PSX FEDERAL BUDGET PROPOSALS

FY2021-22

PAKISTAN
STOCK EXCHANGE
LIMITED

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INTRODUCTION

Fiscal discipline and tax measures have a direct and profound impact on the structure and functioning of the capital markets. The stock market is one of the most documented sectors of the economy and over the decades GOP has perhaps been the biggest beneficiary from it. It is imperative for the growth of Pakistan's economy to create a conducive environment which will help to attract more companies and investors to the capital markets. All capital market participants are fully documented; hence developing the capital markets is fully aligned with FBR's efforts to increase the tax base in Pakistan. An efficient, equitable and broad-based tax system and a culture of corporatization are interdependent. In addition, a broad based capital market helps to achieve important economic and social objectives like increasing the number of tax payers, savings and investment rates, and reducing wealth inequality.

Capital markets can play a significant role in tackling many of the structural imbalances that have bedeviled Pakistan's economy over the years. These include, lack of documentation, small tax base, low savings rates and low investment rates. In fact, these can only be properly addressed by first developing the capital markets. Pakistan's capital market needs to be and can be much larger and deeper than it is today. We have come a long way but need to go much further to help businesses raise capital and for all investors to make a good return. As the markets grow, they will contribute to growth of Pakistan's economy and create new revenue sources for FBR.

To achieve this, well thought through, balanced, regionally competitive and long term tax policies and measures are needed. Tax measures are an important policy tool to increase investments and savings in the economy and to stay competitive with other markets. Capital markets are highly specialized and have many varied and different segments, each with their own commercial imperatives that need to be fully understood before successful tax measures can be implemented. Innovations and new products are a constant feature of capital markets. Hence, it is important that tax policies and measures are reviewed regularly, with input from specialist stakeholders, so that debt and equity markets, commodity futures, mutual funds, REITs, corporate and insurance sector, amongst others, can grow successfully. Development of these important sectors is a prerequisite for the growth of a modern economy and will contribute greatly to the documentation and growth of tax revenue in Pakistan.

As much as favorable tax treatment, investors need a stable and predictable tax environment. Government of Pakistan must consider adopting long term measures to promote savings and investment and development of the capital market.

We believe that in the coming years, Pakistan's capital market has immense potential for growth. PSX remains committed to building the capacity and trust required for capital formation and financial inclusion by introducing new products and investing in world-class trading infrastructure.

We are pleased to present the following proposals for the kind consideration of the Ministry of Finance and the Federal Board of Revenue for inclusion in the federal budget 2021. The core principle of our proposals is aimed at increasing the size and depth of the capital market by incentivizing new listings and increasing the investor base, without impacting government revenues.

All the proposals detailed below essentially focus on impediments and disincentives that are negatively impacting the development of the capital market, as well as the documented corporate sector. The recommendations are primarily designed to remove the disincentives, and the incidence of double, and at times multiple, taxation that are penalizing capital formation, which is essential for our corporate sector to be able to compete effectively in the world. Most proposals are revenue neutral, and in many cases, likely to increase the government's revenue.

We believe that implementation of these proposals will greatly help in improving the saving rate, encourage investment, increase tax revenue, contribute to economic growth and lower wealth inequality in Pakistan. We look forward to your favourable consideration and discussing these proposals with you.

EXECUTIVE SUMMARY

S. NO.	DESCRIPTION	PROPOSAL
1	ALIGN RATES OF CAPITAL GAINS TAX ON DISPOSAL OF SECURITIES WITH OTHER REGIONAL EXCHANGES AND OECD COUNTRIES AND WITH THE RATES OF CGT ON SALE OF IMMOVABLE PROPERTY	*CGT rates on listed securities be brought in line with other regional and OECD countries and with CGT on sale of immovable property. This is essential to eliminate the tax driven distortion between different asset classes.*
2.	INTRODUCTION OF REGISTERED SAVINGS (RSIA) AND INVESTMENT ACCOUNTS AND INDIVIDUAL SAVINGS ACCOUNT (ISA)	*It is proposed that the Government of Pakistan introduce a mechanism and regulatory structure for the launch of RSIAs or ISAs to help channel savings towards productive investments.* *These schemes will help channel capital which is invested in unproductive areas and from the large undocumented sector into productive parts of the economy.*
3.	BRING ETF INVESTMENTS AT PAR WITH THE TAX INCENTIVES AVAILABLE TO INVESTMENTS IN NEW SHARES AND COLLECTIVE INVESTMENT SCHEMES (CIS)	*It is proposed that ETFs be added to the definition of shares for the purpose of tax credit in the Income Tax Ordinance, 2001. Moreover, holding period in case of ETFs for the calculation of tax credit be considered to have commenced from the date of purchase from the stock market for investors other than the Authorized Participant.*
4.	REDUCTION OF WITHHOLDING TAX ON INCOME FROM MARGIN FINANCING TRANSACTIONS	*It is proposed to reduce the rate of withholding tax on the gross income earned on MF transactions from 10% to 2.5% or to charge 10% on the net income (spread) earned on such financing.*
5.	RATIONALISATION OF TAX RATES FOR COMPANIES LISTED ON STOCK EXCHANGE	*Reinstatement of the repealed section 65C of the Income Tax Ordinance, 2001 amended to allow tax credit to certain companies meeting the prescribed requirements of free float.*
6.	ELIMINATION OF MINIMUM TAX REGIME FROM LISTED COMPANIES	*Minimum tax regime should be eliminated or reduced for listed companies as such companies are documented and compliant with specific documentation requirements of various statutes.*
7.	ENHANCED TAX CREDIT FOR LISTED SMALL AND MEDIUM ENTERPRISES (SME)	*In order to encourage small and medium enterprises to get listed on the SME Board, it is proposed that the rate of tax for such listed SME companies be lowered by giving tax credit of 50% of tax payable for 3 to 4 years and 20% onwards of the tax payable.*

8.	DOCUMENTING REAL ESTATE SECTOR & PROMOTING REITS STRUCTURES	• *Exemption for CGT to be applied to all categories of REITs (mix-use projects)* • *Removal of sunset clauses for Developmental REIT Scheme and Rental REIT Scheme.* • *Rate of tax on dividend to be synchronized with mutual funds.* • *Exempt advance tax on property transfers to/from a REIT Scheme.*
9.	UNLOCKING POTENTIAL OF PRIVATE FUNDS	• *Insert proper definition of Private Fund referring to 2015 regulations* • *Exemptions of profits and gains to be given to all categories as available to Private Equity & Venture Capital.* • *Revision of CGT rates as provided for mutual funds, CIS and REITs* • *Specified exemptions to include Private Fund*
10.	DEVELOPMENT OF REGULATED COMMODITY MARKET	• *Exempt commodity futures contracts and EWRs from the application of withholding taxes under Income Tax Ordinance, 2001 like these are exempt from GST under Sales Tax Act, 1990.* • *It will be only applicable on physical settlement of futures contract by exchange of delivery of underlying commodity. On contract, CGT is already applicable.*
11	LEVELLING TAX FOR CORPORATES	*Inequality of taxation of businesses should gradually be removed by reducing corporate tax rate/increasing tax rates for AoPs*
12.	DISPARITY IN FBR & SECP RULES RELATING TO SHARIAH COMPLIANCE	*The Shariah compliance criteria under the income tax laws be modified to align it with the definition used by SECP in corporate law and make it practically possible to meet it. This will help in the promotion and development of Islamic capital markets by encouraging new listings of companies on PSX through mobilizing resources from faith-based investor savings.*
13.	PROVINCIAL SALES TAX ON SERVICES – JURISDICTION ISSUES TO BE SETTLED IN COUNCIL OF COMMON INTEREST	*The wordings of the laws enacted by the Sindh Revenue Board, Punjab Revenue Authority and Khyber Pakhtunkhwa Revenue Authority are overlapping. The matter being of equal relevance to all the provinces and affecting the entire Services Sector, may be placed on the agenda of the Council of Common Interests so that a sharing formula for each province can be devised.*

14	CONSISTENT AND LONG TERM TAX POLICIES	*Government of Pakistan must move away from short term measures and frequent changes in tax regime and adopt long term measures to promote savings and investment and development of the capital market.*

1. ALIGN RATES OF CAPITAL GAINS TAX ON DISPOSAL OF LISTED SECURITIES WITH OTHER REGIONAL EXCHANGES AND OECD COUNTRIES AND WITH THE RATES OF CGT ON SALE OF IMMOVABLE PROPERTY

Recent incentives given to the real estate and construction sectors, particularly the reduction of capital gains tax, creates a tax driven distortion between the attractiveness of different asset classes. While the capital gains tax calculation for securities is exact and verifiable, for real estate it is at best nebulous. This needs to be addressed. The Current tax rate of 15% on capital gain on disposal of securities is very high and that too without any benefit of holding period and is higher than the rates on sale of immovable property which are ranging from 2.5% to 10% based on various slabs of capital gains, further, capital gain on immovable property is subject to reduction of 25% to 100% based on various slabs of holding period of immovable property such that there is no tax on capital gain for immovable property where its holding period is more than four years. The current rates of CGT on immovable property along with its holding period are outlined in **"Annexure A"**.

Currently, carry forward of losses is allowed up to a period of three years. Last year and the year before CGT collection was merely Rs. 2.1 billion and Rs. 1.3 billion respectively. Moreover, brought forward losses amounting to Rs. 232 billion are available to be adjusted against future capital gains, therefore CGT collection will continue to be negligible.

A reduction or a time bound elimination of CGT will be a big headline incentive to attract new local and foreign shareholders without any significant loss of tax revenue and in fact over some time is likely to be revenue positive.

Proposal

i. ***Since the current rate of 15% is very high and that too is without any benefit of holding period, therefore it is proposed to reduce this rate in line with other regional and OECD countries such as Bahrain, Hong Kong, India, Malaysia, Mauritius, Qatar, UAE, New Zealand, Hungary, etc. where there is no or very low capital gain tax as compared to Pakistan. (Annexure B)***

ii. ***When CGT was first introduced in the year 2011, to encourage and attract long term investments, the tax rates were as under:***

S.No	Holding Period	Rate of Tax
1	Less than six months	10%
2	More than six months but less than twelve months	7.5%
3	More than one year	0%

We therefore, propose the following CGT rates

S.No	Holding Period	Rate of Tax
1	Upto twelve months	10%
2	More than twelve months	0%

Rationale

Tax treatment of capital gains and dividends favors investment in fixed income and real estate, discouraging flow of capital into productive areas. The CGT in Pakistan is now higher than most regional countries and does not encourage long term savings and investment.

As a comparison, there is no capital gains tax in countries such as Bahrain, Brunei Darussalam, Hong Kong, Oman, Saudi Arabia, UAE, New Zealand, etc. Moreover, countries such as India, Indonesia, Kyrgyzstan, Malaysia, Sri Lanka, Hungary etc. charge reduced rates of capital gains tax compared to the CGT in Pakistan. Reducing the CGT rates will enhance the volume of foreign investment inflow to the equity market and increase the tax base. International applicability of CGT in regional and OECD countries is outlined in Annexure B.

This will also encourage documentation of real estate activity, and lead to an easing of speculative pressure on real estate property prices in Pakistan, where much of the undocumented wealth has been currently flowing.

Proposed Amendment

In Division VII, Part I of the First Schedule to the Income Tax Ordinance, 2001, the following new table shall be inserted in place of existing table:

S.No	Holding Period	Rate of Tax
1	Upto twelve months	10%
2	More than twelve months	0%

This will be a big headline change, with no revenue impact, and will encourage new domestic and international investors to come into the market.

2. INTRODUCTION OF REGISTERED SAVINGS AND INVESTMENT ACCOUNTS (RSIAs) AND INDIVIDUAL SAVINGS ACCOUNT (ISA)

Background

Saving and investment are crucial and play an important role in the process of socio-economic development through capital formation. Pakistan, besides facing problems such as unemployment, rapid growth of population, slow economic growth in the country, has a saving rate that is too low for sustainable national economic development. Low level of saving rates in any economy have been cited as one of the most serious constraints to sustainable economic growth. Higher savings and the related increase in capital formation can result in a permanent increase in economic growth rates.

RSIAs

Registered savings and investment accounts (RSIAs) are personal accounts that allow investors to accumulate savings towards life goals. A defined amount per annum can be contributed to such schemes and this amount enjoys tax benefits. Most RSIA-like schemes in other countries are aimed at retirement savings (e.g., Individual Retirement Accounts and Roth IRAs in the US, Registered Retirement Savings Plans and Tax Free Savings Accounts in Canada). Other variations on the theme promote savings toward other goals like children's education (Registered Education Savings Plans in Canada) or funding future needs of a disable individual (Registered Disability Savings Plan in Canada).

Although their design varies according to the schemes objective, they all have 2 features in common:

- Capital accumulates free of tax (on interest, dividend or capital gains);
- Eligible investments in the account are listed stocks and ETFs, tradable bonds and mutual funds

In the United States, Roth Individual Retirement Arrangement (Roth IRA) is similar to TFSA. The Roth IRA was established by the Taxpayer Relief Act of 1997. The total contributions allowed per year to all IRAs is the lesser of one's taxable compensation. The Packwood–Roth plan would have allowed individuals to invest up to $2,000 in an account with no immediate tax deductions, but the earnings could later be withdrawn tax-free at retirement.

A detailed structure of RSIAs specifically tailored to Pakistan is provided in **Annexure C.**

ISA

Introduction of the different types of Individual Savings Accounts (ISA) such as those available in the UK being tax free will induce and promote national savings. The types of ISAs include the following:

- *Cash ISAs*
- *Stocks and shares ISAs*
- *Innovative finance ISAs*
- *Lifetime ISAs*

Having different types of ISAs will generally attract investment in banks, capital market, unit trusts, investment funds, corporate bonds, government bonds, peer-to-peer loans (loans given to other people or businesses without using a bank) and crowdfunding debentures (investing in a business by buying its debt).

Hence, by introduction of UK style ISAs not only will savings will be encouraged but also investment will increase in different asset classes and financial instruments.

Proposal:

It is proposed that the Government of Pakistan introduce a mechanism and regulatory structure for the launch of Registered Savings and Investment Accounts and Individual Savings Account to help channel savings towards productive investments.

These schemes will help bring capital from both unproductive and the large undocumented sectors into the formal, productive sectors of the economy.

Rationale

Where they have been introduced, RSIAs and ISAs have been very successful in channeling savings to productive investments through capital markets and often constitute the main source of income in retirement. In Pakistan, they will bring the added benefit of driving the government's goal to document the informal sector.

RSIAs could become one of the driving forces in the transformation of Pakistan's economy. By some estimates, 40 million middle-class Pakistanis have an average per capita accumulated wealth of over USD 10,000, for a total of over Rs. 50 trillion. Much of that wealth is currently invested in real estate, gold and other asset classes in Pakistan and offshore. If RSIAs can capture 10% of that wealth, it would be equivalent to more than half the current market capitalization of PSX listed companies or more than the outstanding amount of PIBs and Sukuks.

Many countries have effectively used tax policies to improve savings and investment rates and divert funds to productive sectors of the economy.

Proposed Amendment

Appropriate amendment to be made in the Income Tax Ordinance, 2001.

3. BRING ETF INVESTMENTS AT PAR WITH THE TAX INCENTIVES AVAILABLE TO INVESTMENTS IN NEW SHARES AND COLLECTIVE INVESTMENT SCHEMES (CIS)

Section 62 of the Income Tax Ordinance, 2001, allows tax credit on shares (which definition also incorporates Collective Investment Schemes). It is apparent that issuance of ETF shares to Authorised Participant (being the original investor to whom ETF shares will firstly be issued) will be eligible to claim tax credit under section 62 of the Ordinance. However, the unit holders (who acquire such units from Authorised Participant or from the Stock Exchange) being not the original allottees will not be eligible to claim such tax credit.

Proposal

It is proposed that ETFs be added to the definition of shares for the purpose of tax credit under section 62 of the Income Tax Ordinance, 2001. Moreover, holding period in case of ETFs for the calculation of tax credit under section 62 of the Income Tax Ordinance, 2001 be considered to have commenced from the date of purchase from the stock market for investors other than the Authorized Participant.

Rationale

Such tax credit is essential for the growth of this important asset class in Pakistan by bringing it at par with the tax credit on other asset classes which would attract more investors towards ETFs. Moreover, it would encourage launch of further ETFs in Pakistan.

Proposed Amendment

Appropriate amendment to be incorporated in the Income Tax Ordinance, 2001.

4. REDUCTION OF WITHHOLDING TAX ON INCOME FROM MARGIN FINANCING TRANSACTIONS

Margin Financing (MF) facility is made available to all Trec holders against net ready market purchases of their clients and proprietary positions. NCCPL provides a system to MF participants for recording and settlement of MF transactions, with financing terms and conditions pre-determined by the Margin Financee and Margin Financier. Margin financing facility is made available only in Eligible Securities notified by the SECP.

Presently, the rate of tax on gross income of the Financier is 10% without deduction of any expenditure to earn such income. Whereas, in most cases the funds are borrowed from financial institutions for such MF transactions.

The cost involved in Margin Financing includes financing cost payable to financial institution, trading, clearing and depository charges and other administrative cost which means that the amount deducted as advance tax will not be fully adjusted against the tax liability of most brokers, resulting in claims for tax refunds that are not time bound.

<u>Proposal</u>

It is proposed to reduce the rate of withholding tax on the gross income earned on MF transactions from 10% to 2.5%.
OR
To charge 10% on the net income (spread) earned on such financing.

<u>Rationale</u>

The proposed reduction in the rate of tax on MF transactions will help develop the market and increase tax collection by FBR because ten years back, the size of similar market for margin transactions was several times higher.

<u>Proposed Amendment</u>

Division IIB of Part IV, First Schedule to the Income Tax Ordinance, 2001 shall be amended as follows;

> ***"The rate of deduction under section 233AA shall be 2.5% of profit or mark-up or interest earned by the member, margin financier or securities lender".***
>
> ***OR***
>
> ***"The rate of deduction under section 233AA shall be 10% of net income (spread) earned by the member, margin financier or securities lender".***

5. RATIONALISATION OF TAX RATES FOR COMPANIES LISTED ON STOCK EXCHANGE

It is generally observed that when companies opt for a listing on a stock exchange, their profits grow substantially due to effective corporate governance, better disclosures, and ability to raise capital from the market. Increased number of listed companies and higher profitability leads to higher tax revenue for the government, including incremental revenues from CGT. Hence it is important to encourage companies to get listed on PSX.

However, tax credit on enlistment under section 65C has been withdrawn through Second Amendment Act, 2021. This tax incentive was a very small carrot with no significant revenue impact. Presently, only 10 listed companies are availing this tax credit which we estimate, based on their latest audited financial statements, has a tax revenue impact of Rs. 175 million per annum. Out of these 10 companies, 4 companies are in their 4th or last year of this benefit and 4 companies have recently listed in the current financial year. In fact, the tax revenue benefit in the medium term is very large as the documentation of the corporate sector increases and hence tax revenue of Pakistan.

Further, the CGT collected on these 10 symbols for the 8 months period from July 2020 to Feb 2021 is Rs.176 million, and, extrapolating based on this 8 months average collection of CGT, the tax collection for the 12 months period could be Rs.264 million, compared to the total estimated tax credits of Rs.175 million availed by these 10 companies.

The average rate of tax in the Asian region is 21.32%; whereas, currently in Pakistan the corporate tax rate is 29%. As such it is imperative that the corporate tax rate after the tax credit is brought down reasonably to compete with the other regional and global countries.

Therefore, in order to encourage documentation and create a long term positive impact on tax revenue, there should be reduced rates of tax for listed companies compared to unlisted companies.

Proposal

To encourage documentation of the economy, the corporate tax rate should be permanently lowered for listed companies, by giving tax credit of 20% of tax payable for those companies that meet the prescribed requirements including a minimum free float of 25% throughout. This will be long term positive for tax revenue.

Rational and impact

The table below outlines the five-year summary of listings and de-listings on the Pakistan Stock Exchange:

Particulars	Number of Companies	Capital (Rs.)*
New Listings	21**	46,862 Million
De-listings	40	14,251 Million
Delisted due to Merger	6	120,924 Million

*As of December 31, 2020

** It includes listing of preference shares of already listed companies.

Rationale

i) ***It is generally observed that publically-listed companies are able to improve profitability due to effective corporate governance, better corporate disclosure and availability of additional funds.***

ii) ***The incremental benefits arising from the preferential tax structure for listed companies will foster a business environment that encourages new listings on the stock exchange, resulting in higher trading volumes and lead to:***

   a) ***Higher tax revenue from listed companies' income as a result of higher corporate profits.***
   b) ***Higher revenues from tax on brokers activity on new listings.***
   c) ***Higher revenue from Capital Gains Tax on disposal of newly listed securities.***

iii) ***Furthermore, with the government's increased pace of privatization of its entities, the stock market will attract local and foreign investors and increase the market size. The average rate of tax in the Asian region is 20.06%; whereas, currently in Pakistan the corporate tax rate is 29%. As such it is imperative that the corporate tax rate after above tax credit is brought down reasonably to compete with the other regional and global countries. Following are the average worldwide corporate tax rates:***

LOCATION	2012	2013	2014	2015	2016	2017	2018	2019	2020
Africa	29.0	28.3	27.9	27.9	27.5	28.73	28.81	**28.45**	**28.50**
Asia	22.9	22.1	21.9	22.6	21.9	20.05	20.65	**21.32**	**20.06**
Europe	20.4	20.6	19.7	20.1	20.5	18.35	18.38	**20.27**	**19.99**
Oceania	28.6	27.0	27.0	27.0	26.0	23.67	22.00	**23.75**	**23.75**
North America	33.0	33.0	33.3	33.3	33.3	23.08	23.01	**25.85**	**26.06**
OECD	25.2	25.3	24.1	24.9	24.8	24.18	23.93	**23.59**	**23.51**
Global	24.4	23.7	23.6	23.9	23.6	22.96	23.03	**24.18**	**23.85**

Proposed Amendment

Reinstate section 65C of Income Tax Ordinance, 2001 to be read as under:

"Where a taxpayer being a company opts for enlistment in any registered stock exchange in Pakistan, a tax credit equal to twenty percent of the tax payable shall be allowed for the tax year in which the said company is enlisted and for the following years for those companies that meet the prescribed requirements including a minimum free float of 25% throughout and"

6. ELIMINATION OF MINIMUM TAX REGIME FROM LISTED COMPANIES

Though the concept of minimum tax is prevalent in a few other countries, however, in other countries, as a principle, it is levied only in cases where high-income taxpayers don't pay any tax due to different tax exemptions available to them.

Proposal

Minimum tax regime should be eliminated from listed companies as such companies are strongly compliant towards specific documentation requirements of various statutes.

Rationale

The application of minimum tax on listed companies has resulted in discouraging documentation of the economy. Listed companies have significant documentation and regulatory requirements and need to engage external auditors to audit their business affairs. The stringent regulations keep the listed companies strongly compliant towards filing of income tax / sales tax returns, paying quarterly advance taxes, adjustment of withholding taxes on sales and purchases and consequently filing withholding statements, statements on final taxation and fulfilling various other requirements which resultantly align their books of accounts with the statutory requirements and provide a comfort zone to the authorities and stakeholders over the reported numbers. However, the levy of minimum tax puts downward impact on the earnings of listed company despite having current and brought forward losses.

Proposed Amendment

Appropriate amendment to be made in the Income Tax Ordinance, 2001.

7. ENHANCED TAX CREDIT FOR LISTED SMALL AND MEDIUM ENTERPRISES (SME)

Small and Medium Enterprises (SMEs) contribute immensely to Pakistan's employment, exports and GDP growth, and provide 80% of all employment in the country. A well-functioning SME segment at the Stock Exchange offers a range of benefits including greater access to growth capital for innovative SMEs, documentation, good governance, new jobs through entrepreneurship, more investment opportunity for domestic investors and local venture capitalists.

PSX has launched an SME board to attract smaller companies to get listed on the exchange. The aim is to facilitate SMEs with an alternative to bank financing for their expansion growth and projects.

Proposal

In order to encourage small and medium enterprises to get listed on the SME Board, it is proposed that the rate of tax for such listed SME companies be permanently lowered by giving tax credit of 50% of tax payable for 3 to 4 years of listing and then onwards 20% of the tax payable.

Rationale

i) The share of the manufacturing sector in the job market is only 14%. This is very low because 80% of the manufacturing investments in large scale industries provide less than 20% of the manufacturing jobs. Over 80% jobs are provided by SMEs.

ii) There are significant fiscal tax credit benefits in Spain, Kenya, Brazil, Argentina and other parts of the world for SMEs.

Proposed Amendment

In clause (iii), Division II, Part I of the First Schedule to the Income Tax Ordinance, 2001 after a colon the following proviso shall be added, namely:

"Provided that where a tax payer is a small or medium sized company as defined under the Third Schedule of the Companies Act, 2017 and is also listed on the registered Stock Exchange in Pakistan, the tax credit @ 50% of the tax payable on the taxable income of such company, other than a banking company, shall be allowed for the tax year 2021 and onwards."

8. DOCUMENTING REAL ESTATE SECTOR & PROMOTING REITS STRUCTURES

Current CGT exemption timelines discourage long-term investors from entering the Real Estate Sector. Moreover, different REIT categorization have created distortion and excluded commercial & mixed-use REIT projects.

Higher rate of tax on dividends as compared to mutual funds (enhanced through Finance Act 2019, rate of tax on dividend from REITs Schemes was enhanced from 15% to 25%)

Sale of real estate to a REIT scheme at market value is a paper transaction required to transfer title of real estate in the name of trustee.
Furthermore, REIT Scheme is exempt from income tax when 90% income is distributed as dividend and therefore advance tax cannot be adjusted.

Proposal

- ***Exemption for CGT provided in clause 99A, Part 1, 2nd schedule be applied to all categories of REITs (mix-use projects)***
- ***Remove sunset clauses***
  - ***June 2023 for Developmental REIT Scheme and Rental REIT Scheme.***
- ***Rate of tax on dividend, which is 25% at present, be synchronized with mutual funds @ 15% [First schedule, Part-1, Division-III, paragraph B]***
- ***Exempt advance tax on property transfers to/from a REIT Scheme u/s 236C & 236K.***

Rationale

Promoting documented real-estate will attract more investments particularly by companies with disclosure of actual prices and income. Revenue impact will be positive as it will generate indirect and additional revenues from allied businesses.

Proposed Amendment

Appropriate amendment to be made in the Income Tax Ordinance, 2001.

9. UNLOCKING POTENTIAL OF PRIVATE FUNDS

Revamped regulations in 2015 introduced different types of Private Funds by replacing Private Equity & Venture Capital (PE&VC) Regulations. Currently, pass-through status under the Income Tax Ordinance 2001 is available to only PE&VCs category. Moreover, current sunset clause upto June 2024 for PE&VC is detracting long-term investors from participating.

A private fund (alternate fund) investing in listed securities attracts CGT at the rates that applies to unlisted securities (redemption of units of alternate funds will attract treatment of unlisted security under CGT regime, which is significantly higher for corporate investors).

Proposal

- ***Insert proper definition of Private Fund referring to 2015 regulations***
- ***Exemption provided in clause 101 of part I of second schedule to PE&VC till 2024 shall be applied***
  - ***to all categories***
  - ***no sun-set clause***
- ***Specific rate of 15% CGT be provided in Division VII of 1st Schedule as provided for mutual funds, CIS and REITs (if more than 70% invested in listed equity securities and/or debt securities)***
- ***Exemptions provided in sub-clause (xii) of clause 11A and clause 47B of Part IV of the second schedule to include Private Fund***

Rationale

This sector can be developed with rational taxation. So far only 4 registered PE&VC funds will be unable to meet funding needs of SMEs/startups & to attract foreign investors. Revenue impact will be neutral to positive as only CIVs will be exempted but the investors will still be obliged to pay tax. The amendment will exempt private funds from applicability of withholding tax as it is a pass through entity.

Proposed Amendment:

Appropriate amendment to be made in the Income Tax Ordinance, 2001.

10. DEVELOPMENT OF REGULATED COMMODITY MARKET

Currently, buyer of a commodity withholds tax (4%-9%) from seller before making payment with the exception of growers. This tax adds cost and puts the investors at a disadvantageous position when dealing in actual commodity exchange at PMEX in futures contracts/e-WHRs as grain markets are not documented and as such this tax is actually not being paid.

Proposal

- ***Exempt commodity futures contracts and EWRs from the application of section 153 of the Income Tax Ordinance, 2001 like these are exempt from GST under SRO 445(I)/2004 June 14, 2004.***
- ***It will be only applicable on physical settlement of futures contract by exchange of delivery of underlying commodity. On contract, CGT is already applicable.***

Rationale

Development of regulated and organised commodity markets will greatly benefit the agriculture sector. Revenue impact will be neutral to positive due to adjustability of withholding tax while documentation leading towards more income tax from traders and related parties.

Proposed Amendment

Appropriate amendment to be incorporated in the Income Tax Ordinance, 2001.

11. LEVELLING TAX FOR CORPORATES

- Corporate businesses profits are taxed twice. Once at company level @ 29% and on dividend distribution @15%.
- As compare to 44% of total tax in case of companies, unincorporated businesses are being taxed from 0% to 35% in slabs.
- This inequity in taxation is discouraging corporatization and documentation as unincorporated businesses are subject to substantially lower taxes.
- Absence of clarity in tax laws is causing issues of taxation of Limited Liability Partnerships (LLPs) as companies whereas LLPs are essentially AoPs with perpetual life.

Proposal

- ***Inequality of taxation of businesses shall gradually be removed by reducing corporate tax rate/increasing tax rates for AoPs [First Schedule Part 1, Division I, II, IIA & III].***

Rationale

- ***Equality of tax regime will promote corporatization culture leading towards documentation and will therefore generate more tax revenue.***
- ***Adding clarity with respect to status of LLP will encourage more businesses particularly in services sector to opt for this perpetual business structure. It will also help in increasing tax revenue from these segments.***

Proposed Amendment

Definition of AoP in section 80(2) of Income Tax Ordinance, 2001 be amended to include LLP till the time same tax rates are not applied to all forms of business.

12. DISPARITY IN FBR & SECP RULES RELATING TO SHARIAH COMPLIANCE

In 2016, the Federal Government through Finance Act 2016, had introduced certain amendments in the ITO which allowed 2% rebate in corporate income tax rate to companies which qualified the criteria for Shariah Compliance specified in Clause 18B of Part II of Second Schedule of ITO. Thereafter in January 2017, Rule 231H was inserted in Income Tax Rules, 2002 (Rules) which provided further guidance on the Shariah Compliance criterion mentioned in ITO.

The objective for this rebate, as explained by Securities and Exchange Commission of Pakistan (SECP) in its press release of July 11, 2016, was to incentivize listed manufacturing companies to become 'Shariah Compliant' and that this was introduced in the ITO as part of reforms, with collaboration of SECP, for promotion and development of Islamic Capital market. Thereafter, in November 2018, the corporate regulator introduced the landmark Shariah Governance Regulations 2018 (Regulations), which entailed a comprehensive jurisdictional framework to regulate and govern the corporate sector, including the capital markets, Islamic capital markets, Shariah-compliant securities and Islamic financial institutions. The framework was a major break-through to lay the foundation for a true Islamic financial and economic system. The Regulations encompass a number of elements of Shariah governance which are practical to adopt and implement, ensuring long-term sustainability. On the other hand, the requirements contained in the ITO, as introduced in 2016, are comparatively stringent and impractical for taxpayers to adopt in letter and spirit, which is ultimately defeating its underlying objective i.e. development of Islamic market in Pakistan.

Hence, a re-alignment of income tax requirements with the SECP Regulations is critical so as to enable more companies to obtain Shariah Compliant status and avail the accompanying tax benefits.

Under clause 18B of Part II of Second Schedule of the ITO, 2001, a reduction in corporate tax rate by 2% is allowed to a company which meets the criteria specified in the said clause and Rule 231H of the Income Tax Rules, 2002.

However, the existing compliance requirements are very impracticable and more stringent then the requirements mentioned by SECP in Shariah Governance Regulations, 2018, which makes it practically impossible for the taxpayers to fulfill the criteria and achieve the desired status.

Proposal

It is proposed that Shariah compliance criteria under the income tax laws be modified to make it practically possible to meet it. This will help the promotion and development of Islamic capital markets by encouraging new listings of companies on PSX through mobilizing resources towards faith-based investor savings.

Rationale

The conditions imposed through the ITO, 2001 are impractical to implement given the inadequate depth of Islamic markets of Pakistan, constraining the taxpayers from achieving

the Shariah Complaint status and therefore failing the reforms' underlying objective - (e.g. 100% income from manufacturing operations, financing through licensed Islamic financial institutions only, issuing dividends in last five consecutive years etc.)

Proposed Amendment

1) *The following amendments are proposed under clause 18B of Part II of Second Schedule of the ITO, 2001:*

(a) ....

(b) *derives income **"primarily"** from manufacturing activities only;*

(c) *has declared taxable income **in any three of the last five** ~~for the last three~~ consecutive tax years; and*

(d) *has issued dividend **in any three of the last five consecutive tax years or declared at-least 25% dividend in the last year** ~~for the last five consecutive tax years.~~"*

2) *The following amendments are proposed under Rule 231H of Income Tax Rules, 2002:*

- *"(ii) There should be Riba free financing on the balance sheet of the company, however the company may be leveraged through Islamic modes of financing ~~obtained from licensed Islamic financial institutions~~.*
- *In Rule 231H(iii), the conditions of investments in 100% Shariah compliant instruments / securities be removed and investment in interest bearing deposits should be allowed to the extent of 30% of market capitalization of Equity or total assets, which is in line with SECP Shariah Compliance Regulations 2018.*

13. PROVINCIAL SALES TAX ON SERVICES – JURISDICTION ISSUES TO BE SETTLED IN COUNCIL OF COMMON INTEREST

Provincial Sales Tax is applicable on management services including fund and assets management services. The wordings of the laws enacted by the Sindh Revenue Board, Punjab Revenue Authority and Khyber Pakhtunkhwa Revenue Authority are overlapping as the law governing Sindh Sales Tax enacted by Sindh Revenue Board states that sales tax is to be provided where business is registered while Punjab Sales Tax on Services Act, 2012 and Khyber Pakhtunkhwa Finance Act 2013 states that the province where taxable services are provided or rendered by the service provider is entitled to levy, charge and collect sales tax on such services.

We request that this issue, being of equal relevance to all the provinces and affecting the entire Services Sector, may be placed on the agenda of the Council of Common Interests so that a sharing formula for each province can be devised to resolve this matter.

14. CONSISTENT AND LONG TERM TAX POLICIES

As much as favorable tax treatment, investors need a stable and predictable tax environment. When making a long-term investment decision, they need to know what tax treatment their investment will receive over the term of their investment horizon. Otherwise, they may simply decide not to invest or adopt short term trading strategies (like most investors unfortunately tend to do).

It should also be considered that the changes in policies should be prospective rather than retrospective in nature. One of such example is the amendment made in section 65B of the Income Tax Ordinance through Finance Act 2019 where tax credit for investment in plant & machinery for the purpose of balancing, modernization and replacement was reduced from 10% to 5% retrospectively of the amount invested. Therefore, the government is requested to rectify all such amendments which have retrospective effect so that all the amendments made have a prospective effect.

Government of Pakistan must move away from short term measures and frequent changes to tax treatment and adopt long term measures to promote savings and investment and development of the capital market.

Annexure A

IMPLICATIONS OF HOLDING PERIOD ON CGT ON DISPOSAL OF IMMOVABLE PROPERTY

S.No.	Holding period	Gain
(1)	**(2)**	**(3)**
1.	Where the holding period of an immovable property does not exceed one year.	100%
2.	Where the holding period of an immovable property exceeds one year but does not exceed two years	75%
3.	Where the holding period of an immovable property exceeds two years but does not exceed three years	50%
4.	Where the holding period of an immovable property exceeds three years but does not exceed four years	25%
5.	Where the holding period of an immovable property exceeds four years	0%

TAX ON CAPITAL GAINS ON DISPOSAL OF IMMOVABLE PROPERTY

S.No.	Amount of Gain	Rate of tax
(1)	**(2)**	**(3)**
1.	Where the gain does not exceed Rs. 5million	2.5%
2.	Where the gain exceeds Rs.5 million but does not exceed Rs.10 million	5%
3.	Where the gain exceeds Rs.10 million but does not exceed Rs.15 million	7.5%
4.	Where the gain exceeds Rs.15 million	10%

ANNEXURE B

Capital Gains Tax International Applicability

Capital Gains Tax in Other Regional Exchanges of the world

S.No.	Country	CGT on Corporates	CGT on Individuals
1	Bahrain	Nil	Nil
2	Brunei Darussalam	Nil	Nil
3	Hong Kong	Nil	Nil
4	India	Long term - 10% Short term - 15% (if securities transaction tax payable). Where no securities transaction tax is paid, short term capital gains are subject to taxation at the normal rates.	Long term - Tax on long-term capital gains (arising to any person) on transfer of securities (other than units) listed on a recognised stock exchange in India is computed at the lower of 10% on gains computed without indexation or 20% of gains computed with indexation (if applicable) Short term - 15% provided Securities Transaction Tax (STT) has been paid on sale.
5	Indonesia	Sale of shares on Indonesian stock exchanges is subject to a 0.1% final income tax rate on the proceeds.	Sale of shares on Indonesian stock exchanges is subject to a 0.1% final income tax rate on the proceeds.
6	Kyrgyzstan	Capital gains are subject to ordinary profit tax rate at 10%. There is an exemption available for capital gains from selling shares that occur on the date of a given sale, in the official lists of the stock exchange in the top two categories of listing.	Capital gains are subject to ordinary income tax rate at 10%. There is an exemption available for interest income and capital gains from selling shares that are, on the date of a given sale, in the official lists of the stock exchange in the highest and the next to highest category of listing
7	Malaysia	Stamp duty – 0.3% of consideration paid or market value, whichever is higher.	Capital gains are not taxed in Malaysia, except for gains from sale of shares in a real property company.
8	Mauritius	Nil 15% if holding period is less than 6 months	Nil
9	Oman	Nil	Nil
10	Philippines	0.6% based on the gross selling price, provided the listed corporation observes a minimum public ownership of at least 10% based on the company's issued and outstanding shares, exclusive of any treasury shares or such percentage as may be prescribed by the SEC or Philippine Stock Exchange (PSE), whichever is higher. Otherwise, the 5% / 10% capital gains tax shall apply if the seller is a foreign corporation, or 15% capital gains tax shall apply if the seller is a domestic corporation.	0.6% of the gross selling price for shares of stocks listed and traded in the stock exchange; 15% of the net capital gains for unlisted shares of stock, including shares of publicly listed companies that failed to comply with the minimum public ownership (MPO) requirement. Only 50% of the gain or loss is to be taken into account if the capital asset has been held for more than 12 months; otherwise, 100% of the gain or loss is to be considered.

11	Qatar	10%	Capital gains on the disposal of securities derived by the individual are exempt from taxation provided such securities are not part of the assets of a taxable activity.
12	Saudi Arabia	Capital gains realised from the disposal of shares in Saudi stock companies listed in the Saudi market are tax exempt, subject to certain conditions.	Nil
13	Sri Lanka	Gains made on realisation of shares quoted in any official list published by any stock exchange licensed by the Securities and Exchange Commission of Sri Lanka are exempt from income tax. Such gains are subject to the share transaction levy chargeable at 0.3% on the seller as well as the buyer on the transaction value.	The gains from the realisation of investment assets is taxed at the rate of 10%
14	Taiwan	Capital gains on disposal of Taiwanese marketable securities and futures by resident companies and non-resident companies with a Fixed Place of Business (FPOB) or business agent in Taiwan are exempt from Corporate Income Tax (CIT) assessment, but are liable for Income Basic Tax (IBT) of 12%, with an exemption amount of TWD 500,000.	CGT on securities has been abolished effective from 1 January 2016. Capital gains derived from sales of Taiwan-based securities prior to 1 January 2016 are still subject to CGT if certain conditions are met.
15	United Arab Emirates	Nil	Nil

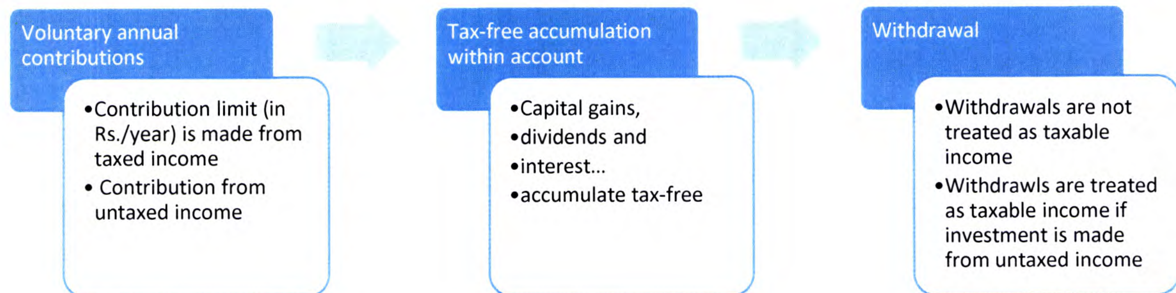
Capital Gains Tax OECD Countries

S.No.	Country	CGT Rate
1	New Zealand	Nil
2	Korea	Same as corporate income tax rate 10%-25% progressive
3	Switzerland	Nil at federal level. The ordinary capital tax rates vary between 0.001% and 0.508%, depending on the company's location of corporate residence in Switzerland.
4	Netherland	Capital Gain realised on disposal of shares qualifying for the participation exemption are tax exempt.. Other capital gain are treated as normal income. The standard rate currently stands at 25%. There are two taxable income brackets. A lower rate of 15% applies to the first income bracket. which consists of taxable income up to 245,000 euro. The standard rate applies to the excess of the taxable income.
5	Hungary	9%
6	Sweden	There is a capital gains tax exemption for Swedish corporate entities on gains related to the disposal of shares held for business reasons.
7	Portugal	Under Portugal's participation exemption regime, capital gains realized on transfer of shares can be exempt from taxation.
8	Spain	Capital gains are treated as normal income and taxed at the standard CIT rate of 25%. Capital gains arising on the transfer of companies resident in Spain in which at least a 5% interest has been held for at least one year are exempt from tax.
9	Norway	A uniform corporate tax rate of 22% applies to capital gains.
10	Latvia	Capital Gains on sale of shares and securities are exempt from tax.

ANNEXURE C

A made for Pakistan RSIA

As discussed in section 2 above, we propose that a RSIA scheme be structured to encourage transfer of capital from unproductive and informal sectors – including repatriation of capital held abroad – to the formal and productive sectors though capital markets. Its main features would be as follows.



Contributions

Contributions from taxed income can be subject to a maximum amount per annum. This will help to divert capital from passive savings and unproductive sectors to productive use.

For contributions from untaxed income, it is proposed that – at least initially – there should be no limit to the amount an investor can contribute to a RSIA. This will help divert funds from the undocumented informal sector to the formal and documented sectors. In this way, GOP would maximize the benefits of RSIAs described above, including tax revenue upon withdrawal. It is proposed that a flat tax rate of between 5-10% be charged on withdrawals of income and gains from RSIAs.

Tax-free accumulation

All income within the account (i.e. capital gains, dividend, interest income) should be tax-free, like VPSs. It is this feature and the opportunity to legally invest in capital market instruments that will attract capital from unproductive and informal sectors.

Withdrawals

Withdrawals from RSIAs funded by taxed income must be tax free, while those funded from untaxed income should be treated as taxable income because contributions are presumed to have been made from sources that have not been taxed.

Unlike VPSs, investors should be allowed to withdraw capital from the account any time they want. That feature is key in attracting capital from wealthy individuals who otherwise may not want to lock up their capital.

Structure and administration

A proper structure and administrative framework are key to the success of the scheme. Protection of client assets and suitability of investment are paramount. As for VPSs, rules regarding tax-free capital accumulation and the treatment of withdrawals must be stable throughout the existence of the scheme. It is also crucial that firm guarantees be offered that

contributions be subject to full amnesty – aside from AML and Terrorist Financing issues due diligence.

Providers

RSIAs should be offered by Asset Management Companies and eligible brokers that meet requirements set out by SECP. Banks may also offer such schemes.

Financial advice

Providers (AMCs and brokers) should provide financial advice to the account holder and have a fiduciary duty.

Allowable investments

Investments should be restricted to listed stocks, ETFs, tradable Government and investment grade corporate bonds and mutual funds. No leverage or short selling should be allowed.

Fees

In order to reduce possible conflicts of interest, RSIA holders should pay the provider an annual fee calculated as a % of assets in the account, either directly or through a mutual fund.

Administration

An administrator/trustee – who may be the provider or an affiliate if they meet the requirements – should oversee the accounts to ensure that all rules regarding contributions, eligible investments and withdrawals are complied with.

Other policy considerations

While establishing a RSIA scheme, GOP should be mindful of the following policy considerations.

Incentive to join formal sector and become tax-filers

Although a RSIA provides a conduit for capital to flow from the informal sector to the documented economy, it does not provide any incentive to actually join the formal sector. Indeed, for a RSIA scheme to be successful in attracting capital to the formal sector, measures must be implemented in parallel to close the door to investment in other vehicles without proper documentation, including real estate, NSS and offshore destinations.

For the same reasons, the scheme should be designed to allow GOP to adjust/reduce contribution limits – while leaving the other features unchanged – to align with evolving policy objectives.

Harmonization with VPS

As a RSIA scheme is designed, it may be necessary to harmonize some features of VPS in order to avoid possible fiscal or regulatory arbitrage as well as not burden providers with 2 different administrative structures.