Special Feature

Finance Supplementary (Second Amendment) Act, 2019

Economic Package for Investment and Export Promotion:

A Synopsis of Finance Minister's Speech

By Research and Publications Department, ICMA Pakistan

The Federal Finance Minister, Mr. Asad Umar, presented a 'Package of Investment and Export Promotion Measures for Industrial Revival' on January 23, 2019 through the Finance Supplementary (Second Amendment) Bill of 2019. This was, in fact, the third Finance Bill for the current fiscal year which was presented in the Parliament. According to the Finance Minister, this was not a budget, rather a corrective package aimed at addressing various sectors of the economy, especially to stimulate investment and industry.

The Research and Publications Department of ICMA Pakistan has extracted the salient features and policy direction and measures taken by the government, as highlighted by the Finance Minister in his speech while presenting the Finance Supplementary (Second Amendment) Bill, 2019 for information and ready reference of our readers.

Economic Situation when the new Government took charge on 18th August 2018

1) Fiscal Deficit was 6.6% of GDP
2) Current Account Deficit was US$ 19 billion
3) Circular Debt was Rs. 1.2 trillion
4) Finance losses of SOEs were 1.4% of GDP
5) Forex Reserves were depleting [pay for only 6 weeks of imports]
6) Exports were stagnant
7) Imports were increasing
8) External Debt was growing

Justifications for Government-managed Adjustment

Government-managed adjustment had become inevitable in order to avoid following risks:

(1) Risk of Default on Debt Servicing

(2) Risk of lesser chance for arranging credit in international markets

(3) Risk of massive compression of all categories of imports, including energy and raw material

(4) Risk of adverse impact on export growth and employment

(5) Risk of massive deprecation of rupee and increase in interest rates

Adjustment Options available for the Government

First Option: To front-load all the corrections by removing imbalances to stimulate the economy to recover to a high growth and productive employment trajectory early in the term of new Government.

Second Option: To take a more gradual adjustment path maintaining a balance of price adjustments when needed and, at the same time, vigorously pursuing structural reforms to strengthen the foundations of the economy.

The government opted for the second option i.e. for the gradual adjustment in structural reforms for two reasons.

Reason # 1: To protect the vulnerable segment of society as high cost of full adjustment in first two years would fall disproportionately on the poor, and the public safety nets will not be able to mitigate the full cost.

Reason # 2: To undertake much-needed structure reforms to provide solid foundations for economic recovery in order to lessen the need for strong and rapid stabilization actions which impacts the vulnerable segments of society.

Difficult Decisions taken to Stabilize the Economy

Sr.	Decisions taken / Efforts Made	Outcome of Decisions / Efforts
1.	Mobilization of additional financing from friendly-countries in the form of: a) Short- and Medium-Term Loans b) Deferred Payment on Imported Oil c) Deposits in the Central Bank of Pakistan	a) Improvement in Balance of Payment Position b) Avoidance of painful sharp adjustment c) Financial space and time to pursue a balanced strategy of macro-economic stabilization and structural reforms
2.	Supplementary Budget approved in October 2018 with additional tax and expenditure measures	a) Reduction in Fiscal deficit from 6.6% of GDP in FY 2018 and an estimated more than 7% of GDP for FY 2019 b) Reduction in Current Account Deficit from 6.1% of GDP in FY 2018 to 5.2% in FY 2019
3.	Rationalization of Electricity and Gas prices	a) Improvement in financial health of energy utilities b) Reducing burden on budget and part finance the huge overhang of circular debt of energy sector.
4.	Adjustments made in Exchange rate by 10 percent and tightening of monetary policy by 250 bps.	a) Reduction in Trade deficit by 5 percent b) Reduction in Current Account deficit by 4.4 percent c) Growth in remittances by 10 percent d) Growth in private sector credit by 100% in first 6 months of FY e) Growth in agricultural credit by 22 percent since last year

Structural Reforms taken for improving Fundamental Weaknesses and Gaps

Sr.	Fundamental Weakness and Gaps in Economy	Structural Reforms Taken by Government
1.	**Revenue-Expenditure Weaknesses / Gap** a) Weak revenue efforts and narrow tax base b) Weak and under-resourced tax administration c) Tax policy has revenue focus d) Tax policy has questionable fairness and equity e) Tax system has inbuilt dis-incentive against revenue collection at federal and provincial level f) Lack of political will of previous Governments to adequately tax the powerful and untaxed segments	a) Separation of tax policy and tax administration b) Creation of Specialized Tax Unit for foreign assets c) Tax broadening measures d) Extensive use of IT for Data Mining and detection of under reporting e) Economic Advisory Council working on various structural issues and its report has been approved by Prime Minister and to be released
2.	**Export-Import Weaknesses / Gap** a) Large and growing gap between exports and imports b) Surging imports 75% imports consist of fuel and industrial raw materials c) Stagnant exports dominated by low-valued added textiles and lack of product & market diversification d) Exports failure to make transition from low technology to high technology e) Falling competitiveness in international markets	a) Expansion in domestic supply for creating exportable surplus b) Reducing cost of production through greater reliance on local produced fuels for power generation c) Aggressive promotion of renewable energy d) Adopting a flexible exchange rate regime e) Diversify exports by supporting micro, small and medium enterprises
3.	**Saving-Investment Weaknesses / Gap** a) Past policy focused on accelerating growth through large scale borrowing to finance investment. b) Investments in Pakistan is lowest in region i.e. almost half the level in India and Bangladesh. c) Low level of savings with national saving rate of only 10.8% of GDP is main factor behind low Investments. d) Non-conductive business and investment climate created by multi-tiered regulations and taxation	a) Government's aggressive policy to improve exports, savings and investments b) Package for Investment and Export Promotion is step in this direction c) Recommendation of EAC are being implement on all key issues.

Future Economic Policy Direction to be followed by Government

Policy 1:
Accelerate investment and domestic savings

Policy 2:
Achieve growth through expansion in domestic supply and financing from domestic resources

Goals of above Policy Direction

a) To create quality jobs for unemployed youth of the country
b) To protect households from rising cost of living
c) To raise productive capacity of the economy
d) To provide targeted subsidies on food and energy to shield poor
e) To achieve double-digit growth in exports and remittances
f) To achieve higher FDI inflows

Future Social Development Policy Direction to be followed by Government

Poverty	a) The Government to spend substantial sums for poverty alleviation. b) The Government to start a graduation program for people to move out of poverty through assets transfer
Education	a) The Government to expand the scope of Waseela-e-Taleem program to almost entire country to enroll as many out of school children of poor families in schools
Health	a) The Government to increase the coverage of 'Insaaf Health Card' across Pakistan b) The Government to reduce incidence of stunting among children through better nutrition
Housing	a) The Government to build low-cost housing and in first phase houses for very poor segment will be built b) The Government to establish Rs. 5 billion revolving Fund to provide Qarze-e-Hasana to needy families c) Low income house tax reduced to 20% from 39%

Measures for reducing 'Cost of Doing Business'

- Settlement of arrears of Gas Infrastructure Development Cess [GIDC] and reduction in overall rate of GIDC
- Efforts underway for reducing cost of compliance with tax laws and rationalizing burden of taxation
- Modification of all federal taxes, income tax, sales tax, FED and customs tariffs to remove anti-business distortions and provide a pro-growth and pro-investment framework
- Requirement of filing withholding statements by agents in respect of tax collections under Section 165 of ITO have been made bi-annual instead of monthly to save businesses from hassle and extra transactions.

Tax Incentives to promote lending by Banks

The Reforms package proposes tax incentives to promote lending by banks to the following 3 priority sectors which can prove to be the drivers of economic growth and lead to creation of employment opportunities:

- SMEs
- Low cost housing
- Agriculture

Incentives to Banks for advancing Loans to SMEs, Low Cost Housing and Agriculture

SMEs	The Government proposes to reduce tax rate on Bank's income arising out of additional SME financing to 20 percent instead of current applicable rate of 35 percent. The additional financing will be worked out on basis of average advances to SMEs during 2018. It will be applicable from tax year 2020 to 2023.
Low Cost Housing	The Government proposes to reduce tax rate on Banks' income from additional low-cost housing finance above base line during 2018 to 20 percent instead of current applicable rate of 35 percent. It will be applicable from the tax year 2020 to 2023.
Agriculture	The Government proposes to reduce tax rate on Banks' income arising out of additional agricultural financing in excess of base line during 2018 to 20 percent instead of current applicable rate of 35 percent. It will be applicable from the tax year 2020 to 2023.

The taxable income of Banks from such advances in above three categories will not be subjected to Super Tax.

Measures to facilitate compliant taxpayers

- Advance Tax on cash withdrawals [0.3%] by tax filers has been done away with whereas tax on non-filers (0.6%) will continue until the time they file returns and become tax filers.
- Withholding Tax on cash withdrawals from PKR bank accounts which are solely funded through foreign remittances from Pakistani expatriate have been abolished.
- Advance Income Tax collected on purchase of certain instruments [Demand Draft, Pay Order, Online Transfer etc.] from Banks against cash by tax filers have been abolished.

Measures to encourage the Corporate Sector

- To lower tax burden on corporate sector and promote economic activity, super tax on non-banking taxpayers is proposed to be abolished after tax year 2019. For banking companies, super tax @ 4 % shall continue.
- To give confidence to business community, it has been reiterated that gradual reduction in non-banking corporate tax rate provided through Finance Act 2018 shall continue to reach the target rate of 25% in 2023.

Measures to promote Investments in Manufacturing and Stock Market

- The Board of Investment (BOI) is piloting a bill for suitable amendments in Special Economic Zone Act, 2012 to become part of First Schedule to Customs Act, 1969 and related laws, which will facilitate investments in SEZs.
- Advance Tax on purchase and sale of shares @ 0.02% of share value by the members of a Stock Exchange registered in Pakistan have been abolished to facilitate and increase investment and business confidence.
- From Tax year 2019 onwards, the capital losses on trade of shares and securities have been allowed to be carried forward for a period of three years for adjustments against capital gains on stock exchange.
- From Tax year 2019 onwards, the payment of dividends between sick and cash strapped companies may be subject to reduced rate of tax in proportion to their share holding if they are availing group relief facility in that tax year. The objective of this measure is to encourage investment in such companies.

Measures to incentivize setting up of new Industries and Projects

- To encourage Greenfield investment and industrialization, exemption has been granted from payment of sales tax on plant and machinery to be used for setting up new industry for production of taxable goods. At present, sales tax exemption on plant and machinery is available only to specified sectors.
- To encourage building up of reserves for investment in new projects as well as for BMR of existing projects, tax on undistributed profits levied on certain public companies have been abolished after the current year.
- Industrial units to be set up for manufacturing plant and machinery and other related items used exclusively for generating renewable energy have been exempted from income tax for a period of five years.

Import Compression measures

The Federal Finance Minister in his speech said that import compression measures taken by the Government during last few months to narrow down the trade deficit have yielded positive results i.e. non-oil imports have decreased by 12.8 percent whereas there is reduction of 23 percent in respect of imports pertaining to 1994 tariff lines alone in December 2018. There has been significant decline in import of luxury items, especially during last two months. The government intends to continue the same policy to further narrow the trade deficit. The following import compression measures have been proposed through the Finance Supplementary (Second Amendment) Bill of 2019:

- To discourage imports of luxury cars and jeeps, the rate of Federal Excise Duty (FED) have been enhanced from 20% to 25% for cars and jeeps upto capacity 3000 cc and to 30% for cars exceeding 3000 cc.
- To discourage imports of CKD Kits of locally assembled cars and jeeps, FED@ 10% has been levied on cars and jeeps with engine capacity exceeding 1800 cc.

Measures to provide relief to Importers

- The commercial importers have been taken out of the 'minimum tax regime' and tax deducted on imports made by them shall now be treated as their 'final tax liability'. Earlier, through Finance Act 2018 the tax deducted at the time of import was changed from final tax to minimum tax for commercial importers.
- The penal surcharge of about Rs. 400 million on overstayed goods of over Rs. 5 billion lying uncleared in bonded warehouses is proposed to be waived off to provide relief to importers of industrial inputs as well as business community who are facing liquidity crunch.
- The concessionary custom duty @ 5% on import of newsprint have been exempted to reduce input cost of newspapers and support media industry. However, existing condition of certification by APNS will continue.

Measures to provide relief to Exporters

To clear up the outstanding income tax and sales tax refunds of the exporters so as to ease their liquidity issue, it has been proposed that the Government would issue 'promissory notes' with following details:

- Promissory notes shall have a maturity period of three years
- Reasonable profit shall be paid on these promissory notes
- Claimants shall be able to raised cash by selling these notes in market
- Taxation laws to be amended to include provisions for refund payment in this manner

Measures to promote Exports

- Review of Regulatory Duty Regime on export side is underway. In first phase, the regulatory duty on copper & lead products exported under DTRE and Manufacturing Bond schemes has been removed.
- Revamping of export promotion schemes like DTRE and Manufacturing Bonds and Export-Oriented Units is underway for optimal utilization by exporters in SMEs.
- Automation of all export promotion schemes, particularly DTRE and Duty Drawback is underway to ensure speedy clearances of raw materials / goods imported under said schemes.
- An exercise has been initiated by government to unify the regulatory framework of export schemes which would be part of the Finance Bill 2019 for implementation in FY 2019-20.
- The facility for import of RBD palm oil / olien under the DTRE Scheme which is presently confined to business units located in KPK and Baluchistan, has been extended to Sindh and Punjab as well.

Measures to encourage domestic Manufacturing Industry

After an extensive exercise carried out by the government to identify those high tariffs which adversely affect export competitiveness and domestic production, regulatory and custom duties on below categories have been reviewed:

- Certain raw materials / inputs (impacting 135 Tariff lines) meant for plastic, footwear, tanning, leather, home appliances, diaper and chemical sectors have been identified for reduction of Customs Duties and Additional Customs Duties (ACD) as well as removal/ reduction in applicable rates of Regulatory Duty (RDs).
- The proposals for reduction/ removal of RDs and reduction in Custom Duty on import of Plastic Moulding Compound would be implemented with passage of this Finance Bill whereas the proposals for reduction in Custom Duty / ACD rates on remaining items would be implemented by March 31, 2019.
- In order to sustain domestic vending sector and encourage local manufacturing of auto parts, Regulatory Duty is proposed to be removed on import of input materials (around 200 Tariff Lines) used in manufacturing of auto parts by the local vendors.

Measures to simplify Tariff and Tax structure

- **Uniform Tax Slabs on Imported Mobile Phones:**

  At present various duties and taxes e.g. RD, WHT, Sales Tax and Mobile levy are levied in different slabs on mobile phones which has resulted in a complicated taxation structure. The government has simplified the fiscal treatment by introducing uniform slabs based on C&F import values of a set. This measure will ensure that low-end cell phones are charged at a low rate whereas higher taxes are levied on high-end phones.

- **Income Tax for Small Shopkeepers:**

  A large segment of small businesses, including shopkeepers, are part of undocumented economy and outside the tax system. It is proposed by the Government to introduce simplified tax schemes for small shopkeepers. Initially, such scheme will be applicable in Islamabad Capital Territory and later extend to rest of country.

- **Review of Custom Tariff:**

  The custom tariffs are being reviewed to bring suitable changes in tariff structure to enhance competitiveness of manufacturing and export sector. This would be effective from March 2019 and include sectors of Chemicals & Plastic; Textiles, Steel, Home Appliance; Paper & Paperboard; Machinery & Capital Goods.

Relaxation in Restriction for Non-Filers to purchase Motor Vehicles

The tax non-filers have been allowed to book, register or purchase a new locally manufactured motor vehicle upto 1300 CC in order to stimulate production of local vehicles and benefit automobile industry and associated vendors. The withholding tax rates for non-filers on such registration is proposed to be enhanced by 50% of existing rates.

Reduction in Minimum Withholding Tax on Small Marriage Halls

To provide relief to low-and middle-income segments and small business, the minimum rate of advance adjustable income tax applicable on marriage halls, marquee, commercial lawns etc. have been reduced from Rs. 20,000/- to Rs. 5000/- subject to condition that the function area is less than 500 sq. yds.

Tax concession for companies participating in National & International Sports Leagues

To promote sports activity and to encourage participation of international players, it is proposed to abolish advance tax at the time of auction of franchise rights, from participating teams in national and international sports leagues organized by any Sports Board or entity established by the Government for the purpose of governing a recognized sport. This provision shall become applicable from July 1, 2019.

Provisional assessment for Taxation of Off-shore assets

Provisional assessment has been proposed in case where an offshore asset, not declared in the income tax return or wealth statement, is discovered by any government agency, such off-shore asset would be subject to summary assessment and tax shall be immediately recoverable on provisional basis. This amendment will ensure better recovery of tax from off-shore assets detected and will promote tax compliance.