

Pakistan Stock Exchange Limited

**PSX
FEDERAL BUDGET PROPOSAL
2018-2019**



**ENABLING INVESTORS
DISCOVER NEW
GROWTH OPPORTUNITIES**

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PAKISTAN STOCK EXCHANGE LIMITED
FEDERAL BUDGET PROPOSALS 2018-19

INTRODUCTION

The Pakistan Stock Exchange (**PSX**), under its new ownership and management, is poised to play an effective role of helping the country achieve a sustained high growth rate through attracting investment, both from within the country, as well as that from abroad and channeling it not only to industry but towards infrastructure projects too.

In order to achieve its objectives, it wishes to present proposals for the Federal Government's Budget 2018. These proposals essentially focus on some impediments and disincentives that have crept in to the development of the capital market, as well as the documented corporate sectors.


All the proposals are primarily designed to remove the disincentives, the incidence of double and at times, multiple taxation, that are penalizing capital formation, which is so essential for Pakistan corporate 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 the PSX proposals is to increase the size and depth of the Capital Market by incentivizing listing of new capital without impacting the Government revenues. In view of the above, the Taxation Committee and Board of Directors are presenting the following proposals for the kind consideration of the Ministry of Finance and the Federal Board of Revenue.



EXECUTIVE SUMMARY

We are presenting following proposals for the Federal Budget 2018-19:-

Proposal No.	Description																				
1.	<p><u>RATIONALIZATION OF TAX ON BONUS SHARES</u></p> <p>i) The Finance Act, 2014 introduced 5% tax on the value of Bonus shares. The levy instead of generating more revenue drastically reduced the issuance of bonus shares and earned very insignificant revenue under this account. Prior to July, 2014 Seventy One (71) companies during the year ended on 30th June, 2014 declared Bonus Shares amounting to Rs. 19 billion; whereas from July 2014 till January, 2018, averaged annual declaration of Bonus share is about 4.0 billion.</p> <p>ii) This has resulted in significantly reducing of issuance bonus shares by listed companies, as a result of which, the government has not been able to generate any meaningful revenues under this account. Following is the detail of Revenues collected on Bonus Shares:-</p> <table border="1" style="margin-left: auto; margin-right: auto;"><thead><tr><th style="text-align: center;">Section</th><th style="text-align: center;">FY: 2014-15</th><th style="text-align: center;">FY: 2015-16</th><th style="text-align: center;">FY: 2016-17</th><th style="text-align: center;">FY: 2-17-18 (28-02-2018)</th></tr></thead><tbody><tr><td style="text-align: center;">236M (Listed Co's.)</td><td style="text-align: right;">240,637,743</td><td style="text-align: right;">460,857,399</td><td style="text-align: right;">785,229,082</td><td style="text-align: right;">437,129,642</td></tr><tr><td style="text-align: center;">236n (Private Co's.)</td><td style="text-align: right;">43,268,568</td><td style="text-align: right;">128,162,049</td><td style="text-align: right;">229,347,780</td><td style="text-align: right;">141,404,259</td></tr><tr><td style="text-align: center;">Total</td><td style="text-align: right;">283,906,311</td><td style="text-align: right;">589,019,448</td><td style="text-align: right;">1,014,576,862</td><td style="text-align: right;">578,533,901</td></tr></tbody></table> <p>We are of the view that abolishment of tax on Bonus share would bring a far reaching impact for the market participants resulting in increase of turnover as well as tax revenue.</p> <p>iii) There is an impression that due to tax on Bonus share, companies are distributing more cash dividend. In fact distribution of cash dividend as percentage of Profit after tax has not changed very much pre and post bonus tax period. Prior to July, 2014 the average annual payout was about 55%; whereas from 1st July 2014 to 31st December 2017 the average annual payout is 51%.</p> <p><u>Proposals</u></p> <p>i) <i>Tax on Bonus shares be abolished (Section 236M and 236N).</i></p> <p>ii) <i>Every public company for the purpose of distribution of at least forty percent of its after tax profits shall be entitled to issue bonus share upto 40% of total distribution of its after tax profit (Section 5A(1) of the Ordinance).</i></p> 	Section	FY: 2014-15	FY: 2015-16	FY: 2016-17	FY: 2-17-18 (28-02-2018)	236M (Listed Co's.)	240,637,743	460,857,399	785,229,082	437,129,642	236n (Private Co's.)	43,268,568	128,162,049	229,347,780	141,404,259	Total	283,906,311	589,019,448	1,014,576,862	578,533,901
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236M (Listed Co's.)	240,637,743	460,857,399	785,229,082	437,129,642																	
236n (Private Co's.)	43,268,568	128,162,049	229,347,780	141,404,259																	
Total	283,906,311	589,019,448	1,014,576,862	578,533,901																	

2.1.

TAX ON CAPITAL GAINS ON DISPOSAL OF SECURITIES UNDER SECTION 37A


- i) Prior to July, 2010 the capital gains on disposal of securities were fully exempt from tax. Stakeholders agreed for the imposition of Capital Gain Tax on short term trading of securities .The Finance Bill, 2010 imposed CGT in three tiers of holding period with progressive rates. However, amendments were brought by the Finance Act, 2012 and 2015 in respect of rate of tax and holding period.
- ii) The Finance Act, 2016 inadvertently modified and imposed tax irrespective of holding period at the rate of 7.5% instead of the stated intention of the Honorable Finance Minister, who in his budget speech stated that the maximum taxable holding period for Capital Gain on Securities may be extended from 4 to 5 years.
- iii) The frequent changes in Capital Gain Tax Regime is detrimental for growth of capital market and dampens the investors base since it discourages trading of securities and not helping in correct price discovery. The Foreign Institutional Portfolio Investment (**FIPI**) has also been negatively impacted. Prior to July, 2014 FIPI net buy (**Positive**) for the year ended on 30-06-2014 was over USD 256 million; whereas from July 2014 till February, 2018, the average annual FIPI net sell (**Negative**) was about USD 254 million.
- iv) That the CGT is not in line with the taxability on other asset class i.e. there is no tax on gain on disposal of immovable property, if the holding period is three years or more.

Proposal

We therefore propose that the following four tiers of holding periods and proposed rates of tax may please be prescribed:-

Period	Proposed Tax Rates for Tax Year 2019
Where holding period of a security is upto twelve months	10%
Where holding period of a security is more than twelve months and upto twenty four months	9%
Where holding period of a security is more than twenty four months and upto thirty six months	8%
Where holding period of a security is more than thirty six months	0%



<p>2.2.</p>	<p><u>TAX ON CAPITAL GAINS ON DISPOSAL OF SECURITIES BY THE FOREIGN INVESTORS</u></p> <p>It is observed that most of the countries of world do not impose capital gain on disposal of securities by the foreigners. Even in the region Bangladesh, Malaysia and many other countries do not levy CGT on transactions of disposal of securities conducted by the foreigners.</p> <p>One the important reason for not imposing such tax is that most of the countries have double taxation treaties. In Pakistan the foreign investors file their returns of income regularly and pay taxes in accordance with the provisions of the Income Tax Ordinance, 2001 or reduced rates provided under the treaties executed with such countries.</p> <p><u>Proposal</u> <i>It is proposed to exempt foreigners from collection of advance CGT by the National Clearing Company of Pakistan Limited.</i></p>
<p>3.</p>	<p><u>RATIONALIZATION OF TAXATION REGIME FOR BROKERS</u></p> <p>Prior to the Finance Act, 2016, advance tax at the rate of 0.01% of the value of purchase and sale of securities was collected under Section 233A of the Ordinance by PSX in lieu of brokers commission income. It was argued that this rate is very high, because it was charged on the value of securities traded in the market and result in huge refunds. It was demanded that the rate of advance tax be reduced to 0.005% of the value of purchase and sale value of securities traded.</p> <p>The Government vide Finance Act, 2016 instead of reduction in tax, doubled the advance rate of tax from 0.01% to 0.02% of the value of purchase & sales of securities and also made it the full and final tax liability of such tax in lieu of brokers commission income earned by them.</p> <p>This has adversely affected the cost of doing business of the brokerage industry. Moreover, according to an estimate, the aforesaid rate of 0.02% tax constitutes almost 60% of brokers' commission income, which is very excessive and harsh by any standard of imposition of tax.</p> <p><u>Proposals</u></p> <p><i>It is proposed that</i></p> <ul style="list-style-type: none"> <i>i) The rate of advance tax be reduced to 0.005% from the recently increased 0.02% of value of purchase and sale of securities; and</i> <i>ii) The advance tax so collected be adjustable instead of final.</i> 

4.1.	<p><u>TREATMENT OF UNREALIZED GAIN ON SALE OF IMMOVABLE PROPERTY TO A REIT SCHEME</u></p> <p>REITs worldwide play a significant role in the economic development of the country. In Pakistan it can achieve the Government's objective of documentation of the economy & real estate, enabling Government to generate appropriate tax revenues from the real estate sector.</p> <p>Prior to 01.07.2015 profits and gains (unrealized) accruing to a person on sale of immovable property to both the REIT Schemes (Development and Rental) were exempt from tax.</p> <p>However, the Finance Act 2015 inserted a proviso; whereby, this exemption restricted only to the profit and gains on sale of immovable property to a Development REIT Scheme up to thirtieth day of June, 2020, which resulted that no REIT Scheme has been launched after this amendment. The current limited exemption cripples REIT's potential and further development ultimately documentation has stopped and no tax has been generated from this avenue by the exchequer.</p> <p><u>Proposal</u> <i>The exemption available prior to the Finance Act, 2015 be restored and made available up to June 2025.</i></p>
4.2.	<p><u>INVESTMENT IN REIT BE TREATED AS INVESTMENT IN STOCK FUND</u></p> <p>Tax on dividend on Stock Funds (including by implication listed REIT funds) was applicable at 10%. However, the Finance Act, 2015, inadvertently inserted listed REIT Fund in the category of Money Market Funds or Fixed Income Funds; thereby imposing a higher rate of tax to dividends on listed REITs.</p> <p><u>Proposal</u> <i>The rate of tax on dividend by REIT Scheme should be similar to that applicable on stock funds (as REIT Funds are listed funds).</i></p>
5.	<p><u>TAXABILITY OF INTER CORPORATE DIVIDEND</u></p> <p>Globally inter-corporate dividends are tax free. This help in group companies to diversify their businesses and utilize the idle funds available in one group company to the new taxpaying venture. Under this concept the reinvestment becomes tax efficient.</p> <p>In Pakistan Inter-corporate dividends within the group companies were exempt from tax. However, the Finance Act, 2016 withdrew the exemption to inter-corporate dividend to such companies that fall within the scheme of section 59B availing group relief, which is tantamount to double and multiple taxation.</p> <p>In order to promote group formation and consolidation in Pakistan, it is imperative to exempt inter-corporate dividends. In return it would strengthen the overall corporate structure in Pakistan and will help holding companies to diversify and economically grow.</p> <p><u>Proposal</u></p> <p><i>i) Exemption to eligible groups under section 59B may be reverted to the position prior to the Finance Act, 2016; and</i></p> <p><i>ii) Tax collection on all inter-corporate dividends other than companies under group relief be considered as adjustable advance tax.</i></p>

6. **TAX CREDIT ON ENLISTMENT OF COMPANY ON THE STOCK EXCHANGE**

Background

In order to encourage new listings, the Finance Act, 2011 introduced Section 65C of the Ordinance; whereby tax credit equal to twenty per cent (20%) for the tax year in which a company opts for enlistment on the Stock Exchange was allowed. Currently the same is for four years from the date of listing subject to the condition that for the last two years the tax credit shall be 10% of the tax payable. **This tax credit is very insignificant** and not enough to attract new listing. Following is the detail of listing and delisting of Company in the last five years.

Particulars	Number of Companies	Capital (Rs.) *
New Listings	28	79,749 Million
Delisting	38	26,737 Million
Delisted due to Merger	9	141,948 Million

*As at 31st December 2017

It is generally observed that on enlistment of companies, their profits enhance substantially due to effective corporate governance, better corporate disclosure and availability of additional funds from the secondary market.

Proposal

Tax Credit of 20% may be allowed for five years from the tax year in which the company is listed.

7. **MARGIN FINANCING SYSTEM (MFS)**

Background

Following are the key features of MFS:

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

Proposal

It is proposed to reduce the rate of withholding tax on the gross income earned on MF transactions from 10% to 2.5%; OR the directly attributable expenditure incurred to earn income from MF transaction be allowed as admissible expenditure.

8. **REQUEST FOR CONSISTENT AND LONG TERM POLICIES**

We also feel that in order to provide confidence to the local and foreign investors and drive growth of capital market, long term taxation policy (at least for 3 years) for the Capital Market may be announced in the forthcoming national Budget 2018-2019.

1. RATIONALIZATION OF TAX ON BONUS SHARES

Background

- i) The Finance Act, 2014 introduced 5% tax on the value of Bonus shares as “Income from other sources”. The levy instead of generating more revenue drastically reduced the issuance of bonus shares and earned very insignificant revenue under this account. Following is the detail of number of Companies and approximate value of Bonus shares issued:-

Year	Number of Companies	Approx. Value (Rs.)
July 2013 to June 2014	71*	19.0 Billion
July 2014 to June 2015	17	3.4 Billion
July 2015 to June 2016	20	3.2 Billion
July 2016 to December 2016	12	1.0 Billion
January 2017 to January 2018	35	4.4 Billion

*Before levy of tax on Bonus Shares.

- ii) The levy has resulted in significantly reducing of issuance bonus shares by listed companies, as a result of which, the government has not been able to generate any meaningful revenues under this account. Following is the detail of Revenues collected on Bonus Shares:-

Section	FY: 2014-15	FY: 2015-16	FY: 2016-17	FY: 2017-18 (till date)
236M Listed Co's.	240,637,743	460,857,399	785,229,082	437,129,642
236N Private Co's.	43,268,568	128,162,049	229,347,780	141,404,259
Total	283,906,311	589,019,448	1,014,576,862	578,533,901

We are of the view that rationalization of the tax imposition from market value to face value would bring a reaching impact for the market participants resulting in increase of turnover as well as tax revenue.

- iii) There is an impression that due to tax on Bonus share, companies distribute more cash dividend. The following data does not confirm this impression. In fact distribution of cash dividend as percentage of Profit after tax has not changed pre and post bonus tax period:-



Exhibit: Dividend Income Tax

Year	Filers	Non-Filers	Total PBT (PKR mn)	Tax Collected (PKR mn)	Total PAT (PKR mn)	% Δ YoY	Total Dividend (PKR mn)	Payout
FY2011	10.0%	10.0%	624,364	218,527	405,837		210,686	52%
FY2012	10.0%	10.0%	646,191	226,167	420,024	3.5%	237,317	57%
FY2013	10.0%	10.0%	764,315	267,510	496,805	18.3%	273,243	55%
FY2014	10.0%	10.0%	884,886	300,861	584,024	17.6%	318,886	55%
FY2015	10.0%	15.0%	925,775	305,506	620,269	6.2%	359,326	58%
FY2016	12.5%	17.5%	857,204	274,305	582,899	-6.0%	305,568	52%
FY2017	12.5%	20.0%	980,632	303,996	676,636	16.1%	320,846	47%
1HFY17	12.5%	20.0%	486,734	150,888	335,847	-	187,843	56%
1HFY18*	15.0%	20.0%	459,190	137,757	321,433	-4.3%	156,445	49%

Source: AHL Research, * Excludes the PAT for the companies which have not announced the results for Dec-17.

Proposals

i) Tax on Bonus share be abolished (Section 236M and 236N).

ii) Sub-Section (1) of Section 5A of the Ordinance be substituted with the following:-

“For tax year 2017 and onwards, a tax shall be imposed at the rate of seven and a half percent of its accounting profit before tax on every public company, other than a scheduled bank or a modaraba, that derives profit for a tax year but does not distribute at least forty percent of its after tax profits within six months of the end of the tax year through cash or bonus shares:-

Provided that for tax year 2017, bonus shares or cash dividends may be distributed before the due date mentioned in sub-section (2) of section 118, for filing of a return:

Provided further that for tax year 2018 and onwards, every public company for the purpose of distribution of at least forty percent of its after tax profits shall be entitled to issue bonus share upto 40% of total distribution of its after tax profits.”

Rationale

Increase in trading volume due to declaration of bonus shares will generate additional revenues under the following heads:-

- Tax on brokers' activity;
- Capital Gain Tax on disposal of securities; and
- Capital Value Tax.

Proposed Amendments:

- Section 236M of the Ordinance be omitted.
- Section 236N of the Ordinance be omitted.



2.1. TAX ON CAPITAL GAINS ON DISPOSAL OF SECURITIES UNDER SECTION 37A

Background

- i) Prior to July, 2010 the capital gains on disposal of securities were fully exempt from tax. Stakeholders agreed for the imposition of Capital Gain Tax on short term trading of securities. The Finance Bill, 2010 imposed CGT in three tiers of holding period with progressive rates. However, amendments were brought by the Finance Act, 2012 and 2015 in respect of rate of tax and holding period.
- ii) The Finance Act, 2016 inadvertently modified and imposed tax irrespective of holding period at the rate of 7.5% instead of the stated intention of the Honorable Finance Minister, who in his budget speech stated that the maximum taxable holding period for Capital Gain on Securities may be extended from 4 to 5 years.
- iii) The frequent changes in Capital Gain Tax Regime is detrimental for growth of capital market and dampens the investors base since it discourages trading of securities and not helping in correct price discovery. The Foreign Institutional Portfolio Investment (FIPI) has also been negatively impacted. Following is the detail of FIPI for your kind consideration:-

S. No.	Period	FIPI Net Buy / (Sell) USD
1.	01-07-2013 – 30-06-2014	*256,167,743
2.	01-07-2014 – 30-06-2015	38,542,251
3.	01-07-2015 – 30-06-2016	(281,629,612)
4.	01-07-2016 – 30-06-2017	(652,093,767)
5.	01-07-2017 – 28-02-2018	(81,381,681)

*Prior to imposition of major change in holding period and rate of tax.

- iv) That the CGT is not in line with the taxability on other asset class i.e. there is no tax on gain on disposal of immovable property, if the holding period is three years or more.



The Comparative chart in respect of frequent changes in holding period and tax rate for the Tax Years 2011 to 2018 is given below for the ready reference:-

S. No.	Period	Tax Year 2011	Tax Years 2012, 2013 & 2014	Tax Year 2015	Tax Year 2016	Tax Year 2017		Tax Year 2018 Securities acquired before 01-07-2016		Tax Year 2018 Securities acquired after 01-07-2016	
						Filer	Non-Filer	Filer	Non-Filer	Filer	Non-Filer
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1.	Where holding period is less than six months.	10%	10%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2.	Where holding period is more than six months, but less than twelve months.	7.5%	8%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
3.	Where holding period of a security is less than twelve months.	N/A	N/A	12.5%	15%	15%	18%	15%	18%	15%	20%
4.	Where holding period of a security is twelve months or more, but less than twenty-four months.	0%	0%	10%	12.5%	12.5%	16%	12.5%	16%	15%	20%
5.	Where holding period of a security is twenty-four months or more, but the security was acquired on or after 1 st July, 2013.	0%	0%	0%	7.5%	7.5%	11%	7.5%	11%	15%	20%
6.	Where the security was acquired before 1 st July, 2013.	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%

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S. No	KSE 100 INDEX Period	34,399	37,784	46,569		
		Tax Year 2015	Tax Year 2016	Tax Year 2017		
				Filer	Non-Filer	Total
1.	Where holding period of a security is less than twelve months.	11,252,323,947 (78%)	8,103,352,102 (62%)	9,062,887,071	3,088,552,650	12,151,439,721 (47%)
2.	Where holding period of a security is twelve months or more, but less than twenty four months.	3,203,157,629 (22%)	2,291,011,967 (17%)	7,331,008,018	2,173,488,278	9,504,496,297(37%)
3.	Where holding period of a security is twenty four months or more, but the security was acquired on or after 1 st July 2012.	-	2,705,143,661 (21%)	3,288,146,505	805,998,083	4,094,144,588 (16%)
4.	Where the security was acquired before 1 st July 2012	-	-	-	-	-
	Gross CGT for the period	14,455,481,576 (100%)	13,099,507,729 (100%)	19,682,041,594	6,068,039,011	25,750,080,605 (100%)
	CGT adjusted due to losses	7,333,873,794	6,879,715,682			8,635,619,571
	Net CGT for the period	7,121,607,782	6,219,792,047			17,114,461,034

S No.	Period	Tax Year 2018		
		Filer	Non Filer	Total
		-----Amount in Rupees-----		
1	Securities were acquired after 01.07.2016	1,896,833,119 (63%)	419,432,396 (68%)	2,316,265,515 (64%)
2	Securities were acquired before 01.07.2016 and holding period of security is twelve months or more but less than twenty-four months	604,643,444 (20%)	68,022,248 (11%)	672,665,692 (18%)
3	Securities were acquired before 01.07.2016 and holding period of a security is twenty - four months or more but the security was acquired on or after 1st July, 2013.	522,769,013 (17%)	126,422,999 (21%)	649,192,012 (18%)
	Gross CGT for the period July 2017 till December 2017	3,024,245,576 (100%)	613,877,643 (100%)	3,638,123,219 (100%)
	CGT adjusted due to losses			2,504,967,340
	Total Net CGT for the period July 2017 till December 2017		1,133,155,879	

Proposal

We therefore propose that the following four tiers of holding periods and proposed rates of tax may please be prescribed:-

Period	Proposed Tax Rates for Tax Year 2019
Where holding period of a security is upto twelve months	10%
Where holding period of a security is more than twelve months and upto twenty four months	9%
Where holding period of a security is more than twenty four months and upto thirty six months	8%
Where holding period of a security is more than thirty six months	0%

Rationale

Capital Gain from short term trading is generating about 64% tax on Capital Gain. Present rate of 15% is very high, because no expenses are allowed against such income nor the unadjusted losses are allowed to carry forward.

Proposed amendment

In Division VII, Part I of the First Schedule, the following new table shall be inserted in place of existing table –

“TAX YEARS 2019, 2020 & 2021

S. No.	Period	Tax Rate
1	Where holding period of a security is upto twelve months	10%
2	Where holding period of a security is more than twelve months and upto twenty four months	9%
3	Where holding period of a security is more than twenty four months and upto thirty six months	8%
4	Where holding period of a security is more than thirty six months	0%



2.2. TAX ON CAPITAL GAINS ON DISPOSAL OF SECURITIES BY THE FOREIGN INVESTORS

It is observed that most of the countries of world do not impose capital gain on disposal of securities by the foreigners. Even in the region Bangladesh, Malaysia and many other countries do not levy CGT on transactions of disposal of securities conducted by the foreigners.

One of the important reasons for not imposing such tax is that most of the countries have double taxation treaties. In Pakistan the foreign investors file their returns of income regularly and pay taxes in accordance with the provisions of the Income Tax Ordinance, 2001 or reduced rates provided under the treaties executed with such countries.

It has been observed that internationally no withholding tax is applicable on Capital gains; however CGT is applicable once on annual basis. Following are the examples:-

- Capital Gain Tax in United Kingdom

Companies shall be chargeable to corporation tax in respect of chargeable gains accruing to them. Capital gains shall be charged on the total amount of chargeable gains accruing to the person chargeable in the year of assessment, after deducting any allowable losses accruing to that person in that year of assessment.

An individual shall not be chargeable to capital gains in respect of so much of his taxable amount for any year of assessment as does not exceed the exempt amount for the year. The exempt amount for any year of assessment is UK Pounds 5,500.

The rate of capital gains tax in respect of gains accruing to a person in a year of assessment is equivalent to the basic rate of income tax for the year. If income tax is chargeable at the higher rate in respect of any part of the income of an individual for a year of assessment, the rate of CGT in respect of gains accruing to him in the year shall be equivalent to the higher rate.

Capital gains tax assessed on any person in respect of gains accruing in any year shall be payable by that person on or before 1st December following the end of that year ,or at the expiration of a period of 30 days beginning with the date of the issue of the notice of assessment , whichever is the later.

- Capital Gain Tax in Singapore

Singapore does not tax capital gains.

Proposal

It is proposed to exempt foreigners from collection of advance CGT by the National Clearing Company of Pakistan.



Rationale

- i) It would be beneficial 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 Capital market.

3. RATIONALIZATION OF TAXATION REGIME FOR BROKERS

Prior to the Finance Act, 2016, advance tax at the rate of 0.01% of the value of purchase and sale of securities was collected under Section 233A of the Ordinance by PSX in lieu of brokers commission income. It was argued that this rate is very high, because it is charged on the value of securities traded in the market and result in huge refunds. It was demanded that the rate of advance tax be reduced to 0.005% of the value of purchase and sale value of securities traded.

The Government vide Finance Act, 2016 instead of reduction in tax, doubled the advance rate of tax from 0.01% to 0.02% of the value of purchase & sales of securities and also made it the full and final tax liability of such tax in lieu of brokers commission income earned by them.

This has adversely affected the cost of doing business of the brokerage industry. Moreover, according to an estimate, the aforesaid rate of 0.02% tax constitutes almost 60% of brokers' commission income, which is very excessive and harsh by any standard of imposition of tax.

Proposals

It is proposed that

- i) The rate of advance tax be reduced to 0.005% from the recently increased 0.02% of value of purchase and sale of securities; and*
- ii) The advance tax so collected be adjustable instead of final.*

Rationale

- i) At present the tax implication on gross commission earned is over 30% whereby it should be 30% over net commission earned so therefore if the expenses incurred to earn commission is 50% then this tax @ 0.02% becomes over 60% on net commission earned thereby justifying the reduction to 0.005% of the value trade and making it adjustable against tax liability.



ii) Collection of advance tax on sale and purchase of securities is given below:

Description	July 16-June 17	July 17-Jan18
	Rs. In million	
Advance tax on sale & purchase of shares	1,974	749

Proposed Amendments

(i) In Division IIA, Part IV of the First Schedule the following table shall be substituted for the existing table –

S. No	Description	Rate
(1)	(2)	(3)
1.	In case of purchase of shares as per clause (a) of sub-section (1) of section 233A.	0.005% of purchase value
2.	In case of sale of shares as per clause (b) of sub-section (1) of section 233A.	0.005% of sale value

(ii) In Sub-Section (2) of Section 233A the word “Final” shall be substituted with “Adjustable”.

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

REITs worldwide play a significant role in the economic development of the country. In Pakistan it can achieve the Government’s objective of documentation of the economy & real estate, enabling Government to generate appropriate tax revenues from the real estate sector.

Prior to 01.07.2015 profits and gains (unrealized) accruing to a person on sale of immovable property to both the REIT Schemes (Development and Rental) were exempt from tax.

However, the Finance Act 2015 inserted a proviso; whereby, this exemption restricted only to the profit and gains on sale of immovable property to a Development REIT Scheme up to thirtieth day of June, 2020, which resulted that no REIT Scheme has been launched after this amendment. The current limited exemption cripples REIT’s potential and further development ultimately documentation has stopped and no tax has been generated from this avenue by the exchequer.

Proposal

The exemption available prior to the Finance Act, 2015 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 Ordinance for the word “2015” shall be substituted by “2025”.
- ii) In Clause (99A), Part I, Second Schedule to the Ordinance 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 upto thirtieth day of June, 2025”.

4.2. INVESTMENT IN REIT BE TREATED AS INVESTMENT IN STOCK FUND

Tax on dividend on Stock Funds (including by implication listed REIT funds) was applicable at 10%. However, the Finance Act, 2015, inadvertently inserted listed REIT Fund in the category of Money Market Funds thereby imposing a higher rate of tax to dividends on listed REITs.

Proposal

The rate of tax on dividend by REIT Scheme should be similar to that applicable on stock funds (as REIT Funds are listed funds).

Rationale

Total tax payment to the government if a Company invests in real estate through REITs is 125% higher, had the Company invested directly in real estate. Even if the taxation on dividend received by Company is reduced to 12.5%, the overall tax payment to the government will still be higher than had the Company invested directly in real estate.

Proposed Amendments

- i) In the first proviso of Part I – Division III of the First Schedule to the Ordinance, the words “or REIT Scheme” be added after the word “Stock Fund”.
- ii) In the second proviso of Part I – Division III of the First Schedule to the Ordinance the word “REIT Scheme” be deleted.
- iii) The third proviso of Part I – Division III of the First Schedule to the Ordinance be substituted with the following proviso:-

“Provided also that if the REIT Scheme is set up on or before thirtieth day of June, 2019, tax imposed on dividend received by a person from such REIT Scheme shall be reduced by fifty percent for three years from thirtieth day of June, 2019.”

5. TAXABILITY OF INTER CORPORATE DIVIDEND

Globally inter-corporate dividends are tax free. This help in group companies to diversify their businesses and utilize the idle funds available in one group company to the new taxpaying venture. Under this concept the reinvestment becomes tax efficient.

In Pakistan Inter-corporate dividends within the group companies were exempt from tax. However, the Finance Act, 2016 removed the words “or section 59B” from the Clause 103A, Part I, Second Schedule of the Income Tax Ordinance, 2001 and withdrew the exemption to inter-corporate dividend to such companies that fall within the scheme of section 59B availing group relief, which is tantamount to double and multiple taxation.

In order to promote group formation and consolidation in Pakistan, it is imperative to exempt inter-corporate dividends. In return it would strengthen the overall corporate structure in Pakistan and will help holding companies to diversify and economically grow.

Proposal

- i) Exemption to eligible groups under section 59B may be reverted to the position prior to the Finance Act, 2016; and
- ii) Tax collection on all inter-corporate dividends other than companies under group relief be considered as adjustable advance tax.

6. TAX CREDIT ON ENLISTMENT OF COMPANY ON THE STOCK EXCHANGE

Background

In order to encourage new listings, the Finance Act, 2011 introduced Section 65C of the Ordinance; whereby tax credit equal to twenty per cent (20%) for the tax year in which a company opts for enlistment on the Stock Exchange was allowed. Currently the same is for four years from the date of listing subject to the condition that for the last two years the tax credit shall be 10% of the tax payable. **This tax credit is very insignificant** and not enough to attract new listing. Following is the detail of listing and delisting of Company in the last five years.

Particulars	Number of Companies	Capital (Rs.) ^{2*}
New Listings	28	79,749 Million
Delisting	38	26,737 Million
Delisting due to Merger	9	141,948 Million

As at 31st December 2017

It is generally observed that on enlistment of companies, their profits enhance substantially due to effective corporate governance, better corporate disclosure and availability of additional funds from the secondary market.

Proposal

Tax Credit of 20% may be allowed for five years from the tax year in which the company is listed.



Rationale

- i) It is generally observed that on enlistment of companies, the profits of the companies have enhanced substantially due to effective corporate governance, better corporate disclosure and availability of additional funds.
- ii) The incremental benefits to revenue due to above factors and increase in volumes shall be as follows:-
 - a) Tax on Companies' income;
 - b) Tax on brokers activity on new listings;
 - c) Capital Gain Tax on disposal of newly listed securities; and
 - d) Capital Value Tax.
- iii) Furthermore, with the government's increase in pace of privatization of its entities, the stock market will attract local and foreign investors and will increase the market size. The average rate of tax in Asian region is 20.05%; whereas, currently in Pakistan due to multiplicity of the taxes for the corporate sector, it goes up to 37% (30% normal tax + 2% Workers' Welfare Fund + 5% Workers' Participation Fund). As such it is imperative that the corporate tax rates after above tax credit are 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
Africa	29.0	28.3	27.9	27.9	27.5	28.73
Asia	22.9	22.1	21.9	22.6	21.9	20.05
Europe	20.4	20.6	19.7	20.1	20.5	18.35
Oceania	28.6	27.0	27.0	27.0	26.0	23.67
North America	33.0	33.0	33.3	33.3	33.3	23.08
OECD	25.2	25.3	24.1	24.9	24.8	24.18
Global	24.4	23.7	23.6	23.9	23.6	22.96

Proposed Amendment

In section 65C, the phrase "following three tax years" be substituted with the phrase "following four tax years".



7. MARGIN FINANCING SYSTEM (MFS)

Background

Following are the key features of MFS:

- Margin Financing (MF) facility is made available to all Members against net ready market purchases of their clients and proprietary positions.
- MF can be obtained as per agreed Financier Participation Ratio (FPR). However, minimum of 25% or VaR whichever is higher should be contributed by Finanee.
- Financing terms and conditions are pre-determined by Margin Finanee and Margin Financier.
- NCCPL provides a system to MF Participants for recording and settlement of MF Transactions.
- Margin financing facility is made available only in Eligible Securities notified by the SECP.
- All MF Transactions are based on counterparty risk in a disclosed manner.
- NCCPL manages risk management of Financier until settlement of MF transaction.
- Financier will manage RMS of Finanee directly.
- Securities are delivered in the MF Blocked CDS A/C of Financier.
- Presently rate of tax on the gross income of the Financier is 10% without deduction of any expenditure to earn such income. Whereas, in most of the cases the funds are borrowed from financial institution for such MF transactions.

The cost involved in MFS 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% or the directly attributable expenditure incurred to earn income from MF transaction be allowed as admissible expenditure.

Rationale

This will help develop the market and will increase tax collection by FBR because 10 years back the size of similar market was many times higher.

8. REQUEST FOR CONSISTENT AND LONG TERM POLICIES

We also feel that in order to provide confidence to the local and foreign investors and drive growth of capital market, long term taxation policy (at least for 3 years) for the Capital Market may be announced in the forthcoming national Budget 2018-2019.

