



# COMMENTS ON TAX LAWS (AMENDMENT) ORDINANCE 2020

## [CONSTRUCTION AMNESTY]





## ➤ PROLOGUE

A document titled ‘Tax Laws (Amendment) Ordinance 2020 (final version)’ (hereafter ‘Ordinance’) is circulating on social media. The Ordinance seeks to amend certain provisions of the Federal tax laws of Pakistan, and the Finance Act 1989. This will bring in to immediate effect, the recently proposed ‘special package for construction industry by Naya Pakistan Housing and Development Authority announced by the Prime Minister. We had also issued our comments on the aforesaid package on 4th April 2020. Should you wish to access the same, feel free to download it through our website link: <https://bit.ly/34LC4aH>. We are pleased to submit our comments on the effect of the said Ordinance.

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The comments in this document are based on the judgment and experience of the author, along with publicly available information. Therefore, it cannot be said with certainty that the author's comments are acceptable by everyone. Tola Associates does not accept nor assume any responsibility, whatsoever, for any purpose. This document is circulated electronically free of cost for general public to create tax awareness in the country.

The readers are advised to consult the actual text of the Ordinance when interpreting specific provisions, and to consult our tax department for clear advice on specific issues.

Lastly, we would like to extend our warm regards to all of you during these tough times. You can visit our website [www.tolaassociates.com](http://www.tolaassociates.com), or download our mobile Application, in order to access our monthly publications, and other publications similar to this, that are issued in light of (a) major development(s).

The aforesaid application can be downloaded from the links hereinbelow:

1. <https://goo.gl/QDM4ZM> (iOS)
2. <https://goo.gl/LFiWyx> (Android)

Best Regards

**TOLA ASSOCIATES**

**Friday, April 17, 2020**

## A. CHANGE IN THE TAXATION REGIME FOR BUILDERS AND DEVELOPERS

The Ordinance has inserted a new Section in the Income Tax Ordinance 2001 (hereafter "ITO"), whereby, the income, profits and gains of any builder or developer, who opt for assessment under this section, shall be computed in accordance with rules and rates provided in the newly inserted **Eleventh Schedule**.

### 1. ELIGIBLE PERSONS

- An individual builder or developer who is registered as such with the FBR.
- A single object 'Company' or Association of Persons (hereafter "AOP") registered under the Companies Act 2017 or Partnership Act 1932, as the case may be.
- For 'builders' the sole object should be the construction of buildings and their disposal, whereas, for 'developers' the sole object should be development of any kind of land by itself, or otherwise.
- The company and AOP should be registered between the date of commencement of this ordinance to 31<sup>st</sup> December 2020.
- The company, LLP and AOP, should also be registered with FBR as a Builder or Developer, as the case may be, between the date of promulgation of this ordinance and 31<sup>st</sup> December 2020.

### 2. ELIGIBLE PROJECTS

- Projects that are:
  - Set up prior to the date of commencement of this Ordinance and completed on or before 30<sup>th</sup> September 2022 (hereafter "Existing projects").
  - Set up, on or after the commencement of this Ordinance, and before 31<sup>st</sup> December, 2020; and completed on or before 30<sup>th</sup> September, 2022 (hereafter "New Projects")
- The estimated project life shall not exceed 2.5 years.
- The project(s) shall commence:
  - In the case of a construction project, on the date when the layout plan is approved by the concerned authority; and
  - In case of developers, the date when the development plan is approved by the concerned authority.
  - Where the builder or developer has taken all necessary steps to procure all approvals, but such approval is delayed for more than 30 days, and resultantly the cut-off date of 31<sup>st</sup> December is not met, the Board has been empowered to provisionally accept commencement of such projects on a case to case basis.

- The date of completion:
  - For a builder, it shall be the date on which the grey structure is completed. Such grey structure shall only be considered as completed when the roof of the top floor has been laid as per the approved plan; and
  - For a developer, the date on which:
    - at least 50% of the total plots have been booked in name of buyers;
    - at least 40% of the sale proceeds have been received;
    - landscaping has been completed; and
    - at least 50% of the roads have been laid up to subgrade level as certified by the approving authority or NESPAK;

### 3. TAXATION

- With respect to existing projects, taxation of incomes earned up to tax year 2019 shall be taxed as per provisions of ITO prior to promulgation of this Ordinance.
- The income earned for tax year 2020 of both existing projects and new projects will be a separate block of income under the head income from business.
- No expenditure or losses shall be deductible from income.
- No tax credit shall be allowed to compute tax liability.
- No advance tax adjustment shall be allowed from tax payable, except advance tax paid under section 236K of ITO after promulgation of this ordinance on purchase of Immovable property utilized in an eligible project.
- There shall be no refund of any tax collected or deducted under the Ordinance.
- Turnover tax or alternate corporate tax under section 111 or 113C shall not be applicable to eligible builders and developers.

### 4. RATES OF TAXES AND TAX LIABILITY

- Tax liability shall be computed on the basis of fixed rates provided in the Eleventh Schedule inserted through the Ordinance. The fixed rates are provided at end of the document.
- The aforementioned rates will be applicable for computing tax liability for the project on an annual basis as per the formula *infra*, which shall be final tax:

Tax liability as per the rates mentioned in Rule  
10 of the Eleventh Schedule

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Estimated project life in years

For example, if a commercial building is to be constructed in Karachi with a covered area of

10,000 square feet, the tax rate applicable will be Rs. 250 per square feet, and will take 2 years for completion. The total tax Liability will be Rs. 2,500,000/- and the liability of 1<sup>st</sup> Year will be Rs 1,250,000 i.e. Rs 2,500,000/2.

- In case of existing incomplete projects, the estimated project life shall be treated as three years, from tax year 2020 through to tax year 2022, and the tax payable shall be reduced by the percentage of completion up to the last day of the accounting period pertaining to tax year 2019, as declared in the registration form.

- In case of development of plots and construction of buildings on the same plots, both rates shall apply.

For example, where a commercial plot is developed in Karachi, and a commercial building is constructed thereon, the applicable tax rates will be Rs. 250 per square yard of land area developed plus Rs. 250 per square feet of area covered.

- The tax so computed shall be paid in advance in 4 equal quarterly installments under Section 147 of ITO.
- For low-cost projects developed or approved by Naya Pakistan Housing and Development Authority (hereafter “NAPHDA”), or under the Ehsaas Programme, the tax rates levied will be reduced by 90%. For example, where tax levied is Rs. 100 per square feet for a builder, if the same builder is operating under NAPHDA, the tax rate will Rs. 10 per square feet.
- In case of development of plots and construction of buildings on the same plots for low cost housing and all projects developed by NAPHDA, the higher rates shall apply.

For example, where a low-cost housing building is constructed in Karachi having covered area more than 3,000 Square feet on a land area developed for the purpose covering more than 250 square yards, as per the rates table, the rate of tax for development is Rs. 150 per square yards and for construction is Rs. 125 per square feet, therefore, higher rate i.e. Rs. 150 per square yards of land developed will be applied.

In terms of the rates, it needs to be clarified as to whether the higher rate per unit of area will be considered or the higher ‘total tax amount’ will be considered. For instance, in the aforesaid example if covered area is 4,000 square feet and land developed area is 300 square yards, then as per a plain reading of the aforesaid provision, the tax liability will be Rs. 45,000 only [Rs. 150 (i.e. higher rate) x 300]. Whereas, the tax liability will be higher

if lower tax rate is used i.e. Rs. 500,000 [Rs. 125 x 4,000]. We understand that this is an omission while drafting the rules and needs further consideration.

Moreover, it also needs to be clarified whether the aforesaid discount of 90% is applicable where the development and construction is on the same plot in case of ‘low cost housing’.

## 5. REGISTRATION WITH FBR AND FILING OF RETURN

- A builder or developer shall electronically register a project on IRIS through FBR website on or before the 31<sup>st</sup> day of December, 2020 through submission of following:
  - registration form as may be prescribed which shall include, inter alia, details of a member or shareholder of a builder or developer, as the case may be.
  - a developer who is also a builder in case of a project shall submit two separate forms for registration as a developer and as a builder.
  - an irrevocable option to be assessed under this Schedule in respect of each project
- A builder or developer availing this scheme shall electronically file a return of income and wealth statement as may be prescribed accompanied with evidence of payment of due tax.

## 6. CERTIFICATION

- Every builder or developer shall be required to obtain and provide to the Board, in the prescribed manner, a certificate from the approving authority, or map approving authority or NESPAK, as the case may be, to the following effect:
  - ‘Total land area’, ‘covered area’ and ‘saleable area’ of the project in square foot or square yard
  - Such other documents as may be prescribed by FBR.

## 7. CHANGE IN OWNERSHIP

- A shareholder or partner in a builder or developer shall not be allowed change in ownership of incomplete project without the prior approval of FBR.
- The FBR will not allow change of ownership where expenditure made is less than 50% of the total estimated cost.
- The FBR may allow succession to legal heirs in case of deceased shareholder or a partner.
- However, the FBR may allow additional partners or shareholders after 31<sup>st</sup> December 2020. Such additional partners will not be eligible for exemption under Section 111 as described in point B(III) below.

## **B. OTHER EXEMPTIONS AND CONCESSIONS UNDER THE ORDINANCE**

Further concessions have been provided to the persons related to construction industry. These are as follows;

### **1. EXEMPTION FROM WITHHOLDING TAX UNDER SECTION 150 AND 153 OF ITO:**

- A builder or developer shall not be required to withhold tax under the captioned Section on;
  - The purchase of building material **other than steel and cement**.
  - The services of plumbing, electrification, shuttering and other similar and allied services **other than those provided by companies**.
- An eligible company under this ordinance shall not be required to deduct tax under Section 150 of ITO while making payment of dividend to its shareholders.

### **2. COMPUTATION OF INCOME TO BE INCORPORATED IN THE BOOKS OF ACCOUNTS**

- A builder or developer opting for taxation under Section 100D shall not be allowed to incorporate profits and gains accruing from such projects in excess of ten times of the tax paid.

Continuing the example given above, wherein the tax paid by a company in the first year is Rs. 1,250,000, and the company will be allowed to incorporate only Rs. 12,500,000 in its books.

- Dividend income paid to a person by a builder or developer being a company out of the profits and gains derived from a project shall be exempt from tax.

### **3. EXEMPTION FROM SECTION 111 OF ITO**

The following amounts will be exempted from the application of Section 111 of ITO (i.e. inquiry regarding source of unexplained income):

#### **i. Eligible amounts**

- Any amounts invested by an individual builder or developer in an eligible project.
- Any amount invested by a shareholder or partner of a builder or developer as capital or land transfer, on or before 31<sup>st</sup> December 2020. Capital shall not include borrowed funds.
- Any amount invested in first purchase of newly constructed buildings of an eligible project.
- Any amounts invested in purchase of a plot for construction of building thereon.

#### **ii. Exclusions**

This exemption shall not be available to:

- Holder of any Public Office as defined in the Voluntary Declaration of Domestic Asset Act 2018, or his benamidar as defined in the Benami Transactions (Prohibition) Act, 2017 (V of 2017), or his spouse or dependents.
- A public listed company, a real estate investment trust or a company whose income is exempt under any provision of the Ordinance.
- Any proceeds derived from the commission of a criminal offence including crime of money laundering & terror financing but excluding offence of tax evasion.

#### **iii. Procedure and conditions**

The procedure to be followed to avail exemption under Section 111 will be as follows:

- Where an individual builder or developer is investing cash in the projects, he shall deposit in a designated new bank account through cross banking instrument on or before 31<sup>st</sup> day of December 2020. Where the aforesaid is investing through 'land', he must have the ownership title of the land at the commencement date of this Ordinance.
- Where the investment is made through a Company or an AOP in cash, it must be done in the same manner as above. Furthermore, if the same opts to invest in the form of land, it must ensure that the ownership title of the land shall be transferred in the name of the Company or the AOP on or before 31<sup>st</sup> December 2020. It may be noted that in such a situation, the person investing in the form of land must possess the ownership title at the commencement date of this Ordinance.
- All monies that are to be invested for first purchase of these projects shall be deposited in a designated new bank account of the person on or before 30<sup>th</sup> September 2022. The same will then, have to be subsequently paid to the builder or developer through a crossed bank cheque.
- Any person making the investment shall submit a prescribed form on IRIS web portal.
- If an investment is made through the transfer of land, the transfer will be at 130% of value as defined in Section 68 of ITO, or at the option of investor, the lower of the values as determined by at least two independent valuers from the list of valuers approved by the SBP. Moreover, the transferor should own the land at the time of promulgation of the ordinance.

- The monies or land invested shall be wholly utilized in the eligible projects.
- In case of first purchaser of building or unit, following conditions are required to be fulfilled:
  - full payment is made through a crossed banking instrument to the builder during a period starting from the date of registration of the project with the Board under this section and ending on the 30th day of September, 2022, in case the purchase is from a new project; and
  - full or balance amount of payment is made through a crossed banking instrument to the builder during a period starting from the date of registration of the project with the Board under the ordinance and ending on the 30th day of September, 2022, in case the purchase is from an existing incomplete project.
- In case of purchase of plot for construction thereon, following conditions are required to be fulfilled:
  - the purchase is made on or before the 31st day of December, 2020;
  - the full payment is made on or before the 31st day of December, 2020 through a crossed banking instrument;
  - construction on such plot is commenced on or before the 31st day of December, 2020;
  - such construction is completed on or before the 30th day of September, 2022; and
  - the person registers himself with the Board on the online IRIS web portal.

#### iv. Certification

- In the case of a builder, the map approving authority, or NESPAK, shall certify that the grey structure, as per the approved map, has been completed by the builder, on or before, 30th September 2022.
- In case of a developer;
  - The map approving authority or NESPAK shall certify that landscaping has been completed on or before 30th September, 2022;
  - A firm of chartered accountants having an ICAP QCR rating of 'satisfactory', notified by the Board for this purpose, shall certify that at least 50% of the plots have been booked for sale and at least 40% of the sale proceeds have been received by 30th September, 2022; and
  - At least 50% of the roads have been laid up to sub-grade level as certified by the approving authority or NESPAK.

#### 4. EXEMPTION FROM CAPITAL GAIN

A new 'Clause (114AA)' has been inserted in Part I of the Second Schedule to the ITO, whereby, any capital gain

derived by a resident individual from the sale of constructed residential property will be exempt, subject to the following conditions:

- The residential property was being used for personal accommodation by the individual, his spouse or dependents and utility bill is issued in name of such individual;
- The land area of the property does not exceed 500 Sq yards in case of a house and 4000 square feet in case of a flat; and
- Exemption under this clause has not previously been availed by the individual, his spouse or dependents.

#### 5. BUILDER INCLUDED IN 'INDUSTRIAL UNDERTAKING'.

Any person directly involved in the construction of buildings, roads, bridges and other such structures or the development of land, to the extent and for the purpose of import of plant and machinery to be utilized in such activity, subject to such conditions as may be notified by FBR, has been included in the definition of industrial undertaking as provided in Section 2(29C) of ITO. This has been done with effect from 1<sup>st</sup> May 2020

This means that tax on import of raw material, plant, machinery, equipment and parts will be adjustable and not minimum under section 148 of ITO. Reduced rates of duties and sales tax as are applicable to industrial undertakings will also be available to such builders.

#### 6. ADVANCE TAX AT THE TIME OF SALE BY AUCTION

In case of an immovable property sold by an auction, the rate of collection of tax under Section 236A has been reduced to 5% (from 10% previously) of the gross sale price.

#### 7. CESSATION OF CAPITAL VALUATION TAX (HEREAFTER "CVT")

Through this Ordinance, CVT which was levied vide the Finance Act 1989 shall cease to apply from the date of commencement of this Ordinance.

#### C. POINTS TO PONDER

- ❖ The fixed tax rates specified are much lower as compared to other sectors. These tax rates are even lower than the minimum turnover tax rates of 1.5% applicable on other sectors. For example, constructed commercial property in Karachi is valued at an average of Rs. 25,000 per square feet, whereas, tax rates specified are Rs. 250 per square feet, which is merely 1% of market value (Rs. 25,000/Rs. 250). Moreover, even these taxes will be built into costs by builders and developers. These

rates need to be considered for revision after taking into account their Fair Market Values.

- ❖ Although the completion of a builder project is linked with completion of grey structure, the time period of 2.5 years for each project is still unreasonable. This time period should be extended to at least 3.5 years. Similarly, the expiry date of registration of projects and completion of projects should also be extended, accordingly till 30th June 2021 and 31st December 2023, respectively.
- ❖ Instead of depositing the project investment money in bank accounts to claim exemptions from Section 111 of ITO by builders and developers, such money may be deposited in an escrow account. The said amounts may only be drawn from the escrow account only after certain verifications. The condition of depositing of monies into any normal bank account may be exploited as amounts may be withdrawn in name of expenditures which would not be incurred for the projects or the amounts withdrawn may be exaggerated as compared to actual expenditures. Moreover, Developers and Builders do expenditures on project with moneys of first purchasers of these projects who make bookings by paying advances and subsequent installments.
- ❖ It is mentioned that persons involved in tax evasion will also be allowed exemption from Section 111. However, it is not mentioned that whether cases already pending with the FBR or the respective appellate authorities are covered in the exemption or not.
- ❖ Exemption from application of Section 111 of ITO with respect to investments in construction, may attract negative implications on Pakistan's Progress report for removal from the grey list of the Financial Action Task Force. This incentive may be misused for parking and laundering of black money.
- ❖ Payments to companies by builders and developers for provision of goods and services has not been exempted from deduction of tax under Section 153 of ITO. Such an exclusion from the aforesaid exemption is neither rational nor logical. This is because the corporate sector is an organized sector of the economy which properly files returns and pays its due taxes on time. Excluding the corporate sector from this relief is equivalent to encouraging undocumented economy in the country.
- ❖ It is provided that there shall be no refund of any tax collected or deducted under the Ordinance, whereas, adjustment of taxes paid under Section 236K are allowed. It needs to be clarified whether refund would also not be allowed in cases where taxes paid under Section 236K exceed tax liability of any builder or developer for the year.
- ❖ It is provided that in case of development of plots and construction of buildings on the same plots for low cost housing and all projects developed by NAPHDA, the higher rates shall apply. The rates need clarification as to whether the higher rate per unit of area will be considered or higher total tax amount will be considered. Moreover, it also needs to be clarified whether discount of 90% will also be applicable in above case where development and construction is on same plot in case of low-cost housing.
- ❖ It has been provided that a builder and developer is required to file a wealth statement along with his return of income. However, it may be noted that a company and an AOP do not file wealth statements. Only an individual may file a wealth statement under Section 116 of ITO.
- ❖ Under the newly added Section 100D, the builders and developers are allowed to declare an income in their books, of up to 10 times the 'tax paid'.
- ❖ With respect to the exemption discussed in point B (iv) above, the term 'resident' needs further clarification. This is because the said term may be subject to a dual or inconsistent interpretation. An example of such inconsistency can be that the term is interpreted as being a resident in terms of Section 82 of ITO, or, an individual being a 'resident' in the property. Moreover, it also needs to be clarified whether such exemption is available only in the case of sale of constructed properties of eligible projects under Section 100D or any other residential property. Furthermore, no sunset clause has been provided for this exemption from capital gain, which makes this exemption perpetual.
- ❖ With respect to the exemption from Section 111 of ITO for a purchaser of plot for construction thereon, it needs to be clarified whether such exemption is for amounts invested in only purchase of plots or, does it also include amounts invested for construction thereon.

➤ **ANNEXURE – RATES OF TAX**

Persons	Property Type	Area	(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
<b>Tax on Builders</b>		<b>Area in Sq. Ft.</b>	<b>Rate/ Sq. ft.</b>		
	<b>Commercial Buildings</b>	Any size	Rs.250	Rs.230	Rs.210
	<b>Residential Buildings</b>	up to 3000	Rs.80	Rs.65	Rs.50
		3000 & above	Rs.125	Rs.110	Rs.100
<b>Tax on Developers</b>		<b>Area in Sq. Yds.</b>	<b>Rate/Sq. Yd</b>		
	<b>Other than Industrial Plots</b>	Any size	Rs.150	Rs.130	Rs.100
	<b>Industrial Plots</b>	Any size	Rs.20	Rs.20	Rs.10





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