BUDGET RED-EYE 2017

KEY MEASURES

Serendipitously, the macro indicators highlighted in last year's Red Eye, by and large remained on track, perhaps indicating a stable performance at the macroeconomic level.

- GDP growth increased to 5.3% on the back of a much improved performance by the agricultural sector, primarily important crops.
- Per capita income increased to US$ 1, 629 compared with US$ 1, 531 last year.
- CPI inflation, while it increased to 4.09% compared with 2.79% last year, was kept under control.
- Tax collection increased, while much less than last year, increased by 8%.
- The government asserts that the fiscal deficit will remain on the downward trajectory observed over recent years; it was 4.6% last year.
- Record low State Bank of Pakistan policy rate retained at 5.57%.
- Exchange rate held stable for fourth year in succession at around US$ 1 = Rupees 104.7.
- PSX index crossed the dizzying height of 52000
- And Foreign Exchange Reserves are maintained at US$ 21 billion; albeit down from the record of US$ 24 billion at the end of October 2016.

Perhaps worryingly, dark clouds continue to gather on the economic horizon. The current account deficit reached an alarming level of US$ 7.25 billion primarily due to an increasing trade deficit and declining workers remittances. Trade deficit on goods, services and primary income stood at US$ 25.9 billion for the period ended July to April 2017; primarily because of declining exports. Workers remittances have fallen by around 2.8% and amounted to US$ 15.6 billion during this period; the government remains optimistic of meeting the target of US$ 20 billion.

Consequently, Pakistan's total external debt and liabilities stood at US$ 75.7 billion at 31 March 2017. Moody's predict that by June 2017, external debt might reach to US$ 79 billion.

The governments focus on infrastructure, including CPEC, has largely contributed to the "Feel Good" perception across the country, and arguably remains the primary contributor in the GDP growth, except that it has a cost. Pakistan's total debt and liabilities stand at a record RS 23.9 trillion at the end of March 2017.

Undoubtedly, the government now needs to focus attention on savings, which have declined to 13.1% as a percentage of GDP; and even more on investment in manufacturing sector. And perhaps, on top of all that, the need of the hour is educating Pakistan.

Irrespective, in accordance with the government's stated vision, arguably the highlight of the Budget 2017-18 is increase in the size of Federal PDSP to over Rs. 1 trillion compared with Rs. 715 billion last year. Further, as expected in an election year, taxation measures are focused towards the voting public, and the net increase in the budget outlay has been kept at Rs. 262 billion only; roughly the size of the increase in Federal PSDP.

Accordingly, the government expects to curtail all other expenditure, including debt servicing on an increased debt balance, at exactly last year's level. This by any standard will be a tall order, considering the numerous proposals announced in the budget speech which include incentive schemes for agriculture, the textile sector, housing and infrastructure, SMEs and IT; and significant increase in defense spending public sector salaries. Except, even if the government succeeds in this difficult balancing act, Pakistan's total debt and liabilities are envisaged to increase by an amount comparable with last year; if not more.

INCOME TAX

- Super tax at 4% on banking companies and at 3% on persons other than banking companies earning more than Rs. 500 million, imposed during tax year 2015, extended to 2016, now extended to tax year 2017.

- Section 5A has been substituted perhaps with a view to rationalize tax on undistributed profits. Henceforth, a listed company which distributes at least 40% of its profits as dividend, in the form of cash or bonus shares, will escape the provisions of this section. In other cases tax will be levied at 10%.

- Last year's sections 7C and 7D were enacted, thereby introducing concessionary tax regimes for builders and developers. The bill envisages to withdraw this regime except where projects stand approved by the Chief Commissioner in tax year 2017. Presumably, subsequently such projects will be taxed under the normal tax regime which is likely to open a Pandora's box for the real estate sector; key driver of GDP growth.

- Tax credit of 3% of tax payable available to manufacturers whose 90% of sales were to persons registered under the Sales Tax Act, pursuant to the provisions of Section 65A is proposed to be withdrawn.

- Tax credit of 20% of tax payable for 2 years available to companies which had opted to get listed on the stock exchange under section 65C has now been extended for another year except that this rate has been reduced to 10% for the last two years.

- The bill proposes to introduce a fourth condition in section 100C for Non Profit Organizations (NPO). Henceforth, where administration and management expenses exceed 15% of total receipts, the NPO will not qualify for tax credit under this section. Further, the bill proposes to tax surplus funds at 10%. Surplus funds are defined as receipts in excess of 25% of total receipts and not spent on charitable and welfare activities, baring restricted funds.

- The bill proposes to do away with provisional assessments in case of non-filing of return; henceforth these will be assessed under section 121, Best Judgment Assessment.

- Pursuant to the recent decision of the honorable Supreme Court in case of service fee retained by agents, the bill proposes to amend section 153(1). Accordingly, tax will be required to be withheld even in cases where the agent or service provider remits net revenue to the principal. This amendment will effect media houses as well as utility bill recovery agents.

- The bill proposes to reintroduce the option of advance ruling for non-residents having Permanent Establishment in Pakistan, which was earlier withdrawn in 2011

- Tax on dividend is proposed to be increased from 10% to 15%. Tax on dividend from mutual funds is proposed to be increased from 10 to 12.5%.

- Tax incidence on capital gains on securities is proposed to be enhanced by prescribing flat tax rate of 15% for filers and 20% for non-filers as against existing three tier slab rates based upon holding period of security.

- Tax rates on profit on debt are proposed to be enhanced by modifying slab rates. The proposed rates are 10% where profit does not exceed Rs. 5 million, 12.5% where profit is between Rs. 5 million and Rs. 25 million, and 15% where profit exceeds Rs. 25 million.

- The bill proposes tax exemption for 3 years, including exemption from minimum tax and withholding taxes on receipts, in case of such companies, individuals or partnerships offering technology driven products and are certified by the Pakistan Software Export Board.

- Benefit of clause (94) of part IV of the Second Schedule, providing for carry forward of tax withheld on service fee receipts, is proposed to be extended to tax year 2018.

- The bill proposes to enhance withholding tax rates ranging from 1% to 5% for non-filers on payments relating to construction and allied services, sale of goods, rendering of services, execution of contracts, property rent, prize bonds and winnings, and on commissions of petrol pump operators.

- Minimum Tax rate for individuals, AOPs and companies enhanced from 1% to 1.25%

- Depreciation on co-owned assets under musharika financing arrangements allowed to tax payers to bring them at par with conventional banking.

- Deductibility threshold of sales promotion etc. expenses to pharmaceutical manufacturers enhanced from 5% to 10% of turnover

- Threshold of deductible allowance for education expenses enhanced from Rs. 1.0 million to Rs. 1.5 million in case of individual tax payers.

SALES TAX

- Provisions relating to taxation of retailers, previously included in Special Procedure Rules 2007 are now proposed to be made part of the Sales Tax Act. This appears to be a housekeeping amendment in substance, pursuant to a decision by the Honorable Lahore High Court. The provisions by and large are the same.

- The bill proposes to impose a 2% further tax on zero rated supplies, except where such supplies are made to persons registered under the Sales Tax Act.

- The bill proposes to introduce strict penalties on manufacturers and transporters of counterfeit cigarettes, including confiscation of related plants and vehicles. However, the benefits of this amendment lie in its prospective implementation. The intent perhaps is to address the decline in taxes recovered on tobacco sales.

- To harmonize procedural matters with Income Tax laws, the bill proposes to allow stay on balance tax recovery, if 25% of tax has been paid and appeal has been filed with Commissioner (Appeals).

- Subject to conditions, primarily in the case of any fertilizer not manufactured from imported LNG, various types of fertilizer supplies have been moved from the Third Schedule to the Eight Schedule.

  The net impact is reduction in Sales Tax from ad valorem 17%. This is in line with the announced policy of maintaining cost of fertilizer for farmers at current levels to support agriculture. Sales tax on supply of natural gas to fertilizer plants has also been reduced to 10% under the same policy.

- The bill proposes to reduce sales tax on all poultry related machinery and equipment to 7% from 17%.

- The bill proposes to increase the amount of Sales tax on import, supply and registration of low priced cellular mobile phones from Rs. 300 to Rs. 650. At the same time Sales tax on supply of medium priced mobile phones is proposed to be reduced from Rs. 1,000 to Rs. 650..

- The bill proposes to exempt sunflower and canola hybrid seeds, combined harvesters upto five years old and agriculture diesels engines from Sales tax.

- According to the Budget speech, there is a proposal to increase Sales Tax on steel from existing rate of Rs. 9 per unit of electricity to Rs. 10.5 per unit of electricity.

FEDERAL EXCISE DUTY

- As in the case of Sales Tax, the bill proposes to introduce strict penalties on manufacturers of counterfeit cigarettes, including confiscation of related plant and machinery.

- As in the case of Sales Tax, in order to harmonize tax laws, the bill proposes to allow stay on balance FED recovery, if 25% of tax has been paid and appeal has been filed with Commissioner (Appeals). However, in this case the existing provision of depositing 15% of the liability to avail stay on balance recovery for a period of six months has not been deleted. This might create anomalous situations.

- FED on various categories of cigarettes has been further increased. Already there is a declining trend in collection of FED on cigarettes which suggests that the government is on the wrong side of Laffer curve. However, perhaps the government is counting on strict implementation of the penalty clauses on manufacture of counterfeit cigarettes introduced in both FED and Sales Tax.

- Duty on cement is proposed to be increased to Rs. 1.25 per KG from the current Rs 1 per KG. While seemingly a nominal change, this may have an inflationary impact on the housing sector.

- FED on telecommunication services in the Federal territory is proposed to be reduced from 18.5% to 17%.

Karachi Office:
Abdul Rauf
Executive Director

Tel: +92 21 3568 5847
abdulrauf@kpmg.com

Sheikh Sultan Trust Bldg. No. 2
Beaumont Road
Karachi-75530

Islamabad Office:
Faisal Banday
Partner
Tel: +92 51 282 3558
faisalbanday@kpmg.com
Sixth floor, State Life Building
Blue Area, Islamabad

Lahore Office:
Kamran I. Butt
Partner
Tel: +92 42 3585 0471-6
kamranbutt@kpmg.com
53 L Gulberg-III, Lahore

This document contains significant highlights of the budget 2017.

The amendments in taxation laws are generally applicable from 01 July 2017, unless otherwise stated. This document contains comments, which represent our interpretation of the legislation, and we recommend that while considering their application to any particular case, reference be made to the specific wordings of the relevant statutes.