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TAX PAK

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TOLA ASSOCIATES

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An Overview of Taxation Schemes for Builders and Land Developers and Way Forward**

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EDITORIAL NOTE

Sixteenth issue of Tax Pak, for the month of February 2019, is in your hands. We have covered the taxation regime of Builders and Developers with our suggested way forward in section of topic of the month.

The Finance Supplementary (Second Amendment) Bill, 2019 ("the bill") was presented before parliament on 23rd January 2019 and has recently been passed by Parliament on 6th March 2019. Our comments on the changes introduced in the bill through the Act may be found through the link <https://goo.gl/yqAqxT>.

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Readers are also requested to circulate this e-copy within their circle, as our primary aim is to benefit the masses. Feedback is always welcomed.

Ashfaq Tola - FCA
Editor in Chief



1. NOTIFICATIONS/ CIRCULARS

1. Revision of Valuation of properties by FBR

In a drive to remove undocumented economy and close safe heavens to park untaxed money, the FA 2016 introduced the regime of valuation of immovable by empowering FBR to prescribe the valuations which were much higher than the decades old regime of DC rates. The taxation officers were required to accept such prescribed values. The FBR had prescribed rates for different cities vide 15 notifications in August 2016 with effect from July 31, 2016.

Now the FBR vide various SROs dated 1st February 2019, has revised earlier valuation of residential and commercial properties all over Pakistan by average 20% with immediate effect. Dr Hamid Ateeq Sarwar, the FBR spokesman, said that the current revision will bring valuation of properties closer to 60% of actual market values. The Salient features are as follows:

- The Fbr Has Notified Value Of Immoveable Properties In Respect Of 196 Categories Of Areas Of Karachi.
- Over 100 Percent Values Of Immovable Properties Have Been Revised Upward In Some Sectors Of Dha Karachi.
- In Remaining Areas Of Karachi, The Fbr Has Upward Revised Values Of Immovable Properties By 15-20 Percent.
- The Fbr Has Also Revised Values Of Immovable Properties Of 538 Areas Of Gujrat.
- In 701 Areas Of Sialkot, The Fbr Has Revised Values Of Immovable Properties.
- The Fbr Has Revised Values Of Immovable Properties Of 31 Area Of Sargodha
- In 338 Areas Of Sahiwal, The Fbr Has Revised Values Of Immovable Properties.
- The Fbr Has Notified The Value Of Immoveable

properties in respect of 28 areas/categories of Rawalpindi.

- The FBR has notified values of immoveable properties in respect of 426 areas of Quetta.
- The FBR has revised values of immovable properties of 339 area of Peshawar.
- The FBR has notified value of immoveable properties in respect of 593 areas of Multan.
- The FBR has also revised values of immovable properties in 17 areas of Mardan.
- The FBR has notified value of immoveable properties in respect of 1234 areas/categories of Lahore.
- The FBR has also revised values of immovable properties in 892 areas of Jhelum.
- The FBR has revised values of immovable properties in 90 areas of Islamabad.
- In case of 26 areas of Hyderabad, the FBR has notified value of immoveable properties in respect of areas/categories of Hyderabad.
- The FBR has notified the value of immoveable properties in respect of 186 areas of Gujranwala.
- The FBR has notified the value of immoveable properties in respect of 811 areas of Faisalabad.
- The FBR has notified value of 7 immoveable properties in respect of areas of Abbottabad.
- The FBR has notified value of immoveable properties in respect of 424 areas of Bahawalpur.

We understand that valuation revision will bring property valuation rates closer to market value and will restrict the parking of black money in real estate on one hand and also rationalize the discretionary powers of valuation done by Directorate General Immovable Properties formed u/s 236F of the Income Tax Ordinance vide FA 2018.

2. Draft Amendment in Export Oriented and Small and medium Enterprises, Rules, 2008[EOSME]

The FBR vide SRO 194(I)/2018 dated 11th February,

2019, has made draft amendment in EOSME whereby it has prescribed an undertaking for the exporters to be submitted to the collectors for transfer of goods from an export-oriented unit, DTRE licensee or a custom bond to an export-oriented unit (EOU).

3. Exemption from Regulatory Duty [RD] on export of waste and scrap of various items

The FBR vide SRO 192(I)/ 2019 dated 11th February 2019 amended SRO 645(I)/2018 dated 24th May 2018, whereby it abolished **25% RD** on the export of waste and scrap of copper, unwrought lead, ferrous and non-ferrous waste of scrap of lead, lead plates/sheets/strip/foil/lead powers and flakes and lead bars, rods profiles and wire produced from material imported under the facility of DTRE, as provided under subchapter 7 of Chapter XII of the Customs Rules, 2001, or the manufacturing bonds scheme as licensed under Chapter XV of the said Rules.

4. Electronic Monitoring, Tracking and Tracing of Specified Goods and Licensing Therefore

By virtue of SRO 250(I)/2019 dated 26 February 2019 the Federal Government has amended rule XIV-B of the Sales Tax Rules, 2006. The Federal Government will monitor and track the specified goods and issue a license to any bidder who will make a system of issuing license which will help in tracking the sales and movement of specified goods. The following specified goods fall under the ambit of this SRO.

- i. Tobacco products
- ii. Beverages
- iii. Sugar
- iv. Fertilizer and;
- v. Cement

Under this new redrafted rule IV-B every package including a tin, container or bottle of specified goods will be affixed with a tax stamp. No person engaged in sale/ purchase of specified goods shall remove or tamper with the affixed tax stamp until the product is

sold to the end consumer.

Further under the redrafted rules, the licensing committee will be formed which will grant license to a company in line with the rules laid down.

5. Special Procedure for Sales Tax on Cottonseed Oil Expelled by Oil Expelling Mills and Composite Unit of Ginning and Expelling

By virtue of SRO 253(I)/ 2019 dated 26 February 2019 the Federal Government has enhanced the rate of sales tax as under for supply of cottonseed by cotton ginners for in-house consumption or to any other registered person and have added a monthly statement in the SRO which will be filled by the cotton seed oil supplier.

EXISTING RATE	NEW RATE
6 per 40 Kg	Rs 7 per 40 kg for period starting from 1st July 2018 to 30th June 2019
	Rs 8 per 40 Kg from onwards

6. Monitoring or Tracking of Certain Registered Persons by Electronic or Other Means

By virtue of SRO (I)/180 2019 dated 4th February 2019 the Federal Government has made certain amendments in the Sales Tax Rules 2006 where they have specified that lower rate of sales tax will not apply to point of sale terminal which are not registered with the Board.

One further amendment is made whereby the sales made online through the registered domain shall also be treated as sale made through registered point of sales and accordingly applicable to reduced rate under SRO 1125.

2. DISTRIBUTORS ARE LIABLE TO SINDH SALES TAX EVEN IF THEY PURCHASE GOODS FROM PRINCIPLE - APPELLATE TRIBUNAL SINDH REVENUE BOARD [ATSR]

In case of M/s JSN Traders, Hyderabad vs Assistant Commissioner, SRB, Karachi (Appeal No. AT-61/2018), the taxpayer involved in distribution of goods of colgate

Palmolive (CPO) and registered under Federal Sales Tax [FST], get SCN and order from SRB for Compulsory registration under Sindh Sales Tax on Service. The Taxpayer preferred an appeal to Commissioner appeals which upheld the Order of Assistant Commissioner. The Taxpayer preferred second appeal against Order of Commissioner Appeals before ATSR. The Taxpayer argued that the activity involves payment of goods made on transfer of goods from CPO to taxpayer along with all risk and rewards transferred at that point, hence it is sale of goods chargeable to tax under FST and not services, hence not liable to be registered under Sindh Sales Tax on Services. Further, since taxpayer is also paying FST, the charging of Sales Tax under SRB would tantamount to double taxation. The Department in rebuttal, argued that none of the clause of the agreement provides transfer of ownership of and exclusive rights in goods from seller to buyer, the preamble and clauses of agreement provides assignment of exclusive territory in which service to be provided and taxpayer is bound to act on the instructions of the Principal as regards fixation of price and allowing the percentage of margin/profit to retailer. Hence taxpayer is providing service to its principal and liable to tax under specific tariff heading 9845.0000 [supply chain management or distribution (including delivery) services].

The ATSR in instant case held that (a) despite the fact that on the payment the ownership of goods was transferred to the appellant along with the element of risk and reward the fact is that the sale of goods by CPO to the taxpayer is not a simple sale and taxpayer is required to deliver the goods as per instructions of the CPO, (b) as per agreement terms, the taxpayer required to use best endeavors to promote sale, which may not be condition in any ordinary sale, (c) In agreement the word used is “deliveries” and not sale, which clearly indicates that the taxpayer has to deliver the goods to the customer and not to sell the goods (d) the agreement provides for submission of various reports which is not condition of simple sale of goods

(d) the agreement provides for submission of various reports which is not condition of simple sale of goods, (e) on termination of agreement products lying unsold will be taken back which shows that ownership not transferred and in normal sale the return of goods may not be a condition. The ATIR further held that in addition to analyzing each clause separately, it is well settled point of law that document to be read and considered as whole to ascertain the scope and object of document and same can be determined by looking into substance rather than form. Since the substance of the whole document is to facilitate sale and delivery of goods and not simple sale of goods. Hence it is distribution services and liable to be taxed under Sindh Sales Tax on Services.

3. ECONOMIC INDICATORS

- The 3-month, 6-month and 1-year KIBOR rate for the month of January 2019 to 10.52%, 10.76% and 11.33%, respectively, which hiked in February 2019 to 10.71%, 10.85% and 11.42%, respectively.
- The 3-month T-Bills rate for the month of January 2019 was 10.31% which hiked to 10.41% in February 2019; The 6-month T-Bills rate for the month of January 2019 was 10.61% which lower to 10.57% in February 2019. The rate for 1 year remained unchanged at 6.97% since October 2018.
- The PSX 100 index at the end of January 2019 was 40,799 points and at the end of February 2019 was 39,054 points while the average index for the month of January 2019 was 39,344.10 points and for the month of February 2019 was 40,362.32 points posting a increase of 2.52%.
- The rate for Crude Oil in the OPEC basket at the end of January 2019 was \$ 60.93, whereas, at the end of February 2019 was \$ 64.86. The increase in price was 6.45%
- The rate of Gold per troy ounce in the month of January 2019 was \$1293.29 whereas in the month of February 2019 it increases to \$1322.70 per troy ounce by 2.27%

- The rate of Sugar at end of January 2019 was 0.3431 US\$/KG which remain unchanged in the month of February 2019.
- The rate of Palm Oil in the month of January 2019 was 516.93 US\$/MT which fell in the month of January 2019 to 522 US\$/MT by 0.98%.
- The US\$ parity to Chinese Yuan at the end of January 2019 was 6.70 whereas in the month of February 2019 it was 6.694 posting a decrease of 0.09%.
- The US\$ parity to Indian rupee at the end of January 2019 was 71.09 whereas in the month of February 2019 it was 71.2085 posting a increase of 0.17%.
- The US\$ parity to Bangladesh Takka at the end of January 2019 was 83.89 whereas at the end of February 2019 it was 83.5379 posting an decrease of 0.42%.
- The US\$ parity to Pakistan Rupee at the end of January 2019 was 139.25 which increased to 139.8780 at end of February 2019 by 0.45%
- The volume of imports in February 2019 was 579,039 Million rupees (4,180 million \$) while the exports were 261,669 Million rupees (1,889 million \$). Exports in July 2018 to February 2019 rose by 1.85% to \$ 15,113 million while Imports in July 2018 to February 2019 decrease by 6.13% to \$36,636 million.
- The stock of currency in circulation was Rs. 4,388 billion as on June 30th, 2018 which increased by Rs. 357 billion up to February 22th, 2019 to Rs. 4,744 billion.
- The Net Government Sector borrowings at end of June 30th, 2018 were Rs. 10,200 billion which increased by Rs. 555 billion up to February 22th, 2019 to Rs. 10,755 billion. The net government sector borrowings were used for the purpose of budgetary support (Rs. 10,104 billion) and commodity operations (Rs. 663 billion); and supported by others (Rs. -12 billion).
- The credit to private sector at end of June 30th,

2018 was Rs. 5,973 billion which rose by Rs. 600 billion up to February 22th, 2019 to Rs. 6,573 billion.

- Workers' remittances for the month of January 2019 and February 2019 were \$ 1,743.25 million and \$ 1,576.52 million respectively, decline by 9.56%.
- Foreign exchange balance at end of January 2019 (Provisional) and March 1st, 2019 (Provisional) were \$ 14,919.9 million (SBP: \$8,191.4 million, Commercial Banks: \$6,728.5 million) and \$ 14,956 million (SBP: \$8,116.5 million, Commercial Banks: \$6,839.7 million) respectively showing a increase of 0.24%.

4. TOPIC OF THE MONTH

AN OVERVIEW OF TAXATION SCHEMES FOR BUILDERS AND LAND DEVELOPERS AND WAR FORWARD

1. Builders and Land Developers Business Model- Accounting and other Considerations

a) Transactions which are in substance delivery of goods

In respect of the real estate transactions, which are in substance similar to the delivery of goods, as per principal enunciated in IFRS 15, to be applied. For example, the sale of plots of land without any development would be covered by the principals of IFRS 15. These transactions are similar to the delivery of goods where the revenues, cost and profits are recognized, when the revenue recognition process is completed.

In cases where the transfer of a legal title is a condition precedent to the buyer taking on the significant risks and rewards of the ownership and accepting significant completion of the seller's obligation, revenue should not be recognized till such time the legal title is validly transferred to the buyer

Under Income Tax Ordinance, 2001, such transactions are accounted under the head

Income from Business except section 36 Long Term Contracts.

b) Transactions in substance construction

In case of real estate contracts, which are in substance construction type contracts, real estate developers/sellers need to assess whether significant risks and rewards related to ownership are transferred to the buyer. The point of time at which all significant risks and rewards can be considered transferred is required to be determined on the basis of the terms and conditions of the agreement of sale. In such cases, the seller usually enters into an agreement for sale with the buyer at initial stages of construction. This agreement for sale is also considered to have the effect of transferring all significant risks and rewards of ownership to the buyer, provided the agreement is legally enforceable and subject to the satisfaction of conditions which signify transferring of significant risk and rewards, even though the legal title is not transferred or the possession of the real estate is not given to the buyer. Once the seller has transferred significant risks and rewards to the buyer, any act on the real estate performed by the seller are in substance performed on behalf of the buyer in the manner similar to a contractor. Revenue in such cases is recognized by applying the **percentage of completion method** [POCM].

Under Income Tax Ordinance, 2001, such transactions are accounted under the Long terms contracts under section 36 and other related provisions.

2. Taxation Regime Prior to 2013

Normal Tax Regime Long-term contracts- Section 36

Prior to 2013 the taxation of long-term contracts including contracts by Builders and land developers was under Normal Tax Regime u/s 36 of the Income Tax

Ordinance, 2001 and other provisions related to Income from business.

Income from any long-term contract is computed on the basis of % of completion method. % of completion in a tax year is determined as under:

$$\% = \frac{\text{Cost of contract incurred before the end of tax year}}{\text{Total estimated contract cost at the commencement of contract}}$$

Total estimated contract cost at the commencement of contract

Long-term contract means a contract which is not completed within the tax year in which work is commenced other than a contract estimated to be completed within 6 months of the commencement of work.

The provisions of section 113, Minimum Tax was also applicable where the tax liability under Normal tax regime was less than specified threshold.

3. Taxation Regime from to 2013-2016

The Normal Tax regime for Builders/Developers remained same, new sections of Minimum Tax 113 A for builders and 113B for land developers were inserted. The said regime for builders was not made effective till June 30, 2018. However, the Federal Government did not issue any notification to make minimum tax regime effective for Builders/land developers and omitted by FA 2016.

This implied that provisions of section 113, Minimum Tax was applicable where the tax liability under Normal tax regime was less than specified threshold.

Under this tax regime, the construction sector had paid Rs2.6 billion during fiscal year 2015-16 (Source: Express Tribune May 03, 2017)

4. Taxation Regime from 2016-2017

4.1 Fixed Tax Scheme for Builders and Developers

The Finance Act, 2016 introduced a unique non-in

come based Fixed Tax Regime for 'Builders' and 'Developers'.

Under this regime, tax liability for the builders and developers may be determined on the basis of area, instead of the value of property or actual transaction value.

Notwithstanding being a Fixed Tax Regime, this scheme was likely to incentivize recording of the actual value of the developed property, as the declaration of the real value did not result in any income-based tax incidence for the seller which is fixed on area basis.

As a consequence of the introduction of the above, the minimum tax regime under sections 113A and 113B for builders and land developers was withdrawn.

4.2 Tax on Builders-Section 7C & Land Developers Section 7D

A fixed tax was payable by a builder on business income from construction and sale of buildings where the project was approved and initiated after 1.7.2016; and payable by land developer on business income from development and sale of residential, commercial or other plots where the project is approved and initiated after 1.7.2016 as under:

This provision was applicable i.e. FTR

- For the project initiated and approved during the tax year 2017 only.
- For which payment under Rule 13S has been made by the builder/developer during tax year 2017; and
- The Chief Commissioner has issued online schedule of advance tax installments to be paid by the builders and land developer in accordance with Rule 13U and 13ZB, respectively.
- It means that a project initiated and approved in a tax year other than 2017 was and will be taxable under NTR subject to section 36 applicable for long term contracts.

✘ Rates of tax applicable on builders under section 7C:

(B) Hyderabad, Sukkur, Multan, Faisalabad, Rawalpindi, Gujranwala, Sahiwal, Peshawar, Mardan, Abbottabad, Quetta					
(A) Karachi, Lahore and Islamabad		(B) Hyderabad, Sukkur, Multan, Faisalabad, Rawalpindi, Gujranwala, Sahiwal, Peshawar, Mardan, Abbottabad, Quetta		(C) Urban Areas not specified in (A) and (B)	
For commercial buildings					
Rs. 210/Sq Ft		Rs. 210/Sq Ft		Rs. 210/Sq Ft	
For residential buildings					
Area in Sq. ft	Rate / Sq.Ft	Area in Sq. ft	Rate / Sq.Ft	Area in Sq. ft	Rate / Sq.Ft
Up to 750	Rs. 20	Up to 750	Rs. 15	Up to 750	Rs. 10
751 to 1500	Rs. 40	751 to 1500	Rs. 35	751 to 1500	Rs. 25
1501 & more	Rs. 70	1501 & more	Rs. 55	1501 & more	Rs. 35

✘ Rates of tax applicable on land developers under section 7D:

(B) Hyderabad, Sukkur, Multan, Faisalabad, Rawalpindi, Gujranwala, Sahiwal, Peshawar, Mardan, Abbottabad, Quetta					
(A) Karachi, Lahore and Islamabad		(B) Hyderabad, Sukkur, Multan, Faisalabad, Rawalpindi, Gujranwala, Sahiwal, Peshawar, Mardan, Abbottabad, Quetta		(C) Urban Areas not specified in (A) and (B)	
For commercial buildings					
Rs. 210/Sq Ft		Rs. 210/Sq Ft		Rs. 210/Sq Ft	
For residential buildings					
Area in Sq. ft	Rate / Sq. Ft	Area in Sq. ft	Rate / Sq. Ft	Area in Sq. ft	Rate / Sq. Ft
Up to 120	Rs. 20	Up to 120	Rs. 15	Up to 120	Rs. 10
121 to 200	Rs. 40	121 to 200	Rs. 35	121 to 200	Rs. 25
201 & more	Rs. 70	201 & more	Rs. 55	201 & more	Rs. 35

4.3 Minimum Tax- Section 113

Under the Fixed Tax Scheme for Builders and Developers the minimum tax under section 113 was not applicable.

4.4 Alternative Corporate Tax (ACT)-Section 113C

Under the Fixed Tax Scheme for Builders and Developers the ACT under section 113C was not applicable.

5. Rational for change in Scheme

5.1 Reasons for introduction of Fixed Tax Scheme

Income of builder or land developer was assessed on the net income basis where declared receipts were reduced by the claimed expenses. As these projects are on long term basis, therefore, provisional assessment on yearly basis on declared receipts was conducted which was followed by the appraisal at the end of the project. The FBR was of view that sometime if construction is carried out under long term contracts the income tax assessed was on the basis of the percentage of completion method. However, due to non-documented economy receipts and expenses could not be verified and resultantly taxpayers inflated expenses and suppressed receipts and a very little revenue was contributed by this sector.

Historically, tax contributions from builders and land developers did not match their investments and profit accruing from the construction sector. The FBR was of the view that the construction was the main industry showing consistent boom despite the wave of terrorism in the last decade and severe economic problems. The bulk of savings are parked in the housing sector and heavy investments are made in real estate.

Under the new regime, the FBR decided to recover the taxes through the representatives of the association. At the time of approval of a house, a building plan or a land development plan, a builder, owner or a land developer was supposed to apply to the chief commissioner of Inland Revenue for payment of tax in a prescribed application setting forth the details of the project, tax liability and schedule of instalments.

Before approval of the project, 5% of the tax liability had to be deposited and the remaining 95% to be deposited in four installments spanning over the project life. In case of default on payments of instalments, the FBR had retained the right to recover the money by exercising special powers including withdrawing money from the bank accounts.

5.2 The Withdrawal of Fixed Tax Scheme:

The Fixed Tax Scheme was abolished vide Finance Act, 2017 due to **Loss of Revenue**. Revenues from the construction sector dipped to a meagre Rs112 million against conservative official annual estimates of Rs 8 billion. The dismally low revenue generation from a booming sector belies all claims of the sector that lured tax authorities into believing that the builders and land developers would pay Rs28 billion in income tax under the new final tax regime in fiscal year 2016-17.

However, the total income tax collection from the developers and builders from sale of new residential, commercial buildings and plots stood at only Rs112 million from July through April, according to FBR data. During the first ten months, the builders paid a meagre sum of Rs74 million in income tax on new schemes while land developers' contribution was abysmally low at Rs38 million.

The FBR had budgeted revenue of Rs8 billion from this new tax regime while Karachi-based ABAD had claimed that it would pay Rs28 billion in income tax under the new regime during the fiscal year 2016-17.

(Source: Express Tribune May 03, 2017)

Although the FTR Scheme seemed a failure due to low revenue collections, there were certain other factors contributing halt on real estate activities, some are as under:

a) Supreme Court Ban on Multi Story Building

During Tax Year 2017, the SC had restrained the Sindh Building

Control Authority (SBCA) and cantonment boards from issuing building approval plans for new high-rise and multi-story commercial and residential projects without the availability of proper water supply and sewerage systems. This had affected the overall activity in the sector.

b) No Proper amnesty was available

As mentioned above the real estate sector mainly consist of undocumented sector, therefore expected revenue generation required amnesty from inquiry into past escaped assessments to enable the developers and builders to come into tax net. The new section 236 W tax on purchase or transfer of immovable property to give proportionate amnesty on property valuation declaration but it did not provide complete amnesty. Further it was introduced late in December 06, 2016 when already six months had lapsed.

c) Involvement of Field Force at various stages:

The Fixed Tax scheme required personal involvement of field officers FBR at various stages of project approval and tax collection which may have caused increased likelihood of corruption and harassment of taxpayers which might have prevented tax payers from availing Regime of Fixed Tax.

6. At Present

Through FA 2017 the Fixed tax regime was abolished and Normal Tax regime/Minimum Tax regime as discussed in 3 above restored for projects which were initiated/ approved after Tax Year 2017.

7. Way Forward

a. Withholding and Other taxes

As withholding taxes indirectly add to the cost of buying and selling, we suggest that limit on exemption from withholding taxes should be increased. Regarding CVT, Stamp Duties, Registration charges, and Town taxes, overall value of these taxes should amount to atmost 1% of the total sale value of property.

b. Fixed Tax Regime and Online Collection of Taxes and Approval for Builders & Developers

We propose fixed tax regime for builders and developers should be available for projects initiated and approved after Tax Year 2017 also. Further, online tax collection system should be introduced under fixed tax regime in order to avoid corruption through personal contacts between tax payers and tax collector.

c. Property Valuation System

We propose, the government should introduce a uniform property valuation system instead of the 2 parallel valuation systems i.e. FBR rates and DC value for stamp duty purpose that has complicated valuation criterion.

d. Revision of FBR rates

The FBR has recently revised valuation upward across Pakistan mentioned in Notification section of this Newsletter. However, there still exist large gap between notified values and actual values which needs to be addressed through further revision. This on one hand will limit the parking of undocumented wealth and would also increase revenue collection on other hand.

e. Computerized Records

We also recommend online documentation and one window operation for documentation and registration of real estate properties to enable a boost in investment in this sector and revenue collection.

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