PakEconomix (Budget Special)

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The Finance Bill, 2024 presented in the National Assembly is heavily influenced by the measures agreed with or suggested by the International Monetary Fund (IMF). Pakistan is facing severe economic challenges, including sluggish growth and diminished business and investor confidence. It was expected that the government would introduce measures not only aligned with the IMF's recommendations, but also focused on broadening the tax base, reviving the economy, and restoring the confidence of businesses and investors.

However, the Finance Bill, 2024 appears to be more focused on the traditional approach of collecting more taxes from individuals already in the tax net, while hoping that higher rates for non-filers will compel non-taxpayers to enter the system. This approach has historically resulted in a continuous decline in business development and confidence, as well as an increase in cash-based and undocumented economic activities to avoid taxation.

While the Finance Bill, 2024 does include some positive measures to enhance tax revenue collection, in many cases, there seems to be a disconnect between the government's proposals and the recommendations of tax experts, chambers of commerce, and economists. For any proposed measures to be successful, it is crucial that the key stakeholders and advisors of the economy and businesses are aligned with the government's initiatives.

Fortunately, there is still time for further deliberation before the Finance Bill, 2024 is approved by the National Assembly and the Senate. This presents an opportunity for the government to make necessary changes, particularly in the areas or sectors most impacted by the proposed measures.

Manufacturing Sector

The Finance Bill, 2024 has a mixed impact on Pakistan's manufacturing sector:

- The Large-Scale Manufacturing (LSM) sector has shown resilience and signs of recovery, with a growth rate of 0.07% driven by various groups including food, beverages, textiles, tobacco, petroleum, and pharmaceuticals. This has helped offset the overall economic impact.
- However, the withdrawal of the reduced sales tax rate on locally manufactured hybrid electric vehicles and the removal of customs duty concessions on imported electric vehicles valued over $50,000 will negatively impact the electric vehicle industry.
- On the positive side, the Bill proposes exemptions from customs duty on raw materials used in the manufacture of solar equipment, which should help drive down prices and support the solar energy sector.
- The exemption from sales tax on local iron and steel scrap, as well as imports and local supply of petroleum products, may also help reduce prices in related construction and manufacturing areas.

- While these relief measures are intended to support the manufacturing sector, there are concerns about the ability to fully pass on the benefits to consumers due to lack of oversight and accountability.
- Overall, the Finance Bill, 2024 presents a mixed bag for the manufacturing sector, with some measures aimed at supporting specific industries, but also some actions that could increase costs and impact competitiveness.

Banking Sector

The Finance Bill, 2024 has proposed measures that could negatively impact the growth and profitability of Pakistan's banking sector:

- The Bill proposes excluding the impact of IFRS 9 implementation from the calculation of taxable income for banks. IFRS 9 was made applicable by the State Bank of Pakistan (SBP) from January 1, 2024.
- The Bill also seeks to make inadmissible any notional gain or loss (except determined through reasonable accuracy) recorded in financial statements arising from accounting standards, policies, guidelines or instructions of the SBP. Previously, this was restricted to IAS 39 and 40 only.
- These measures, along with the government's focus on collecting more taxes from profitable sectors like banking, could put extra revenue pressure on banks.
- The banking sector has seen significant growth in assets, liabilities and investments over the past decade. However, this growth is now at risk due to increasing interest rates, liquidity challenges and lack of incentives from the government.
- The phenomenal growth of the banking sector is being threatened by the government's policy of mainly collecting taxes from profit-making sectors, as evidenced by the absence of any tax relief for banks in the Finance Bill, 2024.
- In summary, the proposed measures in the Finance Bill, 2024 could undermine the growth and profitability of Pakistan's banking sector, which has seen remarkable expansion in recent years. The government's focus on collecting more taxes from profitable sectors like banking, along with the exclusion of IFRS 9 impact and inadmissibility of certain notional gains and losses, could put extra pressure on banks and jeopardize their future growth prospects.

Goods Export Sector

The Finance Bill, 2024 has proposed changes to the taxation of Pakistan's export sector that could have a negative impact on the country's critical need to build up its foreign reserves:

- Previously, exporters were subject to a 1% final tax on their export proceeds, which provided an incentive for them to repatriate those earnings to Pakistan.
- The exporters also had the option to offer their export income under the normal tax regime based on net profits.
- The Finance Bill, 2024 proposes to bring the income of exporters of goods under the normal tax regime, subjecting them to the regular corporate tax slabs.
- Additionally, the Bill seeks to increase the rate of advance tax on export proceeds from 1% to 2%, treating this as a minimum tax.

These proposed changes are concerning for a few reasons:

- They could adversely impact the country's ability to increase its foreign exchange reserves, which are critical for Pakistan's economy.
- The changes may discourage exporters from fully repatriating their earnings to Pakistan, as they may create middle-layer entities outside the country to avoid the higher tax burden.
- There are also risks of increased under-invoicing by exporters to minimize their tax liabilities under the new regime.
- Overall, the proposed taxation changes on the export sector appear to be at odds with the government's need to incentivize exporters and facilitate the inflow of much-needed foreign currency into the country. These measures could undermine the competitiveness of Pakistani exporters and hamper the growth of the country's export-oriented industries.

Real Estate Sector

The Finance Bill, 2024 proposes several measures to further document the real estate sector and increase tax collection from this lucrative but largely unregulated industry:

- Past attempts by the government to bring the real estate sector into the tax net have resulted in increased overall tax liability for buyers and sellers. This has affected transaction volumes and prices, leading to adjustments in property values and a trend of filing nil returns to avoid higher advance tax rates for non-filers.
- To continue efforts to document the real estate sector, the Finance Bill, 2024 proposes that capital gains from disposal of immovable properties acquired on or after July 1, 2024 will be taxed at normal business income tax rates for persons not appearing on the Active Taxpayers List (ATL) at the time of disposal.
- The Bill also proposes significantly higher rates of advance tax for delayed filers and non-filers in real estate transactions.

These measures aim to encourage persons to file true and correct income tax returns and bring more of the real estate sector into the documented tax net. The government hopes this will increase the sector's contribution to the economy, despite previous attempts leading to higher overall tax burdens and affecting transaction volumes and prices.

The real estate industry is seen as a lucrative but largely unregulated sector, and the government is making continued efforts to document it and boost tax collection from this important part of the economy.

Retail Sector

The Finance Bill, 2024 proposes measures that could negatively impact the growth of Pakistan's retail sector:

- The Bill withdraws the relief of reduced 15% sales tax rate on supplies made from retail outlets integrated with FBR's computerized system for real-time reporting of textile and leather articles sales.

- To broaden the tax base, manufacturers, distributors, dealers, wholesalers or commercial importers of all sectors (not just specified sectors earlier) will be brought into the tax net.
- The advance tax deduction rate on gross sales to retailers is being increased from 1% to 2.5% for retailers not appearing on the FBR's Active Taxpayers List (ATL).

These proposals come despite the retail sector facing challenges such as non-documentation, low tax contributions, infrastructure limitations, regulatory issues and economic fluctuations. The wholesale and retail trade accounts for 30.8% of the service industry but only 17.78% of GDP, with a growth rate of just 0.32% attributed to increases in agriculture and large-scale manufacturing output.

The retail sector has seen significant growth in moving from traditional methods to e-commerce platforms and online marketplaces, driven by smartphone penetration. However, the withdrawal of tax reliefs and increased documentation requirements could hamper this growth trajectory.

The government was expected to provide fiscal incentives to boost the retail trade sector and increase documentation. Instead, the Finance Bill, 2024 proposes measures that could further burden retailers, especially smaller players, and discourage their participation in the formal economy.