SECURITIES AND EXCHANGE
COMMISSION OF PAKISTAN

SECP

A DIAGNOSTIC REVIEW OF PAKISTAN'S PRIVATE FUNDS INDUSTRY

MAY 2022

AN APPRAISAL OF THE SECP REGULATED PRIVATE FUNDS SECTOR TO UNLOCK ITS TRUE POTENTIAL BY PRIORITIZING STRATEGY FOR ITS SUSTAINABLE REVIVAL

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CHAIRMAN'S MESSAGE

It gives me immense pleasure in presenting this in-house diagnostic review report undertaken by the Specialized Companies Division of the Securities and Exchange Commission of Pakistan (SECP) on Pakistan's Private Funds sector.

Traditionally, access to finance in Pakistan particularly for startups and small and medium sized enterprises (SMEs), has remained confined to personal savings, financial support from acquaintance or collateral backed loans from banks with low risk appetite. As such, the constantly evolving multi-faceted expansion of business cycle, is not met with formal credit. Private Funds (PF)-collectively refer to both Private Equity and Venture Capital Funds (PE&VC Funds) and Alternative Funds (AFs) and offer a vital avenue for not only providing capital but extending much-needed operational expertise and managerial bandwidth. Considering more than 60% of population comprises of youth in Pakistan and to encourage innovation and knowledge-based ideas into commercial production, the potential of PF industry requires to be practically tapped and fully explored.

In this backdrop, a comprehensive study was undertaken at the SECP to explore the current ecosystem, key impediments, resources available and existing PF industry. Prior to finalization of report, extensive consultation sessions were undertaken with Private Fund Management Companies that have launched funds, with key players of the start-up space to understand their lack of preference for the regulated PE&VC model and with diverse stakeholder at various forums. This report provides holistic synopsis and recommendations for desired key fiscal and regulatory reforms including tax reforms, need for consolidating diverse government workstreams and exploring untapped regulatory incentives provided by SECP as the way forward for a vibrant PF industry that can spur economic activity, catalyze job creation, provide reliable foreign investment channels and increase government revenues.

In recent years, we have witnessed a surge of foreign venture capital investment flowing into Pakistani based start-up companies - reportedly USD 373 million in the calendar year 2021 alone. SECP's multipronged outreach initiative on the amended Private Funds Regulations, 2015 has garnered interest in the SECP regulated PF industry. There is a continued interest in setting up PFs; fresh licenses as Private Fund Management Company (PFMC) have been granted to corporate/business groups; and applications for registration of PE&VC Funds, which had previously completely dried up, have started trickling in. Catalyzing on the recent momentum, I believe that it is the right time for all relevant stakeholders and policy makers, including the Government of Pakistan to consider the recommendations put forth through this report, and collaborate to harmonize their efforts, ideas and initiatives through an inclusive approach.

I would also like to commend the efforts of Private Fund team at SECP led by Ms. Khalida Habib, Executive Director and team members, Mr. Sajjad Ali, Mr. Umar Yahya and Mr. Amjad Iqbal for their time and efforts in planning and development of this premier diagnostic report, synergizing with all relevant stakeholders and providing progressive and robust recommendations for vibrant PF industry.

I am highly optimistic that timely implementation of the policy actions proposed under this report, in a synergistic manner, can result in the development of a sustainable PF sector.

A. INTRODUCTION TO PRIVATE FUNDS

1. In Pakistan, the regulatory framework for private equity and venture capital funds was first introduced in 1995 and has been revised substantially in 2001, 2008, 2015 and most recently in 2020. With the introduction of the private equity and venture capital regulations in 2015 (later amended in 2020) a number of new players have emerged in the private equity (PE) landscape that earlier had a lackluster response from the industry.

2. As of March 31, 2022, the number of NBFCs licensed by the SECP to undertake the business of private equity and venture capital fund management services stand at eight (8). Out of these NBFCs, four (4) have so far successfully launched only five (5) private equity and venture capital funds. Four (4) funds are focused on private equity investment and one (1) fund is targeting venture capital investments. The combined size of these funds stands at a meagre Rs. 10.99 billion with the largest two funds valued at over PKR 3.5 billion each. The sole venture capital focused fund stands at nearly PKR 2.0 billion.

Role of Private Funds:

3. Raising money for expansion or setting-up of a new business in Pakistan often remains a struggle, as there are very few available options for an existing/new business owner. The most common way for raising funds is through personal savings or entering financing arrangements with friends and family. The other option is getting a bank loan, which requires putting up collateral and with it the constant worry of repayments and/or losing the collateral in case the business fails. Also, banks generally have a lower risk appetite and have historically not been able to meet the country's SME financing needs. Another way to raise money is by getting listed on the stock exchange but that process is not favored by SMEs/start-ups, given the associated costs and other requirements such as minimum paid-up capital, paperwork, underwriting costs, higher standards of corporate compliance and record maintenance etc. The other rather less explored option is getting funded by a private equity/venture capital fund.

4. The way PFs work in Pakistan is, that only a Private Fund Management Company (PFMC) can launch a PF, after registration with the SECP. Once the fund is registered, the PFMC is able to raise money from eligible investors with the aim of making the investors a return on their investment. Upon securing funds from investors, the PFMC is able to conduct private equity and venture capital transactions with various investment strategies such as 'buy to sell' or 'buy to keep'. The transaction helps meet the requirements of the investee company, such as for expansion, organic growth, revival, turnaround or to bridge working capital financing needs etc.

5. The PFMC usually invests its funds' money in the investee company in exchange for a current or future stake in its shareholding and seat(s) on its board of directors corresponding to its shareholding. In some equity participation models, the PFMC is also given prerogative to appoint certain key executives. In order to safeguard its investment, the PFMC nominates/appoints individuals that have the business expertise and acumen to help the company achieve the desired performance standards that sync with the ultimate investment strategy of the PEVC Fund. Such mentorship becomes invaluable, especially as it may not be feasible for SMEs to have specialized analysts and advisors given the scale of operations and financial position. Additionally, the investee company gets access to patient investment that does not have to be repaid in the short term. PE&VC investment is also relatively easier for an investee company to deal with, considering limited stress of quarterly performance by investors.

6. The PFMCs charge money from the fund/its investors for fund management services in addition to any performance fees for exceeding pre-specified benchmarks. The valuations of the target company, are mutually decided instead of in an open market.

B. METHODOLOGY OF DIAGNOSTIC REVIEW

7. SECP has undertaken this diagnostic review in parallel with implementation of various alternate measures aimed at stimulating activity in the regulated PF sector (covered in later parts of the report). To deduce key concerns and issues, the review has involved close engagement and one-to-one sessions with the Private Fund Management Companies that have launched funds till date. Individual sessions were also held with key players of the start-up space to understand their lack of preference for the regulated PE&VC model, along with understanding gained through interactions at various forums with the National Incubation Center Islamabad and Ignite Pakistan[1].

8. Additionally, the SECP has been participating at various government forums to clarify key macro level policy issues and recommend required actions to government functionaries, ministries and departments including the SBP and FBR. SECP has presented its proposals on the way forward for catalyzing the sector before different Government forum such as;

- THE CAPITAL MARKET ADVISORY COUNCIL UNDER THE MINISTER OF FINANCE
- THE NATIONAL SME POLICY LED BY THE MINISTRY OF INDUSTRIES
- THE ENGAGEMENT WITH USA AND FOREIGN DIASPORA MANDATE UNDER THE MINISTRY OF IT & TELECOMMUNICATIONS CHAIRED BY THE WORTHY PRESIDENT OF ISLAMIC REPUBLIC OF PAKISTAN
- THE EHSAAS PROGRAMME – POLICY TO PROMOTE STARTUPS INITIATIVE BY THE MINISTRY OF SCIENCE & TECHNOLOGY

The Chairman SECP delivered a presentation on Pakistan's PF industry before the President of Pakistan on February 08, 2022 and March 09, 2022 which was also attended by the Adviser to Prime Minister of Pakistan for Commerce and Investment, government ministries/ departments such as Ministry of IT & Telecommunications, Federal Board of Revenue, State Bank of Pakistan and Pakistani diaspora etc.

9. Sessions with potential entrants to the PF industry and PFMCs exploring launch of PFs also provided meaningful input. Lastly, research on the PF sector in other jurisdictions has aided in examining the local industry from an international perspective and in finalizing our recommendations.

C. EVOLUTION OF PRIVATE FUNDS IN PAKISTAN

10. A number of local and international players expressed interest in investing in the private equity space in early-2000s (2001-2010) and a few local investment houses explored setting up private equity businesses. However, most local investment houses dropped the idea either citing an unfavourable local regulatory regime, more facilitative foreign regimes and double tax treaties.

11. The second wave of private equity funds entered the country around 2012-13 when USAID came up with the Pakistan Private Investment Initiative (PPII) program. The program generated three private equity players, The Abraaj Group, JS group and Baltoro. None of these fund management companies were licensed by the SECP as all three funds were registered offshore and not a single locally

[1]Ignite is a Ministry of IT & Telecommunications initiative for funding a knowledge economy through R&D in ICT and commercialization of research

registered fund was launched under the PPII. The second wave of private equity funds was thus also unable to generate much fanfare. The Baltoro Growth Fund, which launched in 2016, made two investments – one in AGP Limited, which got listed on the Pakistan Stock Exchange, and the other one in a wind power company. Since, none of the abovementioned funds were registered with the SECP, there is lack of readily available verifiable information regarding the size of these funds, their investments, current status etc. which exhibits a key characteristic commonly observed with regards to foreign domiciled funds operating in Pakistan.

12. The third wave was witnessed when the SECP announced the new private equity and venture capital fund regulations in 2015 and has continued with revamping of the regulations in September 2020. While the number of domestically licensed PFMCs increased it did not translate into desired growth in the number of Private Funds, which remained relatively stagnant since 2018.

13. After consistent efforts to revitalize the sector- approval for a new Private Fund subcategorized as a PE&VC Fund has been accorded in February 2022. The said Fund is structured as a Limited Liability Partnership, and it is expected that it will be launched in the coming months. It is envisaged that this fund will pave the way for private funds under this new legal structure to flourish.

D. OVERVIEW OF PRIVATE EQUITY AND VENTURE CAPITAL SECTOR IN PAKISTAN

14. Prior to exploring the private-equity and venture capital space within Pakistan we may first understand a few basics concepts and processes involved in setting up a registered private fund. A look into the model being followed by operators making direct investments in Pakistan's VC/start-up space is also warranted.

15. Currently, there are two major conduits for private capital channeled into potential investees:

i) **SECP Regulated Private Fund Management Companies:**

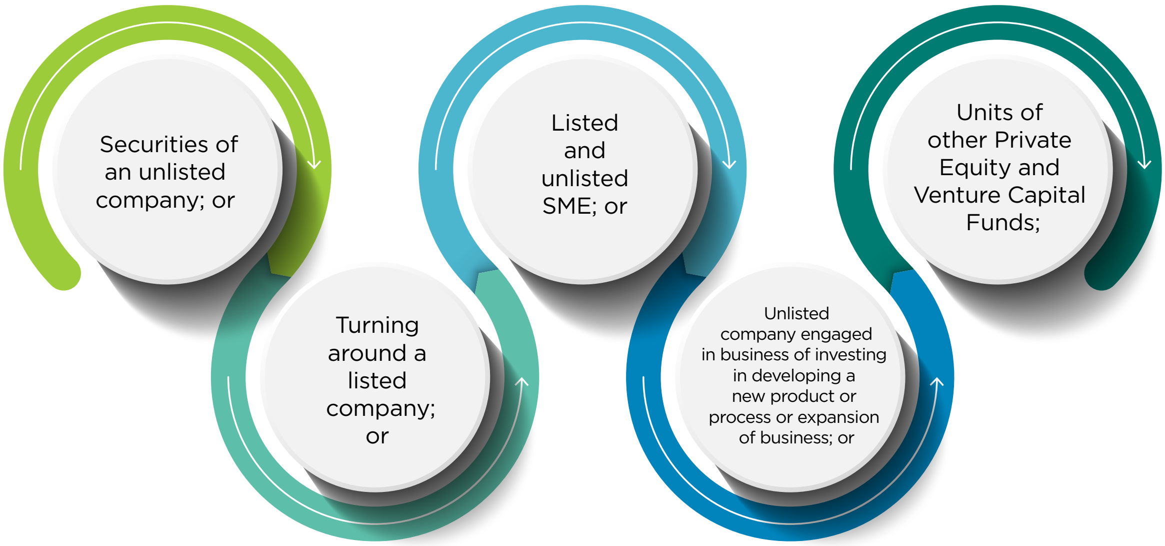
- The professional private fund management activity involves soliciting funds from investors for investing as per disclosed investment objectives.
- This activity is regulated through licensing of fund manager by the SECP and registration of the Private Fund under the Private Funds Regulations, 2015. [Procedure for registration of Private Fund attached as Annexure 'A' and Private Funds Regulations available at https://www.secp.gov.pk/document/private-funds-regulations-2015-updated-as-of-july-08-2020/?wpdmdl=40051&refresh=6204f65e9a72c1644492382]

ii) **Direct investment in start-up space:**

- Certain family owned businesses/ individuals/ groups/ corporates treat investment in start-up space as personal investment.
- These investors basically use their own pool of funds (foreign/non-resident investor funds are usually pooled in some other jurisdiction) and do not actively solicit local investors, rather they seek investment opportunities into the local space

16. In the SECP regulated structure, an NBFC that wishes to invest in private equity and venture capital is required to obtain license. After obtaining license, a private fund management company can launch the following types of Private Funds:

(I) Private Equity and Venture Capital Fund (PE&VC Fund): Can only be established in closed-end structure and invest in:



However, a PE&VC Fund cannot invest in derivatives.

(II) Alternative Fund: Invests in portfolio of securities and other financial assets other than PE & VC Funds so investment in derivatives and normal listed companies is allowed; can be in open-end or closed-end structure.

17. Some of the key features of a licensed PFMC are as follows:

- Can raise money only from eligible investors (max. 50) and QIBs (uncapped) in a separate fund in trust/company/LLP structure;
- Investment committed during fund life;
- PFMC makes revenue through management fees, bonus and performance fee;
- Finite fund life/investment horizon; and
- Expertise in identifying target companies

Industry Snapshot

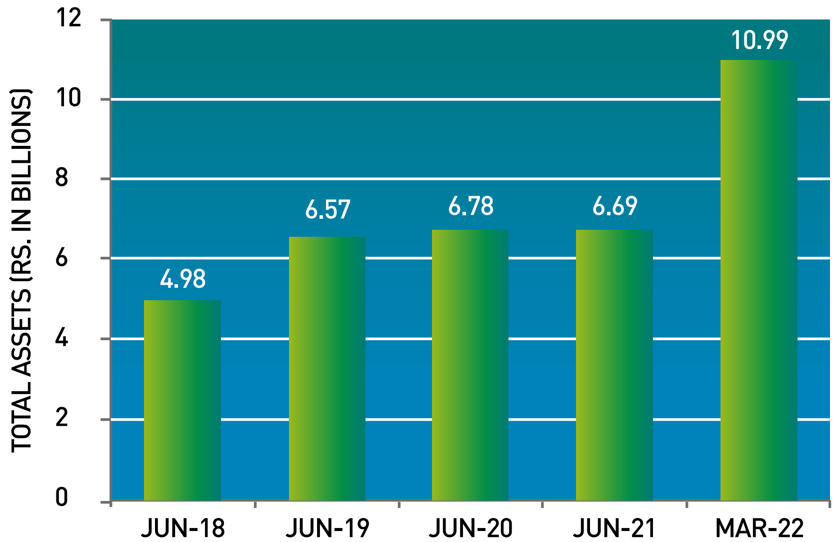
18. The position of the PF industry as on March 31, 2022 along with a five-year growth trend of the total industry figures is as follows:

Name of PFMC	Name of Fund
LAKSON INVESTMENTS LIMITED	LAKSON PVT EQUITY FUND LAKSON VENTURE CAPITAL FUND
IJARA CAPITAL PARTNERS LIMITED	PAKISTAN EMERGING MARKET FUND
PNO CAPITAL LIMITED	PNO PAKISTAN FUND 1
JS INVESTMENT LTD	JS MOTION PICTURE FUND
MAGNUS INVESTMENT ADVISORS	NIL
FAYSAL ASSET MANAGEMENT	NIL
ATLAS ASSET MANAGEMENT	NIL

TOTAL SIZE (PKR BILLION)

10.99

* Approval for registration of a Private Fund in LLP structure has been granted in February 2022 but the Fund is yet to be launched and hence not reflected in the above table



Fresh Applications for Launch of New Funds

19. Prior to this year, the industry remained relatively stagnant, even though the number of PFMCs increased from four (4) to eight (8). It is therefore heartening that despite the fiscal situation and absence of new PF applications from PFMCs that have already launched PFs (apart from the LLP structured fund), applications for six new funds have been received from recently licensed PFMCs.

20. The PFMCs have submitted applications for approval of draft trust deeds and trustee under the trust structure. Consent on trust deeds for five funds has already been granted and application for registration as notified entity are in process, subject to completion of other formalities such as registration of specialized trust under the Sindh Trust Act, 2020 from the Ministry of Industries Sindh. Five of the six funds are being backed by a commercial bank, which endorses the understanding given to the SECP as mentioned in Para 54 of this report.

E. DIRECT INVESTMENT IN START-UP SPACE

21. Pakistan has seen a surge in investments in the venture capital/start-up space from foreigners/local investors through avenues other than the SECP regulated private funds. CY 2020 saw investment commitments of approximately USD 77 million in startup deals whereas CY 2021 recorded investment commitments of over USD 373 million in the start-up arena (approximately PKR 65 billion).

22. Ninety six percent (96%) of the investments in CY 2021 were taken up by foreign investors[2]. Foreign investors evidently preferred making these investments/commitments through foreign holding companies, instead of investing directly in Pakistani startups or through the SECP regulated Private Funds.

CY 2020	CY 2021
Direct Investment in Startup Deals **PKR 13.5 Billion**	Direct Investment in Startup Deals **PKR 65 Billion**
Size of SECP Regulated PF Funds Sector **PKR 7.89 Billion**	Size of SECP Regulated PF Funds Sector **PKR 9.74 Billion**

Figure 1: Size of SECP Regulated PF industry vs. start-up deals in CY 2020 & 21

23. During past two calendar years, commitments of approximately USD 450 million have been received. However, because there is no regulatory obligation to report such deals, the figures cannot be relied upon with 100% certainty. The information is primarily sourced from news articles and websites containing announcements by the relevant investor, venture capitalist (VC) leading the investment round or investee company, and lacks details regarding the timeline for actual flow of funds i.e. the announcement only indicates total committed amount but does not convey when and on what terms the actual investment amount will be received. In a number of cases, information regarding the actual investors is not disclosed, and remains unavailable even to the incubation centers, Ignite and some of the VC players who are trying to maintain such records.

24. In a recent article[3] it was highlighted that the actual money that has been raised by the start-ups has failed to enter Pakistan in its entirety. The start-ups have also raised the concerns that foreign VCs do

[2] Ignite Pakistan

[3] https://www.thenews.com.pk/print/958821-most-of-startup-investments-never-land-in-pakistan

not prefer to bring entire funding to Pakistan and gradually release funds on need basis to run start-up operations. It is easier for them to repatriate their funds if the investment is in countries such as Dubai or Singapore. Furthermore, the concern on scrutiny associated with moving large amounts of investment in and out of Pakistan has also been raised. Lastly, they prefer keeping the money in USD due to the continuously depreciating PKR.

25. Detailed information on the VC deals during the period (based on press clippings, publications by local/foreign start-up data platforms and as shared by Ignite) is as follows:

CY-2020 TOP 5 DEALS:

Company	Investment Amount (USD)
AIRLIFT	22,000,000
BYKEA	13,000,000
FINJA	9,000,000
medznmore	2,600,000
Retail	2,300,000
Remaining 39 Deals (CreditBook, EdkASA, GrocerApp, Other Misc undisclosed)	28,100,000

Total Investment Amount (USD) 2020
77,000,000

CY-2021 TOP 10 DEALS:

Company	Investment Amount (USD)
AIRLIFT	85,000,000
بازار	30,000,000
JABBERWOCK VENTURES cheetay Swift	20,000,000
Tajir	17,000,000
QISST PAY	15,000,000
Educative	12,000,000
TAG	12,000,000
CreditBook	11,000,000
FINJA	10,150,000
BridgeLinx	10,000,000
REMAINING 50 DEALS	150,945,000

Total Investment Amount (USD) 2021
373,095,000

26. Information regarding some of the local venture capitalists/investors that are partnering with foreign funds and investing in local start-ups in Pakistan along with a list of some major offshore VC funds/investors identified based on media reports and information shared by Ignite is as follows:

Locally Domiciled VC Investors in Start-ups	Off-shore funds Investing (FPIs) in Pakistan
• Sarmayacar	• Phillip Morris Investments B.V.
• i2i (Invest2Innovate)	• Franklin Templeton Investment Funds
• 47 Ventures	• Frieslandcampina Pakistan Holding B.V.
• Indus Valley Capital	• Maybank International Trust (Lebuan) Berhad
• Fatima Gobi Ventures	• Lazard Emerging Markets Funds
• TPLe-Ventures	• Kingsway Capital
• Lakson Investments	• Schroder International Selection Fund
• Magnus Communications	• Soma Capital
• Pak Kuwait Investment Co.	• Mantis Capital
• Lean Bricks Co.	• Golden Gate Ventures
• Walled City Co.	• Ictsi Mauritius Ltd.
	• Pharoan Investment Group (Holding) Ltd.
	• Noor Financial Investment Company, Kuwait
	• Zayn Capital
	• Gobi Partners
	• Next Billion Ventures
	• Banana Capital
	• Baltoro Growth Fund

How local Venture Capitalists are operating

27. Most of the local VCs operating in the start-up space do not have any license from the SECP and only a few are incorporated as private limited companies, with object clause enabling investments in other companies. Such VCs tend to invest from their own resources or from funds raised in other jurisdictions and do not actively solicit investors in Pakistan. The investments they make are categorized as personal investments given that the funds have been pooled offshore to be brought into Pakistan.

28. Another model for investments similar to PE&VC investments is being done through the holding company structure. Certain listed companies are also acting as VCs and investing in start-ups. These companies can invest sponsor's own money or can raise money for making further investments from the general public through IPO/offer for sale. There is no specific time-frame for off-loading the investment and investors in such companies can exit through the secondary market.

Promoting the Venture Capital Space

29. To promote innovation, enterprise and conversion of scientific technology and knowledge-based ideas into commercial production, it is very important to promote venture capital activity in Pakistan. The recent boom in the area of information technology has shown that there is tremendous potential for growth of knowledge-based industries. This potential is not only confined to information technology but is equally relevant in several other areas, and with the proper ecosystem and policy support, can translate into economic growth and job creation.

30. A flourishing venture capital industry in Pakistan will fill the gap between the capital requirements of technology and knowledge-based startup enterprises and funding available from traditional institutional lenders such as banks. The gap exists because such startups are necessarily based on intangible assets such as human capital and technology-enabled operations. From the viewpoint of a traditional banker, such tech-based start-ups neither have physical assets nor a low-risk business plan. Not surprisingly, companies such as Apple and Yahoo, etc., initially failed to get capital as startups when they approached traditional lenders. However, they were able to obtain finance from independently managed venture capital funds that focus on equity or equity-linked investments in privately held, high-growth companies. Along with this finance came smart advice, hands-on management support and other skills that helped the entrepreneurial vision to be converted to marketable products.

F. COMPARISON OF SECP REGULATED PF SECTOR WITH GLOBAL PE & VC INDUSTRY:

31. Globally, private funds have played a pivotal role in the development of start-ups and SMEs, and helped in job creation, enhancing size of capital markets through increased listings and broadening tax network. PE funds also play a vital role in focusing on highly-fragmented sectors where they can use their capital and management expertise to bring together a number of compatible companies under single ownership and realise growth through synergies. Thereby, building a stronger, more vibrant and forward-looking sector with the potential of high export-based growth, such as in technology start-ups, textile industry, pharmaceuticals, business processing outsourcing etc.

32. The private equity industry and private equity backed companies directly employed more than 11.7 million workers in the United States in 2020 and generated $1.4 trillion of gross domestic product (GDP), or approximately 6.5% of total GDP[4], according to a report by EY and the American Investment Council. Additionally, the private equity industry paid $218 billion in federal, state and local taxes[5].

33. The table below provides a perspective of the size of the Private Funds industry as a proportion of GDP estimates in other jurisdictions as compared to Pakistan[6]:

USA

Nominal GDP ($) in million[6]
22,939,580

VC Industry Size ($) in millions
40,000

PE Industry Size ($) in millions
4,000,000

Total size ($) in millions
4,040,000

Percentage of GDP
17.61%

CHINA

Nominal GDP ($) in million[6]
16,862,980

Total PE&VC industry size in ($) millions
1,600,000

Percentage of GDP
9.49%

JAPAN

Nominal GDP ($) in million[6]
5,103,110

VC Industry Size ($) in millions
206,000

PE Industry Size ($) in millions
12,000

Total size ($) in millions
218,000

Percentage of GDP
4.27%

INDIA

Nominal GDP ($) in million[6]
2,946,060

Total PE&VC industry size in ($) millions
45,000

Percentage of GDP
1.53%

U.K

Nominal GDP ($) in million[6]
3,108,420

Total PE&VC industry size in ($) millions
31,000

Percentage of GDP
0.99%

MALAYSIA

Nominal GDP ($) in million[6]
371,110

Total PE&VC industry size in ($) millions
12,000

Percentage of GDP
3.23%

[4]New Ernst & Young LLP (EY) Report Highlights Private Equity's Role in the Economic Recovery - American Investment Council
[5]https://www.investmentcouncil.org/economicimpact/#:~:text=The%20private%20equity%20industry%20and,and%20the%20American%20Investment%20Council.
[6]https://statisticstimes.com/economy/projected-world-gdp-ranking.phpNew Ernst & Young LLP (EY) Report Highlights Private Equity's Role in the Economic Recovery - American Investment Council

GERMANY

Nominal GDP ($) in million[6]
4,230,170

VC Industry Size ($) in millions
2,000

PE Industry Size ($) in millions
14,000

Total size ($) in millions
16,000

Percentage of GDP
0.38%

SINGAPORE

Nominal GDP ($) in million[6]
378,650

Total PE&VC industry size in ($) millions
5,000

Percentage of GDP
1.32%

PAKISTAN

Nominal GDP ($) in million[6]
292,220

Total PE&VC industry size in ($) millions
56

Percentage of GDP
0.02%

34. The USA has slightly over 6,000 PE firms and nearly 2,000 VC firms, whereas in China the number of PE firms is approx. 1,673 while the number of VC firms stands at nearly 14,000. It is noted that in India there are nearly 470 PE firms and 520 VC firms. Pakistan with just eight PFMC licenses is far behind.

G. KEY FINDINGS - A STOCK-TAKE OF THE CURRENT SITUATION

(I) FIRST SUCCESSFUL EXIT BY A FUND

35. The industry witnessed its first successful exit. The fund divested 100% of its stake at slightly over 2X returns in approximately four (4) years. Favorable exit is an extremely promising development for the local industry and can also be expected to iron out major perceived impediments to smooth exit, such as tax treatment for distributions to the unitholders, distribution and reinvestment methodology, etc.

(II) FISCAL DILEMMA

(a) Amendments to Income Tax Ordinance, 2001 vide Finance Act, 2021:

36. The FBR through the Finance Act 2021 has discontinued all fiscal incentives available to the PF sector that provide it a level playing field with other pooled investment asset classes; like mutual funds and the Real Estate Investment Trusts. The pass-through status earlier available to PFs has been withdrawn through deletion of clause 101 of Part I of 2nd Schedule of Income Tax Ordinance (ITO). The deletion also triggered minimum tax on PFs in terms of sub-clause (xii) of clause 11A of Part IV of 2nd Schedule. Clause 103 of Part I of 2nd schedule which extended to distribution received by a taxpayer from capital gains of a PF has also been done away with.

37. Similarly, amendments proposed to section 47B have resulted in applicability of withholding tax on PFs, even though such tax is non-applicable for other categories of funds which have pass through status as per tax law. As a result, the following taxation layers become applicable on a PF:

- **Level 1:** 29% tax on income of investee company
- **Level 2:** 29% tax on income of PF
- **Level 3:** 15% tax on dividend to PF investor

In case of corporate PF investor, more layers would be added as per corporate tax regime.

38. The investment through PFs now stands at an inherent disadvantage due to multiple layers of taxation. This unfavourable taxation environment has severely hampered growth of locally domiciled PFs.

39. It needs to be considered that the first fund under the revamped Private Funds Regulations, 2015 was launched in 2017. While, the earlier pass-through status with built-in sunset clause granted by FBR till 2024 was a cause for concern for new entrants of the industry contemplating a 5-7 years fund life. The uncertainty surrounding the fiscal environment for the sector has been further augmented due to the recent withdrawals which also strengthened views of many of the foreign investors who cite lack of consistent policies as a key reason for not investing directly in locally domiciled funds.

40. The PF industry has, however, obtained some clarifications from leading audit firms that clause (57) of Part I of the Second Schedule of ITO provides exemption on total income of a PE&VC Fund, other than specified capital gains, provided that the fund distributes 90% of its income of that year amongst its unitholders.

41. In addition to the above, insertion of clause (103D), Part I of the Second Schedule to the ITO has granted exemption on dividend income and long-term capital gains derived by a PE&VC Fund that invests in enterprises setup under the Special Technology Zones (as defined under Special Technology Zones Authority Ordinance, 2020) for a period of 10 years from the date of issuance of license by STZA authority to the enterprise.

(b) Global Tax Perspective:

42. It needs to be noted that the SECP has been pursuing fiscal reforms for the PF sector, in line with similar fiscal measures adopted by various other jurisdictions. As can be seen below, majority jurisdictions such as UK, USA, China, Malaysia, India, Italy, France, South Korea, Turkey, Bangladesh etc. provide pass-through status for private equity and venture capital funds (practices in other jurisdictions for fund level tax on PE&VC Funds attached as Annexure B).

43. Interestingly, in some jurisdictions such as Israel, which has emerged as a venture capital investment destination, in addition to pass-through status, the investee companies in which a venture capital fund makes an investment was also granted a ten-years tax holiday[7]. Such measures adopted in other jurisdictions have not only ensured tax neutrality but further incentivized investments through PE&VC funds.

(c) Recent Fiscal Developments:

44. In addition to actively pursuing fiscal reforms with the FBR, the SECP has also been advocating the same at various forums, including with the Asian Development Bank, as part of its recommendations for implementation of Capital Market Development Plan and Road Map 2020-2027. Necessity of fiscal reforms has also been highlighted during various workstreams with the Ministry of Finance, the Ministry of IT & Telecommunications, Ministry of Industries and Ministry of Science & Technology workstreams and lastly before the Honorable President of Pakistan. The detailed tax proposals finalized recently with the industry are attached as Annexure C.

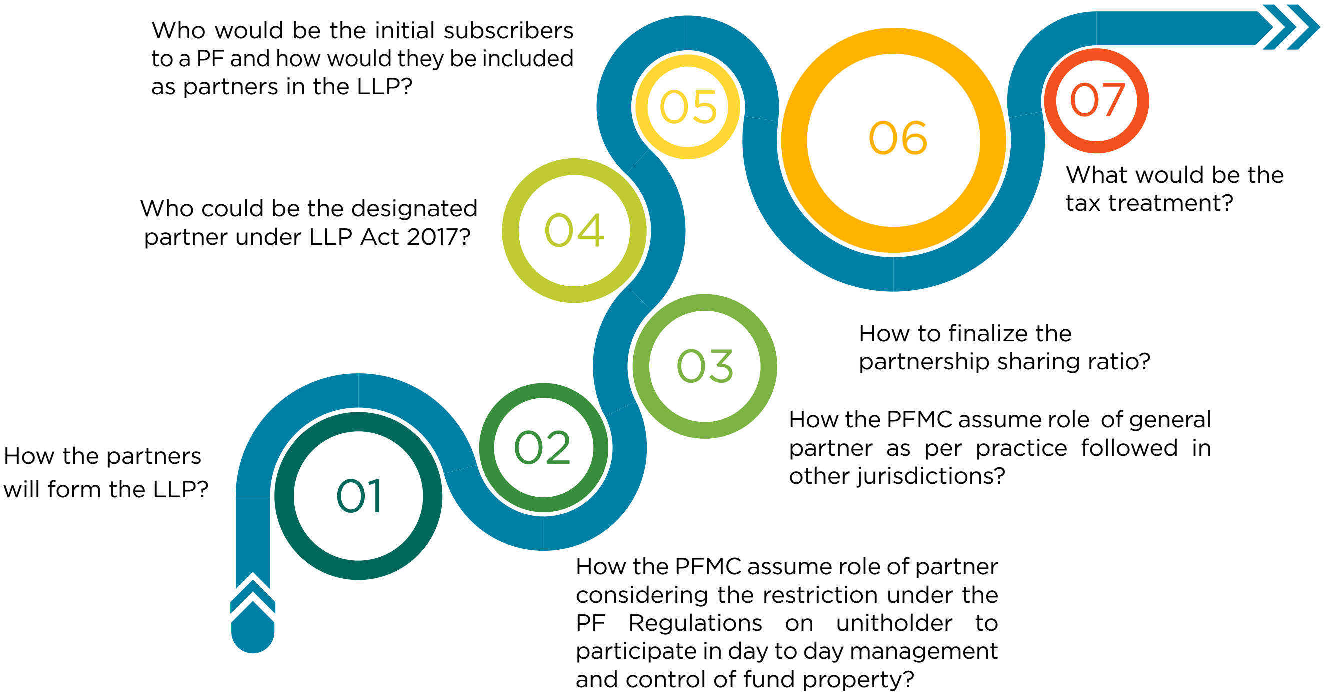
45. A recent news article published on March 09, 2022 cited announcement by the former Finance Minister that Capital Gain Tax on Venture Capital funding into Start-ups will be reduced to zero percent for 5 years. This is an extremely encouraging sign that the tax policy is moving in the right direction. However, amendments to the Income Tax Ordinance, 2001 in this regard are awaited.

(III) PF UNDER LIMITED LIABILITY PARTNERSHIP MODEL

46. The PF Regulations were amended in July 2020 to enable PFs to be established in alternate legal structures in addition to the already allowed trust structure i.e. by incorporating a company under Companies Act, 2017 or registering an LLP in accordance with LLP Act.

47. However, discussions with the industry revealed a common perception that the LLP model under the Limited Liability Partnership Act, 2017 (LLP Act, 2017) is not workable for structuring a fund. Few major concerns as perceived with respect to structuring a fund as an LLP while ensuring compliance with requirements under LLP Act 2017 and PF Regulations, 2015 were:

[7]Venture Capital Investments in Israeli Companies: A Tax Planner´s Primer - Finance and Banking - Israel (mondaq.com)



48. Through further discussions on the above areas, a PFMC expressed interest in exploring launch of a fund in LLP structure. Being a first of its kind initiative, extensive efforts were dedicated towards exploring the legal and operational modalities for ensuring compatibility of an LLP structured fund with the regulatory framework. The SECP remained actively engaged with the PFMC to finalize the optimal route for enabling a private fund in LLP structure. An LLP Agreement and Custodian Agreement was successfully finalized in manner consistent with requirements of the PF Regulations, the LLP Act 2017 and the regulations framed thereunder.

49. Some key features incorporated in the LLP Agreement and Custodian Agreement to provide workable model compliant with the applicable framework are attached as Annexure D.

50. It is pertinent to mention, that during the approval process, it transpired that an LLP structured fund could mitigate the tax disincentives created due to withdrawal of fiscal measures for private funds through the Finance Act, 2021. The provinces of Sindh and Punjab are considering LLPs as Association of Persons (AOP) for tax purposes while issuing NTN. The LLP fund is therefore able to avail single tiered taxation under provisions of section 92, Part III, Chapter V of the Income Tax Ordinance, 2001 thereby ensuring a certain extent of tax neutrality.

(IV) MULTIPLE GOVERNMENT INITIATIVES

51. As stated in earlier sections of the report, the last year has witnessed multiple workstreams led by various Ministries which have included measures relevant to the Private Funds industry. The SECP has enthusiastically supported all such workstreams by providing required comments, feedback, presentations, proposals etc. There is undoubtedly a pressing need for government support and funding to effectively promote and develop the country's private funds sector by allowing closer synchronization with the venture capital space, especially considering success of similar approaches in various other jurisdictions such as Malaysia, Turkey, Korea and Kuwait etc. However, it is felt that there is urgent need to consolidate these government workstreams, towards achieving a common goal, which has not come to fruition. The below figure provides a snapshot of the various workstreams:

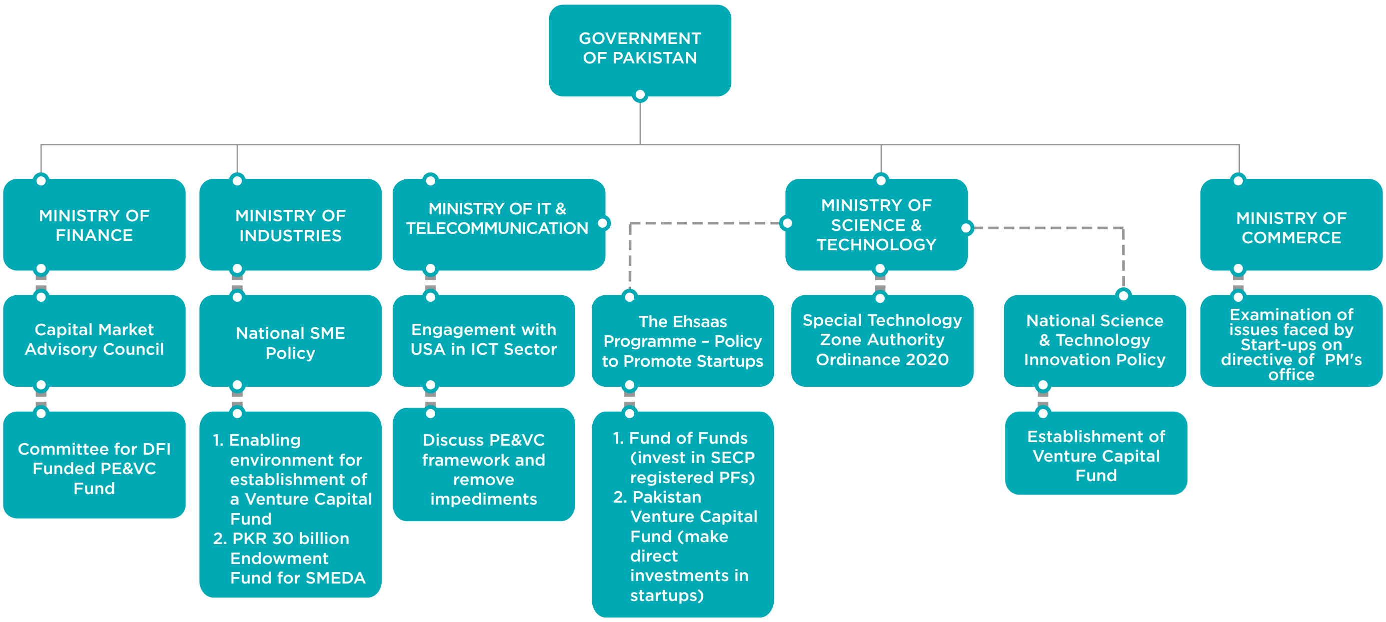


Figure 2: Government initiatives with PF Sector related mandates

52. In addition to the above, the ADB Capital Market Development Plan and Road Map 2020-2027 required that license duration for PFMCs may be extended for at least 7 years from current duration of 3 years. This recommendation is catered through proposed amendments to the NBFC Rules, 2003 for making NBFC license perpetual.

53. As regards the Ministry of Finance mandate of a DFI Funded PE&VC Fund, the Committee comprising representatives from DFIs, SBP and industry experts, in which the SECP also participated as Secretariat for the Committee, has finalized its recommendations, for presentation to the Minister of Finance.

(V) AUGMENT POOL OF INVESTORS

(a) Banks: Amendments to SBP Prudential Regulations

54. The SBP Prudential Regulations for Corporate/Commercial Banking do not explicitly refer to PFs. Following meetings with the SBP, it was accordingly proposed in July 2020 that necessary amendments may be made in Prudential Regulation (PR) R-6 or SBP may clarify to banks/DFIs through FAQs that investments in units of Private Funds registered with SECP are allowed as per limits under Prudential Regulation R-6.

55. A meeting was held with the SBP in February 2022 in which the SBP conveyed that changes to PR R-6 have been recommended for approval. However, SECP was given the understanding that even the current PR do not prohibit such investments by banks. As confirmation of this stance, the SBP was open to providing verbal and written comfort in case any bank is uncertain in making investments in units of PF due to current wording of the PR. Definitive timeline for approval and notification of the amended PR was not available.

(b) Pension Funds: Allowed to Invest in Private Equity & Venture Capital Funds:

56. To enable PE&VC funds to harness long-term sticky capital, pension funds have been allowed to invest up to 5% of net assets of equity sub-fund in units of SECP registered private equity and venture capital funds. However, no pension fund has so far made any such investment.

(c) Insurance Companies Permitted to Invest in Private Funds:

57. Currently, there is ambiguity within the insurance sector regarding investment in units of private equity and venture capital funds. In order to increase the investor pool, develop the private fund industry and provide an additional avenue of investment for the Insurance sector, it is imperative that clarity is provided with regards to investment by Insurance companies in Private Funds and the treatment for calculation of such assets for solvency purposes.

(VI) ENABLING PARTICIPATION OF FOREIGN NBFCS

58. The draft Non-Banking Finance Companies Act, 2021 (draft NBFC Act) which is an updated, dedicated and consolidated parent law for the NBFC sector is expected to resolve some major issues being cited by various PF industry stakeholders; inter-alia, streamline licensing requirements with reduced procedures along with simplified requirements for licensing of foreign NBFCs to operate in Pakistan; enable structuring of funds in alternate legal structures including through variable capital companies, and enhance and optimize the concept of trustee/custodian etc. The draft NBFC Act has been approved by the Cabinet Committee on Legislative Cases and is awaiting introduction in the National Assembly.

(VII) STREAMLINING THE PARTNERSHIP STRUCTURE

59. The Commission reviewed the Partnership Act, 1932 to propose suitable amendments in order to encourage private equity investment by providing limited and unlimited liability options to partners, starting from the partnership act of Islamabad Capital Territory.

60. A concept paper for amendments to the Partnership Act was taken up with the Chief Commissioner, ICT in August 2020 followed by a meeting with the Registrar of Firms, ICT whereby the Registrar of Firms agreed to revert to SECP. However, the efforts could not materialize despite repeated follow-ups. The proposed amendments have been taken up with the Ministry of Finance and subsequent meetings have ensued. SECP contemplates taking up the matter with other provinces.

(VIII) DISCUSSIONS WITH THE START-UP SPACE

61. Issues cited by some players from the startup space were also explored to better understand key impediments contributing to visible preference to continue operating outside the SECP regulated PF framework. Following discussions in two such meetings, key impediments and recommendations on the way forward were submitted to the SECP. The key issues highlighted are summarized below:

Sr.	Issue
01	Perceptional issues owing to skewed international media coverage that sometimes lead to hesitation about Pakistan as an investable jurisdiction for various reasons such as low international ranking as projected in Doing Business Report on enforcement of contracts. Despite changes in SECP's PF Regulations, most foreign fund managers preferred a structure that would allow foreign domiciled general partners (GP) to operate a fund in Pakistan. The optimal structure for foreign fund managers, not currently allowed in Pakistan, would be to have a foreign GP that manages two funds: the international fund and the Pakistan fund. Investments from both funds would be made in the ratio of capital raised. This would allow Pakistani Limited Partners (LPs) to participate and invest in VC funds managed by reputable foreign VCs.

Sr.	Issue
02	An erroneous impression that the procedure for establishment of a Fund in Pakistan is cumbersome and that the whole process takes significant time and requires non-standard documentation.
03	Trustee's process is slow and cumbersome, the fee is high. The process and involvement of the custodian needs to be clarified in a manner that is more systematic.
04	There should not be any Services Tax on management fees for the GP. It should be a passthrough transaction.
05	Onboarding and licensing fees are higher than in global jurisdictions such as Cayman Islands.
06	VC fund regulations are very similar to how AMCs are regulated, even though they are substantially different in nature. Simplification of the structure for a "Venture Capital" investment needs to be explored. VC investors (internationally known as LPs) are far more sophisticated than what is presently presumed. As a result, there is not much required when it comes to the investor's protection (they are able to hire lawyers and negotiate the terms of their investment) and therefore trying to set up escrows / custodians etc., is not really required in most cases. In USA, in terms of the Investment Company Act, 1940 a Private Fund does not need to register with the US Securities and Exchange Commission (the "US SEC") as an investment company, if it has less than one hundred (100) investors.
07	The requirements to get the documents attested and notarized by the Pakistani consulate is outdated, time consuming and cumbersome.

62. A summary of the recommendations received as outcome to the above meetings are as follows:

Sr.	Recommendations
01	Processing time for reviewing application is comparatively longer (2-3 months as opposed to places such as Cayman Islands that revert in 10-15 days). One of the ways to undertake this is to prepare standard documentation and make it available to the potential fund managers. Added to this can be a tracking process, where the applicant can have visibility on the stage of the approval process as set timeline would help the investors anticipate the duration of such procedure.
02	Same regulatory framework applies whether it is a smaller fund or large one. The compliance requirements should be tiered depending on the size of the fund. The registration process can be structured based on fund size or the number of investors etc.
03	Allow fast-track procedure for GPs that have been licensed in other recognized jurisdictions across the world.
04	A technology driven approach needs to be embraced by the concerned authorities like the introduction of QR code for document verification, as is currently used by most of the foreign regulators. Countries including the USA, UK, China and even India have digitized their attestation of documents. A similar step to digitize and simplify the procedure should be introduced in Pakistan as well.
05	Cumbersome compliance requirements such as providing valuations every 6 months need to be done away with.
06	The authorities should opt for an arrangement where escrow/custodian agreements can be executed with the banks, so that the role of an escrow/custodian may be determined as similar to the one's executed by the Dubai International Financial Centre.
07	At the moment only three vehicles i.e., trust, company and limited liability partnership are available for the establishment of the Fund(s) in Pakistan as per the Regulations. SECP may introduce the concept of variable capital companies ("VCCs"), which allows several investment schemes to gather under one umbrella of a single corporate entity while remaining ring fenced from each other. The same model has been adopted by Singapore and has managed to gather the attention of investors.

63. It has also been recommended that a roundtable be conducted with active VCs in Pakistan to discuss how the SECP can support them in setting up funds or parallel funds. It was also proposed that sessions may be set up with top business families of Pakistan for creating awareness regarding the PF regulatory framework, and the flexibility and benefits of investing in the PE&VC space through the regulated PFs.

H. RECOMMENDATIONS

(I) Consistency in Fiscal Reforms

64. There is a pressing need to remove the fiscal impediments created through the Finance Act 2021 to restore investor confidence in the sector. In addition to advocacy for the specific tax proposals, it is essential to create an understanding that consistency in fiscal policies is vital for maintaining confidence of foreign investors. Fiscal measures for the sector therefore need to be considered on a perpetual basis as in other jurisdictions and not as an interim make shift arrangement that may be withdrawn in case of pressure to reduce the number of exemptions.

65. Also, LLP being taxed as an AOP should be explicitly provided in the tax laws so that a consistent policy is adopted across all provinces.

(II) Increasing the Investor Pool

66. The SBP PR Regulations may be amended to explicitly allow investment in units of private funds by banks, to provide clear and simple guidelines for banks to proceed further with PF investments.

67. Existing section 218(2)(b)(ii) of the Companies Act, 2017 permits employees' contributory funds to invest in various asset classes such as government securities, bonds, units of CIS, and in listed securities. However, such employee contributory funds cannot channelize their investment in unlisted companies/unlisted private funds. As a result, the employee contributory funds deploy their long term capital pools to risk free investments and cannot mobilize capital for segments actually requiring long term investments and offering higher potential returns. Normally, employee contributory funds in various other jurisdictions have been allowed to take certain exposure in relatively riskier assets such as unlisted securities/ unlisted private funds. Amendments to the Companies Act, 2017 for enabling employee contributory funds to invest a certain portion in private funds may be considered.

68. Pension funds have been allowed to invest up to 5% of net assets of equity sub-fund in units of SECP registered private equity and venture capital funds. Efforts are required to mobilize such investments through an active campaign by the PFMCs that reaches out to the Pension Fund Managers.

69. Draft amendments have already been proposed to the Unit Linked Product and Fund Rules, 2015 for allowing a unit linked fund to invest in units of Private Funds. Although insurance companies are not expressly prohibited from investing in units of PFs and an insurance company has even made investments in PF units, absolute clarity may be provided to insurance companies that such investments are allowed. Moreover, in order to address the concerns of insurance companies that such investments would adversely affect their solvency ratios, development of requisite criteria for supporting inclusion of investment in private funds by insurance companies in their solvency ratios by providing a certain percentage of allowable investments should be explored.

(III) Flexibility in Investment and Exit for Investors of Unlisted Securities

70. The private-equity secondary market, also often called 'private-equity secondaries' or simply 'secondaries') refers to the buying and selling of pre-existing investor commitments to private-equity and other alternative investment funds. Such markets address the lack of liquidity created due to absence of established trading markets for such interests. Sellers of private-equity investments sell not only the investments in the fund but also their remaining unfunded commitments to the funds. By its nature, the private-equity asset class is illiquid as it is intended to be a long-term investment. In developed jurisdictions such as Hong Kong, United Kingdom etc. there is a robust and maturing secondary market available for sellers of private-equity assets.

71. PSX may be asked to explore if a platform can be established or utilized to accommodate a secondary market where interests/commitments in PFs can be bought and sold. Participation on the platform could be limited only to registered eligible investors and qualified institutional buyers. Such a platform could provide renewed interest in the PF space as it can be beneficial in many ways for both the PFMC and its investors, such as by satisfying various requirements including the need to raise additional capital, the desire to avoid future capital calls, the need to reduce an over-allocation to the asset class or for regulatory reasons.

(IV) Amendments to the PF Regulatory Framework

72. As per clause 2(xiii) of the Private Funds Regulation 2015, a "Private Equity and Venture Capital Fund" can invest mainly in securities or financial assets other than derivatives of an unlisted company or for turning around a listed company or listed and unlisted SME or an unlisted company engaged in business of investing in developing a new product or process or expansion of business. This definition is restricted to investment in companies. Given that PFs are being allowed in alternate structures such as LLPs, clarity may be provided in the definition to enable PE&VC funds to invest in LLPs.

73. The role of trustee/custodian as provided in the PF Regulations may be reviewed in line with international practices to ensure that it complements the activities of the PF and does not in any way cause disruption in the deal flow and operations of a PF.

74. Efforts have been made to simplify the licensing requirements for PFMCs and reduce the application turnaround time. Although the turnaround time is directly proportional to the quality of submissions by the applicants, it is felt that removal of requirements in the NBFC Rules, 2003 with respect to independent director on a PFMC can prove fruitful. Proposed amendments to the said rules already submitted to the MOF include this proposal along with the proposal to make the PFMC license perpetual, instead of for three-year period currently allowed under the rules. The matter needs to be pursued for expeditious notification of amendments to the NBFC Rules, 2003.

75. The fees charged to PFs by the trustees need to be reviewed to ensure that such fee is not serving as an entry barrier. In this context, applicable CDC Regulations also require analysis from the perspective of fees charged to a PF for services provided by the CDC in the capacity of trustee. If such fees are not specifically covered in the regulations, the same may be capped through a circular/notification.

76. Efforts are needed to ensure early promulgation of the draft NBFC Act to streamline the licensing process and enable optimal participation of local and foreign NBFCs in development of the sector.

(V) Aligning the Government Initiatives and launch of a Government backed Private Fund

77. As also mentioned above, the various government initiatives for the PF sector need to be better aligned through a central focal point such as BOI, SBP or SECP, so that a consolidated regulated PF ecosystem can be developed to serve the purposes of the Government and the PF sector. This will entail approaching various ministries to centralize and align the various workstreams for a realizable outcome in the short to medium term.

(VI) Outreach and Coordination Efforts

78. As also recommended by the VC space stakeholders, more sessions may be organized with key players in the VC space to identify impediments and address any bottlenecks (actual or perceived) that they may be facing in entering the regulated PF industry.

79. The framework already provides for establishment of alternative funds. However, we have not witnessed much interest in such funds till date. The outreach and consultation efforts may include mandate to explore how and why alternative funds are yet to be launched within the country and whether there is any appetite for the same.

(VII) Creation of a website

80. There is a dire need for access to information and data regarding private equity and venture capital deals in the start-up space of the country. Therefore, as suggested by stakeholders, it is recommended that a website may be created which could act as a dashboard for maintaining such information.

81. The said website can have information regarding execution of latest deals, size of transactions, information of key players, message board connecting investors and companies that require investments. Stakeholders can also use the website as a forum to collectively identify regulatory issues hampering growth of the industry and take those issues up with the relevant ministry/department.

(VIII) Miscellaneous

82. In order to encourage formation of PFs, especially in alternate legal structures other than trust, an information pack containing sample constitutive documents (trust deed, LLP Agreement, Custodian Agreement) of a private fund may be placed on the SECP website.

The above initiatives, if concluded in a timely manner, can be expected to rejuvenate the private funds sector and ensure its sustainability in the longer term. We can definitely expect to witness an increase in the number of PFMCs and private equity and venture capital funds in Pakistan as the industry becomes more attractive through improved commercial viability and operational ease.

As also mentioned earlier, a vibrant Private Funds sector can, inter alia, usher economic growth, provide job creation, enhance capital market size, broaden the tax network and increase government revenue due to growth of investee company.

Annexure-A

INCORPORATION OF NBFC AND GRANT OF LICENSE AS A PRIVATE FUND MANAGEMENT COMPANY

The Private Fund Management Company (PFMC) is a Non-Banking Finance Company ("NBFC") licensed by the Securities and Exchange Commission of Pakistan ("SECP") to carry out Private Equity and Venture Capital Fund Management Services in accordance with Part VIII-A of the Companies Ordinance, 1984, the NBFC & NE Regulations, 2008 and the Private Fund Regulations, 2015. A PFMC is incorporated/licensed under the Ordinance read with the provisions of the NBFC Rules, 2003 (the "Rules"). Following is the general procedure for Incorporation of NBFC and licensing as PFMC.

NOC for Formation of NBFC

Application to Specialized Companies Division, SECP Headquarter Islamabad for obtaining permission to form an NBFC along with the following documents:

- Form I of the NBFC Rules, 2003 along with all relevant supporting documents
- Fee with Form I (as per Schedule I of the PF Regulations, 2015)

▼

Incorporation of NBFC

Any form of company incorporated as NBFC at the concerned Company Registration Office, as per the existing procedures, forms and fees.

▼

Licensing as PFMC

Application to Specialized Companies Division, SECP Headquarter Islamabad for grant of license to carry out Private Equity and Venture Capital Fund Management Services

- Form II of the NBFC Rules, 2003 along with all relevant supporting documents
- Fee as per Schedule I of the PF Regulations
- Minimum equity requirement of rupees ten (10) million

▼

Licensed granted to PFMC

Registration of Private Fund (under Private Funds Regulations, 2015)

The following documents are required to be submitted for grant of license:

- Date of incorporation as a limited company;
- Authorized, subscribed and paid-up share capital of the company;
- Names and addresses of directors and number of shares held by each of them;
- Directors' interest, direct or indirect, in any other company with details of such interest;
- Details of persons or group controlling the company including major shareholders with number and value of shares held;
- Details of qualified staff engaged;
- Application fee;
- Certified copies of the memorandum and articles of association and certificate of incorporation;
- An affidavit as to the correctness of the above information by the chief executive;
- latest audited copy of the financial statements; and
- Latest equity position of the company.

Annexure-B

GLOBAL TAX REGIME FOR THE PE & VC FUNDS

INDIA

Fund Level Taxation

FUND LEVEL PASS THROUGH

BANGLADESH

Fund Level Taxation

FUND LEVEL PASS THROUGH

MALAYSIA

Fund Level Taxation

VC COMPANY HAS FULL INCOME TAX EXEMPTION ON ITS STATUTORY INCOME DERIVED FROM ALL SOURCES EXCLUDING INTEREST INCOME ARISING FROM SAVINGS OR FIXED DEPOSITS.

TURKEY

Fund Level Taxation

FUND LEVEL PASS THROUGH (PROVIDED THAT A MINIMUM OF 50% OF THE PORTFOLIO IS INVESTED IN TURKISH COMPANIES)

SOUTH KOREA

Fund Level Taxation

FUND LEVEL PASS THROUGH

FRANCE

Fund Level Taxation

FUND LEVEL PASS THROUGH

DENMARK

Fund Level Taxation

FUND LEVEL PASS THROUGH

ITALY

Fund Level Taxation

FUND LEVEL PASS THROUGH

USA

Fund Level Taxation

MOST ENTITIES ARE LIMITED PARTNERSHIPS OR LIMITED LIABILITY COMPANIES THAT ARE TREATED AS PARTNERSHIPS FOR US TAX PURPOSES.

CHINA

Fund Level Taxation

LLP STRUCTURE FUNDS ARE TAX TRANSPARENT AS NO TAX ON ENTITY LEVEL, THERE IS ONLY INVESTOR LEVEL TAX.

MEXICO

Fund Level Taxation

FUND LEVEL PASS THROUGH

SWITZERLAND

Fund Level Taxation

FUND LEVEL PASS THROUGH

UNITED KINGDOM

Fund Level Taxation

FUNDS MOSTLY IN LIMITED PARTNER VEHICLE WHICH IS TAX TRANSPARENT (PARTNER LEVEL TAXATION)

Annexure-C

In case of corporate PF investor, more layers would be added as per corporate tax regime.

Existing	As per Finance Bill 2021	Proposal	Rationale/Comments
Definition	**NIL**	New insertion of definition of Private Fund: **(45A) Private Funds means a fund as defined under Private Funds Regulations 2015.**	SECP vide S.R.O. NO. 1159/2015 dated November 25, 2015 notified the Private Funds Regulations 2015 which repealed the existing Private Equity and Venture Capital Funds Regulations 2008. Therefore, new definition of Private Funds is proposed to be included in the income tax ordinance. Given the amended Regulations are taking into account all forms of Private Funds, it is logical that the tax code be applied equally across the various fund types.
Second Schedule PART I			
(101) Profits and gains derived between the first day of July, 2000 and the thirtieth day of June 2024 both days inclusive, by a venture capital company and venture capital fund registered under Venture Capital Companies and Funds Management Rules, 2000 and a Private Equity and Venture Capital Fund.	Omitted	(i) Removal of limitation on pass through status of all Private Funds (ii) Inclusion of all categories of Private Funds **(101) Profits and gains derived by a Private Fund.**	**Pass through status of PE&VC Funds has been withdrawn.** The objective of this amendment is to provide pass through status to Private Funds in line with the tax treatment for mutual funds. International examples of exemption from fund level taxation in private equity and venture capital: ✓ Malaysia ✓ India ✓ France ✓ Denmark ✓ Italy ✓ Turkey (Exempt, if 50% assets are invested in Turkish companies) ✓ UK ✓ USA ✓ Canada This proposal will remove the ambiguities in Private Equity taxation and encourage investments in Private Equity sector that will go a long way in facilitating availability of local & foreign capital to local businesses with high growth potential mainly within the start-up and SME sector, which is the backbone of our national economy. Investments by Private Fund Management Companies (PFMC) through Private Funds is more than just provision of capital as the PFMC also provides financial advice and strategic direction which results in rapid growth and development of Investee Companies. As SME sector constitutes majority of all enterprises in Pakistan and contributes a significant portion of the GDP of the country, a number of positive outcomes including, capital availability for SME sector, broadening of capital markets, increase in jobs, documentation of economy, capacity building and broadening the tax network etc. are likely to be observed in Pakistan's economy with the influx of Private Equity investments.

Existing	As per Finance Bill 2021	Proposal	Rationale/Comments
(103) Any distribution received by a taxpayer from a collective investment scheme registered by the Securities and Exchange Commission of Pakistan under the Non-Banking Finance Companies and Notified Entities Regulations, 2007, including National Investment (Unit) Trust or REIT Scheme or a Private Equity and Venture Capital Fund out of the capital gains of the said Schemes or Trust or Fund Provided that this exemption shall be available to only such mutual funds, collective investment schemes that are debt or money market funds and these do not invest in shares.	Omitted	(103) Any distribution received by a taxpayer from a Private Fund out of the capital gains of the Private Fund.	Restoring the clause would encourage investors to invest in private equity and venture capital through Private Funds, thereby increasing the pools of capital available to SMEs and start-ups etc. With this omission the tax payers will be subject to rates of CGT as applicable under section 37 for capital gain of private company which may extend up to 29% for corporates 35% for individuals.
PART II			
(5B) The tax in respect of capital gains derived by a person from the sale of shares or assets by a private limited company to Private Equity and Venture Capital Fund shall be charged at the rate of ten per cent of such gains.	Omitted	(5B) The tax in respect of capital gains derived by a person from the sale of shares or assets by a private limited company to Private Equity and Venture Capital Fund shall be charged at the rate of ten per cent of such gains.	In countries like Indonesia, start-up/venture capital companies which attract private fund investment are exempt from even corporate tax. Proposed amendment is crucial for encouraging growth of the SME and venture capital/start-up sector by reducing burden on private limited company when seeking investment form Private Funds.
PART IV			
(11A) The provisions of section 113, regarding minimum tax, shall not apply to,- (xii) a venture capital company, venture capital fund and Private Equity and Venture Capital Fund which is exempt under clause (101) of Part-I of this Schedule;	Becomes redundant pursuant to deletion of 101 above.	(11A) The provisions of section 113, regarding minimum tax, shall not apply to,- (xii) a venture capital company, venture capital fund and Private Equity and Venture Capital Fund which is exempt under clause (101) of Part-I of this Schedule;	This is a consequential amendment that needs to be restored in line with proposal for restoring 101 above as Private Funds should not be subject to minimum tax.

Existing	As per Finance Bill 2021	Proposal	Rationale/Comments
(47B) The provisions of sections 150, 151, 233 and Part I, Division VII of the First Schedule shall not apply to any person making payment to National Investment Unit Trust or a collective investment scheme or a modaraba or Approved Pension Fund or an Approved Income Payment Plan or a REIT Scheme or a Private Equity and Venture Capital Fund or a recognized provident fund or an approved superannuation fund or an approved gratuity fund.	(47B) The provisions of sections 150, 151, 233 and Part I, Division VII of the First Schedule shall not apply to any person making payment to National Investment Unit Trust or a collective investment scheme ~~or a modaraba~~ or Approved Pension Fund or an Approved Income Payment Plan or a REIT Scheme ~~or a Private Equity and Venture Capital Fund~~ or a recognized provident fund or an approved superannuation fund or an approved gratuity fund.	[(47B) The provisions of sections 150, 150A, 151 4[,], 233 [and Part I, Division VII of the First Schedule] shall not apply to any person making payment to National Investment Unit Trust or a collective investment scheme or a modaraba or Approved Pension Fund or an Approved Income Payment Plan or a REIT Scheme or a Private Equity and Venture Capital Fund or a Private Fund or a recognized provident fund or an approved superannuation fund or an approved gratuity fund.]	To exempt private funds from the applicability of withholding tax as it is a pass through entity. The amendments are proposed to continue exclusion of private funds from applicability of section 151, 233, 150 as already exempted to other categories of funds which have pass through status as per tax law.

Annexure-D

SOLUTIONS PROVIDED FOR LLP STRUCTURED PRIVATE FUND

Sr.	Requirement of LLP Act/PF Regulations	Conclusion/Solution
(i)	LLP Act requires that every LLP shall have at least two partners at the time of registration of LLP agreement.	To cater this requirement the Fund is registered through LLP Agreement between PFMC-Designated Partner and CEO of PFMC as Partner. The CEO as partner will be replaced with new partners upon their induction in the LLP/Fund. CEO of PFMC shall not take part or exercise voting rights in management or control of the LLP/Fund's investment or other activities, transact any business in the LLP/Fund's name or have the power to sign documents for or otherwise bind the LLP/Fund (whether or not through a power of attorney on behalf of the LLP/Fund)
(ii)	LLP Act requires that obligation of partner to contribute money or other property or other benefit, whether tangible or in tangible, or to perform services shall be as per LLP Agreement. Further, the form and value of contribution to the partnership of a partner, if any, will be decided mutually by the partners and may consist of moneys, negotiable instruments, properties including valuable rights, intangibles, knowledge and skills, etc. PF Regulations require that participants of a Private Fund shall neither have day to day control over management of fund property, nor the right to give directions in respects of such management.	PFMC shall only be contributing to the Fund in the form of skills, knowledge and services and not be participating as a unitholder/partner having capital stake.
(iii)	LLP Act requires every LLP shall have a Designated Partner at the time of registration who shall be an individual resident Pakistani and has provided prior consent to act as such.	PFMC shall be designated partner of the Fund and has to nominate one of its management as Designated Partner (consent as per Section 5 of LLP Act to be submitted along).
(iv)	PF Regulations require that Private Fund Management Company (PFMC) may raise money for investment in a Private Fund from an Eligible Investor through issue of Units. Units are defined as the instrument of ownership of Private Fund signifying beneficial interest of Unit Holders in that Private Fund.	Fund shall be issuing instrument of ownership of the Fund/LLP held by a Partner of the Fund in accordance with LLP Agreement, signifying percentage of beneficial interest of partner/unit holders in the Fund.
(v)	PF Regulations require that the PFMC shall appoint an independent Trustee/custodian which is registered with the Commission as a Trustee for Collective Investment Schemes under the Non-Banking Finance Companies and Notified Entities Regulations, 2008.	PFMC shall appoint custodian of the Fund. The LLP Agreement provides requisite linkage with the Custodian Agreement for role of the Custodian.

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