CHAPTER 7

INCOME FROM BUSINESS · PART 1

What counts as **business**, what section 18 charges, **speculation business**, the **general rule and the long list of disallowances** (ss.20, 21), the special deductions (ss.26 – 29), **accounting methods and stock valuation**, and **tax on digital transactions**. Law: ITO 2001 · tax year 2027.

CHAPTER ROADMAP

1	Income from business	ss.2(10) · 18 · 19
2	General deductions	ss.20 · 21
3	Special deductions	ss.26 – 29
4	Tax accounting	ss.32 – 35
5	Digital transactions	1% · 2%

DEFINITION — **Business** [s.2(10)] includes any **trade, commerce, manufacture, profession, vocation** or adventure or concern in the nature of trade, commerce, manufacture, profession or vocation — but **not employment**. Even income from an illegal business is taxable.

1 BUSINESS OR EMPLOYMENT?

four tests

OWN WORK OR FOR OTHERS
Working for **remuneration** for another points to employment.

PART OR FULL TIME
Working for **several persons** indicates business; working for one does not by itself make employment.

WHO DOES THE WORK
Work done by a **company or firm** indicates business.

CAPACITY
Dealing in **own** goods / services (independent) vs goods / services of **someone else** (dependent).

2 WHAT SECTION 18 CHARGES

head: income from business

1 PROFITS AND GAINS
Profits and gains of any business carried on at any time in the year (excluding final-tax income).

2 TRADE ASSOCIATIONS
Income of a trade, professional or similar association from **selling goods or services to members** (co-operative societies and clubs included).

3 HIRE OF MOVABLES
Income from the **hire or lease of tangible movable property**.

4 BENEFIT FROM BUSINESS RELATIONSHIP
FMV of any benefit or perquisite, convertible into money or not, including waiver of profit on debt / debt under an SBP scheme.

5 MANAGEMENT FEE
Derived by a management company, including a modaraba management company.

6 PROFIT ON DEBT
Business income **only if** earning it is the business (banks, financial institutions); otherwise **other sources**.

7 LEASE RENTALS
Of a scheduled bank, investment bank, DFI, modaraba or leasing company.

8 MUTUAL FUND PAYOUTS
Amounts a mutual fund / PE & VC fund distributes out of profit on debt to a **bank or NBFC**.

3 GENERAL PRINCIPLES

real profits only

WORLDWIDE
A **resident** is taxed on worldwide business income; a non-resident on Pakistan source only.

ACCRUAL FOR COMPANIES
Companies must use **accrual**; others may use cash or accrual.

REAL, NOT NOTIONAL
Revaluation / impairment gains and **unrealised exchange** gains are not taxed until realised. Capital receipts are not taxed unless made taxable.

TAXABLE EVEN AFTER CLOSURE
Recoveries of deductions (s.70); gain on depreciable assets (s.22(8)); bad debt recoveries (s.29(3)); unpaid liabilities after 3 years (s.34(5)); receipts after discontinuance (s.72).

4 SPECULATION BUSINESS

section 19

WHAT IT IS

A contract to buy and sell a commodity (incl. shares) that is **settled otherwise than by actual delivery**.

NOT SPECULATION

(1) A manufacturer's / merchant's contract to **guard against price fluctuation** in order to fulfil **other contracts for actual delivery**; (2) a dealer's / investor's contract to guard against loss on **his holding of shares**; (3) **jobbing (arbitrage)** by a forward-market or stock-exchange member.

TREATMENT

A **separate business**; expenses apportioned as if a separate head; its **loss is set off only against other speculation income** and carried forward **six years** (speculation only).

Fresh example	Speculation	Trading	Total
Gross revenue	3,000,000	15,000,000	18,000,000
Gross profit	600,000	3,000,000	3,600,000
Common expenses 900,000 by revenue (3/18 : 15/18)	150,000	750,000	900,000
Net income	450,000	2,250,000	2,700,000
Brought-forward loss	520,000	400,000	
Taxable income / (loss c/f)	**(70,000) c/f**	**1,850,000**	

5 DEDUCTIONS · GENERAL RULE

section 20

WHOLLY AND EXCLUSIVELY

Expenditure incurred in the year **wholly and exclusively** for business. It need not be compulsory or unavoidable — a **voluntary** spend to promote business qualifies.

ANIMALS

For animals used in the business (not stock in trade) that die or become permanently useless: **cost less carcass value**.

6 DEDUCTIONS NOT ALLOWED · SECTION 21

part 1

Disallowed (s.21)	Rule
Tax on profits	Any tax, rate or cess on the **profits** of the business. But **sales tax / FED** borne and not charged to customers **is** deductible.
Tax deducted at source	Tax deducted from an amount the person derives.
Expenditure without required withholding	Disallowed unless the tax is deducted and paid (or paid under s.161 / 162); for **purchases of raw materials and finished goods** the disallowance is capped at **20% of such purchases**.
Commission, Third Schedule goods	Commission above **0.2% of gross supplies**, unless the recipient is on the **Active Taxpayers' List**.
Entertainment	Only within Rule 10: abroad; head-office allocation; **foreign customers / suppliers in Pakistan**; customers at the **business premises**; meetings of shareholders, agents, directors or employees; **branch openings** — all directly related to the business.
Funds	Contributions to a fund that is not a recognised PF or approved superannuation / gratuity / pension fund; amounts above **50% of the employer's contribution** to an approved gratuity, pension or superannuation fund; PF contributions without arrangements to deduct tax on taxable payouts.
Fines and penalties	For violating **any law, rule or regulation**.
Personal expenditure	Personal expenses of the person.
Reserves and capital items	Amounts **carried to a reserve fund** or capitalised; **capital expenditure** (depreciation and amortisation are allowed instead).

Disallowed (s.21)	Rule
AOP and its members	Profit on debt, brokerage, commission, salary or other remuneration paid by an **AOP to a member**.
Cash salary	Salary above **Rs. 32,000 a month** not paid by crossed cheque, bank transfer or digital means.
Single account head above Rs. 250,000	Aggregate under one head not paid by a **crossed banking instrument from the business bank account**. Online business-to-business transfers and credit cards count if verifiable. **Exceptions:** utility bills, freight, travel fare, postage, taxes, duties, fees, fines and statutory payments.
Depreciation without withholding	Disallowed in **all years** if required withholding on the purchase payment for the asset was not deducted and deposited.
Pharmaceutical promotion	Sales promotion, advertisement and publicity above **10% of turnover** (pharmaceutical manufacturers).
Non-integrated enterprise	**3%** of the expenditure claimed by a person who fails to install the electronic resource / integrate with the FBR.
No documentary evidence	Any deduction for which evidence cannot be provided (s.174(2)); utility bills above prescribed limits.
Non-NTN purchases	**10%** of purchases from persons without an NTN — **not** agricultural produce bought directly from growers, but **yes** from a middleman.
Cash receipts	Payment above **Rs. 200,000** against a single invoice received otherwise than through banking / digital means: **50% of the corresponding expenditure** is disallowed.

EXAMPLE · CASH AND BANK RULES

Expenses paid other than by crossed banking instrument: rent Rs. 600,000, air tickets Rs. 400,000, salary Rs. 40,000, vehicle repair Rs. 300,000, electricity Rs. 500,000, audit fee Rs. 300,000. **Add back** rent 600,000 + salary 40,000 + repair 300,000 + audit fee 300,000 = **Rs. 1,240,000**. Air tickets (travel fare) and electricity (utility) are exceptions.

EXAMPLE · NON-NTN PURCHASES

Cotton bought directly from a grower with no NTN: no disallowance. The same cotton bought from a **middleman** with no NTN: **10%** of the purchase is disallowed.

7 SPECIAL DEDUCTIONS

allowed by the Ordinance

Expenditure for business · animals · **depreciation** · **initial allowance** · **amortisation** of intangibles · amortisation of **pre-commencement** expenditure · scientific research · employee training · profit on debt · entertainment within Rule 10 · bad debts. (Depreciation and amortisation: Chapter 8.)

SCIENTIFIC RESEARCH · s.26

Research **in Pakistan** for developing the person's business, incl. contributions to a certified research institution. **Not**: acquiring depreciable assets or intangibles, immovable property, or exploring for natural deposits.

EMPLOYEE TRAINING · s.27

Revenue expenditure on an **educational institution or hospital for employees and dependants**; Government-recognised industrial training institutes; training of a **citizen** under a Board-approved scheme (need not be an employee).

8 PROFIT ON DEBT AND LEASES

section 28

PROFIT ON DEBT

Deductible **to the extent the proceeds are used for business**.

LEASE RENTALS

Of an asset to a bank, financial institution, modaraba, leasing company or SPV. For a **passenger vehicle not plying for hire**, the principal is capped at **Rs. 2.5 million**.

OTHER FINANCE COSTS

Securitisation cost for SPV; musharika shares of profit; funds borrowed from modaraba or PTC holders; **PLS accounts**; SBP-line profit shares of HBFC, NDLC, SME Bank.

9 BAD DEBTS

section 29

CONDITIONS

The debt was **included in business income earlier** (or lent by a financial institution in its business); **written off in the accounts** in the year; **reasonably irrecoverable**. Deduction cannot exceed the amount written off.

NOT ALLOWED

Provisions for doubtful debts; bad debts on **loans** (non-financial), **exempt income** or **final-tax income**.

LATER RECOVERY

a = amount received; b = amount of the debt **not allowed earlier**. a > b → difference is **income**; a < b → difference is a **further bad debt**.

EXAMPLE

Example: written off Rs. 400,000, allowed Rs. 300,000 in tax year 2026. Recovered **Rs. 250,000** in tax year 2027: a = 250,000; b = 400,000 − 300,000 = 100,000 → **income of Rs. 150,000**. Had only Rs. 80,000 been recovered: a < b → further bad debt of **Rs. 20,000**.

10 TAX ACCOUNTING

sections 32 – 35

METHOD · s.32

As regularly employed. **Company → accrual**; others cash or accrual. Change only with the **Commissioner's written approval** (to reflect income clearly); adjust so no item is omitted or counted twice.

CASH BASIS · s.33

Income when **received**; expense when **paid**.

ACCRUAL BASIS · s.34

Income when **due**; expense when **payable** — all events occurred and the amount reasonably determinable. Unpaid for **3 years** → taxed in the next year; deductible again when paid.

11 STOCK-IN-TRADE · SECTION 35

valuation

1 COST OF STOCK USED

(A + B) − C: opening value + cost of stock acquired − closing value.

2 OPENING VALUE

Last year's **closing value**; on commencement, the **FMV** when the stock is ventured into the business.

3 CLOSING VALUE

Lower of cost and net realisable value.

4 COST METHOD

Cash basis: prime or absorption cost. **Accrual: absorption cost** (direct material + direct labour + factory overhead). Prime cost = material + labour + **variable** overhead.

5 IDENTIFICATION

Items not identifiable: **FIFO or average cost** (not LIFO). A chosen method changes only with the Commissioner's **written permission**.

6 EXAMPLE

Accounts profit 600,000 (marginal basis); opening 120,000 vs absorption 150,000; closing 240,000 vs absorption 330,000 → −30,000 + 90,000 = **taxable 660,000** (accrual both years).

12 TAX ON DIGITALLY ORDERED GOODS AND SERVICES

delivered within Pakistan

RATES
1% if paid by digital means or banking channels through a payment intermediary; **2%** on **cash on delivery** through a courier — of the gross amount.

NATURE
Final discharge — but **adjustable** if turnover exceeds **Rs. 200 million**. Turnover up to Rs. 200m may **opt out** of the final regime when filing from tax year 2027.

EXPORTS
Export proceeds already under withholding in **ss.154 / 154A** are outside this tax.

COMPLIANCE
Sellers must be **FBR-registered**; marketplaces allow only registered vendors; marketplaces file **monthly** vendor statements; intermediaries and couriers file a **quarterly** withholding statement.

13 WORKED EXAMPLE · ACCOUNTS PROFIT TO BUSINESS INCOME

fresh numbers

Item	Rs.	Reason
Accounting profit before tax	2,000,000	
Add: tax on profits provided	300,000	s.21(a)
Add: penalty for violating a regulation	40,000	s.21(g)
Add: provision for doubtful debts	30,000	s.29
Add: entertainment of local customers at a hotel	60,000	Rule 10
Add: salary of Rs. 50,000 paid in cash	50,000	s.21(m)
Add: accounting depreciation	200,000	Ch 8
Less: tax depreciation	(150,000)	Ch 8
Less: actual bad debts on taxable sales	(25,000)	s.29
Less: unrealised exchange gain	(80,000)	not real profit
Taxable income from business	**2,425,000**	

14 EXAM FOCUS · MCQ TRAPS

what examiners test

1 Hire of movables
Business income — rent of buildings is property income.

2 Profit on debt
Business only for lenders; otherwise **other sources**.

3 Banking-channel rule
Per account head above **Rs. 250,000**, from the **business account**; salary above **Rs. 32,000**.

4 Withholding disallowance
Purchases of raw materials / finished goods: capped at **20%**.

5 Speculation losses
Set off only against speculation income; **six years**.

6 Bad debt recovery
Compare **amount received** with the part **not allowed** earlier.

7 Unpaid liabilities
Unpaid after **three years** from the year of deduction → taxed in the next year.

8 Stock
Closing = **lower of cost and NRV**; accrual = absorption cost; no LIFO.

CLASSIFY IT · BUSINESS OR NOT?

1	Excavators let out on hire	BUSINESS
2	Profit on a retired person's bank deposits	OTHER SOURCES
3	Management fee of a modaraba company	BUSINESS
4	Distributor gets a car for meeting a sales target	BUSINESS
5	Lease rentals of a leasing company	BUSINESS
6	Doctor working independently for several hospitals	BUSINESS
7	Employee under one employer's control	EMPLOYMENT
8	Forward contract settled by paying the difference	SPECULATION

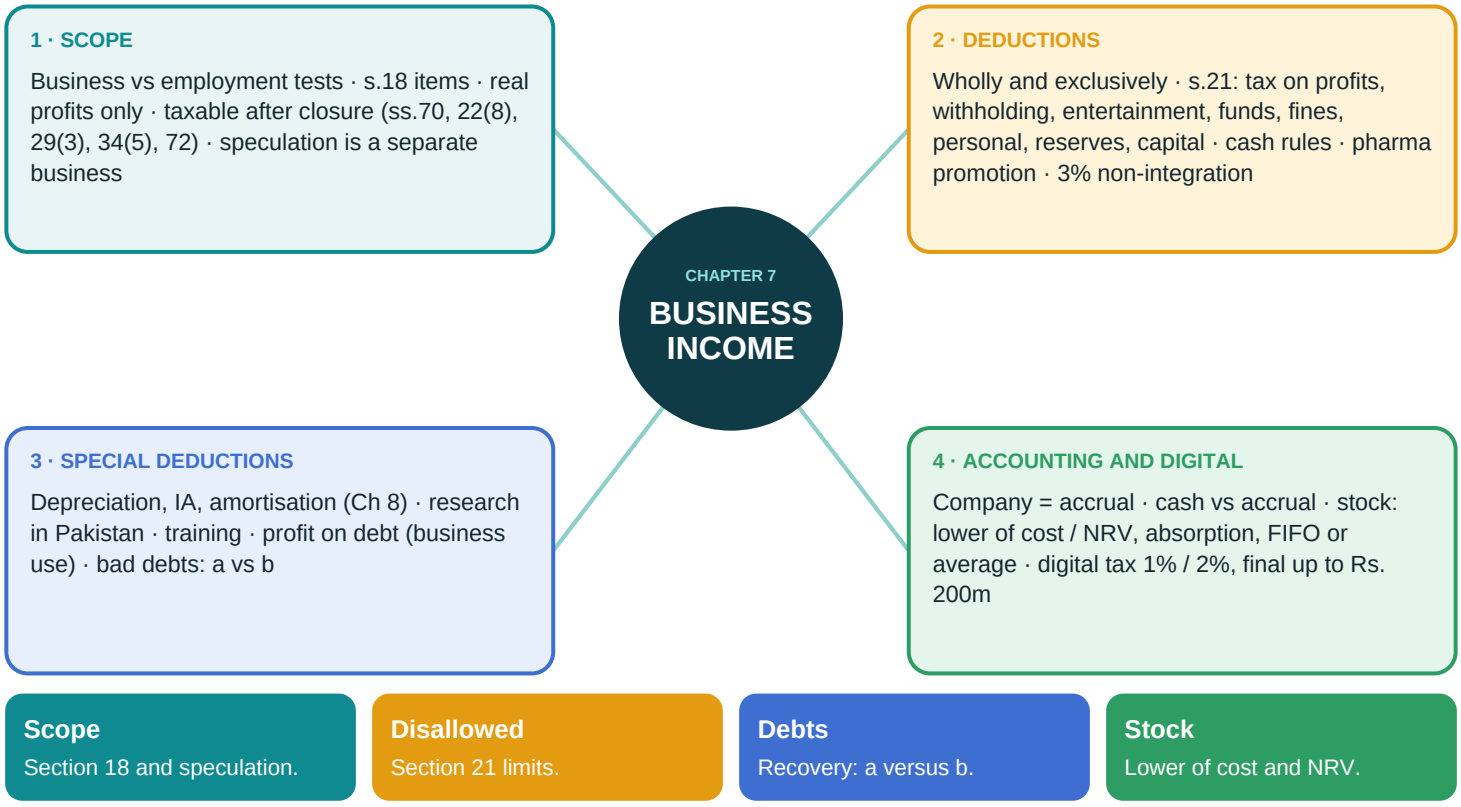
CLASSIFY IT · ALLOWED OR DISALLOWED?

1	Entertainment of foreign buyers in Pakistan	ALLOWED
2	Customer lunch at a five-star hotel	DISALLOWED
3	Salary of Rs. 45,000 paid in cash	DISALLOWED
4	Freight of Rs. 400,000 paid in cash	ALLOWED
5	Fine for breaking a regulation	DISALLOWED
6	Sales tax borne and not charged to customers	ALLOWED
7	Transfer to a general reserve	DISALLOWED
8	Motor vehicle tax on business vehicles	ALLOWED

LIMITS TO KNOW

Cash salary	Single head	Commission	Cash receipt	Digital tax
Rs. 32,000 a month	Rs. 250,000	0.2% (Third Schedule)	Rs. 200,000 → 50%	1% / 2%

REVISION MAP



Scope
Section 18 and speculation.

Disallowed
Section 21 limits.

Debts
Recovery: a versus b.

Stock
Lower of cost and NRV.