TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

TAX PAK

NEWSLETTER BY TOLA ASSOCIATES

OCTOBER

2021

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EDITORIAL NOTE

Greetings everyone! Hope this monthly issue of TAXPAK finds you in good spirits and immaculate health! Although by now you already know, but nonetheless, I will still briefly state that the purpose of this newsletter is to provide a monthly update on the ongoing legal and administrative developments that take place within the field of taxation in Pakistan. Alhumdulillah, so far, we have been successful in our mission to educate about, and keep the public-at-large updated of, these developments on a monthly basis.

Moving on to the content of this letter, I would like to apprise the reader of what information you can expect in this document. This newsletter contains an elaboration of important notifications and circulars issued by the Federal Board of Revenue and its provincial counterparts. Moreover, notifications from the corporate regulatory body i.e. SECP are also discussed. Furthermore, keeping in mind the aforementioned stated purpose of this document, a recent judgment passed by Appellate Tribunal Inland Revenue on Sections 68 and 174 of the Income Tax Ordinance, 2001 ("ITO") pertaining to "Fair Market Value" and "Record". The said judgment contains a discussion regarding the burden of proof in relation to assessing of the fair market value in terms of Section 68 of the ITO and for claiming of business expenses by a taxpayer.

Lastly, this newsletter is concluded with our Topic of the month which for this month happens to be "Comparison of GAAP's 3 Stage Impairment model for Financial Assets on 1 Stage Bad Debt Model of ITO". The said topic will be of interest to the people involved in the profession of Accounts and Taxation as well.

I wish you all a splendid month ahead!

All our readers are requested to visit our website www.tolaassociates.com, or download our mobile application from the links mentioned below, in order to access previously published editions of this monthly issue along with other publications, and to stay updated of future notifications.

1. https://goo.gl/QDM4ZM **(IOS)**
2. https://goo.gl/LFiWyx **(Android)**

Lastly, we request our readers 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. CHANGE IN PETROLEUM RATES

The FBR has issued an SRO bearing No. 1327(I)/2021 dated 7th October 2021, whereby it has made the following changes in chargeability of sales tax on petroleum products w.e.f. 1st October 2021:

S.No.	Description	PCT heading	Current Rate	Previous Rate
1.	MS(Petrol)	2710.1210	6.48% ad valorem	10.54% ad valorem
2.	High Speed Diesel Oil	2710.1931	10.32% ad valorem	11.64% ad valorem
3.	Kerosene	2710.1911	6.70% ad valorem	6.70% ad valorem
4.	Light Diesel Oil	2710.1921	0.20% ad valorem	0.20% ad valorem

2. PUNJAB REVENUE AUTHORITY GUIDELINES FOR AVAILING PERMISSION FOR CHARGING SALES TAX AT STANDARD RATES INSTEAD OF REDUCED RATES UNDER THE PUNJAB SALES TAX ON SERVICES ACT, 2012.

The Punjab Revenue Authority ("PRA") has issued a Notification bearing no. PRA-32-24/2021/253, dated 15th October 2021, through which the following guidelines/procedures have been issued for availing permission for charging sales tax at the standard rate of 16% instead of reduced rates, in terms of Section 10(a) of Punjab Sales Tax Act on Services Act, 2012 on payments made through debit cards/credit cards:

1. The registered person, for grant of permission for charging sales tax at the rate of Sixteen percent, shall submit an application, in writing, to the Authority.
2. The Authority may approve or reject the application. The approval shall be for a period of financial year. However, in case of rejection, an opportunity of hearing shall be provided to the applicant.
3. The registered person shall submit complete details of its services chargeable at standard rate/reduce rate of tax including exempt services of last six months in case of fresh approval and twelve months in case of renewal of its approval.
4. The registered person, in case application is approved shall produce following documents or record quarterly:
    a. Bifurcation of exempt services, services at reduced rate and services at standard rate along with details of relevant portion of input tax consumed.
    b. Registered person shall install EIMS under the EIMS Rules 2019 within 15 days of its application.
5. The registered person, after approval of application, shall not have a right to withdraw therefrom, during that financial year.
6. In case, the registered person violates any provision of the Act, rules framed or notification issued thereunder, the Authority shall withdraw the permission, subject to providing an opportunity of hearing.
7. In case, the permission is withdrawn under para 7, any input tax, adjusted for the period the permission was granted, shall stand recoverable from the registered person.

3. ATTACHMENT OF BANK ACCOUNT UNDER SECTION 140 OF INCOME TAX ORDINANCE, 2001 AND SECTION 48 OF THE SALES TAX ACT, 1990 - WITHDRAWAL OF DIRECTIVE

The FBR had issued instructions vide letters bearing No. 2(24) Rev-Bud/2019, dated 5th May 2019 and No. 6(25)S(IR-Operations)/2019 dated October 10th 2019 respectively, whereby, the following instructions were communicated:

"No Bank accounts attachment unless the taxpayer's CEO/Principal Officer/owner is informed at least 24 Hours prior to attachment and the Chairman FBR's approval is obtained."

The FBR has now issued Letter no. C.No.6(4)S(IR-Operations)/2020, dated 11th October 2021, with the approval of the Chairman, whereby, the above instructions have been withdrawn on ground to re-vest the power vested in the institution of the Commissioner viz-a-viz action under Section 140 of the ITO. The field formations may accordingly exercise the powers vested under SRO 274(I)/2020 dated 2nd April 2020 and Section 48 of the Sales Tax Act, 1990 for recovery of the outstanding demands.

4. MEASURES TO AVOID UNNECESSARY LITIGATION

In continuation of above withdrawal of notification of instructions regarding the attachment of bank account(s), the FBR has issued Letter No. C.No.7(20)S(IR-Operations)/2020 dated 12th October 2021. Through the said letter it has been highlighted that whenever there is litigation, it involves costs of various types including opportunity cost, legal remuneration and man-hours spent on preparing appeals and defending cases before various appellate forums, both on part of the department as well as tax payer. It is, therefore, essential to avoid entering into protracted litigation by exercising prudence ascertaining the potential of a case to pass the test of appeal, so as not to divert resources from other potential cases involving substantial revenue.

In order to forestall potential litigation by taxpayers on procedural lacuna, it is also important to ensure that no procedural lacuna is left during proceedings of the case. It has been observed that in certain cases, officers tend to initiate recovery proceedings without giving statutorily available time of 30 days to the taxpayer by resorting to attachment of bank accounts. Subsequently, tax payers being aggrieved of recovery proceedings before expiry of grace period, obtain stay orders from higher courts resulting in vicious circle of litigation at multiple fora. Therefore, the situation warrants that prudence is exercised both in terms of identifying the cases and deciding if the case has to be pursued at higher legal fora and to what level.

In order to avoid unnecessary "hazards of litigation" the FBR directed its officers that:

1. Coercive measures until case has passed the test of appeal at the level of commissioner IR (Appeals) may be avoided. Moreover, in order to utilize collective wisdom, a committee comprising of Senior Commissioners IR headed by Chief Commissioner IR may be constituted at formation level to deliberate on the cases before according approval of coercive measures.
2. While proposing filing of references and civil appeals, the Zonal Commissioners are expected to exercise their good judgment and:
   a. Propose filing of references and civil appeals in those cases where substantial revenue or a question of law critical to maintaining the essence of the fiscal statues and the tax machinery is involved ; and
   b. Enter into litigation in other cases only after due consideration of the probability of success and costs involved
3. The Zonal Commissioners shall also ensure, in respect of Officers IR subordinate to them, that:
   a. Jurisdiction in respect of a taxpayer or class of taxpayers is exercised by the concerned officer.
   b. All notices issued are properly served as envisaged in the fiscal statutes.
   c. Orders, including ex-parte orders, are passed after affording due opportunity of being heard.
   d. Coercive recovery measures under the relevant provisions of fiscal statutes are taken only after exhausting the time period statutorily available to the taxpayer for voluntary deposit of the assessed liability.

5. CLARIFICATION ON THE ISSUE OF DISCOUNT ON THE STANDARDIZED TAX INVOICE AS PER SRO 1006(1)/2021

The FBR had earlier issued SRO 1006(1)/2021 dated 9th August 2021, whereby it had specified a standardized format for Sales Tax invoice detailing minimum requirements for the integrated Point of Sale ("PoS") Systems. The definition of trade discount as mentioned in the value of supply in sub-section (46) of Section 2 of the Sales Tax Act, 1990 is meant for Business to Business transactions and does not cover retail sector and the Business to Consumer transaction.

Various representations from the taxpayers and Bar Councils/Associations have been received by the FBR seeking clarification of the term "trade discount" as stated in sub-section (46) of Section 2 of the Sales Tax Act, 1990, whether the term also covers "cash discount" given by retailers to end consumers, for the purpose of depiction in the standardized Sales Tax invoice under SRO 1006(1)/2021 dated 9th August 2021.

The matter has been examined by the FBR, and they have issued letter C. No. 05/P0S/1R/2021/164662-R dated 13th October 2021, wherein it has been clarified that the discount if any, to be given by a retailer has to be depicted on the invoice horizontally i.e. from left to right. The captions such as total, sales tax paid, discount allowed appearing at the bottom of the invoice are standalone notations and do not necessarily add or subtract one another.

6. TIER-1 RETAILERS - INTEGRATION WITH FBR'S POS SYSTEM

The FBR has issued a General Order No. 3 of 2022 dated 5th October 2021. Through the said General Order, the FBR has issued a list of taxpayers that are required to be integrated with FBR system but have not yet integrated. The list includes 1,136 identified T-IRs allowing them to be integrated with FBR's system by 10th October 2021 and the procedure for exclusion from the list shall apply as has been laid down in Para 2 of STGO 1 of 2022 dated 3rd August 2021.

It has been further clarified that in terms of Section 8B(6) of Sales Tax Act, 1990, the Tier-1 Retailer who did not integrate its retail outlet in the manner prescribed under Section 3(9A) of the STA, during a tax period, its adjustable tax for that period would be reduced by 15%. The figure of 15% has been raised to 60% vide Finance Act 2021. Upon filling of Sales Tax return for the month of September 2021 by all notified T-IRs who are not yet integrated, their input claim would be disallowed as above, without any further notice or proceedings, creating tax demand by the same amount.

2. CORPORATE NOTIFICATIONS / CIRCULARS

1. PUBLIC OFFERING REGULATIONS, 2017

The SECP updated the Public Offering Regulations, 2017 issued previously through SRO 296(I)/2017 dated 2nd May 2017. The current version is updated till 15th September 2021 and has been placed on their website on 5th October 2021.

Our readers may click the hyperlink given below for a quick access to the updated version of the said Regulations.

Public Offering regulations, 2017 – Updated 15 September 2021.

2. DRAFT AMENDMENTS IN THE ASSOCIATIONS WITH CHARITABLE AND NOT FOR PROFIT OBJECTS REGULATIONS, 2018.

The SECP has proposed draft amendments in the Associations with Charitable and Not for Profit objects Regulations, 2018 through SRO 1325(I)/2021 dated 4th October 2021. These amendments have been placed on their website on 6th October 2021.

The changes are proposed from Regulation 5 **"Grant of License"** to Regulation 15 **"Security Clearance"**. Moreover, Not for Profit (NFP) Forms, Appendices to NFP Forms and NFP Annexures are also proposed to be substituted by the SECP. The details of such proposed amendments can be perused from the link given below.

Draft amendments in the associations with charitable and not for profit objects regulations, 2018.

3. NON BANKING FINANCE COMPANIES AND NOTIFIED ENTITIES REGULATIONS, 2008.

The SECP vide updated the Non-Banking Finance Companies and Notified Entity Regulations, 2017 issued previously vide SRO 1203(I)/2008, dated 21st November 2008. The current version is updated till 13th October 2021.

Our readers may click the hyperlink given below for a quick access to the updated version of the said Regulations.

Non-Banking Finance Companies and Notified Entities Regulations, 2008 – Updated till 13 October 2021.

3. BURDEN TO PROVE FMV ON TAX DEPARTMENT - ATIR

1. RELEVANT PROVISIONS OF LAW

The concept of "Fair Value" is covered in Section 68 of the ITO, whereby, the fair market value of any property or rent, asset, service, benefit or perquisite at a particular time shall be the price which the property or rent, asset, service, benefit or perquisite would ordinarily fetch on sale or supply in the open market at that time. The fair market value of any property or rent, asset, service, benefit or perquisite shall be determined without regard to any restriction on transfer or to the fact that it is not otherwise convertible to cash. Where the price, other than the price of immovable property, is not ordinarily ascertainable, such price may be determined by the **Commissioner.** The Commissioner's power, however, can only be invoked when the price fetchable in the open market is not ascertainable.

As per Section 174(1) of ITO, every taxpayer shall maintain in Pakistan such accounts, documents and records as may be prescribed in Rules. As per Section 174(2), The Commissioner may disallow or reduce a taxpayer's claim for a deduction if the taxpayer is unable, without reasonable cause, to provide a receipt, or other record or evidence of the transaction or circumstances giving rise to the claim for the deduction. Thus, the taxpayer under the law is required to corroborate his expenses /deductions claimed in the return with some sort of evidence and in the absence of such provision of evidence without any justified reason the deductions claimed by the taxpayer cannot be allowed.

2. FACTS OF CASE

In **"The Commissioner Inland Revenue, RTO-II, Lahore Vs Respondent(S): Messrs Sajid Flour Mills (Pvt.) Ltd., Lahore"** (reported as 2021 PTD 1737), the company was engaged in the business of running a flour mill. Initially, the return of income of the taxpayer company was selected for audit under Section 177 of the ITO for the Tax Year 2006 and the taxation officer amended the assessment under section 122(1) read with section 122(5) of the ITO, through an Order dated 30-04-2010. Through the said Order, the learned officer made certain additions in the assessment regarding the profit on sale of wheat stock, loss on sale of vehicles, inadmissible deductions and amended the total income. Feeling aggrieved of the aforesaid order, the respondent company filed an appeal before the learned CIR (Appeals) ("CIRA") which remanded the case back to the officer. In the second round of appeal, CIRA made order in favour of the taxpayer on two issues:

1. Determination of fair market value of wheat stock on basis sales rate provided by Company
2. The additions made under Section 174(2) of ITO

Feeling aggrieved the CIR preferred an appeal with the ATIR Lahore Bench which was partially allowed as follows:

ISSUE 1: DETERMINATION OF SALE RATE/FAIR MARKET VALUE:

In this issue, the ATIR observed that nothing in the order in original dated 28-06-2013 passed by DCIR, suggests that he conducted any sort of inquiry or investigation or any effort was made to determine a fair market value of the wheat stock. At the time of the original amendment, the sale rate per kg was adopted @ Rs. 13.00 per kg against the declared rate of Rs. 10.25 per kg, thereby, giving a difference of Rs. 2.75. However, once the matter was remanded back by the Commissioner (Appeals) for determination of the fair market value, the DCIR reduced the sale rate from Rs. 13.00 to Rs. 12.25 per kg. It is also not clear from the record that on the basis of which information the DCIR determined the sale rate of Rs 12.25, rather the valuation appears to be hypothetical and without any basis.

The burden of assigning reason for determining the fair market value is on the assessing authority and it is not on the assesse to produce evidence to the effect that the valuation arrived by the assessing authority was not in accordance with the prevailing market value. In fiscal matters, it is for the assessing authority to establish that the declared version of the taxpayer is not correct and that too based on substance and material satisfying the judicial requirements.

Section 68(1) and (3) of the ITO provides two Stages for the determination of the fair market value. The first is the price which the capital asset would ordinarily fetch on sale or supply in the open market at that time. If the price is not ordinarily ascertainable such price may be determined by the Commissioner. The second stage comes in operation only when first method does not work. The power available to Commissioner to determine the fair market value can only be invoked when the price fetchable in the open market is not ascertainable. In this case, the assessing officer proceeded to exercise his discretion, however, without bringing on record that the fair market value of the asset was not ascertainable. It appears that the fair market value was determined on the basis of guess work. **The issue was decided by ATIR as against the department and the decision of the CIRA was upheld. In other words, in the case of a question of assessing the fair market value the burden of proof in on department.**

ISSUE 2: ALLOWANCE/DISALLOWANCE OF EXPENSES UNDER SECTION 174(2):

In this regard, the ATIR observed that the order of DCIR shows that the taxpayer did not submit any evidence with regards to the expenses claimed under various heads of account. The DCIR observed that the taxpayer did not even offer any explanation with regards to the expenses claimed under heads of account 'Mobile oil consumed' and 'market fee'. The ITO empowers the Commissioner to disallow any claim of the taxpayer if the taxpayer does not provide receipts, record or evidence with regards to such deductions without any reasonable cause. The taxpayer is required to corroborate his expenses/deductions claimed in the return with some sort of evidence and in the absence of such provision of evidence without any justified reason the deductions claimed by the taxpayer cannot be allowed. In this case, neither was any evidence submitted, nor any reasonable cause was given by the taxpayer for not providing such record or evidence. Therefore, the DCIR was justified in disallowing the expenses claimed by the taxpayer as the expenses claimed were not verified. **Hence, the order of the CIRA deleting the additions made by the DCIR in the expenses claimed in the Heads of account 'Commission paid on wheat purchase', 'Mobile oil consumed', 'market fee' was overturned, and the additions made by the DCIR in these heads were confirmed. In other words, in case of a question of claiming business expenses, the burden of proof in on taxpayer.**

4. TOPIC OF THE MONTH

BAD DEBT EXPENSE - A COMPARISON WITH GAAP MODEL

➢ PREAMBLE

In the end, we conclude our newsletter with our very own topic of the month, in which we will discuss issues related to the impairment of financial assets including trade receivable which is becoming an increasingly hot issue in the current COVID-19 situation, both in Generally Accepted Accounting Principles (GAAP) as applicable in Pakistan, and in the ITO.

1. GAAP BEFORE IFRS 9

Before IFRS 13, the provisions for bad debts were dealt with in IAS 39. The Trade receivables and loans were financial assets measured at amortized cost or the invoiced amount. The IAS 39 required that if there is **objective evidence** that there is a default or delay in payment as against terms of credit etc., then an impairment loss on financial assets has been incurred and the entity must recognize the loss in their profit and loss account. The impairment loss is calculated by comparing carrying amount of receivable or loan with present value of all cash flows. This method was not in agreement with common methods of age analysis and the general provisioning followed by industry for ease or convenience.

2. STAGE MODEL INTRODUCED BY IFRS 9

IFRS 9 "Financial Instruments" was adopted in Pakistan for Companies for periods ending on or after 30th June 2019. Moreover, the IFRS 9 requires an expected credit loss model to ensure earlier and timely recognition of credit losses. This has significant impact on companies as both incurred and future expected credit losses are considered in the measurement of impairment. The following instruments are in the scope of IFRS 9 impairment requirement:

- Financial Assets that are debt instruments measured at amortized cost or fair value through other comprehensive income.
- Loan Commitments and financial guarantee contracts not accounted for at fair value through profit and loss under IFRS 9.
- Contract assets under IFRS 15, Revenue from Contracts with Customer.
- Lease Receivable under IFRS 16, Leases.

Initial Recognition of Financial Asset

An entity is required to create a **credit loss allowance**/impairment allowance on initial recognition of the financial asset. This is calculated by multiplying the probability of default occurring in the next **12 months** by the total lifetime **expected credit losses** that would result from that default.

As per IFRS 9, the credit loss is the difference between all contractual cashflows that are due to an entity in accordance with the contract and all cashflows that an entity expects to receive discounted at original effective rate of interest. The expected credit losses (ECL) is the weighted average of credit losses with the respective risk of default occurring as weights. The Lifetime ECL are those that results from all possible default events over the life of financial instrument. The 12-month ECL is the portion of lifetime ECL which represents the expected credit loss that result from default events on a financial asset that are possible within 12 months after reporting date.

Subsequent treatment of Financial Asset

An entity may continue to provide for 12-month expected credit losses if there is no significant change in credit risk. However, the probability of default occurring in the next 12-months may have changed and the credit loss would have to be adjusted to reflect this.

If the credit list increases significantly since the initial recognition, the 12-month ECL impairment allowance will be replaced by the Lifetime ECL. If the credit quality subsequently improves and the Lifetime ECL criterion is no longer met the 12-month ECL basis is reinstated which means that the credit allowance will reduce.

The above is summarized as the 3-stage approach. This is as follows:

Step 1: Financial assets on initial recognition and financial asset where credit quality has not deteriorated since initial recognition, the 12-month ECL is recognized.

Step 2: Financial Assets whose credit quality has significantly deteriorated since their initial recognition. The rebuttal presumption is that credit quality has significantly deteriorated if more than 30 days past due, a Lifetime ECL is recognized.

Step 3: Financial assets for which there is **objective evidence** of impairment, a Lifetime ECL is recognized.

Interest Income:

For Financial assets at Stage 1 & 2 the interest income will be calculated at the gross carrying amount, whereas for the financial assets at stage 3, the interest income will be calculated on net carrying amount after deducting the impairment allowance.

3. SINGLE STAGE MODEL OF RECOGNIZING BAD DEBTS IN ITO

The provisions contained in Section 29 of the ITO are as follows:

3.1 CONDITIONS FOR ADMISSIBILITY OF BAD DEBTS ARE:

a) The debt is written off in the accounts. It means that provision for doubtful debts is not an allowable tax deduction unless it is written off in the accounts. Therefore, a provision for doubtful debts for the year is required to be added back and any debt written off against provision already made is required to be deducted

b) The Debt was previously included in taxable business income or the debt was in respect of money lent by a Financial institution., for e.g. Advance to employees written off, loan or advance to associate written off, advance against purchases written off are not allowed as bad debt expense even if written off, as they were not previously included in taxable income.

c) There are reasonable grounds to believe that the debt is irrecoverable.

3.2 FULL RECOVERY OF BAD DEBTS

a) According to Section 70 (recouped expenditure) of the ITO, where a person has been allowed a tax deduction for any expenditure or loss incurred in a tax year and, subsequently, the person has received, in cash or in kind, any amount in respect of such expenditure or loss, the amount so received shall be included in the income chargeable under that head for the tax year in which it is received. The said concept is also applicable for the recovery of bad debts and therefore recovery against bad debts already allowed as a tax deduction is a taxable amount. However, if the bad debt was not allowed as a tax deduction in the previous year then the same shall not be treated as taxable amount and shall be deducted from accounting profit in which the said amount has been taken as income.

3.3 PARTIAL RECOVERY OF BAD DEBTS

Section 29(3) of the ITO explains the taxability of partial recovery of bad debts. This is as follows:

Where a person has been allowed a deduction in a tax year for bad debt and in a subsequent tax year the person receives in cash or in kind any amount in respect of that debt, the following rules shall apply, namely:

a) Where the amount received exceeds the difference between the whole of such bad debt and the amount previously allowed as a deduction under this section, the excess shall be included in the person's income under the head "Income from Business" for the tax year in which it was received,

OR

For example, the amount of bad debt was Rs. 230,000 and bad debt previously allowed was Rs. 150,000. Then the difference between the two, i.e. bad debt not allowed, will be Rs. 80,000. Now, if the amount of bad debt received is Rs. 120,000, then Rs. 80,000 out of Rs. 120,000 will be adjusted against the bad debt previously not allowed and the remaining Rs. 40,000 will be added in "income from business".

b) Where the amount received is less than the difference between the whole of such bed debt and the amount allowed as a deduction under this section, the shortfall shall be allowed as a bad debt deduction in computing the person's income under the head "Income from Business" for the tax year in which it was received.

Continuing with the example given in paragraph (a) above, if the amount of bad debt received is Rs. 60,000 then the difference between the amount not allowed and bad debt received (Rs. 80,000 – Rs. 60,000) i.e. Rs. 20,000 will be allowed as a bad debt expense from "income from business".

Conclusion:

While the GAAP move from more a judgmental/subjective model as discussed in Section A which was prone to creative accounting by managers, to a more sophisticated rule based, objective model for reducing the judgment involved; the tax laws applicable on bad debts have been already objective based and required additional requirements in addition of classification of receivable as stage 3 to be claimable as an expense.

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