

Sixth Sense Update

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CAPITAL GAINS TAX: NO CGT ON FIXED INCOME FUNDS

The approved amendment to the Finance Bill 2010 clarifies the treatment of Capital Gains Tax (CGT) on mutual funds.

Fixed Income Funds are Tax Exempt

It is now confirmed that fixed income mutual funds will remain exempt from CGT. The approved amendments to the Finance Bill 2010 state that CGT exemption will be provided to those mutual funds/ collective investment schemes that are debt or money market funds and do not invest in shares. Therefore, the treatment of fixed income mutual funds remains unchanged and they continue to operate in a CGT free regime.

Equity Funds are Taxed

In line with our previous expectations, unit holders of equity funds are subject to CGT. The unit holders of open end mutual funds / collective investment schemes categorized as equity schemes (as per SECP circular 7 of 2009) shall be subject to capital gains tax on the same rates and on the same holding period as applicable for securities under section 37A.

Holding Period	Tax Year	Rate of Tax
Less than 6 months	2010	10.0%
	2011	10.0%
	2012	12.5%
	2013	15.0%
	2014	17.5%
	2015	17.5%
	2016	17.5%
6 to 12 months	2010	7.5%
	2011	8.0%
	2012	8.5%
	2013	9.0%
	2014	9.5%
	2015	10.0%
	2016	10.0%
Greater than 12 months		0.0%

Source: Budget documents, Sixth Sense Research

Capital losses are adjustable against gains made over the same financial year as opposed to our previous expectation of five years.

Moreover, it was decided that CGT would be deducted from the unit holder at the redemption stage at the applicable tax rate and the AMC will deposit the with-held tax in the government treasury every month. Thus, Asset Management Companies will act as tax collection agents for unit holders.

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We believe it is beneficial for the investor to bear the incidence of the tax. Firstly, an investor can control the holding period of his investment. Moreover by holding the investment for over 12 months, the investor can avoid any tax while capitalizing on short term trading opportunities. The investor benefits as the fund manager can trade frequently throughout the holding period and the investor can avoid CGT, by holding the fund for more than one year.

The treatment of CGT on balanced and asset allocation funds is unclear. Using the same rationale as that for equity schemes, we feel that unit holders of such funds may need to pay CGT; however the portion of CGT that is levied on such funds is uncertain.

Investments made prior to July 2010

The approved amendments also confirm the treatment of securities purchased prior to July 1st, 2010. In contrast to earlier expectations, CGT is now applicable for all securities based on the date of disposal, irrespective of date of purchase. Therefore, purchases made before June 30th, 2010 will be liable for the CGT if disposed within one year.

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