



TAX PAK

NEWSLETTER BY
TOLA ASSOCIATES

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EDITORIAL NOTE

Asalam-o-alaikum everyone! Hope this monthly issue of TAXPAK finds you in good spirits and immaculate health! I would like to wish all of you a very happy new year. I hope that everyone has a splendid 2022! About this newsletter, I would like to briefly communicate 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, we usually discuss a (relatively) recent judgment passed by the courts of law. In this monthly edition, we have opted to discuss the judgment passed by the Sindh High Court on 27th October 2020, on whether input tax is adjustable on services obtained by a withholding agent from an unregistered person.

Lastly, this newsletter is concluded with our Topic of the month that is titled "Insight into the discretionary v/s rule based provisions in the GAAP and the Income Tax Ordinance 2001". The said topic will be of interest to the people involved in the profession of Accounts and Taxation as well. d ITO, 2001". The said topic will be of interest to the people involved in the profession of Accounts and Taxation as well.

I wish you all an excellent year 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. SRO NO. 1608(I)/2021, DATED 17th DECEMBER 2021

A draft amendment to Rule 78 of the Income Tax Rules 2002 (“ITR”) has been published through the captioned SRO for objections and suggestions. The said draft amendment proposes to add a new paragraph 7 to Rule 78. The new paragraph is an addition to the prescribed form of a reference to the High Court under Section 133 of the Income Tax Ordinance 2001 (“ITO”). The said amendment now requires the Appellant to certify that the Respondent has been intimated of the filing of the appeal and been given a copy of the said Reference and the date on which the intimation was made and the copy given.

2. CIRCULAR NO. 10 OF 2021-22 – OPERATIONS, DATED 1ST DECEMBER 2021

Through the captioned Circular, the FBR had extended the deadline for digital payments by the Corporate sector, a compliance that has arisen pursuant to the recently introduced Section 21(la) of the ITO, through the Tax Laws (Third Amendment) Ordinance 2021. Through the captioned circular, the FBR has extended the deadline to 31st December 2021.

In relation to the above, the Federal Government has proposed an amendment through a Bill titled “Finance (Supplementary) Act 2021”. As per the proposed amendment, the aforesaid Section will be effective from the date notified by the Board. However, this amendment is subject to approval at the time of the circulation of this document.

3. OFFICE MEMORANDUM – F.NO. 2(26)REV BUD/2020, DATED 7th DECEMBER 2021

The FBR had previously revised the fair market value of properties across 40 major cities, through S.R.O No. 1534-1572(I)/2021 (“previous SRO”) dated 1st December 2021. However, now the FBR has through the captioned Notification, declared the previous SRO to be “in abeyance”, and simultaneously engaged a consultative/grievance redressal process pursuant to which a Valuation Review Committee (“VRC”) has been

constituted. The VRC has been directed to decide upon the representations made by the stakeholders by 10th January 2022 and forward them to the FBR. Furthermore, as per the captioned Notification, all recommendations made by the VRC vis-à-vis the revaluations shall be re-notified on 15th January 2022, and these shall come into force on 16th January 2022.

4. CIRCULAR NO. 04 OF 2022 – OPERATIONS, DATED 14TH DECEMBER 2022

Through the captioned circular, the requirement of acquiring Installed Capacity Determination Certificate (“ICDC”) for FATA and PATA industrial units, placed by a previous circular, was removed. Now, the Commissioner Inland Revenue (“CIR”) will determine the capacity of the installed machinery.

Moreover, certain timelines have also been laid down to streamline the process of import of raw material and its consumption. These are as follows:

(a) Upon an application from the importer to the office of the concerned CIR, the CIR will have to complete the verification process through physical visits of the manufacturing premises and issue a Revocation letter (or otherwise) of the Detention Order within 6 working days.

If the application by the importer is not filed within 5 days of the receipt of a Detention Order, the CIR may issue a speaking order denying the concessions found in various circulars.

The CIR has also been directed to ensure monthly stock-taking of the raw materials consumed by the manufacturing units and file a monthly report by the 10th Month of the Board.

(b) Consumption Certificates: The FATA/PATA domiciled manufacturer will apply with the concerned CIR within 10 days of consuming raw material for the issuance of a consumption certificate (GD Wise) along with the documents required in para 3 of Circular 05 of 2021. CIR shall take a decision on issuing the Consumption Certificate within 30 working days from the date of the application by the taxpayer.

(c) Exemption Certificate for import of industrial inputs/machinery by FATA/PATA resident manufacturers: The CIR shall ensure either issuance or rejection of the exemption certificate within 7 working days of the receipt of the application. If there is no decision made by the CIR within 7 working days, or the exemption application is rejected, the taxpayer shall apply to the CCIR, RTO Peshawar for redressal of his grievance. The said application to the CCIR will be decided within 7 working days of the receipt of application in the CCIR's office.

5. NOTIFICATION NO. SRB-3-4-/33/2021, DATED 17th DECEMBER 2021 – AMENDMENT IN SINDH SALES TAX ON SERVICES RULES (SRB)

Annexure D in Form SST-03, in the Sindh Sales Tax on Services Return, has been substituted by a new Annexure D. The said amendment will come into force from 1st January 2022.

6. DECISIONS OF BUSINESS INTEGRATION COMMITTEE ON POINT OF SALE – F.NO. 42 (1)/BIC/POS/2021/208665-R, DATED 17th DECEMBER 2021

In relation to Sales Tax General Orders, the Committee was informed of the process of STGOs and exclusion certificates being issued by the CIRs. The Chief of POS communicated to the Committee that there have been 5 STGOs issued till date. The committee requested for field formation wise breakup of STGOs and the amount of exclusion certificates issued by the CIRs, and further asked the Chief (POS) to get details of each exclusion issued from the field formations and submit it to the Committee for review and analysis purposes, by 24th December 2021.

For integration targets for the field formation, the Committee was aware of the number of retailers that were integrated but not yet registered, and the number of retailers that were identified through STGOs but not yet integrated. The Committee then decided that targets for each formation be fixed alongwith specific timelines for completion of the targets for the CIRs.

Pursuant to Rule 150(13) of the ZEB, the transactions on each point of sales in notified outlets shall be recorded on a CCTV camera and the recording of the same shall be retained for at least one month, and the same shall have to be provided to the concerned Commissioner whenever requested for the time specified in his request. The Committee decided that this Rule should be operationalized and periodic audits be started by field formations.

7. LAUNCHING OF SINGLE SALES TAX RETURN – OFFICE MEMORANDUM, DATED 24th DECEMBER 2021, NO. 2(54) SS(BDT-1) GST – 210596-R.

Through the captioned Notification, it has been notified that the sales tax return for the Tax Period of December 2021 (that will be filed in January 2022) will be filed through the Single Sales Tax Portal/Return. To facilitate the taxpayers, the uploading of sales tax invoices of December 2021 has been enabled, and the old sales tax return will not be available to file the sales tax return for December 2021.

8. SRO 1759(I)/2021 DATED 7th DECEMBER 2021

Through the captioned SRO, an amendment has been made in its previous SRO 57(I)/2016 (dated 29th January 2016), with effect from 16th November 2021. The notification has amended sales tax rates of petroleum products as follows:

S.No	Description	PCT Heading	Rate
(1)	(2)	(3)	(4)
1	MS Petrol	2710.1210	0.00% ad valorem
2	High speed diesel oil	2710.1931	7.20% ad valorem
3	Kerosene	2710.1911	8.19% ad valorem
4	Light diesel oil	2710.1921	0.46% ad valorem

9. SRO 1604(I)/2021 DATED 16th DECEMBER 2021

Through the captioned SRO, an amendment has been made in its previous SRO 57(I)/2016 (dated 29th January 2016), with effect from 1st December 2021. The

notification has amended sale tax rate of petroleum as follows:

S.No	Description	PCT Heading	Rate
(1)	(2)	(3)	(4)
1	MS Petrol	2710.1210	1.63% ad valorem
2	High speed diesel oil	2710.1931	7.37 ad valorem
3	Kerosene	2710.1911	8.19% ad valorem
4	Light diesel oil	2710.1921	0.46 ad valorem

2. CORPORATE NOTIFICATIONS / CIRCULARS

1. S.R.O 1581 (L)/2021, DATED 7th DECEMBER 2021

The SECP has through the captioned SRO has granted exemption to the banking companies licensed and authorized by the State Bank of Pakistan to open Roshan digital Accounts ("RDA") and performing the functions of distributing the units of; (i) Collective Investment Schemes; and/or (ii) Voluntary Pension Schemes of multiple Asset Management Companies to their RDA holders, from the requirement of obtaining license under Section 64(1) of the Securities Act 2015 to undertake regulated securities activity as securities advisor.

The complete SRO can be found at the following link:

<https://www.secp.gov.pk/document/permission-to-rda-eligible-banks-to-distribute-units-of-cis-vps-of-multiple-amcs/?wpdmdl=43833&refresh=61cf2570bada41640965488>

2. SRO 1395(I)/2021, DATED 27th OCTOBER 2021

The SECP has through the captioned SRO has published amendments to the Public Offering (Regulated Securities Activities Licensing) Regulations 2017, to seek public opinion. The complete SRO and amendments can be found on the link stated hereinbelow:

<https://www.secp.gov.pk/ur/document/sro-s-r-o-1395i-2021-amendments-in-the-public-offering-regulated-securities-activities-licensing-regulations->

[2017/?wpdmdl=43621&refresh=61cf2765e48481640965989](https://www.secp.gov.pk/document/s-r-o-1574i-2021-amendments-in-the-associations-with-charitable-and-not-for-profit-objects-regulations-2018-2/?wpdmdl=43738&refresh=61cf29069b6bd1640966406989)

3. SRO 1574(I)/2021, DATED 29th NOVEMBER 2021

Through the captioned SRO, the SECP has made amendments to the Associations with Charitable and Not for profit Objects Regulations 2018. The complete amendments can be found on the following link:

<https://www.secp.gov.pk/document/s-r-o-1574i-2021-amendments-in-the-associations-with-charitable-and-not-for-profit-objects-regulations-2018-2/?wpdmdl=43738&refresh=61cf29069b6bd1640966406989>

4. SRO 1605 (L)/2021, DATED 14th DECEMBER 2021

The SECP has through the captioned SRO made amendments to the Non-banking Finance Companies and Notified Entities Regulations 2008. The complete SRO and amendments can be viewed on the following link:

<https://www.secp.gov.pk/document/sro1605-i-2021-notification-for-amendments-to-nbfcne-regulations-2008-nbmfcs-and-housing-standards-2/?wpdmdl=43825&refresh=61cf297c3dcc71640966524>

3. INPUT TAX IS ADJUSTABLE ON SERVICES OBTAINED FROM UNREGISTERED PERSONS - SINDH HIGH COURT

MESSRS SHIELD CORPORATION LIMITED THROUGH ASSISTANT FINANCIAL CONTROLLER (PETITIONERS)

VERSUS

GOVT OF SINDH THROUGH SECRETARY FINANCE DIVISION, SINDH SECRETARIAT, KARACHI AND 3 OTHERS. (RESPONDENTS)

IRFAN SAADAT KHAN, JUSTICE & MUHAMMAD FAISAL KAMAL A LAM, JUSTICE

➤ PREAMBLE:

This segment pertains to the case titled "Messrs Shield Corporation Limited Through Assistant Financial Controller (Petitioners) V/S Govt of Sindh Through Secretary Finance Division, Sindh Secretariat, Karachi and 3 Others. (Respondents)" that was decided in October 2020 by the Sindh High Court. There were a host of

Petitions filed before the Sindh High Court (“SHC”) that concerned a common issue in contention. Hence, the Learned Division Bench of the SHC decided the matter through a consolidated judgment, the title of which has been stated *supra*.

Facts: The Petitioners in this case were Limited Companies doing business in different sectors, and were duly registered for Sales Tax. The said petitioners are also liable to withhold sales tax (where applicable) on taxable services being provided to them by different services providers. Nevertheless, the Petitioners filed their Sales Tax Return electronically, and in course of that electronic filing, the input tax **claimable** on taxable services provided to the Petitioners by unregistered persons was disallowed to them. Due to this, their sales tax liability has increased, which as averred by the Petitioners before the SHC was causing them prejudice, unconstitutional and without jurisdiction.

Prayer: The Petitioners prayed for the SHC to allow input adjustment of the deductions made by those unregistered persons, and to declare the withholding tax procedure prescribed in the Sindh Sales Tax Rules 2011 (“SSTR”), Sindh Sales Tax Special Procedure (Withholding) Rules 2011 and 2014 (“SSTSPR”), to be illegal, unconstitutional and without jurisdiction.

1. ARGUMENTS ADVANCED:

The advocates for the Petitioners appeared before the Honourable SHC to present their submissions, in order to convince the SHC to allow their Prayer, as mentioned *supra*.

a) By the Petitioners:

The counsels for the Petitioners took the argument that the denial of the adjustment of input tax (due to no fault on part of the Petitioners) on taxable services provided to them by unregistered persons was a discriminatory treatment against them. Moreover, the advocates further argued that the Petitioners being withholding agents, should not suffer (by denying their claim of input tax adjustment due to the complacency of an

unregistered person), as the Petitioners being withholding agents have duly withheld tax on the taxable services provided to them.

Furthermore, the counsels also argued that both Section 15A of the Sindh Sales Tax on Services Act 2011 (“SSTSA”) and Rule 22A of the SSTSR contain inclusive definitions, hence, should the two terms should be treated in the widest possible manner, and that their input tax adjustment claim should not be denied due to the taxable services being provided by an “unregistered person”. They also relied on **2020 SCMR 333** to support their contention.

b) By the Respondents

The counsels for the Respondents argued that the Petition is not maintainable and should be dismissed at the very outset. The said advocates further contended that the law makers have placed a clear bar on any benefit (in this case input tax adjustment for the service recipient) that can be given in respect of obtaining taxable services from unregistered persons. They stated that the underlying policy measures regarding such a bar was to get the unregistered persons registered and to document the economy. Furthermore, they also argued that the Petitioners in this case are enrolled with the Sindh Revenue Board (“SRB”) as a withholding agent and not a service provider. Hence, the Petitioners should approach the sales tax department rather than the SRB.

The advocates argued that these policy measures do not cause any financial loss or prejudice to the Petitioners as in this case, the element of input tax adjustment would become the cost components of the goods being dealt with by the Petitioners, and hence will ultimately be passed on to the consumer.

2. DECISION OF THE COURT

The Honourable SHC deliberated upon the arguments advanced by counsels for both the sides. The Court pointed out that the advocates for the Respondents have not drawn their attention to any law that places a bar upon the claiming of input tax adjustment relating to the services obtained by a withholding agent from an unregistered

person. Moreover, the Court also pointed out that as per the law, the name, CNIC, and NTN of unregistered persons have to be entered even if the services are obtained from unregistered persons. The Court held that the form designed by the Respondent is, hence, defected and needs correcting. Furthermore, the Court was also of the view that an input tax adjustment claim cannot be denied merely on the basis that the service provider was an unregistered person.

The Court held that the petitioners were entitled to claim input tax adjustment for the services provided to them by unregistered persons. Simultaneously, the Court directed the SRB to make the necessary changes in their e-filing form, in order to fix the discrepancy.

4. TOPIC OF THE MONTH

INSIGHT INTO DISCRETIONARY VS RULE BASED PROVISIONS IN GAAP AND THE INCOME TAX ORDINANCE (“ITO”)

➤ PREAMBLE

At the end, we conclude this edition of our newsletter with our very own topic of the month, in which we will discuss provisions relating to discretionary powers vs. rule-based powers in the GAAP and ITO. In the previous edition’s topic of the month we discussed that the fair value determination of immovable property is rule-based i.e. dependent on the valuation issued by the FBR. Whereas, in case of other assets the Commissioner has discretionary power to determine the fair value. However, we did not comment on which of the above is more preferred. In this segment and edition, we will look at some other instances of rule based vs discretionary provisions of ITO along with some trends in the GAAP in this regard. Before moving forward though, we would like to draw your attention on a very hot topic of discussion these days i.e. rising inflation, falling GDP and rising unemployment. It is influenced by the State Bank of Pakistan (“SBP”) through its Monetary Policy Statements/decisions. Our interest in this is to check whether the actions of the SBP to structure Monetary Policy are of a discretionary nature or whether they are based on predetermined rules. A comparison of same with

trends in the GAAP can provide us some idea of which could be the best choice in taxation policy as well.

1. MONTEARY POLICY

It has been a considerable debate over whether the monetary policy rate used by Central Bank be rule based or discretionary. It is a considered view of many economists that the role of Central Bank was exactly the opposite of what it is supposed to do and that it was reason behind Great Depression of 1930 and Great Recession of 2008. Friedman argued that poor monetary policy by the U.S. central bank, the Federal Reserve, was the primary cause of the Great Depression in the United States in the 1930s. In the view of the economists, the failure of the Fed (as it is usually called) to offset forces that were putting downward pressure on the money supply and its actions to reduce the stock of money were the opposite of what should have been done. They also argued that because markets naturally move toward a stable center, an incorrectly set money supply caused markets to behave erratically (A Monetary History of the United States, 1867–1960). The Chicago School economists were in favour of using the K-percent rule to automatically grow money supply based on the GDP, irrespective of economic conditions to bring stability to the economy over the long term. Thus, the Central Bank officials are not allowed under K-percent rule to use their discretion in managing money supply.

Similarly, the Taylor Rule published in 1992 to 1993 by John Taylor in “Discretion vs. Policy Rules in Practice”, also suggest that the Central Bank target interest rate should be based on formula based on managing two variables: Inflation and GDP/Unemployment. The Taylor’s equation is as follows:

$$r = p + 0.5y + 0.5(p - 2) + 2$$

Where,

r = nominal Central Bank rate

p= the rate of inflation

y= the percent deviation between current real GDP and long term linear trend in GDP

This means that FED will adjust interest rates on the basis of the changes in inflation and real GDP growth. It was

observed by John Taylor that the US FED perfectly followed this rule in 1990's which witnessed a very stable economic growth. However, we can see a deviation from this rule in 2006 and 2007 when the FED kept the interest rates too low to cause the housing bubble and the recession of 2008. Therefore, irrespective of economic conditions the Central Banks should follow Rule based policy rather than discretionary policy. **In Pakistan, we have seen a stable inflation and GDP growth during the years 2015-2017 as interest rates by SBP were 'rule based' as mentioned above. However, we have also seen a discretionary rate policy followed by a hike in the interest rate to 13% in 2019 which resulted in instability with inflation and the lowest GDP growth in the history pre COVID.**

2. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

In order to reduce manipulation and creative accounting avenues and reduce agency cost to shareholders, the GAAP have been witnessing changes, whereby accounting policies are becoming more and more rule based rather than discretionary.

For example, in classification of Financial Assets, IFRS 9 requires classification to be based on the following, rather than the management's discretion:

- (a) Entity's business model for managing the financial assets
- (b) The contractual cashflow characteristics of the financial assets.

(i) Amortised Cost:

A financial asset is classified as measured at amortised cost where:

- (a) The objective of the business model within which the asset is held is to hold assets in order to collect contractual cash flows; and
- (b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

(ii) Fair Value through other comprehensive income

A debt instrument **must** be classified and measured at fair value through other comprehensive income if it meets both of the following:

- (a) The financial asset is held within a business model whose objective is achieved by both collecting contractual cashflows and selling financial assets; and
- (b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All other debt instruments must be measured at fair value through profit or loss.

(iii) Equity instruments

Equity instruments may not be classified as measured at "amortised cost" and must be measured at fair value. This is because contractual cashflows on specified dates are not a characteristic of equity instruments. However, if an equity instrument is not held for trading, an entity can make an irrevocable election at initial recognition to measure it at fair value through other comprehensive income with only dividend income recognized in profit and loss account.

IFRS 9 is very specific/rule based about how instruments may be classified, which means there is limited scope for judgment. However, entities have a choice about the irrevocable FVTOCI election for equity instruments not held for trading.

Similarly, in the earlier IAS 17, the entity had a choice of classification of lease as either a financial lease or an operating lease giving more room for the management of recording off-balance sheet liabilities. Changes have been made through new IFRS 16 in which it has removed the differentiation between operating and finance lease from the lessees' point of view, and provided a structure for identifying whether the arrangement in question is a lease or not.

3. THE INCOME TAX ORDINANCE 2001

Before commenting on the discretionary vs rule-based provisions in the Income Tax Ordinance 2001 ("ITO"), we would like to draw our readers' attention towards our stance that the discretionary powers of Commissioner in ITO must be restrained to avoid misuse.

(i) Discretionary Provision:

The prime example of discretionary power given to the Commissioner in the ITO is in Section 109 “Recharacterization of income and deductions” in which the Commissioner may:

- (a) recharacterise a transaction or an element of a transaction that was entered into as part of a tax avoidance scheme;
- (b) disregard a transaction that does not have substantial economic effect; or
- (c) recharacterise a transaction where the form of the transaction does not reflect the substance.
- (d) disregard an entity or a corporate structure that does not have an economic or commercial substance or was created as part of the tax avoidance scheme.

(ii) Rule based Provisions:

A few examples of rule based provisions are as follows:

• **Thin Capitalisation -Section 106:**

Where a foreign-controlled resident company (other than a financial institution or a banking company) or a branch of a foreign company operating in Pakistan, has a foreign debt-to-foreign equity ratio in excess of three to one at any time during a tax year, a deduction shall be disallowed for the profit on debt paid by the company in that year on that part of the debt which exceeds the three to one ratio.

• **Repair and Maintenance Allowance on Property Income-Section 15A:**

In computing the income of a person chargeable to tax under the head “Income from Property” for a tax year, a deduction shall be allowed in respect of repairs to a building, an allowance equal to one-fifth of the rent chargeable to tax in respect of the building for the year.

• **Value of Perquisites-Section 13:**

The value of perquisites for determination of employee salary income in respect of motor vehicle provided by employer, accommodation etc. are rule based provided in Income Tax Rules 2002.

• **Deductions not allowed - Section 21:**

Following are rule-based deductions which are not allowed:

- Any entertainment expenditure in excess of such limits or in violation of such conditions as may be prescribed.
- Any expenditure in respect of sales promotion, advertisement and publicity in excess of ten per cent of turnover incurred by pharmaceutical manufacturers.
- Any expenditure on account of utility bill in excess of such limits and in violation of such conditions as may be prescribed.

• **Cost of Passenger Transport vehicle - Section 22:**

The cost of a depreciable asset being a passenger transport vehicle not plying for hire should not exceed two and half million rupees.

Conclusion

Today’s modern economies rely more on free markets to set prices and interest rates for stability and prosperity and if any central planning authority is in any way involved in these, the current practice is to limit these discretionary powers by making them systematic and more rule based. This in our view should also apply in tax policy.

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