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INTRODUCTION

Taxation policy is the primary fiscal tool to shape the economic landscape of the country and provides the basis for guiding development, innovation and entrepreneurship which are foundations of sustainable growth, employment generation and social stability in the nation. In today's world data is the most critical resource for any activity and taxation revenue generation is no exception. Without sufficient data and integrity of that data, the full potential of tax revenue generation will remain unrealised.

In this context, PSX believes that the government's first and foremost role is in comprehensively documenting all economic activity in the country. The financial sector including the capital markets are few of the well documented sectors in the economy, along with companies listed on the stock exchange. At the same time, whether it is rest of the service and trade sector, the real estate sector, the agricultural sector – which together constitute the bulk of GDP – all have to be documented in order to have a realistic picture of actual economic activity and the taxation potential therein. Unless this is done, fiscal deficits will remain the bane of economic development, holding back the country's progress.

Concurrently, in order to support the documentation drive, digitization of the payment system is a must in today's world. Estimates of the cash based economy range from 35% to 50% of GDP. Technology is now available to digitize a huge portion of these cash transactions and thus allow for proper assessment of the economic activity pool. It is therefore imperative that the government devise a policy for comprehensively digitizing the payment system and provide incentives to the private sector to rapidly adopt it.

Finally, in order to fashion a proper policy, appropriate data collection methodology and data analytics expertise is imperative. In this regard it is recommended that the Federal Bureau of Statistics be made into an autonomous body with sufficient resources, powers and accountability to the parliament to provide independent surveys, statistical studies and assessments based on global best practices. Unless data integrity is established, policies based on flawed data and estimates thereof will not achieved desired objectives.

Coming to capital market itself, 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 bedevilled 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 2023-24. 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 favorable consideration and discussing these proposals with you.
# EXECUTIVE SUMMARY

<table>
<thead>
<tr>
<th>S. NO.</th>
<th>DESCRIPTION</th>
<th>PROPOSAL</th>
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<tbody>
<tr>
<td>1A</td>
<td>ALIGN RATES OF CAPITAL GAINS TAX ON DISPOSAL OF SECURITIES WITH THE RATES OF CGT ON SALE OF IMMOVABLE PROPERTY</td>
<td>CGT rates on listed securities be brought in line with CGT on sale of immovable property. This is essential to eliminate the tax driven distortion between different asset classes. Further, CGT on all derivatives and future contracts traded on PSX to be taxed in line with future commodity contracts traded at PMEX.</td>
</tr>
<tr>
<td>1B</td>
<td>TAX RELIEF FOR FOREIGN INVESTMENT IN CAPITAL MARKET</td>
<td>In order to attract and encourage foreign investment into capital market, it is proposed to offer tax relief to foreign investors in terms of exemption on capital gains and dividend earned on such investment, in line with similar tax relief offered for investment in GoP securities.</td>
</tr>
</tbody>
</table>
| 1C    | TAXATION OF CAPITAL GAIN ON DISPOSAL OF SECURITIES                            | • It is proposed that an explanation be added under section 37A to clarify that, the share of a company, disposed off in a tax year for which the company has the status of a public company, “becomes a security” with effect from the date of acquisition, irrespective of the status of said company at the time of the acquisition of the said share.  
• It is proposed that the proviso added under sub-section (1) of section 37A be revised to exclude taxation of offer of sale at the time of new listings. |
| 2A    | 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 25% free float, which will generate CGT and other tax revenue. |
| 2B    | LEVELLING TAX FOR CORPORATES                                                 | • Inequality of taxation of businesses should gradually be removed by reducing corporate tax rate/increasing tax rates for AoPs.  
• Restoration of exemption on inter-corporate dividend between companies eligible for group taxation. |
<p>| 2C    | 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. |</p>
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<td><strong>3.</strong></td>
<td><strong>REINSTATEMENT OF TAX CREDIT ON INVESTMENT IN SHARES</strong></td>
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<td>It is requested to reinstate Section 62 of the Income Tax Ordinance that was removed in the Federal Budget 2022-23 to promote savings for the taxpayers with no major impact on revenue.</td>
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<td><strong>4.</strong></td>
<td><strong>UNLOCKING POTENTIAL OF PRIVATE FUNDS</strong></td>
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<tr>
<td></td>
<td>• Insert proper definition of Private Fund referring to 2015 regulations</td>
</tr>
<tr>
<td></td>
<td>• Reinvestate exemption of profits and gains to be given to all categories of Private Equity &amp; Venture Capital including Private Fund.</td>
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<td></td>
<td>• Revision of CGT rates as provided for mutual funds, CIS and REITs</td>
</tr>
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<td></td>
<td>• Specified exemptions to include Private Fund</td>
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<tr>
<td><strong>5.</strong></td>
<td><strong>DOCUMENTING REAL ESTATE SECTOR &amp; PROMOTING REITS STRUCTURES</strong></td>
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<td></td>
<td>• Exempt advance tax on property transfers to/from a REIT Scheme.</td>
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<td></td>
<td>• Remove sunset clause for all categories of REIT.</td>
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<tr>
<td><strong>6.</strong></td>
<td><strong>GRANDFATHER PROVISION FOR TAX TREATMENT OF COMPANIES THAT LIST ON PSX</strong></td>
</tr>
<tr>
<td></td>
<td>It is proposed that in order to encourage companies to list, their tax status should be grandfathered at the time of listing application i.e. no new cases for past tax returns should be opened, except for such pending cases on which proceedings have already been initiated under the Ordinance, before the date of listing application, will continue as per the provisions of law.</td>
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<tr>
<td><strong>7.</strong></td>
<td><strong>ELIMINATION OF MINIMUM TAX REGIME FROM LISTED COMPANIES</strong></td>
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<td>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.</td>
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<td><strong>8.</strong></td>
<td><strong>RATIONALIZE THE CURRENT TAX RATE ON DIVIDENDS</strong></td>
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<td>It is proposed to rationalize the tax rate on dividend, as it would generate more investment in stocks and thus more revenue for the Federal Government.</td>
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<td><strong>9.</strong></td>
<td><strong>PROVINCIAL SALES TAX ON SERVICES – JURISDICTION ISSUES TO BE SETTLED IN COUNCIL OF COMMON INTEREST</strong></td>
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<tr>
<td></td>
<td>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.</td>
</tr>
<tr>
<td>10.</td>
<td>INTRODUCTION OF REGISTERED SAVINGS (RSIA) AND INVESTMENT ACCOUNTS AND INDIVIDUAL SAVINGS ACCOUNT (ISA)</td>
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<td>----------------------------------------------------------------------------------------------------------------</td>
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<td>It is proposed that the Government of Pakistan introduce a mechanism and regulatory structure for the launch of RSIArs 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.</td>
</tr>
<tr>
<td>11.</td>
<td>CONSISTENT AND LONG TERM TAX POLICIES</td>
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<tr>
<td></td>
<td>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.</td>
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</tbody>
</table>
1A. ALIGN RATES OF CAPITAL GAINS TAX ON DISPOSAL OF LISTED SECURITIES WITH THE RATES OF CGT ON SALE OF IMMOVABLE PROPERTY

During discussions with respect to the Federal Budget 2022-23 with the then Finance Minister and FBR Chairman, a consensus was developed that the tax on capital gains on listed securities should be uniform with that on real estate and other classes of assets. This is important to remove any tax driven distortions amongst different asset classes and to create a level playing field to ensure efficient allocation of scarce resources towards productive assets.

On June 10, 2022, Finance Bill 2022 (Bill) addressed this issue through introduction of revised rates based on holding period, aligning capital gain tax rates on disposal of securities with rates on disposal of immovable properties. However, the Finance Act 2022 (Act) has again created such tax disparity between securities and immovable properties.

There is an anomaly in Act with respect to the rate of tax to be paid under section 37A of the Ordinance, which has arisen due to a Proviso added on in the Act, which was not in the Bill. The same is explained as follows:

Division-VII of First Schedule of the Ordinance as approved in the Act contains the following Proviso which was not present in the Bill presented earlier. The Proviso states:

Provided that for securities except at S. No. 8 of the table,

(i) the reduced rates of tax on capital gain arising on disposal shall apply where the securities are acquired on or after the first day of July, 2022; and

(ii) the rate of 12.5% tax shall be charged on capital gain arising on disposal where the securities are acquired on or before the 30th day of June, 2022 irrespective of holding period of such securities

This is to submit that subsequent inclusion of above Proviso has changed the taxability under section 37A altogether.

We would reiterate that the Bill was the outcome of detailed and comprehensive discussions at the relevant forums. Any suggestions and comments by the stakeholders on the Bill were also limited to the extent of table presented in the Bill, without expecting that any Proviso would be added, which completely changes the taxation scheme.

The Bill was drafted in order to bring uniformity in taxation of capital gain on securities under Section 37A and taxation of gain arising on disposal of immovable property under Section 37(1A).

However, the addition of above referred Proviso defies the purpose of uniformity of taxation. Under the Ordinance as it is now, a person has to pay tax @ 12.5% on disposal of a security which was acquired by him in 2012. On the contrary, on disposal of immovable property acquired by him in 2012, he has to pay tax @ 0%. While in the case of securities, the tax rate is 12.5% even if sold after ten years.
The above example clearly illustrates that the taxation on gain on securities is not presently aligned with the taxation on gain on immovable property, as was agreed.

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. 5.6 billion and Rs. 8.8 billion respectively. Moreover, brought forward losses amounting to Rs. 281 billion are available to be adjusted against future capital gains, therefore CGT collection will continue to be negligible.

In addition to above, all derivatives and future contracts traded on stock exchange are subject to higher CGT that should be aligned with future commodity contracts traded at PMEX.

**Proposal**

i. It is proposed to remove the flat CGT rate of 12.5%, applicable on disposal of securities acquired on or before June 30, 2022, so that gain on such securities be subject to the same rates as applicable on securities acquired after Jun 30, 2022.

ii. CGT rate for all derivatives and future contracts traded on stock exchange is proposed to be taxed at 5% in line with tax rate on future commodity contracts entered into by the members of Pakistan Mercantile Exchange.

**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**

*The following proviso under Division-VII of First Schedule of the Income Tax Ordinance, 2001 should be removed*

Provided that for securities except at S. No. 8 of the table,-

(i) the reduced rates of tax on capital gain arising on disposal shall apply where the securities are acquired on or after the first day of July, 2022; and

(ii) the rate of 12.5% tax shall be charged on capital gain arising on disposal where the securities are acquired on or before the 30th day of June, 2022 irrespective of holding period of such securities

*In relation to derivatives and future contracts traded on PSX:*

Division VII, Part I of the First Schedule to the Income Tax Ordinance, 2001, serial # 8 of the table shall be amended to include “all derivatives and future contracts traded on stock exchange”.
1B. TAX RELIEF FOR FOREIGN INVESTMENT IN CAPITAL MARKET

In order to attract foreign investment and to support the depleting foreign exchange reserves, government has recently announced a major relief for non-resident banking companies making investment in government debt securities, including treasury bills and PIBs, whereby profit on debt and capital gains from such debt instruments shall be exempt from tax for these non-resident banking companies.

A similar incentive for the capital market will not only benefit the struggling economy, but will also help restore local investors’ confidence in the market, which will eventually yield a positive impact in terms of tax revenue.

Proposal
In order to attract foreign investors into the capital market, it is proposed to exempt income derived from such foreign investments from tax.

Rationale
1) This move will further help inject foreign inflows into the foreign exchange reserves of the country; and
2) Help increase foreign and local investors’ confidence in the capital market and economy, which will trigger increase in taxable activities in the market and consequently tax revenue

Proposed Amendment
Appropriate amendment to be made in the Income Tax Ordinance, 2001 to exempt capital gain and dividend income, derived from foreign investment in capital market, from tax, in line with similar tax relief offered for investment in GoP securities.
1C. TAXATION OF CAPITAL GAIN ON DISPOSAL OF SECURITIES

The newly added sub-section (3B) of section 37A has not resolved the issue of how the holding period of a security is to be determined.

In addition, the proviso added under sub-section (1) of section 37A through The Finance (Supplementary) Act, 2023 is discouraging for the capital market, as it would result in taxation of the offer for sale at the time of new listings.

Proposal
1) It is proposed to add an explanation under Section 37A to clarify that the share of a public company, disposed off in a tax year, "becomes a security" with effect from the date of acquisition.

2) The Finance (Supplementary) Act, 2023 has barred application of section 37A on disposal of shares of a listed company made otherwise than through registered stock exchange and which are not settled through NCCPL and the provisions of section 37 section are to apply in such case. It is proposed that offer for sale at the time of listing should be excluded from the proviso's purview.

Rationale
Section 37A needs to be revised to provide clarity with respect to determination of holding period and treatment as security. The revision is necessary to remove ambiguity and to provide a standard treatment for shares of listed company under the tax law.

Proposed Amendment
Following explanation be added to Section 37A(3)

"For removal of doubt, it is clarified that for the purposes of this section, the share of a company, disposed off in a tax year for which the company has the status of a public company, "becomes a security" with effect from the date of acquisition, irrespective of the status of said company at the time of the acquisition of the said share."

In addition, following explanation be added under proviso to sub-section (1)

"It is clarified that the aforesaid proviso shall not apply in case of offer for sale of shares at the time of listing on stock exchange"
2A. 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.

The average rate of tax in the Asian region is 19.52%; whereas, currently in Pakistan the corporate tax rate is 29%. In addition, super tax @ 4% has also been imposed through Finance Act 2022 on high earning persons. 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:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Number of Companies</th>
<th>Capital (Rs.)*</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Listings</td>
<td>21**</td>
<td>52,944 Million</td>
</tr>
<tr>
<td>De-listings</td>
<td>40</td>
<td>8,835 Million</td>
</tr>
<tr>
<td>Delisted due to Merger</td>
<td>8</td>
<td>5,434 Million</td>
</tr>
</tbody>
</table>

*As of December 31, 2022

** 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.
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 19.52%; whereas, currently in Pakistan the corporate tax rate, apart from recently levied super tax, 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:

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</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>28.3</td>
<td>27.9</td>
<td>27.9</td>
<td>27.5</td>
<td>28.73</td>
<td>28.81</td>
<td>28.45</td>
<td>28.50</td>
<td>27.97</td>
<td>27.60</td>
</tr>
<tr>
<td>Asia</td>
<td>22.1</td>
<td>21.9</td>
<td>22.6</td>
<td>21.9</td>
<td>20.05</td>
<td>20.65</td>
<td>21.32</td>
<td>20.06</td>
<td>19.62</td>
<td>19.52</td>
</tr>
<tr>
<td>Europe</td>
<td>20.6</td>
<td>19.7</td>
<td>20.1</td>
<td>20.5</td>
<td>18.35</td>
<td>18.38</td>
<td>20.27</td>
<td>19.99</td>
<td>19.84</td>
<td>19.74</td>
</tr>
<tr>
<td>Oceania</td>
<td>27.0</td>
<td>27.0</td>
<td>27.0</td>
<td>26.0</td>
<td>23.67</td>
<td>22.00</td>
<td>23.75</td>
<td>23.75</td>
<td>23.75</td>
<td>23.75</td>
</tr>
<tr>
<td>North America</td>
<td>33.0</td>
<td>33.3</td>
<td>33.3</td>
<td>33.3</td>
<td>23.08</td>
<td>23.01</td>
<td>25.85</td>
<td>26.06</td>
<td>26.37</td>
<td>25.33</td>
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<tr>
<td>OECD</td>
<td>25.3</td>
<td>24.1</td>
<td>24.9</td>
<td>24.8</td>
<td>24.18</td>
<td>23.93</td>
<td>23.59</td>
<td>23.51</td>
<td>23.04</td>
<td>23.57</td>
</tr>
<tr>
<td>Global</td>
<td>23.7</td>
<td>23.6</td>
<td>23.9</td>
<td>23.6</td>
<td>22.96</td>
<td>23.03</td>
<td>24.18</td>
<td>23.85</td>
<td>23.54</td>
<td>23.37</td>
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</tbody>
</table>

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"
2B. LEVELLING TAX FOR CORPORATES

- Corporate businesses profits are taxed twice. Once at company level @ 29% and on dividend distribution @15%. This is in addition to the super tax of upto 4% introduced through Finance Act 2022.
- As compared 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.
- Removal of exemption on inter-corporate dividend under section 59B of the Income Tax Ordinance, 2001 is unfavorable to potential corporate groups discouraging compliance with best practices of corporate governance requirements.

Proposal

- Inequality of taxation of businesses shall gradually be removed by reducing corporate tax rate/increasing tax rates for AoPs [First Schedule Part I, Division I, II, IIA, IIB & 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.
- Part I, Second Schedule, clause 103C reinstated as follows:

  "Dividend income derived by a company, if the recipient of the dividend, for the tax year is eligible for group relief under section 59B.”
2C. 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 (GEM 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 Division II, Part I of the First Schedule to the Income Tax Ordinance, 2001 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 2023 and onwards.”

[Signature]
3. REINSTATEMENT OF TAX CREDIT ON INVESTMENT IN SHARES

Tax credits are essential for small savers, especially salaries class, to promote long term savings for their retirement and other life goals. These savings are channelized towards the stock market and government securities.

Capital market already struggling to match returns available under other investment avenues, needs incentives to attract investors. Withdrawal under Finance Act 2022 of tax credits available to individual investors for investment in new shares, mutual funds, sukuk, and life insurance policies will divert the public funds towards other undocumented sectors offering attractive returns.

Proposal

It is requested to reinstate Section 62 of the Income Tax Ordinance that was removed in the Federal Budget 2022-23 to promote savings for the taxpayers with no major impact on revenue.

Rationale

Tax Credits available under Section 62 of Income Tax Ordinance 2001 have been incentivizing individuals towards savings for retirement and other objectives for the last many years. In a country which has savings rate much lower than its peer group, such measures are perhaps even more important. Such incentives are not uncommon in other countries.

Proposed Amendment

Restore section 62 of the Income Tax Ordinance, 2001
4. 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 up to June 2025 for PE&VC is deterring 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

No modern economy can develop without a well-functioning VC and PE industry. These are woefully absent in Pakistan, primarily due to inconsistent tax treatment for such investment vehicles. The benefits that will accrue to Pakistan’s economy are clear and there are innumerable international examples to follow in the tax treatment. Current taxation regime for Private Funds is discouraging for locally domiciled funds due to the following reasons:

a. No pass through status at fund level.
b. Not aligned with taxation of collective investment schemes.
c. Taxation at entity, investors and investee company level.

Therefore, making the development of the domestic industry unviable, resulting in value creation taking place offshore. Therefore, we strongly propose:

a. Provide tax credit of 100% to all categories of private funds without any sunset clause.
b. Restore exemption of tax on capital gain, earlier available to the investors of private funds or a specific rate, as provided for mutual funds, CIS and REITs.
c. Exclude private funds from application of minimum and withholding taxes.

Rationale

This sector can be developed with rational taxation. 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:

➢ Insert proper definition of Private Fund referring to 2015 regulations
➢ Revise clause 152 of part I of Second Schedule for:
  ▪ Inclusion of Private Fund; and
  ▪ Removal of sun-set clause.
> Restore exemption of tax on capital gain, earlier available to the investors of private funds or a rate of 12.5% CGT be specified 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
5. DOCUMENTING REAL ESTATE SECTOR & PROMOTING REITS STRUCTURES

REITS are an ideal instrument to document and help develop the real estate sector, a priority for the government. They also allow smaller investors to gain exposure to the real estate sector, an important step to reduce wealth inequality in Pakistan.

Following table illustrates the investment avenues and the value of these assets classes in Pakistan.

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Investment amount (Rs in Trillion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Estate</td>
<td>90.00</td>
</tr>
<tr>
<td>Banking deposits</td>
<td>22.73</td>
</tr>
<tr>
<td>PSX Market capitalization</td>
<td>6.32</td>
</tr>
<tr>
<td>Mutual Funds AUMs</td>
<td>1.40</td>
</tr>
</tbody>
</table>

It is evident from the above table that real estate sector is a major investment avenue in Pakistan, however it is undocumented. REITs can prove to be an effective tool in bringing this sector into the tax net and encourage documentation. Therefore, it is imperative to incentivize REITs.

In comparison to Pakistan, REITs form an integral part of the international capital market as can be seen in the below chart:

<table>
<thead>
<tr>
<th>Country</th>
<th>Mkt Cap (USD mn)</th>
<th>Stock Market Size (USD mn)</th>
<th>REIT as % of Stock Market Cap</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>1,599,680</td>
<td>42,640,760</td>
<td>3.8%</td>
</tr>
<tr>
<td>Japan</td>
<td>137,150</td>
<td>6,330,570</td>
<td>2.2%</td>
</tr>
<tr>
<td>Australia</td>
<td>120,690</td>
<td>1,851,070</td>
<td>6.5%</td>
</tr>
<tr>
<td>UK</td>
<td>100,970</td>
<td>3,283,790</td>
<td>3.1%</td>
</tr>
<tr>
<td>Singapore</td>
<td>18,020</td>
<td>445,640</td>
<td>17.5%</td>
</tr>
<tr>
<td>Canada</td>
<td>76,240</td>
<td>3,348,430</td>
<td>2.3%</td>
</tr>
<tr>
<td>Thailand</td>
<td>10,040</td>
<td>522,400</td>
<td>1.9%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>9,060</td>
<td>432,850</td>
<td>2.1%</td>
</tr>
<tr>
<td>India</td>
<td>8,730</td>
<td>3,382,650</td>
<td>0.3%</td>
</tr>
<tr>
<td>South Korea</td>
<td>7,460</td>
<td>2,109,740</td>
<td>0.4%</td>
</tr>
<tr>
<td>Turkey</td>
<td>6,930</td>
<td>230,910</td>
<td>3.0%</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>5,020</td>
<td>2,432,370</td>
<td>0.2%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>3,470</td>
<td>2,781,920</td>
<td>0.2%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>770</td>
<td>617,290</td>
<td>0.1%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>334</td>
<td>28,200</td>
<td>0.5%</td>
</tr>
</tbody>
</table>

Proposal

➢ Exempt advance tax on property transfers to/from a REIT Scheme u/s 236C & 236K.
➢ Remove sunset clause i.e. June 2023 for all categories of REIT.
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


6. GRANDFATHER PROVISION FOR TAX TREATMENT OF COMPANIES THAT LIST ON PSX

In view of strong structural reforms in the capital market, companies in Pakistan have immense potential to raise funds from the capital market. This will result in greater documentation of the economy and increased tax revenue. At the same time this will help to grow the capital markets, provide attractive investment opportunities and hence improve the savings and investment rates in Pakistan. Listed companies become part of the documented, regulated and formal corporate sector. Hence, PSX is continuously endeavoring to encourage listings.

Proposal

It is proposed that in order to encourage companies to list, their tax status should be grandfathered at the time of listing application i.e. no new cases for past tax returns should be opened, except for such pending cases on which proceedings have already been initiated under the Ordinance, before the date of listing application, will continue as per the provisions of law.

Rationale

It is well known that a large part of Pakistan’s economy is undocumented and a significant number of companies operate in the informal sector. This will encourage such companies, particularly SMEs, to become documented and start paying taxes, without the fear that past tax returns or lack of them will be questioned. Moving forward they will be documented and paying full tax. Hence, this will be a significant revenue positive measure.

Proposed Amendment

Part IV of Second Schedule of the Income Tax Ordinance, 2001 shall include the following clause:

"The provisions of section 122, section 176 and section 177 shall not be applicable to those taxpayers being companies which opt for enlistment on the Main or GEM Board of Pakistan Stock Exchange, except such pending cases on which the proceedings have already been initiated under the Ordinance, before the date of listing application, will continue as per the provisions of law."
7. 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

8. RATIONALIZE THE CURRENT TAX RATE ON DIVIDENDS

The tax rate is 25% in case of a person receiving a dividend from a company where no tax payable by such company due to exemption of income or carry forward of business losses or claim of the tax credit, thus 50% for non-filers which is more than normal tax regime of 29%. It is therefore proposed that the tax rate being exorbitant for such a category may be reduced.

Proposal

It is proposed that the tax rate on dividend be rationalized to incentivize small investors

Rationale

The dividend is paid out of the tax-paid income of the company, tax on dividend amounts to triple taxation of the same income. The present tax rate on the dividend is confiscatory in nature and has discouraged investment in stocks which in turn has slowed down the process of industrialization.

Proposed Amendment

➢ It is proposed to remove the following clause (d) under Division I, Part III of the First Schedule:

(d) 25% in case of a person receiving dividend from a company where no tax is payable by such company, due to exemption of income or carry forward of business losses under Part VIII Chapter III or claim of tax credits under Part X of Chapter III.
9. 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.
10. 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 towards 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 Payckwood–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.

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, RSIsAs 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.

RSIsAs 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 RSIsAs 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 Sukus.

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

Proposed Amendment


\[\text{Signature}\]
11. 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. 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

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 RSIA 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.