Property Boom in Pakistan- Its Impact and Taxability

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Thanks to Almighty Allah to Whom all praise and gratitude is due. Without His help none of us can attain our goals, no matter how hard we try and what means we use. It is because of His blessings that we sustain all ordeals and get solace after sorrows. We are grateful to Him for giving us strength and energy to not only undertake this task but also complete it. We would also like to grab this opportunity to thank our Faculty In-charge, Deputy Director Amina Naeem, whose persistent support and essential help throughout this dissertation has enabled us to submit it in time. Without her continuous guidance, we would never have accomplished this task. The group worked in coordination with each other which resulted in the production of this report.

Preface

The research report is an in depth and exploratory study on **"The Property Boom and its taxability".** This report consists of table of contents, statement of the problem, scope of study, methodology, Literature Review the main discourse of our analysis followed by issues in taxability of Capital gains on immovable property and some practicable suggestions.

PROPERTY BOOM: ITS IMPACT AND TAXABILITY

Introduction

Taxation is the backbone of a country's economic system. Tax collection is crucial for the economic wellbeing of the people. An ideal taxation system hardly exists anywhere in the world, however; different societies across the world have struggled hard to ensure maximum collection of revenue through taxes so as to provide basic services to their people. Pakistan's taxation system is far from ideal and is plagued by myriad of challenges such as tax evasions, leakages, exemptions, reduced rates etc., it is due to these factors that Pakistan has been lagging behind both in resources generation and mobilization in the region and taxation only comprises 8.9 percent of the total GDP which is the lowest in the region.

Tax exemptions in all types of taxes imposed in Pakistan have always been a serious constraint for the tax administration to enhance revenue generation in Pakistan. Out of theses exemptions, two exemptions have been extremely detrimental to the interests of revenue in Pakistan. One exemption is given to incomes accrued from agriculture and another is exempting the capital gains received from the sale and purchase of an immovable property either by an individual or AOP. The scope of this research report does not extend to deliberate on ways and means of taxing agriculture income. The primary objective of this report is to investigate various aspects including legal, political, economic and Socio-cultural limitations which have still kept the capital gains from sale and purchase of immovable property out of tax net.

As we know that real estate has emerged one of the most important sectors in Pakistan's economic discourse. This presents a unique opportunity to reconsider taxing immovable property so as to mitigate resource constraints and avoid economic meltdown of the Pakistani state.

Statement of the Problem

Tax reforms have always been a formidable challenge for every political dispensation due to various socio-political and cultural considerations. Pakistan is threatened by serious financial crises due to the absence of additional resource mobilization to meet increasing expenditures costs of the government with dwindling tax to GDP ratio. In this situation it is highly imperative for the government to rid itself of tax exemptions guaranteed to incomes coming from the sale and purchase of immovable property.

Some important questions shall be addressed during the course of this research endeavor. What were the major factors responsible for the incidence of property boom in the last decade and how it has impacted the economic discourse of the country? What are the legal, political, social and cultural factors obstructing the taxation of immovable property in Pakistan? How much revenue could have been accrued if immovable property were in the tax net especially in the previous decade? How taxation of immovable property is contributing in the revenue generation in other south Asian countries especially our neighboring state India?

Literature Review

Due to paucity of empirical research on the topic under consideration, the syndicate major reliance has been on certain basic documents such as The State Bank Annual Reports on the state of Pakistan Economy available on the Central Bank official website, The Economic Surveys carried out over the last 10 years, reports published by the Ministry of Finance, government of

Pakistan and several other independent research reports published in well reputed research journals such as Economic Journal of Pakistan published by Pakistan institute of Developmental Economics etc.., During literature review, the syndicate found out major deficiency of literature pertaining to explore the linkage between the massive property boom and its impact on the over-all economic growth of the country. Moreover, it was also felt that real estate sector has emerged a significant variable of growth and investment yet its inherent potential of bringing in more revenue in the state exchequer through its effective taxation has not been realized. This report is an effort to sensitize the policy makers to tap the immense potential of real estate sector by imposition of tax on capital gains on immovable property to generate additional revenues and keep the wheels of the state machinery moving.

Methodology

This research is qualitative-cum- exploratory in nature whereby the basic purpose is to find ways and means to tax capital gains on immovable property. Major reliance has been on secondary sources for carrying out this research.

1. PROPERTY BOOM IN PAKISTAN AND CONTRIBUTORS TO ITS GROWTH:

Pakistan was quite a part of the global property boom that we witnessed at the turning of the 21st century. Prior to 9/11, the real estate in Pakistan was undervalued due to the flight of capital and the slump in business within the country. The situation was extremely bad as there hardly were any buyers. Small and medium size investors were least interested in investing in Pakistan, as most of them were in search of better opportunities abroad. The catastrophic events of 9/11 became one of the major turning points and had a direct impact on the flourishing of real estate in Pakistan. In 1999-200 Pakistan had foreign exchange reserves of $1.967 billion. As of October 2004, our reserve position stood at$12.271 billion[1].

This boom was more prominent in metropolitan cities like Karachi, Lahore and Islamabad where the prices of property increased manifolds within a span of a year or so. Authorities like Defence Housing Authority showed extraordinary growth. Likewise many property developers mushroomed overnight and plethora of housing societies came up on the property scene of Pakistan. The boom that Pakistan witnessed came into two phases.

1.1 First Phase of boom:

The first phase erupted right after the 9/11 incident. A few months after the US incident, prices of the property started to rise. This happened only in the Karachi's Defence Housing Society, Lahore's Defence Housing Society and Gulberg, and Islamabad's F-6, F-7, F-8 sectors, Blue Area and the Jinnah Super localities. The prices in other areas witnessed marginal increases.

Property in Islamabad saw a very sharp rise. Houses which were available for Rs5 million in

[1] Economic Survey of Pakistan

2000 and 2001 shot up to Rs30 million by mid 2003 in F-6, F-7 and F-8 sectors[2]. The smallest rise was in Karachi where houses worth Rs5 million went up to Rs12 million in the same period. No doubt that the major reason behind the first phase of property boom in Pakistan was the events of 9/11 that created an atmosphere of fear and suspicion among Pakistani expatriates living in the US; hence, Pakistan started receiving inward remittances. A fair amount of remittances were invested in metropolitan cities as these areas had the most transparent property title and transfer procedures. Likewise areas like the up-market Defence Housing Authority in Lahore were benefited enormously. The value of one plot in the Defence Housing Authority shot up from about $65,000 before 11 September to in excess of $1.5million after it. Similarly, in Johar Town, another affluent middle class locality, average prices rose on an equally spectacular basis - from about $35,000 to more than $132,000 in 2002. As a result property prices went up that caused the local investors to join in too.

1.2 The second phase of boom

The second phase of property boom in Pakistan, which was rather an outcome of the first phase, started in the second half of 2003. By mid 2003 most other areas of major metropolitan centres joined the bandwagon of real estate boom. Price appreciation had a large degree of variance. In some localities prices increased by 15-20 per cent, whereas in other areas it was by 35-50 per cent.

Pakistan's economy recorded a growth of 6.4 per cent in 2003-04. This expansion was being fuelled by the easy availability of credit and the lax monetary policy. In 2006 the bank interest

[2] www.forum.freeadsproperty.com

rates dropped down to 5% from 18%(The National Savings)[3]. This decrease in the interest rate initiated the tremendous boom in the realty of Pakistan, not just in one city but cities all over the country. Private sector credit off-take was at record and banks started to venture into home financing business. Reportedly, banks disbursed Rs8 billion for the housing sector but the amount of borrowed money that found its way into real estate purchases was far greater than that. Moreover, many medium-sized businesses such as the exporters, traders, manufacturing unit owners and the agriculturists took out business loans and utilized the funds for real estate investments, due to a lack of legitimate opportunity for small and medium businesses. Thus in real terms a greater amount of money found its way into real estate than the Rs8 billion disbursed by the banks, inflating property prices across Pakistan.
While the easy credit factor caused speculative increase in property prices genuine factors were also witnessed. As economic and business conditions improved in 2002 and 2003 genuine demand for housing also surfaced. Housing projects which were lying empty in the middle class areas of the major cities started to fill up rather quickly at the end of 2003.

Variation in the rise among different localities of the same city is due to the fact that home buyers preferred new places of residence. Moreover, a lot of agricultural land was converted into housing schemes. The availability, closeness to the city, and town planning itself helped people toward buying and investing. Another feature that boosted the real estate boom is the preference of individuals to park their excess capital or savings in property investments due to a number of factors. Historically, the appreciation in real estate has been greater than the rate of inflation and the rate of return offered by banks on deposits. In addition a large segment considers interest

[3] www.bbcnews.com

bearing deposits as 'unethical' from the religious point of view; thus, they tend to direct their money into real estate investment.

The property boom that Pakistan witnessed soon showed the repercussions on Pakistan's economy. We can call it a mix bag of effects. The impact of real estate market boom is discussed in the following chapter.

2. Impact of Property Boom on the Economy

The linkage between the real estate market and the general conditions of the economy has been studied extensively. However, most academic research is focused on the ways in which economic fundamentals affect property prices or the ways in which expectations about fundamentals affect property markets. Most Research also compares the importance of economic fundamentals, in affecting outcomes in the real estate market. Economic models arising from this line of research are capable of generating patterns of price change over time in property markets in response to variations in economic conditions and to exogenous shocks. There has, however, been much less attention given to the opposite line of causation—the potential for exogenous changes in property markets to affect the subsequent economic performance of the economy.

The economy can be affected by fluctuations in the property price through a variety of channels. Changes in property prices can influence private consumption and investment through wealth and balance-sheet effects. They also affect consumer price inflation via both direct and indirect channels, and can have a significant effect on country's competitiveness in international markets. The banking sector is susceptible to fluctuations in the property price due to its exposure to the property market. Finally, the fiscal position of the government may be affected via the revenue channel.

This section presents an analysis of the effects of property price fluctuations on the various sectors of the economy.

The importance of the real estate sector as a catalyst for growth can be gauged from the fact that it is the second largest employer next only to agriculture. This is because of the chain of backward and forward linkages that the sector has with the other sectors of the economy especially with the housing and construction sector. About 250 ancillary industries such as cement, steel brick timber and building materials are dependent on the real estate industry. A unit increase in the expenditure of this industry has a multiplier effect and the capacity to generate income as high as five times.

The property boom that Pakistan witnessed brought along with itself a boom in real estate industry of Pakistan too. The impact on the economy of Pakistan was thus humongous. Following are few of the positive and negative effects of property boom in Pakistan.

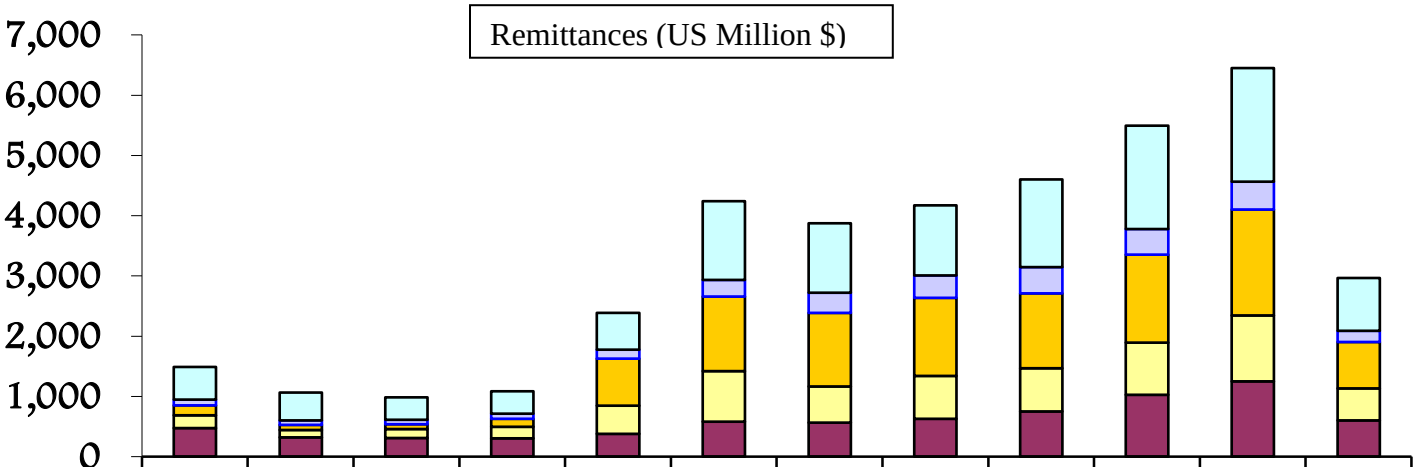
Immediate effects of property boom

1. Rags to riches

The rocketing real estate prices in Lahore have resulted in hundreds of rags-to-riches stories. Poor farmers with small pieces of land in the villages close to the municipal limits could hardly make ends meet. But with the fast expansion of the city's frontiers, they sold off their property, pocketing millions of rupees overnight. The city's roads are now clogged with brand new four-by-fours - the names of BMW and Lexus are becoming increasingly common on the streets. The cars are just one sign of the ostentatious new rich, showing off money which was unheard of a few years back. More than 30m cellular phone subscribers is another signpost of the upturn. Pakistan's electricity company chief Tariq Hameed says there have also been record sales of refrigerators, washing machines and split air conditioners which have caused a sudden surge in electricity demand. Not surprising then that this summer there were many power cuts in peak hours. All this is all the more amazing when one considers that just five years ago, Pakistan was on the verge of bankruptcy, with only a little more than $1bn in foreign exchange reserves and its stock market teetering at 1,000 points.

2. **Massive remittances**

Two months after 9/11, the forex reserves went up to $4bn as Pakistan joined the US coalition against the "war on terror". The forex reserves now stand at more than $12bn. Moreover there is little doubt that the catalyst for this growth has been the massive amount of remittances sent back by non-resident Pakistanis in the US and later from Europe. In 2001, the remittances totaled a little more than $1bn. But since 2002, Pakistan has received nearly $4bn in remittances every year. That means an additional inflow of $14-15bn has been returned to the country since the 2001 attacks. The wealth flowing in to Pakistan now is second only to the boom created by money sent back to the country by its blue-collar workers in the Middle East in the 1980s. The difference is that the 1980s money created a lower middle class, whereas today the principal beneficiaries are upper middle class people in big cities. They brandish credit cards and drive Mitsubishis. Their children go to grammar schools, eat burgers and pizzas and celebrate Halloween and Valentine's Day [4] .

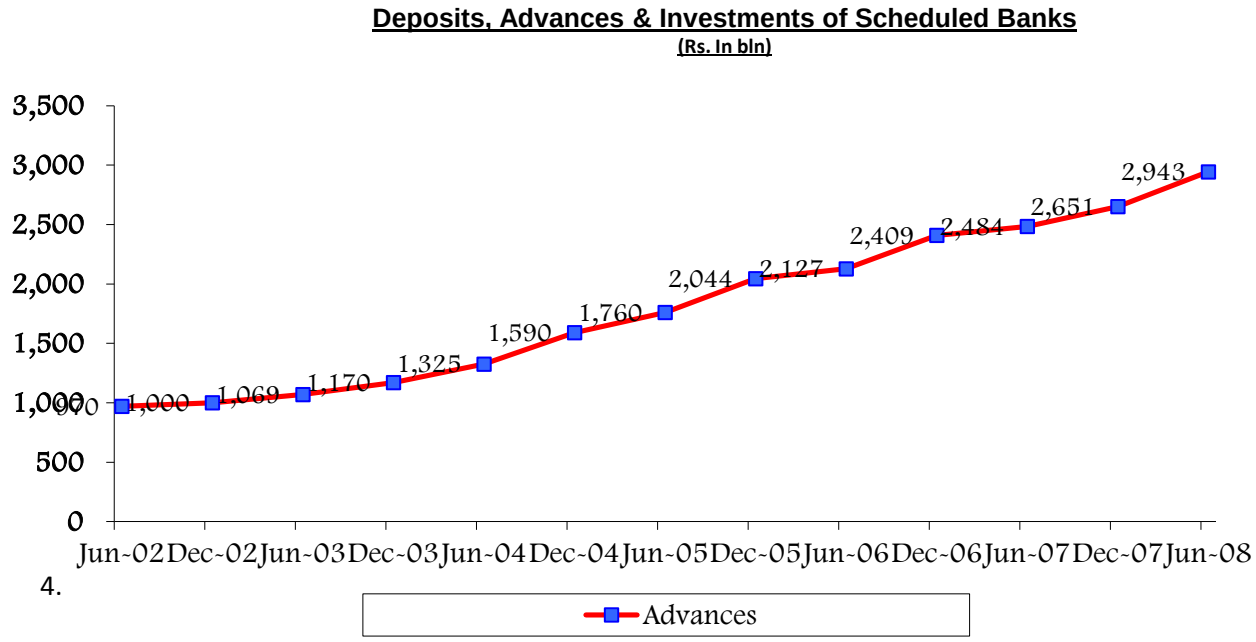


	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09-Nov
Others	542	461	373	376	612	1,307	1,150	1,163	1,452	1,714	1,889	876
UK	99	74	73	81	152	274	334	372	439	430	459	188
USA	166	82	80	135	779	1,238	1,225	1,294	1,242	1,460	1,762	767
UAE	208	125	148	190	469	838	597	713	716	866	1,090	534
Saudia Arabia	475	318	310	304	376	581	565	627	750	1,024	1,251	600

[4] State Bank Of Pakistan , Annual Reports F Y 1998-2009

3. Banking sector boom

Banking sector also cashed into the boom and went into house financing big way. Due to increased liquidity banks had money to lend but found returns on loans low. This was because the loans taken against land were being re invested into the property market. This produced a negative effect on economy as banks were lowering credit standards and in main cases were willing to inflate the value of collateral. The end result was that most properties in urban Pakistan went out of the reach of genuine buyers and speculators walked off with millions in the process. However, banking sector experienced tremendous continued growth during these years. Following graph depicts the growth of advances during the years of the boom [5].

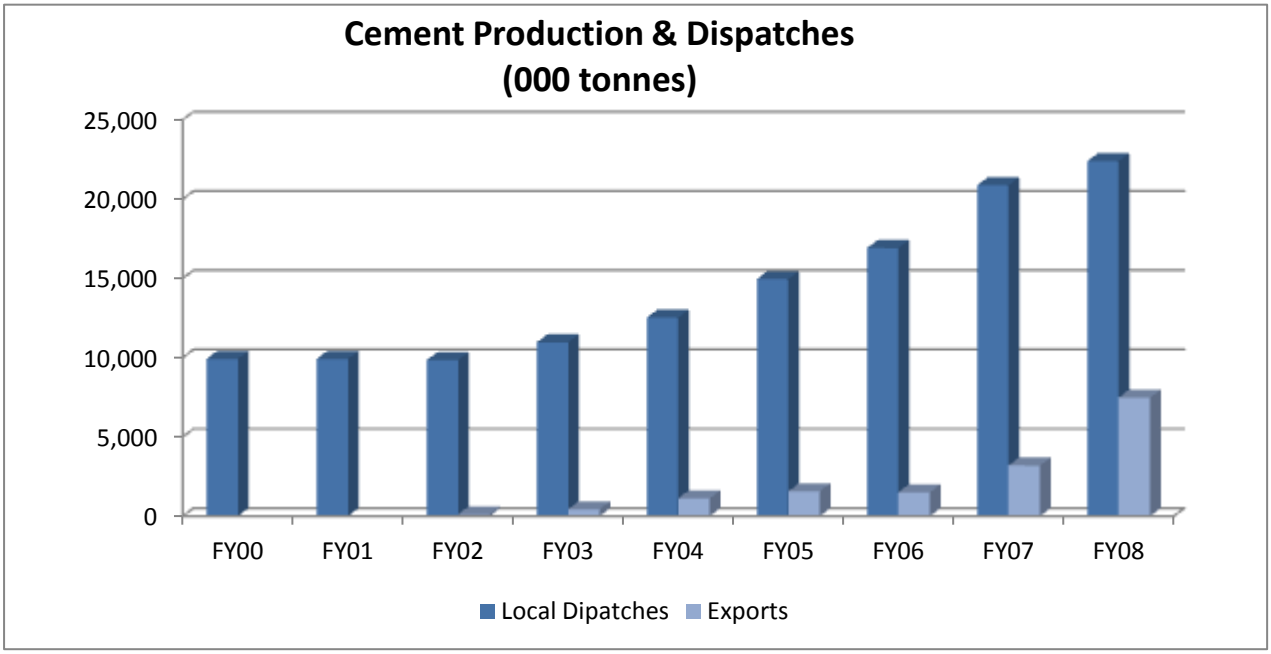


4.

[5] State bank of Pakistan , Annual Reports F Y 2002-2008

5. Construction Sector

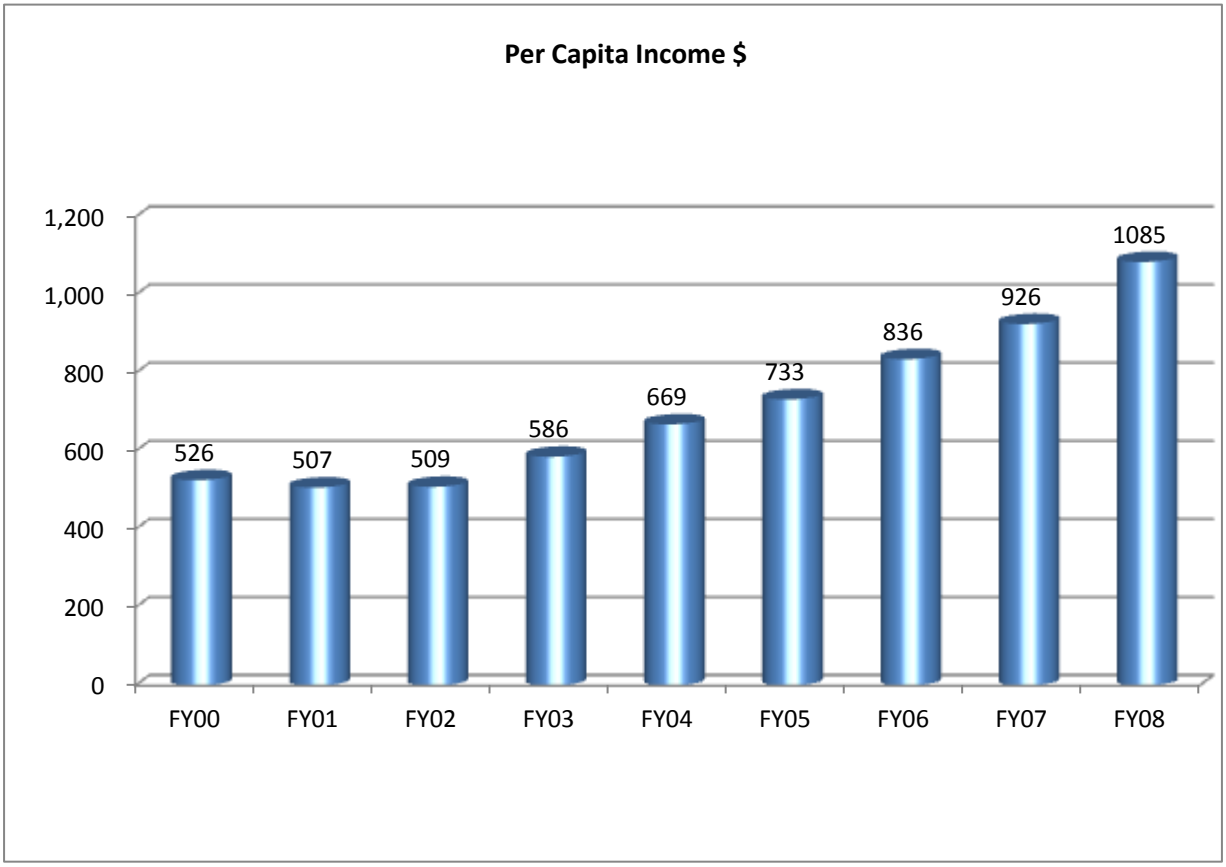
Towards the end of 2003, property boom in Pakistan entered into its second phase. Lured by the huge profits made by the speculators and high demand for the houses and apartments, construction sector jumped into the market. Builders and developers started new housing projects in the metropolis cities of Pakistan. Most of the people preferred to book new houses from these builders because it was cheaper and payment was in installments. Following graph shows increase in the demand of the cement during the period of the boom which reflects the increased activity of the construction sector [6].



[6] Economic Survey of Pakistan Reports from F Y 2001-2008

6. Rise in Income

Growth in the construction sector and banking sector were the major deriving forces in creating the demand for more labour, reducing unemployment rate substantially during the last decade. As a result the GDP per capita income increased during the said period. According to Finance Division of Government of Pakistan, GDP per capita income increased from $450 in 1999 to $926 in 2007 and $1085 in 2008. GDP Purchasing Power Parity (PPP) also shows similar type of increase. In 1999 GDP PPP stood at $270 billion which shoot up to $504.3 billion in 2008. Poverty levels also came down, owing to backward and forward linkages of property boom, in the previous decade. It was reduced by the 10% from 34% in 1999 to 24% in 2007 [7].



[7] Ministery of Finance , Government of Pakistan observations from FY 2001-2008

3. TAXABILITY OF PROPERTY IN PAKISTAN:

Property sector (real state/sale and purchase of immovable property) has the tax potential of billions of rupees. Like other sectors this sector also comes under different phases of business cycle i.e. growth and shrinking. Many persons are earning huge 'income' from the sale and purchase of property and this income is not being charged at all by the provinces as they cannot collect any tax over income due to constitutional bar while the federation is not charging any tax over this 'income' due the presence of provision 37(5)(c) in the income Tax Ordinance(ITO)2001.

3.1 Legal Perspective of taxability of capital gains on immovable property:

One cannot find a single provision in the Constitution which clearly bars the federation from taxing this potential sector of property.

Case for bringing the property under Federal Tax Net:

Constitutional Provisions relating to taxation:

Income Tax is a federal subject as per paragraph (a) clause (3) of article 160.

In the Fourth Schedule of the Constitution, Federal Legislative list has been given.

Entry No. 47: Taxes on income other than agriculture income.

Analysis: It means all incomes are chargeable to tax (including the gain/income derived from sale of immovable property the except agriculture income).

3.2 Changes in 18th Amendment

18th Amendment along with its drastic changes into the Constitution of Pakistan brought minor changes with respect to taxation of property too. The main entry relevant with the taxation of property is the Entry No.50.

The wording of entry No.50 before 18th Amendment:

"Taxes on the capital value of assets, not including taxes on capital gains on immovable property"

The wording of entry No.50 after 18th Amendment:

"Taxes on the capital value of assets, not including taxes on immovable property"

Analysis:

It means that CVT (capital value tax) on the immovable property lies in the domain of the provinces. Therefore, the FBR has transferred this power to the provinces.

There is another dimension to this phenomenon. First, the CVT is not an income tax rather it is form of property tax. Second , the omission of words " on capital gains" from the entry no:50 of the Fourth Schedule of the Constitution has removed the constitutional bar of imposing of the income tax on property under the head income from 'capital gains'. The omission of the above-mentioned words from the entry no: 50 does not reflect any other purpose but income tax on immovable property under the head capital gains.

162. Prior sanction of President required to Bills affecting taxation in which Provinces are interested.- No Bill or amendment which imposes or varies a tax or duty the whole or part of the net proceeds whereof is assigned to any Province, or which varies the meaning of the expression "agricultural income" as defined for the purposes of the enactments relating to income tax, or which affects the principles on which under any of the foregoing provisions of this Chapter moneys are or may be distributable to Provinces, shall be introduced or moved is the National Assembly except with the sanction of the President.

Analysis: (It means that with the assent of the President, the bill for amending the provision 37(5)(C) of Income Tax Ordinance can be brought in the parliament)

163. Provincial taxes in respect of professions, etc.- A Provincial Assembly may by Act impose taxes, not exceeding such limits as may from time to time be fixed by Act of [1][Majlis-e-Shoora (Parliament], on persons engaged in professions, trades, callings or employments, and no such Act of the Assembly shall be regarded as imposing a tax on income.

Analysis: (It means that provinces cannot levy any tax on the "income" derived from the sale and purchase of the property.

77. Tax to be levied by law only.- No tax shall be levied for the purposes of the Federation except by or under the authority of Act of [1][Majlis-e-Shoora (Parliament) [8].

3.3 Taxability of capital gains with reference to Income Tax Ordinance 2001

Basically capital gain is any income that is derived from the sale of an investment. Capital investment can be in the form of a home, a farm, a ranch, a family business, or a work of art.

[8] 18th Constitutional Amendment(8th April 2010) 1973 Constitution Of Pakistan,

When any kind of property is purchased at a lower price & then sold at a higher price, the seller makes a gain. Then this sale of a capital asset is known as capital gain. This type of gain is a one-time gain and not a regular income such as salary or house rent. Hence we can say that capital gain is not recurring.

In the Income Tax Ordinance 2001, there is provision which inhibits the taxability of sale and purchase of property i.e. Clause (C) of Sub-Section (5) of Section 37. In this provision the term 'immovable property' has been excluded from the definition of the term 'Capital Asset'. If this provision is amended then the sale and purchase of property can be taxed under the head income from capital gains.

So, it is recommended that a bill should be brought in the Parliament for amending the provision 37(5)(c) of ITO 2001 after seeking the prior approval of the president and taking all other stakeholders under confidence. It will be in the interest of the provinces to help the federation in this matter as ultimately they are the beneficiaries of the revenue generated by the federation.

The following points should also be considered while taxing the property sector.

- The rate of tax should be kept very low (1 or 2 percent) initially for reducing the resistance to this move.
- The time of possession of property may be considered.

In the past the FBR used to tax the sale and purchase property by imposing the Capital Value Tax (CVT) at the rate of 4 percent. But, after the passage of 18th Amendment , the federation can no longer levy this tax but this power has been transferred to provinces.(1)

CVT was not an income tax.

The FBR also collects Capital Gain Tax (CGT) but sale and purchase of property is excluded from its ambit while in the world the property is taxed under the ambit of CGT.

The constitutional bar of imposing income tax on immovable property has been lifted via omission of the words in the entry no: 50 of the Fourth Schedule of the Constitution. So, immovable property can be brought under tax net via simple amendment in Section37 (5) (c) of the ITO 2001.

4. CAPITAL GAINS & ITS TAXIBILITY IN INDIA

This chapter relates to the study of capital gain tax in Indian Income tax Act 1962.The main purpose of selecting Indian income tax act is that, India and Pakistan share same history till 1947 and they are governed by the same act i.e. 1922 income tax act till 1947.

Taxes in India are levied by the Central Government and the State Governments. Some minor taxes are also levied by the local authorities such the Municipality or the Local Council. The Central Board of Direct Taxes (CBDT) is a part of the Department of Revenue in the Ministry of Finance, Government of India. The CBDT provides essential inputs for policy and planning of direct taxes in India and is also responsible for administration of the direct tax laws through Income Tax Department. The CBDT is a statutory authority functioning under the Central Board of Revenue Act, 1963. The Central Board of Revenue as the Department apex body charged with the administration of taxes came into existence as a result of the Central Board of Revenue Act, 1924. Initially the Board was in charge of both direct and indirect taxes. However, when the administration of taxes became too unwieldy for one Board to handle, the Board was split up into two, namely the Central Board of Direct Taxes and Central Board of Excise and Customs with

effect from 1.1.1964. This bifurcation was brought about by constitution and contituted two Boards u/s 3 of the Central Boards of Revenue Act, 1963. The major tax enactment in India is the Income Tax Act of 1961 passed by the Parliament, which imposes a tax on income of individuals and corporations. This Act imposes a tax on income under the following five heads

- Income from house and property,
- Income from business and profession,
- Income from salaries,
- Income in the form of Capital gains, and
- Income from other sources

Capital Gain tax under Indian Income tax

Section 45 to 55A of the Income-tax act, 1961 deal with the capital gains. Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset can be chargeable to income-tax under the head "Capital Gains" and shall be deemed to be the income of the previous year in which the transfer took place. There are four requisites of a charge to income tax, of capital gains under section 45.Firstly,there must be a capital asset. Secondly, the capital asset must have been transferred. Thirdly, the transfer must have been effected in the previous year. Fourthly, there must be a gain arising on such transfer of a capital asset.

Capital assets as defined in Indian income tax law are those assets of Any kind of property (movable, immovable, tangible, intangible) held by an assesses, whether or not connected with his business or profession, is "Capital Asset". Stock-in-trade, consumable stores, raw materials

held for the purpose of business/profession, Items of personal effects, that is, personal use excluding jewellery, costly stones, silver, and gold, Agricultural land in India, Specified Gold Bonds and special Bearer Bonds and Gold Deposit Bonds are excluded from the definition of capital Asset under Indian income tax act 1963.There are two types of Capital Assets:

Short Term Capital Assets [STCA] are assets which are held by an assessee for less than 36 months, immediately before its transfer, is called Short Term Capital Asset. While Long Term Capital Assets [LTCA] are An asset, which are held by an assessee for 36 months or more, immediately before its transfer, is called Long Term Capital Asset. In other words, an asset which is transferred on or after 36 months of its acquisition by assessee, is Long Term Capital Asset. Selling mutual funds and company shares after one year also constitutes a long-term capital gain.

4.4 Short-term and long-term capital gains:

Gains on sale of capital assets held for more than three years are treated as long-term capital gains and are taxed at concessional rates compared short-term capital gains. While calculating taxable long-term capital gains, the cost of acquisition and the cost of improvement are linked to a cost inflation index. As a result, the indexed cost of acquisition is deducted from the sale consideration received, to arrive at the capital gain. Long-term capital gains are taxed at a flat rate of 20 per cent for individuals and foreign companies, and 30 per cent for domestic companies. Long-term capital gains on the transfer of shares/bonds issued in a foreign currency under a scheme notified by the Indian Government are taxed at 10 per cent.

4.5 Capital gain tax rates

In case of short-term capital gains, assesse will be taxed depending on the tax slab relevant to assesse after assesse has added the capital gain to his annual income. However if the transaction was levied with Securities Transaction Tax (STT), gain will be taxed 10%.

Incase of long term capital gains, assesse will be taxed 20%. When the transaction is levied with STT, assesse doesn't need to pay any tax on your gain. In this case, assesse can either calculate his capital gain using an indexed acquisition cost, or choose not to opt for indexing[9].

4.6 Example of treatment of capital gains tax on sale of residential property in India

> A person owns a property in Delhi that has a market value of 5 lakhs INR. He purchased it around 10 years back, when it was just 1 lakh INR. The registered price of property at that time was 50,000 INR. And now after the cost indexing and everything, its actual price has gone to 2 lakhs INR.Suppose that the cost of acquisition of the residential house or real estate was Rs. 1.50 lakhs INR (Rs.1 lakh plus registration expenses of Rs. 0.5 lakhs). The indexed cost now is Rs.2 lakhs (as mentioned). Since the property is a long-term asset, we are concerned only with the indexed cost for tax purposes. Hence, cost for the purposes of Capital Gains calculation would be taken as Rs. 2 lakhs if sell that property today. Now, if property is sold for Rs. 5 lakhs, then we would accrue a Long Term Capital Gain (LTCG) of Rs. 3 lakhs. The same is taxable at 20% flat rate and the tax amount comes to Rs. 60000/-. TO save this tax, either buy a new residential property (provided that you don't own more than 1 other residential property). Here, Invest the full Capital Gains of Rs. 3 lakhs to save your tax fully. If invested an amount lower than Rs. 3 lakhs, then have to pay tax on the remaining amount. if a house bought for Rs. 2.5 lakhs, then have to pay tax on Rs. 50000, which comes to Rs. 10000. Please note that if this new house is sold before 3 years from the date of purchase, tax exemption, now would be taxed in that year of sale.

[9] Indian Income Tax Act, 1961

Capital Gain in Pakistan

Gain arising from disposal of capital asset. such income is chargeable to tax under the head capital gain u/s37 of income tax ordinance2002.Capital gain can be calculated according to following procedure

i. disposal of capital assets within 12 months

ii. disposal of assets after 12 months

If the asset is disposed within 12 months its capital gain will be calculated by subtracting the cost of asset from the consideration received on disposal of assets. But if the assets are disposed off after 12 months then the amount of gain determined will be multiplied by ¾.

Analysis:

Gain arising from the sale and purchase of immovable property is taxed in Indian income tax act while on the other hand it is not taxed under Pakistan income tax ordinance. Taxes on capital gains provide a major chunk of revenue in India. Pakistan sharing a similar cultural background and administrative structure is well in the shape of adopting a similar tax application of capital gains. Hence, India's case study is a good guiding document to bring capital gains on immovable property into Pakistan's tax base.

Issues in taxability of immovable property:

5.1 Misperception about the tax policy

One of the major problems is that the people are not aware of the purpose and intentions taxing the capital gains on property. Therefore, there exists many apprehensions about taxability of capital gains on immovable property. Identification of tax policy is prerequisite to tax capital gains on immovable property. It will clarify objectives, extent, modes and methods for taxability of property. Moreover, it will help in identifying hurdles for taxation and purposing concrete steps in resolution of those problems.

5.2 Legal issues

At present, there does not exist any law for the taxability of capital gains on property. Moreover, income tax comes under the purview of the Federal Govt. For the purpose of taxation of on capital gains on property, there must be a legal covering in the already existing laws. According to section 37(5)(c) of income tax ordinance 2001 , the immovable property is exempted from taxation on any capital gain on it. Therefore, there is a need for the promulgation of new laws and amendments in already existing laws, rules and regulation.

5.3 Problems pertaining to stake- holders

The unrest among stake holders about taxing immovable property is due to the fear of setting aside their concerns in enactment of new laws by the legislators. They feel that new taxation will have negative impact on their business activity. Moreover, the rule and requirements regarding their businesses are not practically possible in our local

environment. They have strong reservations against the creation of new rules and regulation about registration and documentation of property sector.

5.4 Effects of taxability on economy

The boom in property sector has occurred at the cost of manufacturing sector. There is no doubt that this property boom has added to improvement in economic index of Pakistan. Moreover, it also attracted foreign exchange for Pakistan from overseas Pakistanis in abroad. But, this growth did not prove to have a long lasting impact on the overall economy of Pakistan. The growth in cement, steel and paints sector was short-lived. But, the issue is that the take holders involve in property sector are so much influential that they are directly and indirectly affecting any new policy for the taxability of property sector.

5.5 Property sector is not automated and documented

There is no requirement of keeping automated records of sale and purchase of property, transactions between parties, and registration of property dealers. There has been practice of business on file without proper documentation and registration in the records of the provincial governments. Moreover, all the other legal requirements are not fulfilled in true letter and spirit, which may become a major cause for concealment of tax. The stake holders also oppose this requirement on the basis of involvement of illiterate people in this business and fear of increase in cost of business due to new requirements.

5.7 Issue of determination of historical cost

The manners in which the cost of property is determined at the time of acquisition and its actual price at time of sale will be evaluated are important issues. Although, there is a method given in income tax ordinance, 2001 and there are many methods available in

international accountancy standards, but, all these have very low practical possibility for application in Pakistan. The determination of exact and actual price at the time of acquisition of an asset at the time of its acquisition and disposal is a very controversial issue in Pakistan.

5.8 Issues pertaining to tax rates

Tax rates according to income tax ordinance on capital gains depend upon the duration for holding of the property. There are high rates on selling a movable property before one year time. But, the application of same method on immovable property is controversial. Duration of holding of property is very important for the purpose of imposing new taxes. The issue is that whether there should be any incentive for a person who holds a property for more than one year duration. Moreover, another major controversial issue is whether these rates should be fixed or fluctuating, maximum or minimum is yet to be resolved.

5.9 Categories of persons to be taxed

The tax rates for the different classes of persons are different according to income tax ordinance 2001.The matters for different rates for all categories of persons like individual, association of persons and companies, resident and nonresident, are to be resolved.

5.10 Monitoring of sale and purchase

There is a tendency that seller and purchaser of property show lesser amount of transaction to avoid and conceal incomes. Therefore, the methods to monitor such issues are to be sorted out.

Conclusion

It is indisputable to state that real estate sector has emerged one of the most important variables driving Pakistan economy. Over the decades, this sector has witnessed exponential investment both from internal and external sources. Money from Foreign direct investment, external remittances and internal finances from commercial banks all of them ended mainly in the sale and purchase of property and development in the form of housing societies. Due to these factors , the average price of property have increased manifold across the country with corresponding increase in average incomes both at inter-personal and inter-regional levels. However, massive increase in wealth and its accumulation did not correspond with resultant increase in state's revenue mainly because of lack of concrete policy measures to tap this potential sector of revenue generation by incorporating capital gains on immovable property in the tax net. In the light of recommendations given in the report, if this undocumented sector is brought into the tax net, the deteriorating economic conditions can be arrested in which the state has been immersed for the last many decades.

6. Suggestions

1. **Objectives of tax policy**

   The new tax policy should be aimed at broadening the tax network, automation and proper documentation for creation of proper data base, taxing those who are earning huge profits and regularizing the business of property. The growth of many sectors like cement and steel is dependent upon property sector. Therefore, the new tax policy should not discourage their business activities.

2. **Promulgation and amendments in laws**

   Enactment of new tax laws has always been a political issue. In the current poor economic condition of Pakistan, it is need of time that new taxes should be imposed on those sectors which are earning huge profits. There are many big profit makers who have earned billions of rupees and they did not pay a single penny in the government exchequer. Therefore, taxability on property sector has tremendous potential for the broadening of tax net work.

3. **Proper automation and documentation**

   The tax network can't be broadened without the help of the automation and documentation of the sale and purchase of the property sector. The practice of sale and purchase on files and without proper registration should be checked and penal actions should be imposed against those who are involved in illegal practices.

4. **Rationalization of tax rates**

   The tax rates should be rationalized with a purpose of taxing huge profits. There should be exemption in law for the small investors. In the beginning, minimum tax rates should be applied so that new tax should not hurt the activity of this sector. The new tax should

be fluctuating and should increase with the increase in profit margins. There should be incentives for those who hold property more than three years. However, high tax rates should be for short term capital gains as practiced in India.

5. **Monitoring and Enforcement**

Monitoring and enforcement have been two major issues in implantation of any tax policy and enhancement in revenue collection. A special mechanism should be adopted to monitor the sale and purchase in accordance with all legal requirements. Moreover, a data base can be supported by collecting exact information from all housing societies with their compulsory compliance. Therefore, there is a dire need to reactivate the enforcement wing of Inland Revenue service.

6. **Involvement of stakeholders in policy formulation**

All the stakeholders must be given a chance to settle their issues while devising a new policy for tax generation and tax collection. The rules and regulation related to new tax should be simplified to make it easily understandable by the common man.

7. **Method for determination of cost**

It is the need of time to formulate a proper and practical mechanism to determine the cost of property at the time of acquisition of property and the marginal difference at the time of sale. The earned profit in lieu of this sale and purchase should also keep in view the currency exchange rates. In this way, a very lenient approach should be adopted in the favor of tax payer.

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