June-2019

Pre Budget 2019-20 Expectations

An IMF Budget in the Making

Karachi Chamber Of Commerce & Industry

Research & Development Department

Rationalization of taxes – an arduous task

The Federal Budget FY20 is due to be announced on June 11, 2019 with an expected total outlay of PKR 6.5Tn and is likely to revolve around incessant increase in tax collection, removal of tax exemptions broadening of tax base, improvement in tax infrastructure, removal of anomalies, debt repayments, and implementation of measures to resolve long lingering problems like energy shortages. The budget will contain measures to address issues pertaining to fiscal and monetary policies. It is expected to focus on stabilization of the economy, managing external deficit by reducing imports, reduction in fiscal deficit through revenue mobilization, and expenditure control, setting the path for public debt reduction.

The FBR has conveyed to business chambers that business would be made extremely difficult for the non-taxpayers from FY20 as cost of doing business of un-registered businessmen would be made very high as compared to compliant taxpayers.

The IMF has not budged from its demand that the govt. should impose heavy taxes equivalent to 1.7% of the GDP. It requires that tax collection target for the FBR should be increased by 25% to a formidable PKR 5.5Tn for FY20 while FBR has proposed to fix its target to around PKR 5.1Tn against revised estimates of PKR 4.1Tn for FY19. The federal cabinet has in principle, approved additional revenue generation of PKR 1.4Tn as part of tax reforms. Consequently, additional taxes of over PKR 700Bn would be levied on the nation.

The budget is shaping up to be heavily reliant on IMF pre-conditions, as Pakistan recently secured a bailout of $ 6Bn under strict terms. Removal of zero-rating status of the five export sectors, as part govt. commitment to remove tax exemptions, is the bone of contention between the govt. and the industrial sector. If implemented, it would sound the death knell for Pakistan's export sector which is already facing stagnation due to lack of value addition, uncompetitiveness and insipid global market conditions.

The forthcoming budget expected to substantially stifle national GDP growth, suppress most form of development activity, hamper agricultural sector and unleash an unbearable wave of inflation across all income levels. The budget appears to have all the hallmarks of a typical IMF budget, In other words, budget FY20 is undisputedly an "IMF budget".

Tax proposals as part of the budget are being based on three key pillars

- i- Withdrawal of tax exemptions granted through Statutory Regulatory Orders (SROs)
- ii- Increase in existing tax rates
- iii- Bolstering of revenue collection by widening the tax base

Some Expected Key Features of Budget FY20

- ✓ The budget strategy paper estimated FY20's federal current expenditure at more than PKR 6Tn including:
  - ❖ Interest payments of more than PKR 2.8Tn and,
  - ❖ Defense expenditure of about PKR 1.28Tn, which is more than 16% higher than the original estimates for FY19.

- ✓ IMF has put a condition of generating more revenue, with the intention to take tax-to-GDP ratio 12.3%. This appears unrealistic and irrational, as the revenue collection target of PKR 4.39Tn for FY19 has largely remained unfulfilled.
- ✓ Over PKR 700Bn in additional revenue is designed to come mainly from two areas: sales tax and income tax.
- ✓ General Sales Tax (GST) rate is expected to increase by 1% to 18%.
- ✓ The FBR is contemplating on different options including abolishing of tax exemptions in the range of PKR 250Bn, bringing more items into Excise Duty mode, reducing taxable limit for income tax ceiling from PKR 1.2Mn to

Macroeconomic Framework	FY20
Current Account Deficit as % GDP	3%
Fiscal Deficit to GDP	6%
Primary Deficit - Debt Servicing	0.6%
Investment to GDP	15.8%
Savings to GDP	12.8%
GDP Growth	4%
Agriculture Growth	3.5%
Industrial Growth	2.3%
LSM Growth	1.5%
Construction Growth	1.5%
Service Sector Growth	4.8%
Commodity Sector	2.9%
Wholesale and Retail Trade	3.5%
Inflation	8.5%

Source: KCCI Research, Newsflows

PKR 0.8Mn, increasing tax rate on mobile packages, hiking taxation on tobacco and others to make next fiscal year target achievable.

- ✓ Growth in exports are targeted to increase from $ 24.8Bn in FY18 to $ 34.7Bn in FY23.
- ✓ It is also planned to contain imports wherever necessary.
- ✓ The real GDP growth target has been envisaged at 4% with contribution of agriculture growth at 3.5%, industrial growth 2.3% and large scale manufacturing 1.5%, construction 1.5% and services sector 4.8%.
- ✓ Despite envisaging nominal growth of 12.5% including GDP growth of 4% and rising inflation of 8.5% for FY20, Pakistan's size of economy and per capita income will continue to shrink in dollar terms in budget FY20 because of steep fall of exchange rate.
- ✓ The govt. is envisaging current account deficit bringing down from revised estimates of 4.7% of GDP for FY19 to 3% of GDP for FY20, equivalent to $ 8.6Bn.
- ✓ Total investment to GDP is projected at 15.8% in FY20 against 15.4% for FY19.
- ✓ With industrial sector growth of 2.3% against 1.4%, the Large Scale Manufacturing (LSM) is envisaged to grow at 1.5% in FY20 against negative 2% in FY19.
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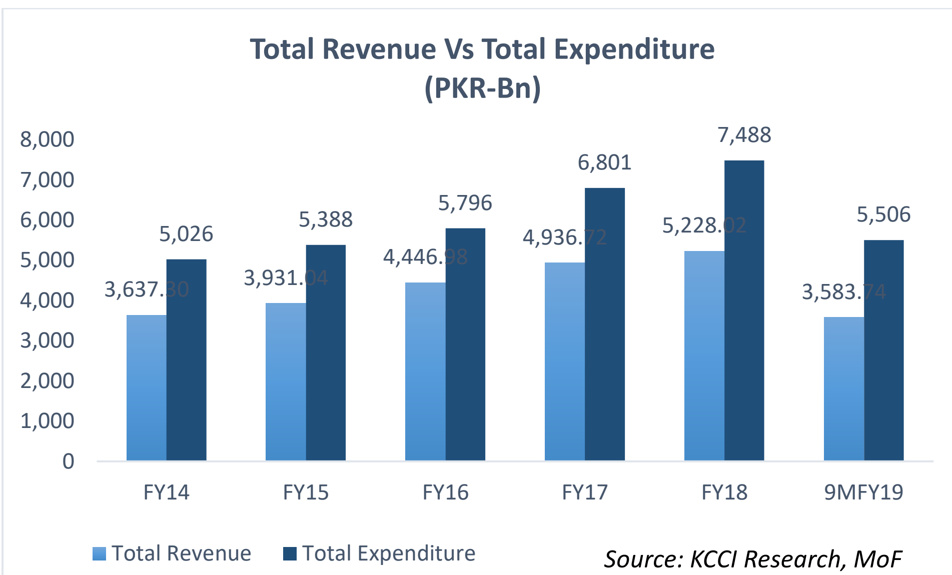
- ✓ The govt. would not increase electricity tariff for households that are consuming electricity less than 300 units a month, and PKR 230Bn would be allocated in budget 2019/20 to protect them from electricity price hike. However, for other categories, the National Electric Power Regulatory Authority (Nepra) would determine increase in tariff.

KCCI has submitted its budget proposals to the Government

KCCI's proposals for federal budget FY20 cover a wide range of topics, including trade and industry development and its safeguards, ease of doing business, domestic and foreign investment in the economy, improving competitiveness, focus on development of domestic commerce, import substitution, and development of SMEs, among other areas. It has also asked for due share of Karachi in the federal and provincial developmental budgets. Implementation of the chambers' growth oriented proposals would lead to fast paced economic growth through promotion of trade, business and industry in Pakistan.

KCCI has long been vouching for curbing the unbridled discretionary powers given to the tax man, which are often employed to harass the business community. It has also been demanding for rationalization of the unfair taxation system prevalent in Pakistan which instigates corrupt practices and gives undue advantage to non-payers of tax at the expense of the compliant tax payers.

However, it is yet to be seen whether the budget actually incorporates KCCI's business friendly proposals, and what concrete steps the govt. would take to provide a conducive environment to the industry. Concerns also remain as to whether the forthcoming budget would be successful in increasing the tax net rather than further burdening the existing tax payers.



Expectations for Budget 2019-20

The tables below give a bird's eye view of the tax measures are expected to be incorporated in the upcoming budget. Sector-wise impacts have also been mentioned where applicable.

Sales Tax		
Sectors	**Budgetary Expectations**	**Impact**
5-Zero Rated	The govt. has decided to impose a standard rate of 17% (18% if increased) sales tax on the five export-oriented sectors – textile, leather, carpets, surgical and sports goods, thereby rescinding SRO 1125.	***Revenue***: *PKR 75-80Bn.* ***Sector***: *-ve*
Sugar	Sales tax rate on sugar from 8 to 17%.	***Revenue***: *PKR 25Bn* ***Sector***: *-ve*
Edible Oil	Tax rate on the local supplies of edible oil to increase from PKR 1/ Kg to standard 17%.	***Sector***: *-ve*
Steel	Special sales tax procedures for the steel sector will be done away with. Standard sales tax rate to apply.	***Revenue:*** *PKR 25Bn* ***Sector:*** *-ve*
Tractors	Sales tax rate on tractors may be increased from 5% to 17% to generate additional revenue. This will push the tractor prices up by PKR 37,000.	***Sector:*** *-ve* ***Revenue:*** *PKR 10Bn*
6th Schedule	No major changes are expected in the sixth schedule of the sales tax that offers concessional tax rates on imports of food, pharmaceutical and machinery.	***Sector***: *Neutral*
Sales Tax Act 1990	The FBR has proposed to shift sectors operating under the Sales Tax Special Procedure Rules to relevant Schedules of the Sales Tax Act 1990. The special tax treatments applicable on commercial importers, jewelers, wholesalers-cum-retailers, chains of wholesale-cum-retail outlets, sectors availing zero-rating facility, cotton ginning/expelling units CNG, steel melting units, steel re-rolling units and ship breakers might be abolished.	***Sector:*** *-ve*

Income Tax		
Sectors	**Budgetary Expectations**	**Impact**
SMEs	It is under consideration to reduce decrease corporate income tax rates for small corporations. It is also under consideration to increase turnover tax for loss making companies to 1.25%.	*Sector: +ve*
Salaried Class	The govt. looks set to reverse tax concessions extended by the previous govt. to the salaried class and reverting back to the income tax brackets applicable in TY17. Sweeping tax cuts had been given to low salary earners, raising the exemption threshold almost three times to KR 1.2Mn from PKR 0.4Mn.	***Revenue:*** *PKR 14Bn*
Manufacturers	An amendment to the income tax law is expected that would require manufacturers to register their distributors and dealers for filing of returns.	***Sector**: -ve*
FTR	Tax authorities have proposed the abolition of the Final income Tax Regime for both exporters and importers in a bid to capture their real income. The FBR wants exporters and importers to file income tax return and fully disclose their expenditures and incomes.	***Sector**: -ve*
WHT	The FBR is contemplating to reduce numbers of WHT, bringing it down from existing 50 to 25 in totality.	***Sector**: +ve*
Corporate	One of the main income tax proposals is to freeze the corporate income tax rates at current 29%. This would effectively mean 1% increase in tax liabilities of the big firms.	***Sector**: -ve*

Federal Excise Duty		
Sectors	**Budgetary Expectations**	**Impact**
Importers/ Exporters	FED on aerated and beverages will be brought into the tax net. The FBR is also contemplating upon options to abolish presumptive regime for importers and exporters.	
New items	It has proposed to increase FED on existing items and imposition of FED on new items to generate additional revenue.	***Sector**: +ve*

Customs Duty		
Sectors	**Budgetary Expectations**	**Impact**
5th Schedule	FBR and National Tariff Commission (NTC) have proposed to abolish 5th Schedule of Customs Act and phased withdrawal of Regulatory Duty (RD) and Additional Customs Duty (ACD) on imported items. FBR and NTC have proposed to introduce fresh slab of zero on customs duty against existing four slabs with rate of 3, 11, 16 and 20%.	
Petroleum	Customs duty of 5% will be imposed on import of LNG. Moreover, another 3% RD is being considered on import of petroleum products.	***Sector****: -ve*
Imports	It has been proposed to increase additional customs duty rate to 3% from existing 2% on tariff lines currently subject to 3% and 11% normal customs duty. For items falling under 16% slab, it has proposed to double the additional customs duty rate from 2% to 4% and for items with duty slab of 20%, the govt. plans to raise the additional customs duty rate to 5% from existing 2%.	***Sector****: -ve*
Raw Material	The govt. is also working on rescinding SRO 565 of 2006.	***Revenue:*** *PKR 18Bn*
Imported Mobiles	The FBR has also proposed reduction in taxes on import of mobile phones in the range of 10 to 20%, but under the baggage rules provision of allowing one mobile phone set will be withdrawn.	***Sector:*** *+ve*

Fiscal Operations 9MFY19

	3MFY19	6MFY19	9MFY19
Total Revenue	**1,102,096**	**2,327,115**	**3,583,737**
Tax Revenue	**975,205**	**2,082,505**	**3,162,132**
Federal	886,583	1,894,732	2,874,424
Provincial	88,622	187,773	287,708
Non-Tax	**126,890**	**244,610**	**421,605**
Federal	112,280	215,355	356,305
Provincial	14,610	29,255	65,300
Total Expenditure	**1,643,772**	**3,357,017**	**5,506,217**
Current Expenditure	**1,479,930**	**2,984,381**	**4,798,350**
Of which : Mark-up Payments	507,063	876,697	1,459,211
Defence	219,392	479,594	774,708
Development Expenditure & net lending	**108,964**	**369,388**	**684,157**
Statistical Discrepancy	**54,879**	**3,249**	**23,710**
Budget Deficit	**541,677**	**1,029,902**	**1,922,480**
Financing	**541,677**	**1,029,902**	**1,922,480**
External	**210,770**	**217,958**	**524,457**
Domestic	**330,907**	**811,944**	**1,398,023**
Non-Bank	238,437	234,357	610,369
Bank	92,470	577,587	787,654

Source: KCCI Research, MoF

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