



## COMMENTS ON AMNESTY TO CONSTRUCTION INDUSTRY

### ➤ PROLOGUE

A document titled Proposed Special Incentive package for construction industry (“Package”) by Naya Pakistan Housing and Development Authority (“NAPHDA”) is circulating in media. The proposed package contains Direct and Indirect tax and other economic incentives for the construction and development sector. The package is a good sign for the growth of overall economy as construction and development sector supports hundreds of related industries in country. Major related industries are cement, iron and steel, woodworks, goods transport, etc. The package will also act as a stimulus for the employment generation. The package is similar to the package extended to stock exchange in 2012, in which we also provided our input while framing the same. Since the package is still a proposal we are presenting our initial comments on salient features of the proposed package. We will issue our comprehensive final comments once the package is embedded into law.

### A. TAX MEASURES BY FEDERAL BOARD OF REVENUE

Following are the direct tax measures:

1. Tax Regime builders and developers will be changed from normal to a fixed tax regime. The regime was also implemented earlier under section 7C and 7D of Income tax Ordinance, 2001 (“ITO”) for projects undertaken and approved during tax year 2017 only. It is expected that these sections will be amended to continue the fixed tax regime for upcoming projects also.
2. Income will be treated as a separate block of income and tax will be levied on fixed basis. Tax will be levied on per square foot basis for builders and on per square yard basis for developers.
3. Payments for goods and services provided to builders and developers will not attract tax deduction under section 153 of ITO. However this exemption will not be applicable to companies and steel and cement providers. For example an individual or AOP providing steel and cement will not be exempted from tax deduction. Similarly, a company providing any material or services will also not be exempt from deduction of tax.
4. Builders and developers will be allowed to declare wealth amounting to ten times of the tax paid as imputable income. For example a builder paying tax amounting to Rs. 100,000 will be eligible to declare Rs. 1,000,000 in his wealth.
5. For the low cost projects developed by NAPHDA, the tax rates levied will be reduced by 90%. For example in case tax is levied at Rs. 200 per square feet for the builders, if the same builder is operating under NAPHDA, tax rate will Rs. 20 per square feet.
6. Exemption from application of 111 of ITO is also proposed, i.e. source of any amount declared in the wealth statement will not be inquired which is invested for the following:
  - a. Purchase of land **and** construction of any structure on such land;
  - b. Construction of any structure on already owned land; or
  - c. First purchase of newly constructed property.

This exemption will be applicable only for amounts invested during period from passing of proposed legislation till 30<sup>th</sup> June, 2022.

This means that amounts invested in purchase of just land will not be qualified for the exemption unless any structure is built on same. Moreover, exemption is limited to only amounts invested in first purchase of newly constructed property and the same is not available

in case of subsequent purchases. However, this needs to be clarified whether first purchase should be from approved builders only or from any ordinary person.

7. Holding period for constructed property will be brought to 3 years, i.e. the period prevailing prior to July 01, 2019. Whereas, holding period for open plots will remain same i.e. 8 years, however, the rates of capital gain tax may be reduced on scale down from fourth year onwards. Rate of capital gain tax will be reduced in proportion to increase in valuation tables also.
8. Fresh revaluation process of real state will be expedited.
9. Sales tax and Federal Excise Duty on construction material will be suitably reduced
10. Construction, purchase and sale of first house will be exempted from all taxes, including capital gain tax.

#### **B. TAX MEASURES BY PROVINCIAL REVENUE AUTHORITIES**

1. Sales tax on builders and developers will be levied at Rs. 50/Sq. Ft and Rs. 100/Sq. Yard, respectively, by all provinces and ICT.
2. In case builders and developers are chargeable to sales tax as above, construction services provided to them will be exempt from any sales tax.
3. Low cost housing by NAPHDA or provincial housing authorities will be completely exempted from sales tax.
4. All Provincial and Municipal taxes, duties, fees, levies, charges on transfer and registration of urban properties to be clubbed under one head and charged at the rate of 2 percent of valuation.

#### **C. OTHER MEASURES**

1. Policy on high rise construction has already been approved by Prime Minister and notification of same has been issued for Islamabad Capital Territory. However, the same has yet not been issued for other major cities/urban areas. A suo moto case is also pending with respect to high rise constructions. The same should also be considered while framing the law.
2. Prime Minister has approved status of industry for construction sector.
3. Preferably a 6% interest rate will be offered for housing mortgage of 100,000 low cost housing units under NAPHDA.

#### **➤ POINTS TO PONDER**

1. With respect to collection of fixed tax on area basis, it has not been made clear whether such tax will be collected during first year of the project or on the basis of percentage of completion or on some other basis. For example, in case a 100,000 square feet project is undertaken by a builder which will be completed in two years and tax rate is fixed at Rs. 200/ square feet, will the builder deposit complete tax of Rs. 20,000,000 in the first year or will he deposit 50% in first year and 50% in second year, etc.

As per rules applicable in earlier regime, commissioner was empowered to issue schedule of payments on four-monthly installment basis.

2. 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 exclusion from exemption is neither rational nor logical as the corporate sector is the organized sector of the economy which properly files returns and pay their due taxes on time. Excluding the corporate sector

from this relief is equivalent to encouraging undocumented economy in the country. The exemption from withholding tax should also be extended to downstream sectors like distributors of raw materials.

3. A suo moto case is also pending with respect to high rise constructions in mega cities. Mega city of Lahore has been cleared for such mega projects. Similar clearance should also be provided to mega city of Sindh, i.e. Karachi. The implications of the case should also be considered while framing the law.
4. 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 Financial Action Task Force's grey list. This incentive may be misused for parking and laundering of black money.

Moreover, the incentive is framed in a way not to encourage trading of open plots and files as there is a precondition of building a structure on such plot. However, since there is no minimum limit prescribed for such construction, incentive will be claimed by investment in open plot and building a fictitious minimal structure thereon.

5. For mortgage of 100,000 low cost units at 70% financing, SBP will be required to issue debt of Rs. 210 billion (given average cost per house at Rs. 3 million) to commercial banks. Moreover, these housing colonies will be developed in city outskirts for which government will have to further invest for Hospitals, Schools, Parks, road transportations etc. This will further add to the debt to be issued by SBP.
6. At the rate of 70% financing and 6% mortgage rate for a tenure of 10 years, monthly installment for the resident comes out to be Rs. 23,314. The project is for low income family whose combined monthly income would be around Rs. 50,000 per month. Normally mortgaging banks in Pakistan provide the facility only when monthly rental is less than 40% of take home income. However, in above case, rental is more than 46% of take home income. This means that for the target resident, payment of monthly rental will not be possible. Therefore, either the interest rate should further be reduced or Government will end up providing further subsidy to these houses.
7. The time duration provided for exemption from section 111 of ITO is too short as a normal project takes at least 5 to 7 years to be completed, therefore, the proposed expiry date of 30<sup>th</sup> June, 2022 should be extended.
8. It needs to be clarified whether the persons, who have pending cases under Anti money laundering and Benami properties laws, will also be eligible to take benefit of the package.

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