P@SHA
Pakistan IT Industry Association

Unleashing the **Potential** of **IT & ITeS Sector**

Policy Paper 2023

Pakistan's Guide to Becoming a Tech DestiNation

https://www.pasha.org.pk

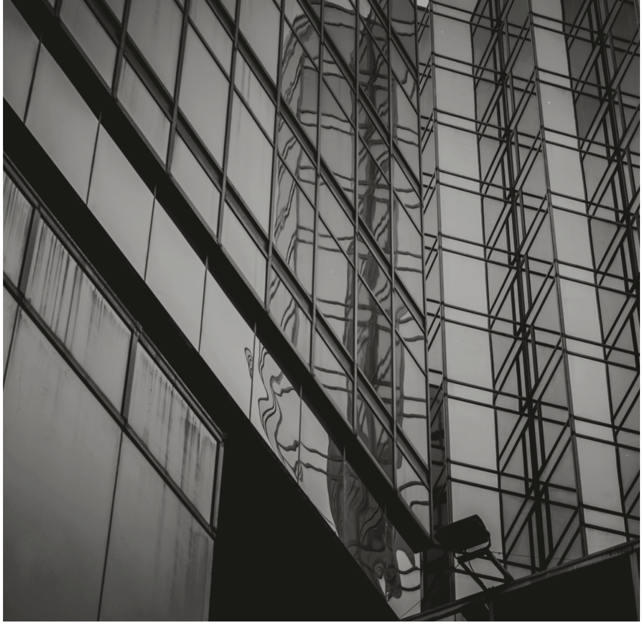
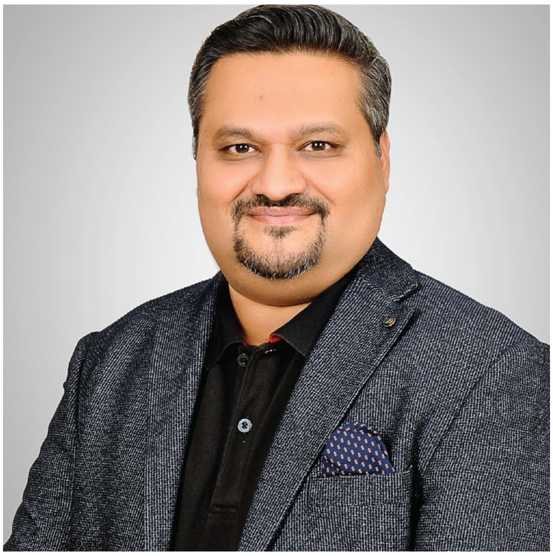


Table of
Contents

Foreword by

Chairman P@SHA



I am pleased to present the Policy Paper: Unleashing the True Potential of the IT & ITeS Sector in Pakistan. This document serves as a policy guide to make Pakistan an attractive Tech Destination and to create a robust framework that will drive the growth and development of Pakistan's IT/ITeS industry.

The IT industry in Pakistan has achieved remarkable milestones, crossing USD 2.6 billion in exports in 2022. Notably, it holds the unique distinction of being Pakistan's only export industry with a 77% trade surplus. Supporting the livelihoods of 800,000 professionals and freelancers, as well as over 10,000 companies, the IT industry has proven to be the highest-growing sector in our nation. It has demonstrated the potential to address the current account deficit and shape the financial future of Pakistan.

At P@SHA, we have actively represented and advocated for policies on behalf of the IT industry at all levels of the government. We believe that by implementing these measures, we can foster a highly favorable business environment for the IT/ITeS industry in Pakistan. This will not only attract foreign investment but also promote industry growth and enhance the sector's competitiveness on the global stage. Our ultimate goal is to unlock the full potential of the IT/ITeS industry, establish Pakistan as a thriving hub for technology-driven innovation, and drive sustainable economic progress.

I extend my gratitude to all the stakeholders, including the government, industry players, and the Dedicated policy team at P@SHA, for their unwavering support and expertise in the development of this comprehensive framework. Together, let us work towards shaping a prosperous future for Pakistan's IT/ITeS industry.

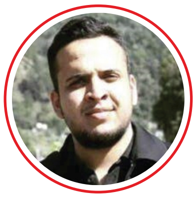
Muhammad Zohaib Khan

Chairman, P@SHA

Contributors

Kashoon Leeza
Author
Policy Lead P@SHA

Sharif ud din Khilji
Reviewer
Tax Consultant



Gulraiz Iqbal
Research Support
P@SHA

Mohsin Ali
Reviewer
Member CEC P@SHA

Shahzad Shahid
Reviewer
Treasurer P@SHA

Bilal Hashmat
Reviewer
Member CEC P@SHA

Strategic Input

CEC P@SHA
Government Relations Committee, P@SHA

Tax Exemption for IT/ITeS industry

Issue a: Income Tax

Over the past two years, the tax regime for the IT and ITeS sector has undergone abrupt changes. Initially, the IT/ITeS industry was granted a fiscal incentive of 100% tax exemption until 2025. However, in July 2021, a policy shift occurred from tax exemption to a tax credit regime. The process for tax credit application was imprecise and cumbersome. Furthermore, in 2022, the Final Tax Regime (FTR) was introduced, which revoked the Tax Credit regime.

The frequent changes in the tax regime, despite the initial commitment of tax exemption until 2025, have created uncertainty among IT companies and lack of confidence in investors. Inconsistent policies and frequent changes in policy raise questions about the government's understanding of the investment climate of the IT sector. It's worth noting that the IT industry operates differently from traditional industries, and when policies change too frequently, companies may choose to withdraw their operations and relocate to countries with more favorable and consistent business climates. Therefore, it is essential for the government to understand the intricacies of IT business operations and introduce supportive policies that ensure the growth of the tech industry and ensure the consistency of the policies.

Proposed Reform for Income Tax	Responsible Departments
Immediately reinstate 100% Income Tax Exemption from export income for IT and ITeS companies for 5 years	Primary: FBR, State Bank of Pakistan; Supporting: PSEB

Issue b: Exemption for VC investments for IT & ITeS

The exemption of on profits & gains of Venture Capital (VC) funding into entities in Pakistan is set to expire in 2025. However, most of the funding that Pakistani-origin startups receive is done outside the jurisdiction of Pakistan, as these startups are often incorporated in other countries to gain investor confidence for raising venture capital.

It is important to note that Venture Capital investments are both high-risk and long-term. They are high-risk as often less than 15% of startups scale into profitability, and they are long-term because it takes several years for a startup to become profitable. Additionally, investment in Pakistan is seen as a high risk investment compared to other countries. Therefore, the exemption must be extended to 2030 (or at least 7 years from implementation) with assurances of continuity, so that investors feel confident in sending their venture capital funds into Pakistan.

Once the exemption expires in 2025, investors are faced with a scenario where they have to pay 29% Capital Gains tax on their high-risk and long-term investments, which discourages them from investing in Pakistan. Extending the exemption on profits & gains on VC funding will encourage investors to invest in the Pakistani tech industry, which will lead to the growth and development of the industry. In order to bring clarity in relation to income earned by VCs, the term profits & gains need to be replaced with "any income" to ensure that all returns on such investments including business profits and capital gains are exempted.

Proposed Reform for Capital Gains Tax (for IT & ITeS)	Responsible
Exempt income of venture capital funding into startups until 2030, with the current rate of 29% being reduced to zero percent. This exemption is currently implemented until 2025 for startups. The word profit & gains need to be replaced with any income.	FBR

Issue c: Dividend paid by start-up companies and export-oriented IT companies to be given exemption

Currently the tax on dividend is 15% to 25% which discourages companies to bring money to Pakistan. This type of taxation discourages sole/ AOP business (start-ups and exporters of IT & IT enabled services) from transitioning into corporates. The second stage taxation in the form of dividend tax in companies hence also a hinderance in brining FDI into such entities. This exemption on dividend would encourage FDI to be coming directly into Pakistan instead of being parked outside Pakistan and incentivize corporatization.

Proposed Reform for Exemption on Dividend paid by IT & ITeS and Startup(s)	Responsible
Exempt the dividend tax for startup and IT & ITeS companies	FBR

Tax Exemption for IT/ITeS industry

Issue d: Custom Duty

IT hardware is a fundamental component necessary for the functioning of IT firms. The hardware includes physical components, such as servers, computers, and networking devices, that store, process, and transmit digital information. However, the IT industry faces a significant challenge in the form of high custom duty on imported hardware components, leading to inflated equipment costs. Currently, IT firms are obligated to bear 100% overheads when importing hardware that ultimately increases export revenue.

Eliminating custom duty on IT hardware for IT firms is paramount as it will provide a much-needed impetus to the industry. High custom duty on hardware increases equipment costs, ultimately affecting the profitability of IT firms. This, in turn, results in reduced investment in hardware, adversely impacting the performance and competitiveness of IT firms in the global market. Neighboring countries have also introduced similar policies for example, under India Customs Tariff 2021, IT related imports are exempt from custom duty.

Computer hardware and technology sub-components which are imported in Pakistan for the purpose of exporting them by adding new software and/or hardware component, or by configuring them as part of a larger hardware and/or software system attract import duties. This makes Pakistan unfeasible for such technology solutions export. It is critical to recognize such imports as re-export items or components of value-added manufacturing for subsequent export, and must be given 100% exemption from all import duties, GSTs and any other levies or taxes.

Proposed Reform for Custom Duty	Responsible Departments
Remove duties and sales tax on laptops and other IT Hardware for PSEB-registered IT/ITeS companies involved in the production of IT & ITeS related software, solutions, services, product, consultancy, and hardware. Remove duties, sales tax, and any other levies and taxes from items which are imported in Pakistan for re-export after slight modification. Items to be used as sub components or components of a technology/IT solution/platform resulting into value added manufacturing for further export must be declared exempt of all duties, GST, other taxes, and levies.	Primary: FBR Pakistan Secondary: Pakistan Software Export Board (PSEB)

Issue e: Exemption on Equipment (computers, Laptops)

The primary raw material for the IT & ITeS sector is the basic equipment required. Availbility of essential and quality equipment increases services productivity, resulting in better digital transformation and thereby increasing exports.

Proposed Reform for Exemption on Equipment (computers, Laptops)	Responsible
Exempt sales tax on the equipment for IT & ITeS Industry	FBR Pakistan

Issue f: Exemption of software to be restored

Currently, there is difference of opinion on software as goods or services between Federation or Provinces, and therefore exemption by Federation would lead to ease of doing business for the sector. Tax officers tend to view software as good and charge sales tax accordingly. With the exemption, the provincial authorities can claim the right to charge sales tax as services. FBR can also collect such sales tax under ICTO 2001 on services.

Proposed Reform for Exemption of Software (Services)	Responsible
Exemption of software to treat Software as services	FBR Pakistan

Forex retention & Utilization for IT/ITeS industry

Issue a: Forex retention

The policies outlined in Chapter 12 of the FE Manual restrict foreign currency retention of IT sector exporters to a mere 35% of their proceeds, necessitating them to exchange the rest at uncompetitive bank forex rates. Consequently, the exporters are disinclined to bring their export proceeds to Pakistan, and the fluctuating dollar rate introduces further uncertainty. It is imperative to recognize that the IT/ITeS sector has unique operational requirements that differ from other industries. IT/ITeS companies must regularly make payments for imported services, including servers and advertising, which often lack local alternatives, such as Google or YouTube advertising. Therefore, allowing full retention of inward foreign currency is of utmost importance to IT/ITeS firms.

In the bigger picture, enabling 100% retention of inward foreign currency will increase forex inflows, as reducing the cost of doing business will increase foreign investment and encourage firms to park their foreign currency in Pakistan. Current policies negatively impact forex inflows, jeopardizing Pakistan's anticipated IT/ITeS forex inflow of $5 billion over the

Issue b: Forex utilization

Foreign currency payments are processed by authorized dealers that often create unnecessary hindrances due to a lack of understanding and over-compliance. These dealers have been authorized by the State Bank of Pakistan (SBP) in accordance with the Foreign Exchange Regulation Act (FERA) and SBP Act. The inordinate delays and complexities associated with even the simplest transactions discourage IT/ITeS companies from keeping their foreign currency funds in Pakistan. To be internationally competitive IT/ITes companies need to be agile with instant access to funds transfer to and from Pakistan. For instance, foreign companies need to repatriate their profits to head offices, while others have to make payments to vendors. The difficulties in the payment process make Pakistan an infeasible destination to set up such operations and create an unfavorable business environment for both local and foreign companies. Therefore, it is essential to streamline this process and make forex transactions direct and hassle-free without the need for time-consuming steps.

Proposed reforms for Forex retention & utilization

Immediately reinstate 100% Income Tax Exemption from export income for IT and ITeS companies for 5 years

- 100% retention in foreign currency for international income allowed
- 100% retention in foreign currency for international equity allowed by foreign residents for investment in Pakistan (inward remittance).
- 100% of retention of foreign currency for international and local VC / PE funds. With a condition, the fund should at least be deployed 70% in IT/ITeS companies/startups within 3 years.
- 35% of the foreign currency amount received in a year is to be repatriated without limitation

Responsible

Primary: State Bank of Pakistan

Secondary: PSEB (Pakistan Software Export Board)

Ease of doing business

FBR: Business Conducive Operations

Issue a: IT & ITeS Tax Reforms Committee

Considering the absence of a standardized definition for IT and ITeS companies, they encounter challenges when communicating with FBR for tax-related matters. An illustration of this challenge arose with the implementation of the Tax Credit Regime in July 2021, where tax exemption certificates were subject to the discretion of tax officers who possessed limited understanding of the IT & ITeS industry. Consequently, protracted negotiation processes ensued, amplifying uncertainty for companies involved. Addressing this issue necessitates both the standardization of definitions for the IT sector, as discussed in the "Standardized Definitions" section, and the establishment of a tax dispute resolution committee (proposed here).

Proposed reforms for Tax Reforms Committee	Responsible
Establish a resolution committee consisting of experts from both the private sector and relevant public departments to review and approve taxation policy and reforms for IT/ITeS companies.	PSEB, FBR, P@SHA

Issue b: Auto issuance of exemption certificate in respect of payments to non-resident persons

The FBR law maintains that issuance of exemption certificate in respect of payments to non-resident can delayed given if there is "time taken for explanation/ clarification through IRIS" by the tax authority. This creates an unnecessary challenge as this would provide an open-ended time for CIR to keep seeking explanation/ clarification. The process should be completed within 30 days excluding any adjournment days sought by taxpayer.

Proposed reforms for Auto issuance of exemption certificate in respect of payments to non-residents	Responsible
FBR must automate the process of issuance of exemption certificate in respect of payments to non-resident persons. On case- to-cases basis the issuance can be extended only for 25 days for due diligence.	FBR

Issue c: Clarification on non-applicability of Super Tax on export proceeds of IT & IT-enabled Services

Super Tax was introduced in the Finance Act 2022. There has been reported cases of IT & ITeS companies that have been served super tax notices, highlighting that in one case, super tax has been withdrawn directly from exporter's bank account, despite appeal filed and under review. As per FBR Income Tax Ordinance, the super tax is not applicable under 100% tax credit regime for FY2021-22 and under final tax regime for FY2022-23 for export-oriented companies.

Proposed reforms for Clarification on non-applicability of Super Tax on export proceeds of IT & IT-enabled Services	Responsible
FBR must issue a notification explaining he non- applicability of super tax on export process both for FY 22-23 and FY 21-22.	FBR

Issue d: Company Accounts

Currently, IT/ITeS companies encounter the challenge of receiving unwarranted notices from FBR, resulting in escalated business costs and undermining industry trust. Moreover, such notices serve as a deterrent for unregistered companies seeking to register themselves. To mitigate this uncertainty for IT and ITeS companies, it is imperative to involve authorities like the Board of Investment (BOI) and the Pakistan Software Export Board (PSEB) in the process. By incorporating these authorities, the goal is to establish a more transparent and collaborative environment that fosters trust, reduces unnecessary notices, and encourages unregistered companies to complete the registration process.

Proposed reforms for Company Accounts	Responsible
FBR should not be allowed to cease the accounts of registered IT and ITeS companies without signed authorities from Joint IT & ITeS Tax Committee.	PSEB, FBR

Ease of doing business

Single Window Operations

Issue a: Company Registration

The registration process for new companies is unduly cumbersome, requiring numerous steps and approvals. It is imperative to simplify this process to not only foster the establishment of new companies but also attract multinational corporations seeking to establish their presence in Pakistan.

Proposed reforms for Company Registration	Responsible
Allocate a budget to develop an integrated platform that provides single window operations for IT companies to interact with relevant government agencies for registration and post-registration purposes.	SECP, FBR

STZ Initiative

Issue a: Enabling STZs

The existing IT industry in Pakistan, which predominantly comprises SMEs, faces significant challenges related to the ease and cost of doing business. Special Technology Zones (STZs) were approved in August 2020, and the launch of STZA took place in January 2021. However, three years have passed, and STZs have not yet been enabled for the existing IT/ITeS industry. This delay has deprived the industry of the tax exemptions and other benefits that STZs offer, hindering its growth and competitiveness. Urgent action is required to enable STZs for the existing IT industry and provide the much-needed support for its development.

Proposed reforms for Enabling STZs

- Ensure IT/ITeS industry representation in STZA Board of Governors
- STZA one window framework should be finalized including organizations such as LDA, KDA, CDA, KPKDA, FDA, etc.
- Implementation of Single Window for the timely issuance of Zone Enterprise and Developer licenses. Explicitly mention turnaround time for issuance not longer than 45 days.
- Rent regulation on government-issued land
- Incorporation of STZA benefits in relevant laws i.e. Income Tax Ordinance 2001, Sales Tax Act 1990 and Customs Act 1969. Currently these benefits are not fully incorporated in these laws.
- Enable STZA benefits for the entire IT industry (Virtual zone concept).
- Prioritize Special Technology Zones (STZs) within master plans and land development regulations.
- Public-Private Infrastructure Enablement & Development
- Amendment in tax laws in the upcoming finance bill of 2023 to operatironize :
  - Exemption on sales tax on services required.
  - For customs duty exemptions, allow import of capital goods manufactured locally.

Responsible

STZA — Special Technology Zones Authority; Ministry of Information Technology & Telecom, Government of Pakistan

Definition of Startup(s)

Issue b: Startup Definition

There are conflicts in the definitions outlined in tax laws and the Companies Act, which lead to inconsistent benefits for startups depending on the applicable law. For instance, if we consider a non-tech startup that has been in operation for 6 years with a turnover of PKR 99 million, it qualifies as a startup under the Companies Act but not under the ITO, thereby missing out on tax benefits.

Moreover, the current startup definition set by SECP fails to include certain startups that have the potential for scaling. Consequently, these startups are excluded from government facilities or schemes designed to support them. It is imperative to revise and standardize the definition of startups. For instance, the current SECP definition imposes a turnover limit of PKR 100 million (USD 565K), whereas India has set the limit at INR 1 billion (USD 13.5 million). By aligning the definition with international standards and accommodating promising startups, Pakistan can foster a more inclusive and supportive environment for the startup ecosystem.

Proposed reforms for Startup Definition

Revise startup definition as per global standards with a turnover limit of PKR 350 million and company age of 5 years or less. The exemption period for start up also need to be increased from three years to five years.

Responsible

SECP

FBR PAKISTAN

Growth of IT industry

Policy Consistency

Policy inconsistency is one of the major challenges faced by the IT and ITeS industry, creating a sense of uncertainty and instability within the industry. One explicit example of policy inconsistency is the revocation of tax exemptions in FY 20-21. The sudden and unexpected changes in regulations, especially pertaining to the taxation regime, leave businesses in a state of anxiety and unpredictability. As a result, foreign clients, who play a pivotal role in bringing revenue to Pakistan, are increasingly discouraged from engaging with the country's IT and ITeS sector. It has a trickle-down effect on the growth of IT industry. Compared to 2020-2021, the growth of annual exports has dropped from 47% to 29% in the year 2021-2022. If Pakistan's tech sector is to grow, policy continuity is essential. In the FY itself, the growth of industry has become stagnant. By creating a stable regulatory environment, the IT and ITeS industry can thrive, contributing substantially to the overall economic prosperity of the nation.

Proposed reforms for Policy Consistency	Responsible
▪ Policy continuity must be ensured for IT/ITeS and prioritized, irrespective of changes in government. Policies- existing and new- should be implemented and executed at the state level.	PM Office

Policy Directive to avoid Internet Blockades

Pakistan's IT industry faced a significant setback due to ongoing internet blockage, resulting in daily financial losses estimated at USD 3-4 million. The recent nationwide internet slowdown in Pakistan caused major disruptions to businesses and individuals who rely on stable and consistent internet access. More than the economic loss, Pakistan's perception in the whole world is severely damaged. It was crucial to restore uninterrupted internet access to protect the industry, which plays a vital role in generating employment, fostering technological advancements, and attracting foreign investment.

Proposed reforms for Uninterrupted Internet Availability	Responsible
▪ Prevent future blanket ban of internet and social media platforms. ▪ Issue a policy directive to streamline a process for internet ban including taking buy in from relevant stakeholders such as MoITT and PSEB before such bans are put in place.	PTA, P@SHA, Ministry of Interior

Brand Pakistan

Issue a: Soft Image of Pakistan

It is crucial to establish Pakistan as an appealing destination for the tech industry, considering the global competitiveness of this sector. To position Pakistan's IT industry on a global scale, it is necessary to enhance its image internationally. While efforts have been made to improve the ease and cost of doing business in Pakistan, investments are hindered by the prevailing negative perception of the country. In comparison to India, Pakistan boasts more flexible processes; however, India has effectively promoted its investment climate, diverting investments towards its shores. In order to capitalize on the revenue potential of the IT industry, urgent measures must be taken to launch strategic communication campaigns that brand Pakistan as a leading tech destination.

Proposed reforms for Soft Image

Allocate PKR 2 billion to enhance the image of Pakistan by taking the following steps:

- Promote brand name "TechDestination Pakistan".
- Launch a targeted publicity campaign and create marketing materials showcasing Pakistan's software capabilities, success stories, IT sector initiatives to enhance international perception
- Engage the services of an international PR company to improve the country's image in the tech sector
- Showcase Pakistani technological innovations at international forums, with funds drawn from public-private partnerships.
- Appoint international ambassadors and provide training to Pakistan's commercial counselors to advocate for the country's IT industry, foster collaborations, and attract foreign investments.
- Participate in top global IT exhibitions and events with industry delegations organized by TDAP and PSEB to network, showcase capabilities, and explore business opportunities.

Responsible

Human Capital

Issue a: Skills Development

The scarcity of skilled human capital in Pakistan poses a significant obstacle in achieving the desired export growth within the IT industry. Addressing this challenge requires the formulation of an urgent and comprehensive strategy.

Skill development initiatives can play a crucial role in transforming the unskilled and semi-skilled workforce in Pakistan into advanced, high-value skilled professionals, thereby increasing the export yield per worker. By prioritizing training programs and courses that upgrade and enhance skills, the IT workforce can effectively contribute to generating substantial revenue for Pakistan's economy.

Proposed reforms for Skills Development

Allocate PKR 3 billion for PSEB and PKR 11 billion for provincial driven skill development initiatives, along with local and international associations. The following steps need to be taken:

- Develop a 5-year roadmap of skill development initiatives
- Create public-private training institutes that offer industry-driven training programs for reskilling and upskilling the workforce

Responsible

Issue b: IT Graduates

The growing demand of off-shore services and local companies in Pakistan suggests the need to have an increased number of skilled workforce. This challenge pertains to both, the quantity and quality of graduates.

As per P@SHA Skill Requirement Survey 2021, there are over 40,000 job openings in just 140 companies. As of now, there is an estimation of over 100,000 open jobs in the IT industry. With only 25,000 graduates being produced by the universities on an annual basis, this represents a grave situation that can only be addressed by strategic planning of increasing the supply of quality employable graduates for the IT/ITeS industry.

Proposed reforms for IT Graduates

Take the following steps to increase employable IT graduates to 100,000 per annum:

- Re-launch the Outreach Rural Support Program and provide 20,000 scholarships to students from rural areas.
- Launch awareness programs about high-potential career opportunities in the IT/ITeS industry in Pakistan.
- Offer different types of degrees of varying durations, such as 2-year associate degrees and 1-year micro degrees.
- Launch short-term conversion programs for graduates of other subjects to transition to the IT sector, obtain the required skills, and become employable.

Responsible

Make in Pakistan

Issue a: Pakistani Products

Government is facing a major deficit in the balance of imports and exports. While the government policies are developed to discourage the public from consuming imported goods and services and to prefer locally made products, government departments themselves prefer to procure from international vendors and import IT products and services.

In absence of IT business opportunities, local companies find it hard to develop and mature their products and services on a sustainable basis. Conversely, other nations adopt protectionist measures to safeguard their domestic companies, granting them preferential treatment in government procurement. Consequently, it is imperative to implement reforms aimed at achieving the following objectives:

- Discourage govt organizations from importing IT/ITeS services that can be produced locally
- Discourage govt organizations from competing with private sector in business
- Encourage IT/ITeS SME sector by providing them incentives and opportunities

This will provide strong references to local IT companies with regards to their service offerings and delivery capabilities. Subsequently, these companies will be equipped to export their offerings, enabling them to compete on an equal footing with other economies.

Proposed reforms for Pakistani Products

Take the following measures to promote local innovation in Pakistan:

- NITB and provincial IT departments (such as PITB and KPITB) should conduct an assessment of the current IT solutions used by all government institutes.
- Establish a federal-provincial task force with private sector representation to decide whether a local product can be used or if it needs to be imported. All government departments, including law enforcement agencies, should submit software procurement requests to this committee.
- PPRA rules should be amended to add quota for local products/SMEs
- Funds should be allocated to develop commonly used local products in Pakistan to ensure savings on the foreign exchange and develop product-based industry

Responsible

Pakistan IT Industry Association

P@SHA Secretariat, Street 7, I-10/3
Islamabad, Pakistan

+92-51-8736624 | +92-51-8736625

services@pasha.org.pk

https://www.pasha.org.pk