Icon Capital Management pvt ltd

PAKISTAN
FY16 BUDGET PREVIEW
MAY 2015

What to Expect from this Budget:

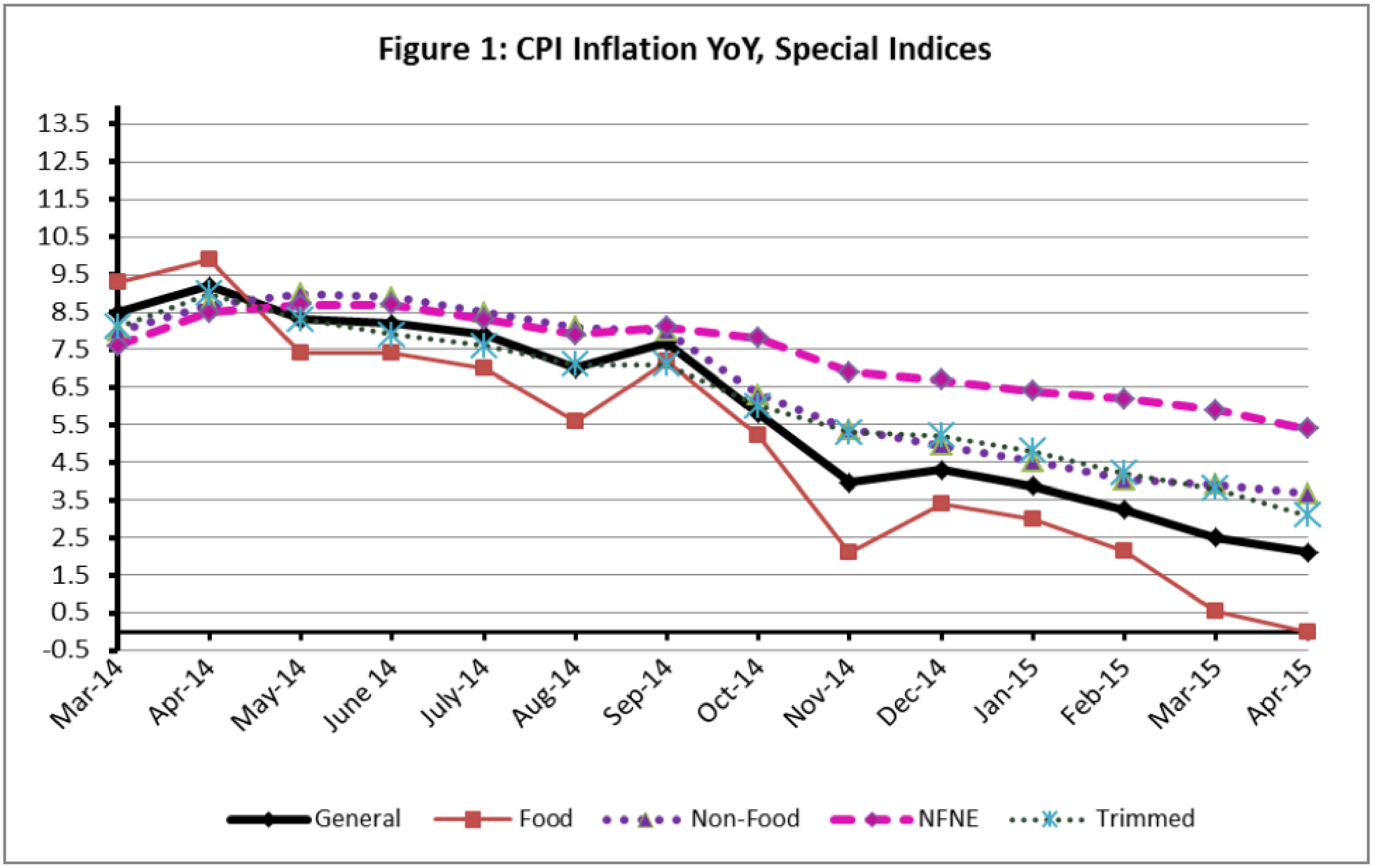
Current Year Summary

Government of Pakistan is set to announce its budget on 5th of Jun-2015. The government has projected a GDP growth rate of 5.5% for 2015-16 backed by projected growth of 3.9% in agriculture, 6.4% industry (with 6 % in LSM, 8.3% in small and household, 8.5%in construction industry and 6% in electricity generation and gas distribution), and 5.7% in services, according to an official document. The government is projecting a growth of 15.2% in indirect taxes in 2015-16 budget.
It is loud and clear that Government has and will take aggressive steps to fasten the economy. An example of this would be the much appreciated step by recently reducing interest rate by 100 basis point, which now stands at 7%.

Macro-Economic Indicators Representing a Brighter View:

Economists are beginning to see light at the end of the tunnel. It is suggested that FY 15/16 would be reviving year for the country because conditions are becoming much better at Macro level & country like Pakistan which was struggling to sustain required growth now hold all the aces to achieve targets.

- Current Account deficit narrowed down amid low oil imports and higher inward remittances (up 14%YoY), significantly below target inflation (average 4.8% in 10MFY15).
- Marginal uptick in real GDP growth of 4.14 from 3.7 percent and Foreign exchange reserve buildup (US$16662M vs. US$12183M).
- Inflation is also moving towards declining trend and now standing at 3.1 from 8.7.



Positive news to look for!!

China–Pakistan Economic Corridor

- Gwadar Port: Completed: Handed over to China for 40 years starting 2015.
- Upgrading of Karachi–Peshawar Main Line: Feasibility study underway.
- Khunjerab Railway: Feasibility study underway
- Karachi - Lahore Motorway (KLM): Approved, Construction to begin 2015
- Havelian to Khunjrab Rail track: Approved
- Hazara Motorway: Under construction
- Iran–Pakistan gas pipeline: Under construction, Iran's part of the pipeline is complete.
- Gwadar-Ratodero: Under construction, approx. 820-km long, expected completion Dec, 15
- Havelian Dry Port: Feasibility study underway for the container port
- Orange Line (Lahore Metro): Approved
- Upgrading of Gwadar International Airport: Approved
- China-Pakistan Joint Cotton Bio-Tech Laboratory: Approved
- Gwadar-Nawabshah LNG Terminal and Pipeline Project: Approved
- 70 MW Hydro-Electric Suki Kinari Hydropower Project: Approved
- Port Qasim 2x660MW Coal-fired Power Plant: Approved
- 720MW Karot Hydropower Project: Approved
- Zonergy 9x100 MW solar project in Punjab: Approved
- Jhimpir wind Power project: Approved
- Thar Block II 3.8Mt/a mining Project: Approved
- Thar Block II 2x330MW Coal Fired Power project: Approved
- Development of Private Hydro Power Projects: Approved
- Dawood Wind Power project: Approved
- Hubco Coal-fired Power Plant Project: Approved
- Cross-border fiber optic data communication system project, a digital terrestrial multimedia broadcast pilot project at Murree: Approved

Energy:

One of the main problems faced by the country is ongoing energy crises. These crises resulted in many losses for the production companies in Pakistan. As per election manifesto of current government, they are putting many genuine efforts. Following are the projects that are in pipeline.

- The Hebei-based unit of PowerChina (SHA: 601669) last week officially initiated the construction of the 49.5-MW Dawood wind power plant in Pakistan's province of Sindh.
- MUNDA DAM PROJECT: If completed this would help in Hydropower generation of 740 MW, Flood Control, and Irrigated Agriculture development of 15,100 Acres command Area.
- AKHORI DAM: Hydel Power Potential of 600MW (2155Gwh/Annum).
- KURRAM TANGI DAM PROJECT: Power Generation (5 Power Houses) 83.4 MW (350 GWh)
- The minister said that the government would prioritize development projects to provide the necessary financing for the 3,600MW LNG-based projects. Other than the LNG power project only one coal based power project at Jamshoro financed by Asian Development Bank has been kept in the PSDP of the next fiscal year.

Completion of these projects on time could add value to eliminate current energy, water, and irrigation problems in many areas of Pakistan**.**

Karachi stock Exchange Proposal:

Karachi Stock Exchange has put the proposal to encourage listing of companies:-

1. **Reduced rate of taxes for listed companies**

   The Finance Act, 2014 had reduced corporate tax rate from 34% to 33% for all the listed companies. In upcoming budget, KSE once again keeping in view the regional and global rates suggested to reduce tax rate to 25%. Our point of view is that Government may reduce the tax rate by 5% to promote business activity.

   The capital market is under a process to introduce companies on SME board. It is proposed that reduced rate of tax for such listed companies be introduced i.e. 15% to 20% which will results in broadening of tax base hence, will eventually increase tax revenue.

2. **Tax Credit on Listing on Stock Exchange**

   Presently the tax credit equals to 15% of the tax payable is available for the tax year to the companies opting for enlistment in a registered stock exchange in Pakistan. KSE has proposed that this should be allowed up-to five years from the tax year in which company listed.

3. **Compulsory Distribution of dividend by the listed companies**

   Finance Act, 1999-2000 made it compulsory for the listed companies with free reserves of more than 40% of its paid-up capital to distribute at least 50% of its taxed profit as cash dividend. KSE has proposed to reintroduce compulsory distribution of dividend by the listed companies in the coming budget. This will definitely add value to investors but companies might resist to this proposal this is why it is highly unlikely that this would happen.

4. Capital Gain Tax on disposal of securities

Prior to 1st day of July 2010 the capital gain on disposal of securities were fully exempt from tax and after extensive deliberation between the Government and the Capital market stakeholder, it was agreed that there will be three tiers of holding periods. KSE recommended the following with three tiers of holding periods with proposed rates-

Period	Tax Year	Existing Tax	Proposed
Less than six months	2015	12.5%	12.5%
More than six months less than twelve months	2015	12.5%	10.0%
More than twelve months but less than twenty four months	2015	12.5%	0%
Equal to or more than twenty four month	2015	0%	0%

5. CGT may reduce to 10% but the exemption of CGT on long term holdings may be withdrawn.

It is proposed in the Finance Act 2014 that the value of Bonus shares shall be taxable as “Income from other source”. Since the value of bonus shares, the amount of any bonus declared, issued or paid by a company to its shareholder is not “Income” at all and it is just an accounting treatment. Therefore it tax on bonus share should be withdrawn.

Government is likely to withdraw tax on bonus as per our expectation.

6. Withholding tax on capital gains earned by non residents who are exempt under the double taxation agreement

It is proposed that NCCPL should not withhold the Capital Gain Tax from those foreign institutional investors who are NTN holder and appearing on the Active Taxpayers List.

7. Tax on Inter Company Dividend

Tax on intercompany dividend which is in fact is a double or multiple taxations. When company earns profit it pays tax at 33% before distributing dividend to its corporate share holders, at the time of distribution of dividend to its shareholders, it further withholds tax at the rate of 10% on such dividend. It is therefore proposed by the Karachi stock exchange that dividend paid by the company to another company be exempted from tax

FY16 Budget Preview:-

Government Representative Statements Indications.

- It is obvious from the statements of Government representative & Prime minister himself that Government has complete focus on Economic growth, fiscal consolidation, energy reforms and infrastructure development. This focus would form the picture of Federal Budget.
- According to the statements of government spoke person the government has decided to fix the next fiscal year PSDP at Rs 580 billion and revenue collection target is being set at Rs 3,100 billion as compared to the budgetary target of Rs 2,810 billion for the current fiscal year. After a shortfall of Rs 205 billion, the target has been revised downward to Rs 2,605 billion. He said the inflation target is being revised upwards from current year's 4.8 percent to 6 percent for the next fiscal year.
- The tax collection target for the next fiscal year is enhanced by Rs 500 billion as compared to the current fiscal's revised. target of Rs 2,605 billion.
- Debt servicing is anticipated to touch Rs1, 406b (4.6% of GDP) during next fiscal year as compared to Rs1, 299b (4.7% of GDP) estimated for FY15.
- Govt is expected to increase defense budget to Rs817b (2.9% of GDP) up by 10% over the last year's budget.
- Fiscal deficit for 2015-16 is estimated at Rs1, 312b (4.3% of GDP) as compared to Rs1, 402 (5.1% of GDP) estimated for FY15.
- Govt is likely to set a lower bank borrowing target in Budget FY16. This will affect bank's spread on Govt securities.
- FBR to impose 5% sales tax on zero-rated industries i.e. textile, leather, carpet, sports goods and surgical instruments.
- In a bid to increase the revenues of the national kitty, the government has proposed to increase the rate of capital gains tax (CGT) rate on the trade of securities that are sold within two years. Additionally, it was proposed, that gains from the sale of Shares after two years should also be taxed by imposing 7.5% CGT.
- Govt. is also likely to set aside an amount for the construction of motorways and bridges out of the total PSDP allocation for FY16. It is anticipated that Rs149bn will be set aside for these projects.
- Govt. is also considering imposing taxes on bank products like pay order, bank draft and letter of credit.
- Govt. may impose standard tax rate of 17% on power generation plants, machinery & equipment and apparatus for mine construction, removing tax exemptions given in previous budget.
- Govt. targets to increase foreign exchange reserves to over US$20bn by the end of FY16. In FY15, it is anticipated to cross US$18bn.