMPT
2	Foreign salary of a resident, no foreign tax	TAXABLE
3	Foreign income of a citizen in the year of return after 5 years abroad	EXEMPT
4	Same citizen, third year after return	TAXABLE
5	Foreign national resident 2 years; income kept abroad	EXEMPT
6	Same person; income brought into Pakistan	TAXABLE
7	Citizen leaves Pakistan, stays abroad all year: foreign salary	EXEMPT
8	Foreign rent of a long-term resident	TAXABLE

CLASSIFY IT · FOREIGN TAX CREDIT?

1	Foreign tax 120,000; Pakistan tax on it 242,500	CREDIT 120,000
2	Foreign tax 300,000; Pakistan tax on it 242,500	CREDIT 242,500
3	Foreign tax paid 3 years after the year end	NO CREDIT
4	Credit exceeds Pakistan tax	LAPSES
5	Foreign business loss against Pakistan income	NOT ALLOWED
6	Foreign loss unabsorbed	6 YEARS
7	Two foreign heads of income	CREDIT PER HEAD
8	Average rate	TAX ÷ TAXABLE INCOME

LISTS TO KNOW

Foreign loss	Credit timing	s.50	s.51	Average rate
6 years · same head	paid within 2 years	up to 3 years	4 prior years · 2 years exempt	tax ÷ taxable income

REVISION MAP

1 · PRINCIPLES

Resident: worldwide income · foreign income computed separately and head by head · same business principles · foreign losses never against Pakistan income

2 · FOREIGN TAX CREDIT

Lower of foreign tax paid and average rate × net foreign income · average rate = tax before credit ÷ taxable income · per head · paid within two years · excess lapses

CHAPTER 13
FOREIGN INCOME

3 · FOREIGN LOSSES

Deductible only against foreign income · same head · carried forward six years · earliest first · speculation is a separate head

4 · EXEMPTIONS

s.50 short-term resident (3 years; not business in Pakistan, not income received here) · s.51 returning citizen (4 prior years; 2 years) · s.102 foreign salary with foreign tax paid

Computation
Separate and head by head.

Credit
Lower of two taxes.

Losses
Six years, same head.

Exemptions
ss.50, 51 and 102.