PSX FEDERAL BUDGET PROPOSALS
FY2019-20

PAKISTAN
STOCK EXCHANGE
LIMITED

TABLE OF CONTENTS

INTRODUCTION

Pakistan's capital market has seen robust growth over the years in terms of its market capitalization, which now stands at over PKR 8.1 trillion. While the past year has seen a host of challenges during a time of weakening balance of payments coupled with political uncertainty, the recent setbacks in the stock market also reflect the narrow investor base in the country.

Keeping in mind the chronic macro-economic stability challenges, low savings and investment rates, underdeveloped rural economy, digitalization of financial transactions and the emerging connectivity with China and other neighboring economies, Pakistan has immense potential given implementation of strong structural reforms in the capital market. Reforms aimed at helping the economy in raising money for infrastructure and housing sectors through long-term debt instruments, enhancing efficiency of the commodities market to support rural economy, revamping the non-bank financial sector and development financing institutions and increasing the access of capital market to the marginalized areas to have a real impact on lives of the poor people. A special emphasis will be needed to support small and medium sized enterprises through a secondary trading market with nominal regulatory burden.

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). Government of Pakistan must consider adopting long term measures to promote savings and investment and development of the capital market.

In order to achieve its objectives, PSX wishes to present proposals for the Federal Government's Budget 2019. These proposals essentially focus on some impediments and disincentives that have crept into the development of the capital market, as well as the documented corporate sectors.

All the proposals outlined below are primarily designed to remove the disincentives, 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 cases, likely to increase the government's revenue.

The core principle of our proposal is aimed at increasing the size and depth of the capital market by incentivizing listing of new capital without impacting government revenues. In view of the above, we are presenting the following proposals for the kind consideration of the Ministry of Finance and the Federal Board of Revenue.

EXECUTIVE SUMMARY

S. NO.	DESCRIPTION	PROPOSAL
1.	INTRODUCTION OF REGISTERED SAVINGS AND INVESTMENT ACCOUNTS	*It is proposed that the Government of Pakistan introduce a mechanism and regulatory structure for the launch of registered savings and investment accounts (RSIAs) to help channel savings towards productive investments.* *RSIAs will help bring capital from the large undocumented sector into the formal economy. Further, 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.*
2.	FUNDING THE FEDERAL GOVERNMENT EMPLOYEES PENSION SCHEME	*The government should start funding its pension liabilities to avert a future pension crisis and encourage capital formation in Pakistan. An adequately funded pension scheme would offer old age benefits to retired employees at public sector enterprises and government workers, without putting burden on the annual budget. Further, it is recommended that a certain percentage of the funded pension scheme be invested in the capital markets.*
3.1	ELIMINATION OF CGT ON DISPOSAL OF SECURITIES – FOREIGN INVESTORS	*In line with the practice in peer markets, and to attract foreign capital to Pakistan, it is proposed to exempt the imposition of capital gains tax on disposal of securities for foreign investors.*
3.2	REVIEW THE MECHANSIM FOR PAYMENT OF CGT ON DISPOSAL OF SECURITIES – DOMESTIC INVESTORS	*In line with the common practice internationally, the government should review and revise the mechanism for payment of tax on capital gains for filers. An alternative to the current convention should be explored along with pros and cons. Withholding tax at NCCPL level for filers should be debated thoroughly and replaced with the obligation on investors who are filers to pay CGT through annual tax returns. However, the current mechanism of withholding on CGT for investors who are non-filers shall remain the same provided no WHT on such non-filers whose Capital Gains is up to Rs. 100,000 per annum. In any case, NCCPL should provide information on all investors' capital gains and losses to tax authorities for tracking purposes.*

3.3	ALIGN THE RATES OF CAPITAL GAINS TAX ON SECURITIES WITH THE RATES OF CGT ON SALE OF IMMOVABLE PROPERTY	*Align the rates of capital gains tax on disposal of securities with the rates of CGT on sale of immovable property, using similar slabs of holding period as those on real estate.*
4.	TAX TREATMENT ON CREATION/REDEMPTION OF UNITS OF EXCHANGE TRADED FUNDS	*It is proposed that in order to facilitate the market for Exchange Traded Funds, transfer of Portfolio (basket of securities) from Authorized Participants (AP) to ETF's Account should not be treated as disposal and therefore holding period of ETF constituents be carried forward to the ETF, upon conversion of Portfolio Deposit to ETF units, for the purpose of CGT calculation.*
5.	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%.*
6.	RATIONALISATION OF WITHHOLDING TAX ON DIVIDENDS	*Government should introduce a mechanism to remove the double taxation of company's profits - once in the hands of the company and once in the hands of shareholders as dividends - such that the effective tax rate on dividends is on par with profit on debt.* *Rationalize the current tax rate on dividends to make it equal to the tax rate on profit from debt.* *Provided that there should be no withholding tax on dividends up to Rs. 100,000 per annum.*
7.	TAX CREDIT FOR COMPANIES LISTED ON STOCK EXCHANGE	*The 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.*
8.	ELIMINATION OF CAPITAL VALUE TAX ON PURCHASE OF SECURITIES	*It is proposed that Capital Value Tax should be withdrawn on the purchase value of any shares of a public company listed on a registered stock exchange in Pakistan or Modaraba Certificates or any instrument of redeemable capital as defined under the Companies Act, 2017, or as provided under Section 7 of the Finance Act, 1989.*
9.	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 permanently lowered by giving tax credit of 50% of tax payable.*

10.	TREATMENT OF UNREALIZED GAIN ON SALE OF IMMOVABLE PROPERTY TO A REIT SCHEME	*The tax exemption on sale of immovable property to both types of REIT schemes (Development and Rental), which was available prior to Finance Act, 2015 should be restored and made available up to June 2025.*
11.	REQUEST FOR CONSISTENT AND LONG TERM TAX POLICIES	*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.*

1. INTRODUCTION OF REGISTERED SAVINGS AND INVESTMENT ACCOUNTS

Background

Saving and investment are crucial for playing an important role in the process of socio-economic development through capital accumulation. Pakistan, besides facing problems such as unemployment, rapid growth of population, slow economic growth in the country, has a saving rate that is meager and undesirable 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. 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) as long as it stays in the account;
- 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 A.**

Proposal:

It is proposed that the Government of Pakistan introduce a mechanism and regulatory structure for the launch of registered savings and investment accounts (RSIAs) to help channel savings towards productive investments.

RSIAs will help bring capital from the large undocumented sector into the formal economy. Further, 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.

Rationale

Where they have been introduced, Registered savings and investment account (RSIAs) 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 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.

Proposed Amendment

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

2. FUNDING THE FEDERAL GOVERNMENT EMPLOYEES PENSION SCHEME

At present, Pakistan's pension scheme for government employees is an un-funded, pay-as-you-go scheme. Government of Pakistan exclusively finances the pension expenditure by obtaining a provision in the annual budget for this purpose. This has all the making of an impending pension crisis in future, and places unfair burden on future generations.

In case of public sector enterprises too, much of the pension liability remains un- funded. The future monetary obligations are taken to be met from future taxation, which places undue fiscal burden and responsibility on future generations. Age analysis of population suggests growing state pension expenses given the expected increase in the older age group.

These conditions have led to increasingly stressed pension arrangements. Pension system reforms are focused on extending coverage to funded pension systems, which are professionally managed, extend to the informal sector, and facilitate switching from the existing employer schemes. While in the public sector, funds have been created at the provincial level to pre-fund the future liability.

Avoiding a looming pension crisis

Governments in various countries have actively worked to provide financial security for their aging populations by maintaining adequately-funded pension funds. These pension funds invest in a diversified range of global assets including equities, bonds, mutual funds, ETFs, and even real estate, infrastructure, and alternative assets.

In Canada, the CPPIB (Canada Pension Plan Investment Board) is the government's primary pension scheme, and has grown to become one the largest pension funds in the world. The CPPIB invests in the full stack of assets outlined above and returns are used to finance government's pension liabilities every year. This takes the burden of pensions away from the annual budget. The CPP fund now manages over $356 billion in assets, up from $128 billion in 2010.

An actively managed government pension fund in Pakistan will also help channel investment towards capital markets, since equities feature heavily at global pension funds. In Pakistan, the federal government could set up such an investment holding as a single-purpose asset management company with 100% control, and run by professional investment managers.

Proposal

The government should start funding its pension liabilities to avert a future pension crisis and encourage capital formation in Pakistan. An adequately funded pension scheme would offer old age benefits to retired employees at public sector enterprises and government workers, without putting burden on the annual budget. Further, it is recommended that a certain percentage of the funded pension scheme be invested in the capital markets.

Rationale

With Pakistan facing very high levels of poverty and the Government of Pakistan facing a rise in the old age population and having a scarcity of resources and funds to provide any old age benefits. An adequately funded pension scheme is one of the resources which the Government of Pakistan could offer to facilitate retired public sector employees.

Proposed Amendment:

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

3.1. ELIMINATION OF CGT ON DISPOSAL OF SECURITIES – FOREIGN INVESTORS

It is observed that most countries do not impose capital gains tax on disposal of securities by foreigners. Bangladesh, Malaysia, and many other countries do not levy CGT on transactions of disposal of securities conducted by foreigners. Even in countries that do have CGT on foreign investors, the rules are distinctly different from those that apply to domestic investors, in order to provide an attractive tax environment and avoid double taxation.

One important reason for not imposing such tax is that most of the countries have double taxation treaties. In Pakistan, foreign investors file income tax returns regularly and pay taxes in accordance with the provisions of the Income Tax Ordinance, 2001 or reduced rates provided under treaties executed with such countries. Foreign investors should be given preferential tax rates as they might still be required to pay taxes in their home country where they are considered as a resident taxpayer.

The table below outlines the convention for capital gains tax on disposal of securities by foreign investors in various countries:

CGT on Foreign Investors	No CGT on Foreign Investors
Turkey	Singapore
India	Bangladesh
UK	Thailand
USA	UAE
Canada	Hong Kong
	Malaysia
	Vietnam
	South Africa

<u>*Proposal*</u>

In line with the practice in peer markets, and to attract foreign capital to Pakistan, it is proposed to exempt the imposition of capital gains tax on disposal of securities for foreign investors.

<u>*Rationale*</u>

i) ***The exemption of CGT on foreign investors would facilitate substantial capital inflow by relaxing the cumbersome and time consuming account opening and registration process for foreigners as they get discouraged and overwhelmed with the current registration structure and look for better investment alternatives in regional markets.***

ii) ***Pakistan has taxation treaties with a number of countries thus foreigners would be liable to pay taxes according to the treaty. Therefore, taxing foreigners would burden them and not only increase their cost of business but most importantly discourage them from investment in Pakistan's capital market.***

<u>*Proposed Amendment*</u>

It is proposed that the proviso to sub-rule 2 of Rule 13N of Income Tax Rules, 2002 shall be omitted.

3.2. REVIEW THE MECHANSIM FOR PAYMENT OF CGT ON DISPOSAL OF SECURITIES – DOMESTIC INVESTORS

At present National Clearing Company of Pakistan Limited calculates and collects Withholding Tax on Capital Gains made on disposal of shares listed on Pakistan Stock Exchange Limited. However, it is witnessed that in many countries there is no capital gain tax collected by any institution but rather individuals/corporates are required to file their tax returns and pay taxes if any on the capital gains made by trading of shares.

A broad range of countries including Canada, USA, Indonesia, India, and Vietnam do not mandate the collection of CGT by any intermediary at the time of disposal of securities, and the CGT is payable at the time of filing of returns. In Singapore, Hong Kong, Malaysia and Mauritius there is no capital gains tax.

Therefore, considering international perspective, it would be appropriate if in Pakistan, payment of capital gains tax be made obligatory on individuals and corporates and the status of National Clearing Company of Pakistan Limited should be such that only the information is provided to the tax authorities by NCCPL.

Proposal

In line with the common practice internationally, the government should review and revise the mechanism for payment of tax on capital gains for filers. An alternative to the current convention should be explored along with pros and cons. Withholding tax at NCCPL level for filers should be debated thoroughly and replaced with the obligation on investors who are filer to pay CGT through annual tax returns. However, the current mechanism of withholding on CGT for investors who are non-filers shall remain the same provided no WHT on such non-filers whose Capital Gains is up to Rs. 100,000 per annum. In any case, NCCPL should provide information on all investors' capital gains and losses to tax authorities for tracking purposes.

Rationale

In line with international practice for collection of capital gains tax, an obligation to file returns and pay taxes on disposal of securities at year end would encourage a widespread tax culture among investors. Further, it would also lead to an increase in number of UINs.

Proposed Amendment

It is proposed that section 100B, 8th Schedule to the Income Tax Ordinance 2001 and Rule 13N of Income Tax Rules, 2002 shall be amended accordingly.

3.3 ALIGN THE RATES OF CAPITAL GAINS TAX ON SECURITIES WITH THE RATES OF CGT ON SALE OF IMMOVABLE PROPERTY

Currently the tax rates on capital gains from the disposal of securities are prescribed using various slabs that denote the holding period of the securities. The tax on these comparable slabs of holding periods of securities are higher than those for immovable property, and not aligned with the CGT on disposal of real estate, and result in making the real estate sector particularly appealing to investors when compared to capital markets. The current rates of CGT on disposal of securities and immovable property are outlined in Annexure B.

Such a convention is the norm in most developed and developing markets, where real estate and equities are given an equal footing in terms of their tax treatment. The alignment of these tax rates will also lead to an easing of speculative pressure on real estate property prices in Pakistan, where much of the undocumented wealth has been currently flowing.

Proposal:

Align the rates of capital gains tax on disposal of securities with the rates of CGT on immovable property, using similar slabs of holding period as those on real estate.

Rationale

This will 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.	Period	Tax Rates Filer	Tax Rates Non Filer
For securities acquired on or after July 1, 2016			
1	Where holding period of a security is up to one year	10%	20%
2	Where holding period of a security is more than or equal to one year but less than two years.	7.50%	20%
3	Where holding period of a security is more than or equal to two years but less than three years	5%	20%
4	Where holding period of a security is more than three years.	0%	0%
For securities acquired before July 1, 2016			
5	Where holding period of a security is up to three years.	5%	20%
6	Where holding period of a security is more than three years	0%	0%

4. TAX TREATMENT ON CREATION/REDEMPTION OF UNITS OF EXCHANGE TRADED FUNDS

An Exchange Traded Fund (ETF) is a pooled investment vehicle, with shares which can be traded throughout the day on a stock exchange, at a price determined by the market. Similar to a traditional mutual fund, an ETF provides investors a proportionate share in a pool of underlying securities.

ETFs are one the fastest growing categories of passive fund investments, with global investment in listed ETF securities now around $4.82 trillion, up from $3.55 trillion at the start of 2017. ETFs typically track an underlying index; they can also be based on sectors and strategies. They hold immense potential for investors to gain exposure to various market themes, without paying excessive management fees for getting a diversified exposure or developing a portfolio.

As PSX is preparing to introduce ETFs in 2019, working actively with all market participants and regulators, the tax structure for ETFs needs to be rationalized to incentivize prospective APs to deal in ETFs. As per current tax structure, a transfer of Portfolio (basket of securities) from AP to ETF's Account (both maintained with Trustee), would trigger Capital Gains Tax (CGT).

Internationally, the growth and attraction of ETFs has been driven by the essential requirement that creation and redemption of ETF units by authorized participants are not subject to capital gains. A fundamental feature of ETFs is that the creation and redemption of their units are made in-kind, and not in cash as in the case of a mutual fund, so it does not trigger capital gains tax. In almost every market where ETFs are traded, regulators have allowed the practice of in-kind transfer portfolio securities. Examples include Saudi Arabia, Canada, UK, and USA.

Proposal

It is proposed that in order to facilitate the market for Exchange Traded Funds, transfer of Portfolio (basket of securities) from Authorized Participant (AP) to ETF's Account should not be treated as disposal and therefore holding period of ETF constituents be carried forward to the ETF, upon conversion of Portfolio Deposit to ETF units, for the purpose of CGT calculation.

Rationale

Tax relief for ETF instruments will play a significant role in the successful launch of ETFs in Pakistan, as the current structure would trigger capital gains in the creation/redemption of ETFs units. Moreover, a rationalized rate of tax on ETF investments, at par with the tax on other asset classes, would attract more investors towards ETFs.

Proposed Amendment

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

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

Margin Financing (MF) facility is made available to all Members 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 render that the amount deducted as advance tax could not be fully adjusted against the tax liability of most brokers leading toward claims for tax refunds that are not time bound.

Proposal

It is proposed to reduce the rate of withholding tax on the gross income earned on MF transactions from 10% to 2.5%.

Rationale

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.

Proposed Amendment

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".***

6. RATIONALISATION OF WITHHOLDING TAX ON DIVIDENDS

Withholding tax (WHT) on profit from debt instruments is currently charged a lower rate compared to the WHT charged on dividend from equity investments. The difference ranges between 2.5%-5% (as can be seen in the table below). This reduces the incentive to invest in the equity market.

Tax treatment on various asset classes should not be the primary driver of investment decisions. Profit on debt and dividends should receive the same tax treatment. At present, it is observed that corporate profits are first taxed at the company level, and subsequently, the resulting profits which are distributed as dividends are taxed at the individual level. This is essentially a form of double taxation, and result in the misallocation of capital in an economy by giving an upper hand to fixed income investments. To remove this discrepancy, the government should introduce a mechanism to eliminate the distortions on the tax charged on dividends, and make the effective tax rate equal to that on debt.

Tax Rate on investments	Filers	Non-Filers	
		Profit paid is more than rupees five hundred thousand	Profit paid is rupees five hundred thousand or less
Profit on Debt U/S 151	10%	17.50%	10%
Sukuk-holder (individual or an association of person), if the return on investment is more than one million U/S 150A	12.50%	17.50%	
Sukuk-holder (individual and an association of person), if the return on investment is less than one million U/S 150A	10%	17.50%	
Dividend U/S 150 & 236S	15%	20%	

Proposal

i) ***Government should introduce a mechanism to remove the double taxation of company's profits - once in the hands of the company, and once in the hands of shareholders as dividends - such that the effective tax rate on dividends is on par with profit on debt.***

ii) ***Rationalize the current tax rate on dividends to make it equal to the tax rate on profit from debt.***

Provided that there should be no withholding tax on dividends up to Rs. 100,000 per annum.

Rationale

A similar tax treatment on dividends from equity investment and debt instruments will provide a level playing field to equities and attract higher inflows in the stock market. Further, it would lead to increase in number of UINs.

Proposed Amendment

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

7. TAX CREDIT FOR COMPANIES LISTED ON STOCK EXCHANGE

In order to encourage new listings, the Finance Act, 2011 introduced Section 65C of the Income Tax Ordinance, 2001; whereby tax credit equal to twenty percent (20%) for the tax year in which a company opts for enlistment on the Stock Exchange was allowed.

Currently, the tax credit is given for four years from the date of listing, subject to the condition that for the first two tax years the tax credit shall be 20% of the tax payable and 10% for the last two tax years. This tax credit is very insignificant and not enough to attract new listings.

It is generally observed that when companies opt for a listing on a stock exchange, their profits enhance substantially due to effective corporate governance, better disclosures, and availability to additional funds from the market. Increased profitability ultimately leads to higher tax revenue for the government as the number of listed companies on PSX grows. Higher listings, coupled with regulations to increase trading activity will result in higher liquidity, and also lead to incremental government revenues from CGT.

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	29	80,886 Million
De-listings	38	18,325 Million
Delisted due to Merger	9	142,777 Million

*As of December 31, 2018

<u>Proposal</u>

The 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.

<u>Rationale</u>

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 20.65%; 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
Africa	29.0	28.3	27.9	27.9	27.5	28.73	**28.81**
Asia	22.9	22.1	21.9	22.6	21.9	20.05	**20.65**
Europe	20.4	20.6	19.7	20.1	20.5	18.35	**18.38**
Oceania	28.6	27.0	27.0	27.0	26.0	23.67	**22.00**
North America	33.0	33.0	33.3	33.3	33.3	23.08	**23.01**
OECD	25.2	25.3	24.1	24.9	24.8	24.18	**23.93**
Global	24.4	23.7	23.6	23.9	23.6	22.96	**23.03**

Proposed Amendment

In section 65C of Income Tax Ordinance, 2001,

(i) ***The phrase "for the tax year in which the said company is enlisted and for the following three tax years" be substituted with the phrase "for those companies that meet the prescribed requirements including a minimum free float of 25% throughout and;***

(ii) ***The following proviso should be omitted;***

"Provided that the tax credit for the last two years shall be ten percent of the tax payable."

8. ELIMINATION OF CAPITAL VALUE TAX ON PURCHASE OF SECURITIES

The Finance Act, 2004 introduced capital value tax at the rate of 0.01% of the purchase value of Modaraba certificates or any instrument of redeemable capital as defined in the Companies Act, 2017 or shares of a public companies listed on a registered stock exchange in Pakistan.

Thereafter, through Finance Act 2009, the CVT on shares traded on the stock exchange was withdrawn however inadvertently CVT on Modaraba Certificates and instrument of redeemable capital was not withdrawn.

The FBR was then approached, who instead of removing the CVT on Modaraba Certificates and instrument of redeemable capital, re-imposed CVT on shares of a public Company vide Finance Act, 2012.

Proposal

It is proposed that Capital Value Tax should be withdrawn on the purchase value of any shares of a public company listed on a registered stock exchange in Pakistan or Modaraba Certificates or any instrument of redeemable capital as defined under the Companies Act, 2017, or as provided under Section 7 of the Finance Act, 1989.

Rationale

Withdrawal of Capital Value Tax will reduce the cost of business for the industry, and facilitate the development of capital markets

Proposed Amendment

The following clauses of sub-section 2 of section 7 of Finance Act, 1989 shall be omitted;

(E)	***Purchase of Modaraba certificates or any instrument of redeemable capital as defined in the Companies Ordinance, 1984***	***0.02% of the purchase value***
(F)	***Purchase of shares of a public company listed on a registered stock exchange in Pakistan***	***0.01% of the purchase value***

9. 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 source of financing for their expansion projects, and equity financing would be a cheaper alternative for these companies as compared to debt financing.

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.

Rationale

i) **The share of the manufacturing sector in the job market is only 14% which is very low because 80% of the manufacturing investments in large scale industries provide less than 20% of the manufacturing jobs. The rest 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 Companies Act, 2017 and is also a listed on the registered Stock Exchange in Pakistan, the rate of tax imposed on the taxable income of such company, other than a banking company, shall be 20% for the tax year 2020 and onwards."

10. TREATMENT OF UNREALIZED GAIN ON SALE OF IMMOVABLE PROPERTY TO A REIT SCHEME

Real estate has been a very popular asset class among Pakistani investors, especially in the informal, undocumented sector. Real Estate Investment Trusts (REITs) can play a significant role in the economic development of a country. In Pakistan, they can help the Government achieve the objective of documenting the economy and real estate, generating appropriate tax revenue from the real estate sector.

Prior to 2015, profits and gains (unrealized) accruing to a person on sale of immovable property to both REIT Schemes (Development and Rental) were exempt from tax.

However, the Finance Act 2015, inserted a proviso, whereby, this exemption became restricted only to gains on immovable property to a Development REIT Scheme up to the June 30, 2020, which has resulted in no new REIT scheme being launched after the amendment. The current limited exemption cripples REIT's potential and further developments have been stagnant with no revenue generated from this avenue by the exchequer.

Proposal:

The tax exemption on sale of immovable property to both types of REIT schemes (Development and Rental), which was available prior to Finance Act, 2015 should be restored and made available up to June 2025.

Rationale

i) ***This will encourage documentation of real estate activity in the country.***

ii) ***New REITs will distribute mandatory dividends which will result in generation of new tax, thus enhancement of revenue under this head.***

Proposed Amendments

i) ***In Clause (99A), Part I, Second Schedule to the Income Tax Ordinance, 2001 for the word "2015" shall be substituted by "2025".***

ii) ***In Clause (99A), Part I, Second Schedule to the Income Tax Ordinance, 2001 the following proviso shall be omitted:***

"Provided that profit and gains on sale of immovable property to a Developmental REIT Scheme with the object of development and construction of residential buildings shall be exempt up to thirtieth day of June, 2020".

11. REQUEST FOR CONSISTENT AND LONG-TERM TAX POLICIES

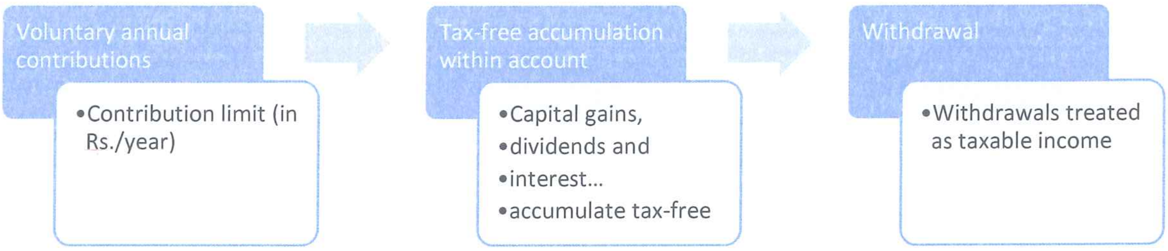
As much as favorable tax treatment, investors need a stable and predictable tax environment. When making a long-term investment decision, they need to know what tax treatment their investment will receive over the term of their investment horizon. Otherwise, they may simply decide not to invest or adopt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

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

A made for Pakistan RSIA

As discussed in section 1. above, we propose that a RSIA scheme be structured to encourage transfer of capital from the informal sector – including repatriation of capital held abroad – to the formal sector though capital markets. Its main features would be as follows.



Contributions

Contributions are presumed to come from capital that would not otherwise be invested in the formal sector and generate tax revenue for GOP. Likewise, it is presumed that the capital comes from sources that have not been subject to income tax – otherwise, contribution to a VPS is a better alternative.

For these reasons, it is proposed that – at least initially – there should be no limit to the amount an investor can contribute to a RSIA. In this way, GOP would maximize the benefits of RSIAs described above, including tax revenue upon withdrawal. Furthermore, unlike VPSs, no tax credit should be given with regard to contributed amounts.

Tax-free accumulation and permissible investments

All income within the account (i.e. capital gains and dividend) 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 the informal sector.

Investments should be limited to listed equities, ETFs, tradable bonds and mutual funds. Principle-based prudential rules must be adopted to ensure protection of client assets and suitability of investments.

Withdrawals

Withdrawals 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 may otherwise 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.

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. No trading commissions should be allowed.

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.

ANNEXURE B

Capital Gains Tax on disposal of Immovable Property

S. No.	Period	Tax Rates
For immovable property acquired on or after July 1, 2016		
1	Where holding period of immovable property is up to one year	10%
2	Where holding period of immovable property is more than or equal to one year but less than two years.	7.50%
3	Where holding period of immovable property is more than or equal to two years but less than three years	5%
4	Where holding period of immovable property is more than three years.	0%
For immovable property acquired before July 1, 2016		
5	Where holding period of immovable property is up to three years.	5%
6	Where holding period of immovable property is more than three years	0%

Capital Gains Tax on disposal of Securities

<table>
<tr><th rowspan="3">S. No.</th><th rowspan="3">Period</th><th rowspan="3">Tax Year 2015</th><th rowspan="3">Tax year 2016</th><th colspan="2" rowspan="2">Tax Year 2017</th><th colspan="4">Tax Year 2018 and 2019</th></tr>
<tr><th colspan="2">Securities acquired before 01.07.2016</th><th colspan="2">Securities acquired after 01.07.2016</th></tr>
<tr><th>Filer</th><th>Non-Filer</th><th>Filer</th><th>Non-Filer</th><th>Filer</th><th>Non-Filer</th></tr>
<tr><td>1</td><td>Where holding period of a security is less than twelve months</td><td>12.50%</td><td>15%</td><td>15%</td><td>18%</td><td>15%</td><td>18%</td><td rowspan="3">15%</td><td rowspan="3">20%</td></tr>
<tr><td>2</td><td>Where holding period of a security is twelve months or more but less than twenty-four months</td><td>10%</td><td>12.50%</td><td>12.50%</td><td>16%</td><td>12.50%</td><td>16%</td></tr>
<tr><td>3</td><td>Where holding period of a security is twenty -four months or more but the security was acquired on or after 1st July, 2013</td><td>0%</td><td>7.50%</td><td>7.50%</td><td>11%</td><td>7.50%</td><td>11%</td></tr>
<tr><td>4</td><td>Where the security was acquired before 1st July, 2013</td><td>0%</td><td>0%</td><td>0%</td><td>0%</td><td>0%</td><td>0%</td><td>0%</td><td>0%</td></tr>
</table>