Federal Budget FY 2021–22

What's in it for SMEs, Women-Led Businesses, Construction & Housing and Digital Financial Services?

Overview

The government presented its third federal budget (FY 2021-22) in Parliament on the 12th of June, 2021. The budget built on the better-than-expected snapshot of the economy presented in the Pakistan Economic Survey 2020-21, which projects a growth rate of 3.94% for FY 2021-22. In line with the forecasted growth, overall expense for the fiscal year is budgeted at PKR 8.48 trillion. Notable priorities include sustainable growth, special initiatives such as the *Naya Pakistan Housing Scheme and the Kamyab Jawan Programme,* increased development spending under the PSDP compared to previous years, optimal revenue mobilization and expedited refunds[1]. The budget follows the medium-term budget strategy approved by the federal cabinet in April 2021. A macro-level snapshot of the budget is presented below.

Exhibit 1: Budget FY 2021-22 – A Macro Snapshot

Revenue *(PKR billion)*		**Expenses** *(PKR billion)*	
Tax revenue	5,829	Interest payments	3,060
Non-**tax revenue**	2,080	Defense	1,370
Less provincial share	(3,412)	Pension	480
Net revenue	4,497	Grants and Transfers	1,168
Non-bank borrowing	1,241	Subsidies	682
Net external receipts	1,246	Running of government	479
Estimated provincial surplus	570	Provision for Disaster/Emergency/Covid	100
Bank borrowing	681	Other expenses (current)	185
Privatization proceeds	252	Development	964
Total	**8,487**	**Total**	**8,847**

Source: Budget in Brief, Ministry of Finance

Revenue

The budget sets out a 24% increase in the tax revenue target from the PKR 4.7 trillion mark achieved by the Federal Board of Revenue (FBR) in 2020-21. It is pertinent to note that tax collection grew by 6.1% in FY 2020-21 and 0.1% in FY 2019-20, which raises the question whether this target is achievable. Notable changes in the inflow and outflow of revenue are presented in Exhibit 2. Outflow to the provinces is expected to increase by 19%, compared to the amount budgeted last year.

Exhibit 2: Notable Movements in Inflow and Outflow of Revenue *(in PKR billion)*

	FY 2020-21		FY 2021-22	% Change in Budgeted Amount
	Budgeted	Actual	Budgeted	
Provincial Share in Revenues (outflow)	2,873	2,704	3,411	↑19%
Petroleum Levy (inflow)	450	500	610	↑36%

Source: Budget in Brief, Ministry of Finance

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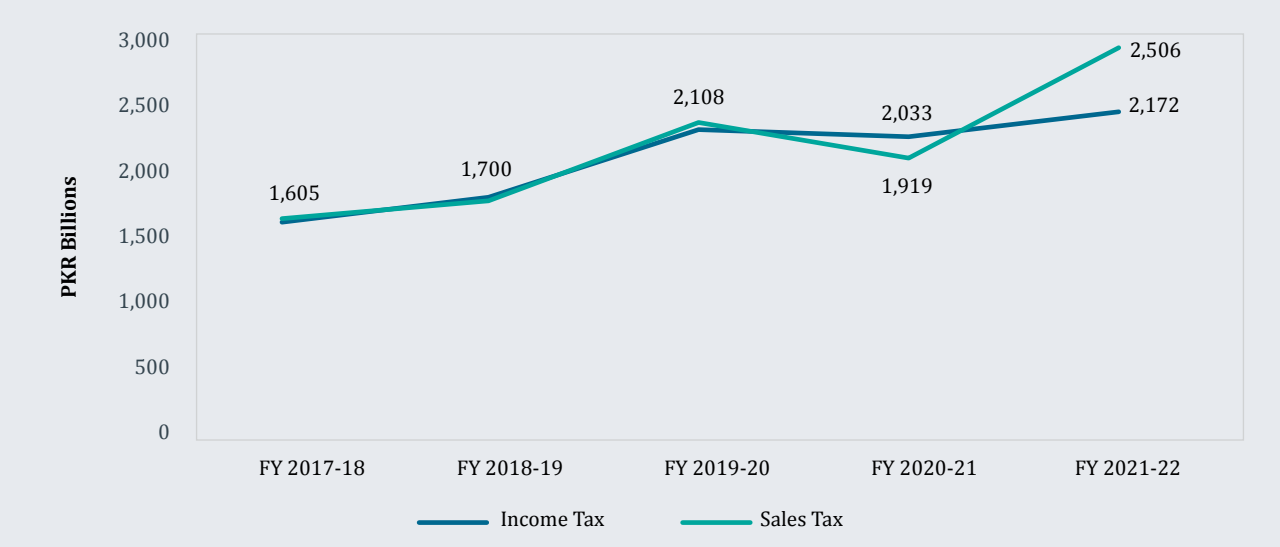
[1] Government of Pakistan. Federal Budget 2021-22
https://www.finance.gov.pk/budget/Budget_2021_22/6_Budget_in_Brief_English_2021_22.pdf#page=11

Actualized revenue from the petroleum levy was 11% higher than the budgeted amount, and for this year it is budgeted at 36% higher than the previous year but it is also pertinent to mention that regressive taxes constitute a suboptimal option as indirect taxation burdens low-income segments disproportionately. For this budget, the gap between direct and indirect taxation has increased significantly—from 41:59 to 37:67 over the last one year, which is especially concerning given that the economy is still facing significant inflationary pressure and uncertainty due to the COVID-19 pandemic; which also is not yet a thing of the past.

Exhibit 3: Income Versus Sales Tax *(Budgeted)*

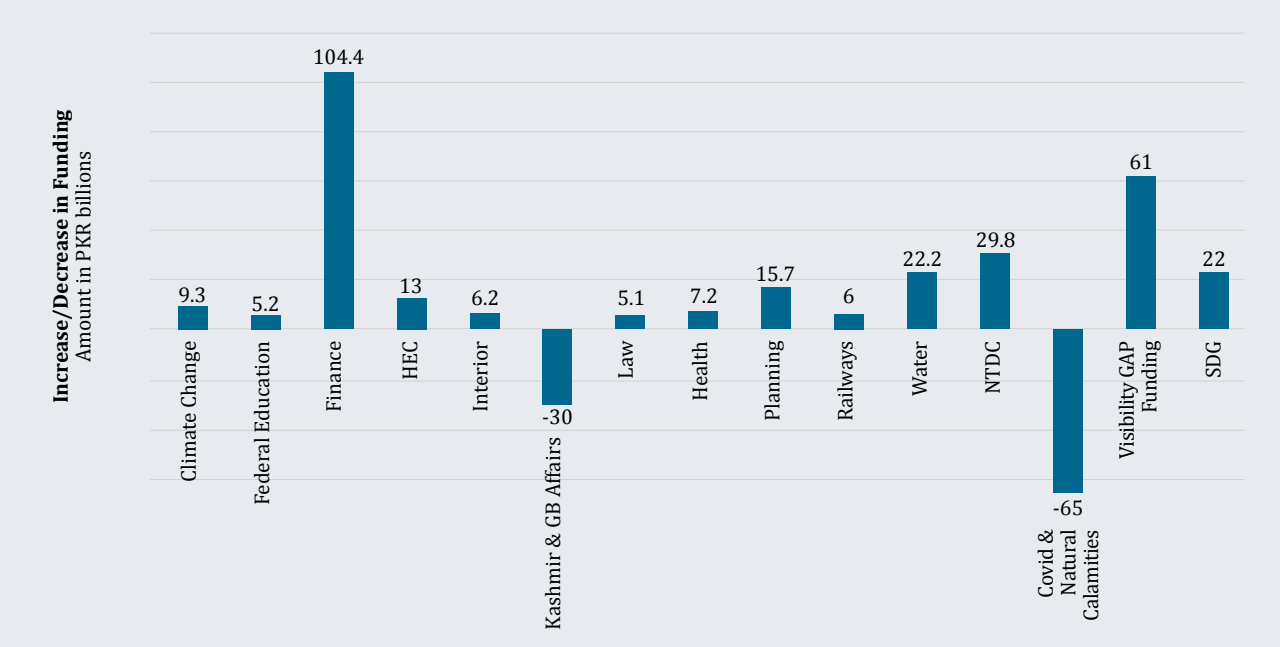


Source: Budget in Brief, Ministry of Finance

Expenses

On the expenditure side, interest payments continue to account for a major chunk of the current expenditure. Together with defense services expenses, both heads are budgeted to increase by 4% and 6%, respectively. The Federal Public Sector Development Programme (PDSP) budget has been increased from PKR 650 billion in the previous year to PKR 900 billion. Notable increases and decreases in PSDP are presented in the exhibit below.

Exhibit 4: Federal Divisions with Notable Increase/Decrease in PSDP Allocations *(greater or less than PKR 5 billion)*



Source: Budget in Brief, Ministry of Finance

Another significant expenditure is on subsidies, which have been tripled from PKR 209 – 682 billion. The power sector is the primary beneficiary. A number of schemes have also been introduced, for which the federal grants budget has been increased from PKR 900 billion to PKR 1.2 trillion.

Exhibit 5: Recipients and Increases in Federal Subsidies and Grants *(PKR billion)*
All items increased by PKR 5 billion and more are shown below.

Subsidy or Grant	Title	Amount in Budget 2020-21	Amount in Budget 2021-22	% increase in budgeted amount
Subsidies	**Power**	**140**	**596**	**↑326%**
	WAPDA/ PEPCO	*129*	*245*	
	KESC	*11*	*85*	
	PHPL & IPPs	-	*266*	
	Petroleum	10	20	↑100%
	Naya Pakistan Housing Authority	30	30	-
Grants	Azad Jammu & Kashmir	55	60	↑9%
	Gilgit Baltistan	32	47	↑47%
	Benazir Income Support Programme (BISP)	200	246	↑23%
	Drawback on local taxes and levies (DLTL)	10	20	↑100%
	Higher Education Commission (HEC)	-	65	∞
	Contingent & Misc.	416	440	↑6%

Source: Budget in Brief, Ministry of Finance

Salient Features

The annual budget impacts all sectors of the economy, directly and indirectly. For FY 2021-22 import duties have been reduced or exemptions granted on inputs for a large number of industries and sector. As a balancing act on the revenue side, withholding tax (WHT) has been introduced on several industries and tax concessions have been withdrawn. Major winners include, Automobile, Property & Housing, and SMEs. **Exhibit 6** presents a snapshot of the measures introduced for each sector.

Exhibit 6: Sectors under Focus

Sector/ Industry/ Segment	Measure(s)
Textile, Steel, Dairy, Poultry, Packaging, Cables, Paint, Electronics, Digital Payments, Pharma, Food Processing, Paper, Dairy, Tourism, Apparel, Chemical, Warehousing, Agriculture	Reduction/exemption of import duty on inputs
Digital Payments, Food Processing, Automobile, Telecom, and FATA/PATA	Reduction/exemption of FED
Digital Payments, Air Travel, Petroleum, Property, and Minerals	Deletion/Streamlining of WHT
Pharma, Poultry, Livestock, Edible Oil, Battery, Tyres, Chemicals, Cosmetics, IT, and Automobile	Introduction of WHT/Income Tax
Paper, Automobile, Warehousing, and IT	Reduction/Exemption of Sales Tax
Mobile Phones, Exporters, Importers, Property, SMEs, Women-led businesses, and Warehousing	Streamlining/Facilitation
Chemical, Petroleum, and Misc. (55 items - 6th/8th schedule)	Increased Sales Tax; Withdrawal of Concessions
Tobacco, Telecom, and Automobile	Introduction of Tax
Renewable Energy	Exemption/Reduction in Tax

SMEs are likely to constitute a significant segment of some of the sectors named in the federal budget—namely, dairy, livestock, minerals, poultry. The variety of incentives introduced for industries, as outline above coupled with robust measures for improving ease of doing business could have a positive effect on formalization of SMEs within Pakistan.

Sector Focus

Small and Medium Enterprises

New Tax Regime for Manufacturing SMEs

The budget proposes to introduce a new taxation regime for manufacturing small and medium enterprises (SMEs). While it is a good sign that the taxation authorities have recognized SMEs as a separate category, there are differences in the scope and criteria of the definition used by FBR as compared to the one used by the State Bank of Pakistan (SBP)[2] and the one proposed in the SME Policy 2020 (see **Exhibit 7** for details).

Exhibit 7: SME Definitions - as Followed by FBR, SBP and Proposed in the SME Policy 2020

	Companies Ordinance/FBR	State Bank of Pakistan	SME Policy 2020 *(proposed)*
Sector Scope	Manufacturing	Manufacturing, Trading, Services	Universal
Criteria	Turnover	Employees, Turnover	Turnover
# of Sub-categories	Two (category I and II)	Two (Small and Medium enterprises)	Four (New/Startup, Micro, Small, Medium enterprises)
Range of Turnover	• *Category I:* Less than PKR 100 million • *Category II:* Between PKR 100 – 250 million	• *Small:* Less than PKR 150 million • *Medium:* Between PKR 150 – 800 million	• *New:* Less than PKR 50 million (age of business <5 yrs) • *Micro:* Less than PKR 6.5 million • *Small:* Between PKR 6.5 – 100 million • *Medium:* Between PKR 100 – 650 million
Range of Employees	N/A	• Small enterprise: Up to 50 • Medium enterprise (Trade): 51 – 100 • Medium enterprise (Manufacturing & Services): 51 – 250	N/A

Based on recent reports[3], it is expected that these classification differences will be ironed out, which holds the promise to unlock focused and coherent action from different state regulatory bodies for the development of the SME sector. As stipulated in the Finance Act, SMEs will be required to register either with the FBR (iris) or with Small and Medium Enterprise Development Authority's (SMEDA) SME registration portal. This SME registration will be developed by Punjab Information Technology Board (PITB) and SMEDA, under the National Business Development Program (NBDP) for SMEs. The agreement was signed between PITB and NBDP-SMEDA in June, 2021[4].

An SME has the option to choose to be considered for tax purposes either under the normal or final tax regime. Each of these regimes have two further subcategories of taxation which are presented in the exhibit below.

Exhibit 8: Normal and Final Tax Regime Categories for SMEs

Category	Annual Turnover	Rate
Normal Taxation Regime for SMEs		
Category – 1	Does not exceed PKR 100 million	7.5% of taxable income
Category – 2	Exceeds PKR 100 million but less than PKR 250 million	15% of taxable income
Final Taxation Regime for SMEs		
Category – 1	Does not exceed PKR 100 million	0.25% of gross turnover
Category – 2	Exceeds PKR 100 million but less than PKR 250 million	0.5% of gross turnover

Source: Finance Act 2021-22

Once a choice is made between the *normal* or *final* tax regime, it will be irrevocable for three years. SMEs that opt for taxation under the normal regime can be selected for a tax audit whereas those opting for the final tax regime cannot be subjected to a tax audit. The procedural details would become clear once the National SME Policy and National SME Action Plan 2020 documents are made public by the government.

[2] https://www.sbp.org.pk/publications/prudential/SME-PRs-Updtd-Apr-2021.pdf
[3] https://tribune.com.pk/story/2240037/sbp-says-aware-smes-difficulties
[4] https://nbdp.org.pk/news_detail.php?news_id=4

In order to understand the impact of these taxation regimes on varying profit margin and turnover, a simple 'what if' analysis is presented below.

Exhibit 9: 'What if' SME Taxation Analysis

Category	Turnover	Profit Margin	Profit	Normal Tax *(on Profit)*	Final Tax *(on Turnover)*
I	100,000,000	1%	1,000,000	75,000	250,000
I	100,000,000	3%	3,000,000	225,000	250,000
I	100,000,000	5%	5,000,000	375,000	250,000
II	200,000,000	1%	2,000,000	300,000	1,000,000
II	200,000,000	3%	6,000,000	900,000	1,000,000
II	200,000,000	5%	10,000,000	1,500,000	1,000,000
I	50,000,000	2%	1,000,000	75,000	125,000
I	100,000,000	2%	2,000,000	150,000	250,000
II	175,000,000	2%	3,500,000	525,000	875,000
I	50,000,000	4%	2,000,000	150,000	125,000
II	175,000,000	4%	7,000,000	1,050,000	875,000

Amounts in PKR; Cells highlighted green = lower tax liability

The analysis reveals that the normal (income/profit based) tax regime is preferable for SMEs operating at a profit margin of less than **3.35%.** At profit margins higher than 3.35%, the final (turnover based) tax regime is preferable regardless of the turnover amount. Given that a choice of taxation regime will remain fixed for three years, SMEs with profit margins close to 3.35% would have to be careful in their selection. For example, consider an SME with a profit margin of 3% that initially selects the normal (income based) tax regime. An improvement in its profit margin to 5% through process innovation by the third year would end up incurring an additional tax liability of PKR 100,000 to 200,000 under the normal tax regime as compared to the final one. At a macro level, it would be reasonable to assume that more SMEs would have a profit margin greater than this threshold. Consequently, the choice of taxation regime is tilted in favour of the final tax regime.

Special Schemes for SMEs

The budget unveiled special schemes for SMEs valued at PKR 12 billion. These schemes aim to provide increased access to credit for SMEs, mitigate the effects of the pandemic and catalyze the development of the SME sector. The breakup of PKR 12 billion worth of schemes announced in the budget is presented in the following exhibit.

Exhibit 10: Financial Schemes for SMEs

Scheme	Amount *(PKR billion)*
SME/ Risk Sharing Facility	5
Refinance and Credit Guarantee Scheme for Collateral Free Lending to SMEs	1.2
Others (CGS for small farmers, crop/ livestock insurance, and possibly Covid - 19 stimulus)	5.8
Total (PKR billion)	**12**

Source: Budget in Brief 2021-22, Ministry of Finance

The goal of credit guarantees and a collateral free lending scheme is to boost the credit uptake of SMEs. In 2020, SBP and the Ministry of Finance introduced a three-month SME risk-sharing mechanism to encourage SMEs to avail loans to support employment and prevent layoffs due to the pandemic. The end user SMEs for that scheme were able to obtain financing at a reduced rate of 5%. The government had committed to bear 40 – 60% of first loss on the disbursed portfolio. It is expected that the SME risk sharing scheme in this year's federal budget would have similar goals of supporting SMEs and encouraging formal financing uptake.

According to a news report, it is expected that the SBP will encourage banks and development finance institutions (DFIs) to meet a disbursement target of PKR 60 billion over the next three years in loans through the collateral-free schemes for the SME segment[5]. For context, current outstanding SME financing stands at PKR 482 billion. The modalities of these schemes shall become clear once they are announced by the Government.

[5] https://www.dawn.com/news/1623429

The SBP Governor, in a recent statement, said that these schemes will increase the credit uptake ratio for SMEs by 30%[6]. SME portfolio growth over the past five years (pre-Covid) has been lackluster for several reasons. While this scheme certainly lays out the government's intention to jumpstarting greater lending to SMEs, its success will hinge on an associated set of measures which will need to be simultaneously implemented.

These measures include building the capacity of the financial sector to ubiquitously use cashflow based lending methods for SMEs, while also making use of technologies and techniques aimed at reducing information asymmetries. These include establishing Credit Risk Databases[7] (already exist in Japan, Philippines, etc.) and enhanced utilization of credit bureaus by fast-tracking integration of utility and telco bill payment data.

As more and more SMEs start using digital financial services for their business transactions and finances, there will be a big opportunity to introduce credit scoring methodologies and techniques. Most of these initiatives have already been undertaken in other countries, and Pakistan can learn from them to leapfrog to a financial system that meets the financing needs of its SMEs more effectively.

Advance Tax on Electricity Consumption

The advance tax deduced on electricity consumption has been revised for industrial, commercial and domestic consumers. For SMEs the pertinent consumption slab is an electricity bill exceeding PKR 20,000.

Exhibit 11: Proposed Revisions to Advance Tax on Electricity Consumption

Gross Bill Amount *(Commercial & Industrial)*	**Existing**	**Proposed**
Exceeds PKR 20,000 *(monthly)*	i) 12% for commercial consumers ii) 5% for industrial consumers	i) PKR 1,950 plus 12% of the amount exceeding PKR 20,000 for commercial consumers ii) PKR 1,950 plus 5% of the amount exceeding PKR 20,000 for industrial consumers

Source: Finance Act 2021-22

In order to gauge the impact of this revised rate of advance tax on electricity consumption, a quick 'what-if' analysis reveals that the proposed regime gives a fixed annual benefit of PKR 5,400 for commercial consumers regardless of the electricity consumption. However, industrial consumers receive a fixed PKR 11,400 disadvantage from the proposed rate, irrespective of the electricity consumption.

Exhibit 12: 'What If' Analysis on Proposed Advance Tax on Electricity

Bill Amount *(annual)*	**Existing Advance Tax** *(A)*	**Proposed Advance Tax** *(B)*	**Impact** *(B – A)*
PKR 240,000 *(commercial)*	PKR 28,800	PKR 23,400	PKR 5,400 relief
PKR 3 million *(commercial)*	PKR 72,000	PKR 66,600	PKR 5,400 relief
PKR 6 million *(commercial)*	PKR 144,000	PKR 138,600	PKR 5,400 relief
PKR 240,000 *(industrial)*	PKR 12,000	PKR 23,400	– PKR 11,400
PKR 3 million *(industrial)*	PKR 150,000	PKR 161,400	– PKR 11,400
PKR 6 million *(industrial)*	PKR 300,000	PKR 311,400	– PKR 11,400

Industrial units would end up paying slightly more advance tax on electricity consumption as compared to other commercial business units. Manufacturing/industrial units generally consume more electricity as compared to the non-manufacturing/commercial businesses; hence the latter will end up paying a greater proportion of their tax liability as advance tax on electricity.

With this increased advance tax levied on the manufacturing/industrial segment, timely processing its tax refund claims becomes more important as the segment already pays a higher proportion of its overall tax liability due to a greater consumption of electricity, as compared with non-manufacturing SME sectors.

[6] https://profit.pakistantoday.com.pk/2021/05/06/new-schemes-for-smes-to-accelerate-credit-uptake-ratio-up-to-30pc-baqir/

[7] CRD is a database which contains financial statement information and default information of borrowers, mainly collected from banks and credit guarantee associations. CRDs are used by financial institutions to measure and analyse the credit risk of borrowers while financial regulators use it to monitor credit risk at the macro level.

Box A: Government Support for SME Financing

Promoting SME finance has been a mainstay within the set of policy actions by the government for many years. The up-take has been slower than anticipated, chiefly due to an asymmetry in collateralization preferences of the supply and demand side. SME financing as a proportion of overall private sector financing is currently 7%, down from a recent peak of 9% in 2016. Microfinance institutions have a successful cashflow based lending model that commercial banking hasn't practiced, however, the commercial banks can theoretically give an SME the credit amount it needs which microfinance banks often can't due to max limits on credit amount. SMEs need the best of these two worlds. And this is exactly what the policymakers are attempting to accomplish, with additional impetus from socio-economic development projects in the works (Kamyab Jawan, Kamyab Kissan, Naya Pakistan Housing Scheme) that rely on providing credit en-masse. The federal budget is introducing subsidies (credit guarantee, risk sharing, collateral free loans) as a catalyst to bridge this gap between microfinance and commercial banks' financing domain. Undoubtedly, the end goal is to build financial intermediation capacity for SMEs within the industry. Yet, as with any economic subsidy, there's a balancing act to be played between achieving immediate socio-economic goals & building a permanent intermediation capacity within the financial services industry.

Construction & Housing

Capital Gains Tax

The revenue target by the government from Capital Value Tax has been set at PKR 562 million. Comparing with the initial budget 2020-21, this is a significant decrease from PKR 2.7 billion in projected revenue[8]. A range of streamlining measures in the legislation have also been introduced on property taxation. Capital Gains Tax up to PKR 5 million on disposal of immovable properties will be taxed at 5% against the existing rate of 2.5%[9].

Gains greater than PKR 5 million will be taxed in line with the existing rates. Additionally, the pre-existing provisions of the holding period in the Income Tax Ordinance shall apply, which are

Exhibit 13: Existing Holding Periods for Capital Gains Tax *(CGT)*

Holding Period of Immovable Property	Gain on which Tax Rate is Applied
Less than a year	Consideration (sale price – cost)
Between 1 & 2 years	3/4th of Gain (sale price – cost)
Between 2 & 3 years	½ of Gain
Between 3 & 4 years	¼ of Gain
Exceeds 4 years	Zero

Source: Income Tax Ordinance, 2001

Exhibit 14: Updated slabs for Capital Gains Tax (CGT)

Amount of Capital Gain	Rate
Less than PKR 5 million	5% *(Increased from 2.5% in budget FY 2021-22)*
Between PKR 5 & 10 million	10%
Between PKR 10 & 15 million	15%
Above PKR 15 million	20%

Source: Finance Act 2021-22; Income Tax Ordinance, 2001

Property Income

The taxable income from property has been moved to net income basis, allowing certain "admissible" deductions that have been expenses by the taxpayer exclusively and wholly on/for the property. Furthermore, property income can be adjusted against a loss in any other income head. Withholding tax rates applicable to income from property have been revised for "Individuals" and "Association of Persons" *(as legally defined)*. See **Exhibit 15** for details.

[8] https://www.finance.gov.pk/budget/Budget_2021_22/6_Budget_in_Brief_English_2021_22.pdf#page=18

[9] https://www.pwc.com.pk/en/assets/document/AFFTaxMemorandumonFinanceBill2021.pdf

Exhibit 15: Proposed WHT Rates

Annual Property Rent *(gross)*	Rate of Tax
< PKR 300,000	0%
> PKR 300,000 but =< PKR 600,000	5% of amount exceeding PKR 300,000
> PKR 600,000 but =< PKR 2,000,000	PKR 15,000 + 10% of amount exceeding PKR 600,000
> PKR 2,000,000	PKR 155,000 + 25% of amount exceeding PKR 600,000

Source: Tax Memo, Federal Budget 2021 by PWC

Naya Pakistan Housing Scheme

Naya Pakistan Housing Scheme aims to provide **5 million** housing units to low and middle-income segments, as part of its socio-economic uplift agenda. The current supply sector caters to mostly upper-middle population segment. The program is a flagship scheme of the present government, that will build these housing units all over the country. The scheme would also induce growth in the construction and housing finance industry. Up till now, it has received eligible applications from 1.8 million people, of which 22% are women. According to the plans available with the Naya Pakistan Housing Authority, housing units are available in 4 sizes from 740 – 1100 square feet[10]. The maximum price of these housing units is PKR 3.5 million. In July 2020, SBP mandated that all banks finance the housing and construction of residential and non-residential buildings. Banks shall ensure that such financing is at least 5% of their domestic private sector credit by December, 2021.

The subsidy for Naya Pakistan Housing Authority is set at **PKR 30 billion**, the same amount which was earmarked in FY 2020-21 but later revised to **PKR 5 billion**.

An amount of **PKR 1 billion** has also been set aside for Naya Pakistan Certificates, a high-interest yielding sovereign investment certificates issued by SBP. The income of Islamic Naya Pakistan Certificates Company Limited shall be completely exempt from income tax.

Women-led Enterprises

The tax payable by women enterprises under the head 'income from business' is proposed to be reduced by 25%. However, this would be applicable to women-led businesses established from 1st July 2021. This may encourage older businesses to re-incorporate in order to avail the benefits of this measure. In terms of eligibility, sole proprietors owned by women, an association of person all of whose members are women, or a company whose 100% shareholding is held by women are eligible. It would be encouraging to broaden eligibility criteria for women-owned businesses. A comparable and realistic classification was introduced by International Finance Corporation (IFC) in, classifying women-owned businesses as one that meets any one of these three yardsticks:

1. At least 50% women-ownership
2. Sole women proprietorships
3. Women participation in ownership & management (top manager)

At this point, it is not known whether this scheme would be limited in terms of size of businesses as no further details are available in the budget publications.

Digital Financial Services

Deletion of Withholding Tax (WHT) on Transactions

WHT has been removed on banking transactions and funds transfers in the federal budget FY 2021-22.

[10] https://naphda.gov.pk/housing-structure.aspx

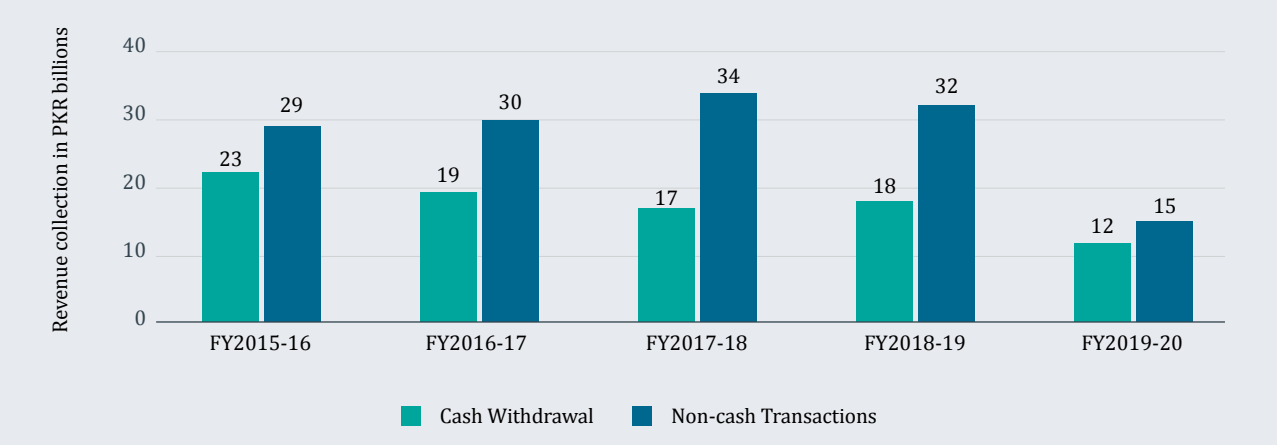
Exhibit 16: Withholding Tax on Banking Transactions, Removed

Type of Transaction	WHT Rate before Budget FY 2021-22	Applicability	Change
Cash Withdrawal	0.6%	On amount exceeding PKR 50,000, in a day, by Tax non-filers	Deleted
Banking Instruments and Non-cash transactions (demand draft, pay order, online funds transfer etc.)	0.6%	On amount exceeding PKR 50,000, in a day, by Tax non-filers	
Sending money abroad through payment cards	1%	Gross Amount	

Source: Finance Act 2021-22

This is a positive step for the banking sector that is expected to bring in more inflows to bank accounts, encourage digital transactions and reduce the money in circulation in the economy. The government had collected **PKR 27 billion** revenue through tax withheld on Cash and Non-Cash banking transactions in **FY 2019-20**.

Exhibit 17: Withholding Tax on Cash and Non-cash Domestic Transactions



Source: FBR Year Book 2019-20 by Federal Board of Revenue

Deletion of FED on Merchant Discount Rate

Merchant discount rate (MDR) is the cost of a transaction conducted by a customer using a payment card, such as credit or debit card, at a point of sale (POS) machine at a retail store. The cost ranges from **1.5 – 2.5%** of the transaction amount. Federal Excise Duty was being levied at **16%** on this MDR within federal jurisdictions, which has been abolished in the federal budget. Given the small market share of digital transactions conducted in federal territories, the impact of this measure is expected to be limited. Provincial budgets have not introduced such a measure.

Domestic Smartphone Manufacturing

In order to promote mobile phone manufacturing in Pakistan, customs duty has been exempted on "plant, machinery and production line equipment" required for manufacturing mobile phones.

The distributors, dealers, sub-dealers, wholesalers and retailers of locally manufactured mobile will benefit from a reduced rate of minimum tax at **0.25%** of gross turnover amount, provided that the beneficiary is on the Active Taxpayers' Lists. Except some specific type of entities mentioned, the standard rate is **1.5%** of gross turnover.

Conclusion

The current budget aims to build on the V shaped recovery from the pandemic and sustain these gains over a longer period of time. Several industries have been prioritized, especially those such as automobile and construction, which have recovered well from the pandemic supported by robust demand. Support has been extended to SMEs to enable sustainable growth across the board.

The automobile sector has gotten relief to promote the low-end vehicle segment (< 1000cc) for the general population. The electronic vehicle (EV) segment has also attracted relief in view of the government's pro-environmental focus, in line with the focus of the current government on the segment when it announced a novel Electric Vehicle policy in December, 2020[11]. A host of taxes have been reduced or exempted for these two areas, EVs and low-end vehicle segment. A couple of areas of concern are the removal of FED across the board for high-end vehicles too, and the exemption of customs duty on the import of Completely Built Units (CBUs) of vehicles under 1,000cc.

Measures for the SME sector have been significant: formal definition, taxation regime and reduced rates as compared to those that were applicable on small companies. More details would start to emerge on the specific schemes for SMEs as the newly approved National SME Policy and the related policy action plan is released in the public domain. The government is keen on increasing access to credit for SMEs.

The construction industry progressed remarkably after the initial pandemic driven lockdown, hitting an all-time high production of 5.7 million tonnes in Oct. 2020[12]. It is expected to continue on this trajectory given the focus on the Naya Pakistan Housing scheme, given that the government has incentivized the sector for participation in the scheme (e.g. under section 100D of the Income Tax Ordinance). Property sector received a host of streamlining measures in the legislation, which reflects an existing favorable stance towards the real-estate sectors through tax amnesty schemes. Minor but positive signals on renewable energy and climate change, such as tax reductions on bagasse powered plants and significant increase in PSDP funding for climate change division, in the current budget is noticeable. This is a good sign for green infrastructure development and financing in Pakistan.

PSDP funding has been significantly increased. In order to meet these expenses, the tax revenue target is steep keeping in mind the performance against the tax revenue targets for the past two years.

Box B: Unlocking Equity Financing for SMEs

On the SME financing side, there has been an opportunity to unlock equity financing from private investors, by introducing a holding period for equities' investment into SMEs similar to that in real estate. Currently, a private investor does not consider SMEs as an option for investment because, aside from other investment considerations, a 4-year holding period of a real estate investment provides a 0% tax rate on the capital gains on the sale of that investment. This year's federal budget has not touched upon this potential to unlock equity investment in SMEs. Investments in SMEs spur employment generation, economic productivity and exports. Real -estate investment does not complement an economy with these supplementary socio-economic benefits; the capital gain circulates between the upper-middle segment of the population within which real estate changes hands. Investment returns from SMEs can be reasonably considered to be a high-risk/high-return option. The risk-return matrix has added impact consideration: the SME segment contributing 30% to GDP and 25% to exports. Hence, opening up an alternative funding source through equity finance can delivery multi-pronged benefits.

To make good on this investment option, the SECP has already started exploring crowd funding options- via its regulatory sandbox, with specific interest in leveraging equity crowd funding platforms for investment in SMEs. Similarly, Pakistan Stock Exchange (PSX) introduced the Growth Enterprise Market Board (GEM Board) with significantly reduced listing requirements for SMEs.

As non-bank financing avenues start opening up, tax incentives at par with other asset classes, such as real estate, can entice a segment of investors to consider equity financing in SMEs as a viable option.

[11] https://www.thenews.com.pk/latest/762680-govt-announced-new-electric-vehicle-policy-for-pakistan

[12] https://profit.pakistantoday.com.pk/2020/11/07/as-construction-boom-takes-off-cement-production-reaches-industrys-capacity/

About Karandaaz

KARANDAAZ PAKISTAN is a Section 42 company established in August 2014 and focuses on fostering economic growth and creating jobs through financial inclusion of unbanked individuals and unserved enterprises, with a special focus on women and youth. The company has four verticals:

Karandaaz Digital

Focuses on expanding the poor's access to digital financial services in Pakistan by working across the ecosystem with all stakeholders.

Karandaaz Capital

Provides wholesale structured credit and equity-linked direct capital investments to micro, small and mid-size enterprises (MSMEs) that demonstrate compelling prospects for sustainable business growth and employment generation in Pakistan.

Karandaaz Innovation

Manages the Innovation Challenge Fund and Women Ventures, providing risk capital and grants to partners with the aim to generate innovative solutions in areas of financial inclusion and entrepreneurship.

Knowledge Management and Communications

Supports the company's core financial inclusion goal by developing and disseminating evidence based insights and solutions.

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