



Pakistan Software Houses Association for IT & ITES

Removal of Tax Exemption from the IT and ITeS Industry in Pakistan

A quick understanding of Impact



Contents

1

Strategic Importance of IT and ITeS Industry
(Background, historical trend)

2

Modalities of IT Industry
(How IT industry works and is different from others?)

3

Understanding Tax Regime Changes
(Tax Exemptions VS. Tax Credit)

4

Impact Analysis of Change of Tax Regime
(Impact on IT Industry)



Strategic Importance of IT Industry

- Export Trend
- Job Creation for Poverty Alleviation
- Case-study of OSP



300,000

IT Professionals



25,000

IT graduates/year



\$1.2 billion

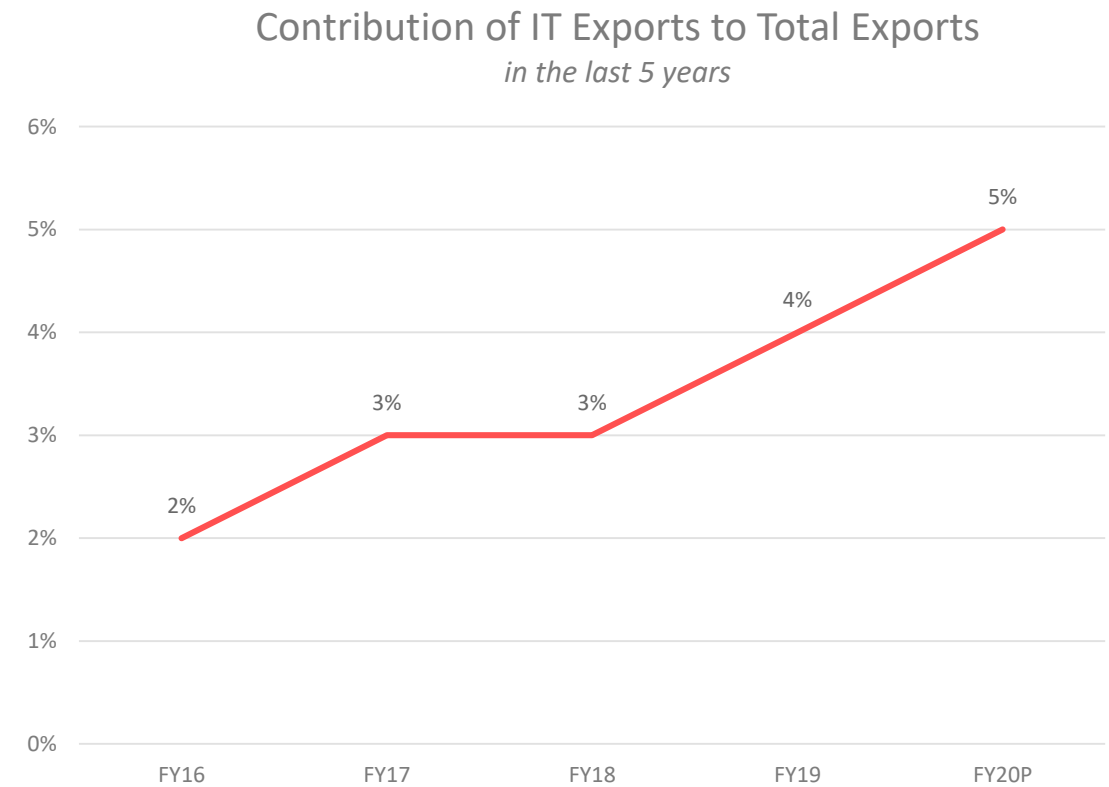
IT Export Record

25-30% of the services sector



increase in contribution to total export in the last 5 years

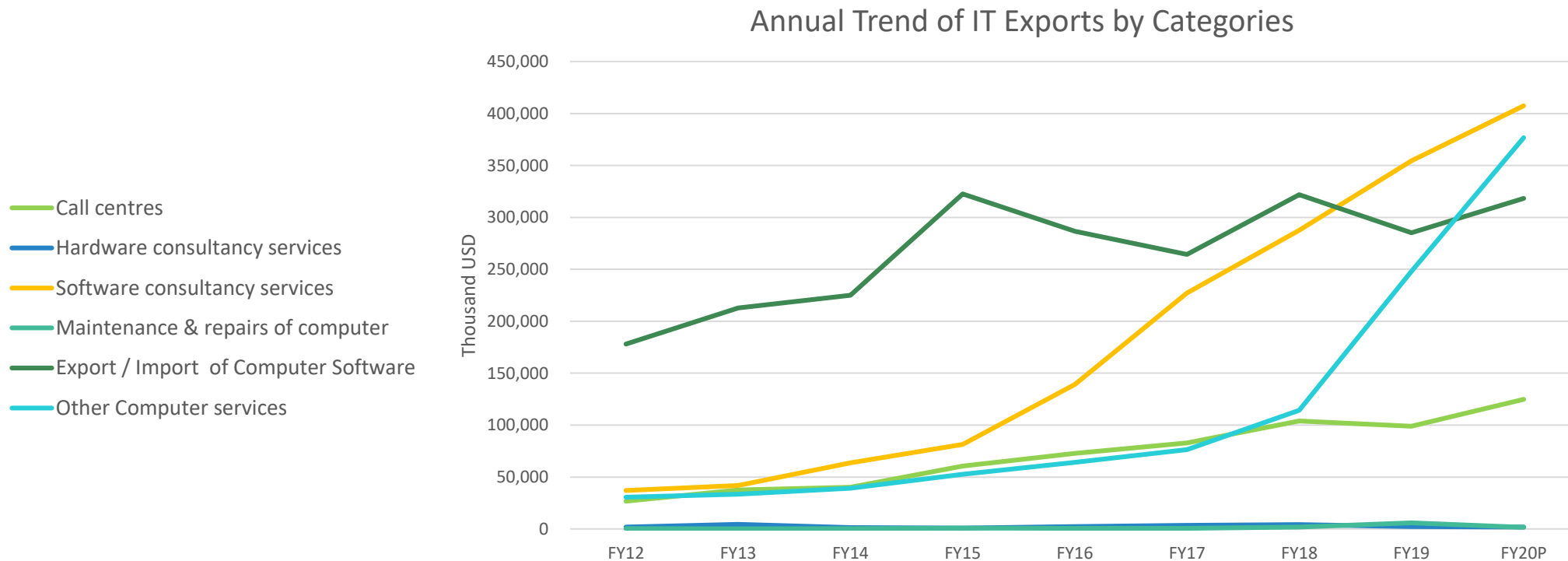
In 2021, IT Industry growth has surpassed all traditional sectors with YOY IT exports* increased by **24%**.
100% increase in contribution to total export in the last 5 years



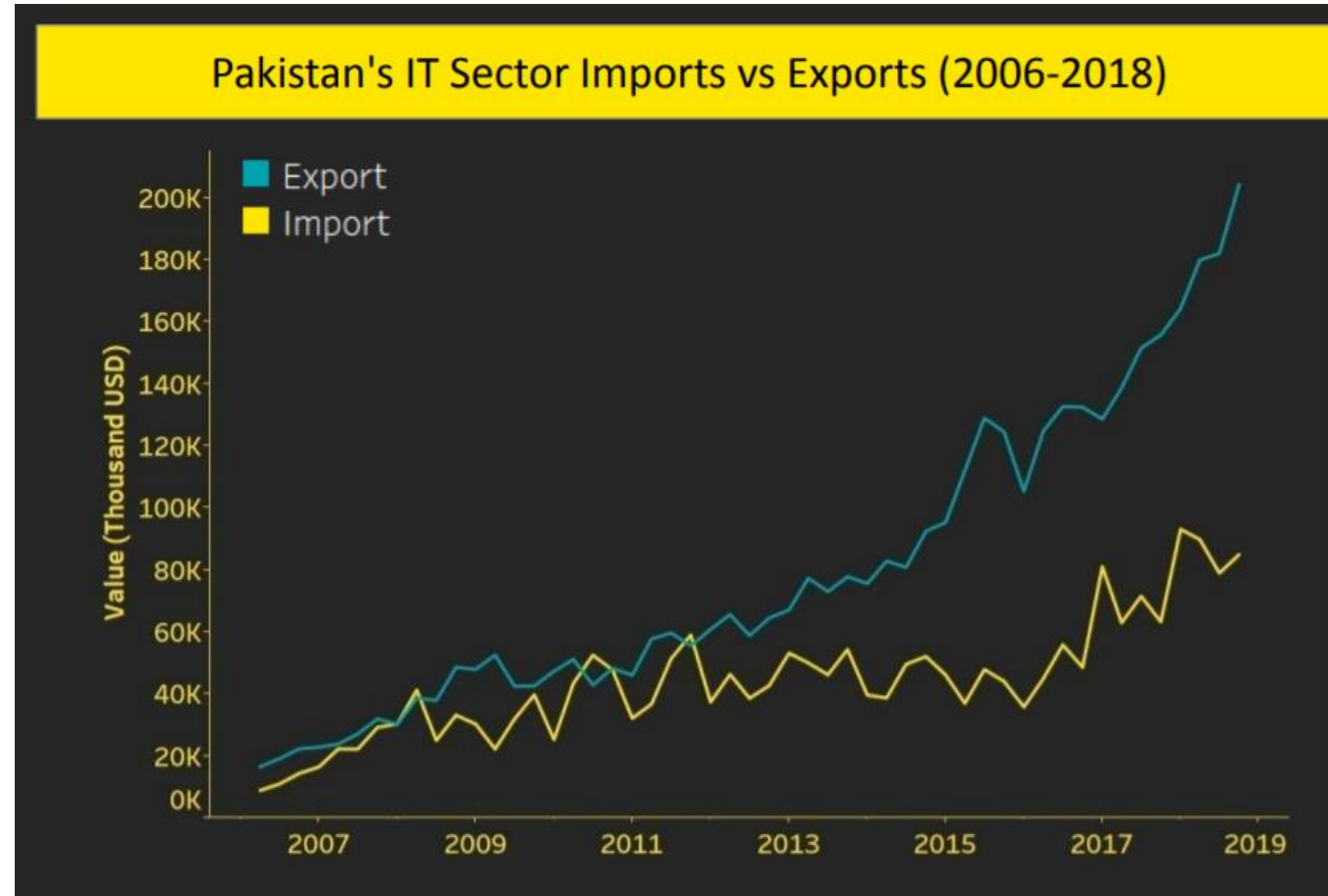
Source: State Bank of Pakistan

* This doesn't include the exports by freelancers or unregistered companies.

A closer look at the growth pattern indicates that three categories in trade services had the most **consistent growth**: 1) Software Consultancy Services, 2) Other Computer Services, and 3) Call Centers.



Unlike other industries, IT industry has low imports and high exports.



Source: Invest Pakistan

IT Industry uses approx. 50% of the revenue for payroll.

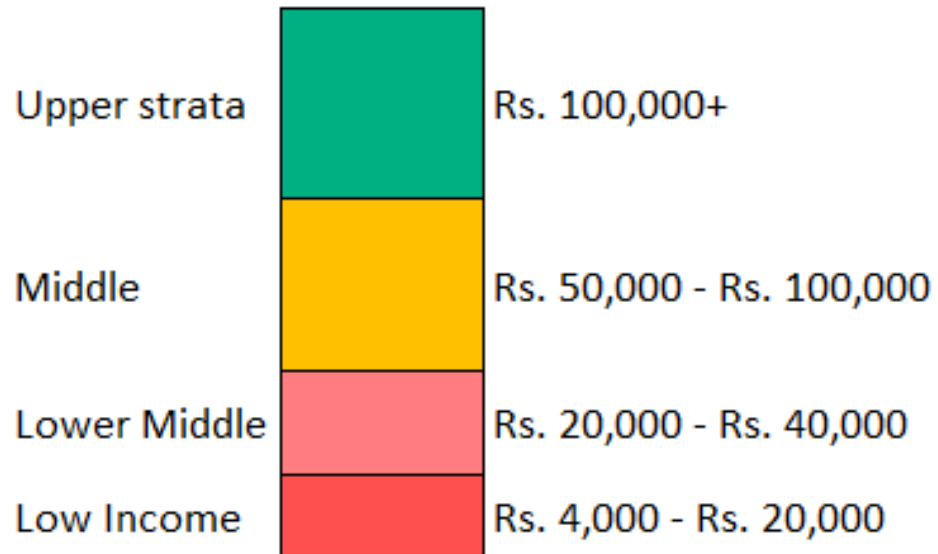
- 1 billion USD in job creation and salaries with no additional pressure on public services



One IT Professional can **raise the living standard of the family** and contribute to Knowledge-based Economy & Community.

In India, 4 million families are pushed to the middle sector due to IT sector.

Income level required for a family to move to middle-class: Rs. 50,000 – 100,000. According to HIES 2018-2019, average monthly income for urban sector is Rs. 53,000.



Fresh Graduate Salary: Rs. 35,000 – 50,000

1 – 5 Years Experience: Rs. 50,000 – Rs. 150,000

5+ Years Experience: Rs. 150,000+



Dr. Muhammad Shahnawaz

Selected for OSP for FAST in 2007. Graduated in 2011.

Current Designation: Principle AI Application Engineer AIS Sensing Team STMicroelectronics, France

"I am from a village (Ballan Wala) in Sialkot, studied in a school in my village where we did not even have the basic facilities. The only dream my parents had was to educate their children but they did not have resources or means to send us to good universities in big cities. Me being the first engineer in the generation in my village coming from a family with not so much money (in village often the education is thought to be a thing for rich), changed it for everyone and since then people started to send their kids to universities and now almost every year we have 10, 20 or 30 graduates in our village.

After FAST my life was very different, I had confidence taller than Mount Everest and I was ready for any challenge. I did my masters from NUST with full scholarship, and later went for PhD in one of the top universities in the world Politecnico di Milano, Italy on one of the most prestigious scholarships in the world, Erasmus Mundus. Today I am working as a successful researcher in a big company with international team and leading and participating in many international projects. This is only possible with OSP. I think my life will be very different if it was not for OSP.

In short OSP not just changed my and my family's lives but lives of many people around us."

US\$ 400



Agriculture

Unskilled but very large employment pool

US\$ 600



Textile

Semi-skilled & unskilled employment pool

US\$ 3,500



Freelancers

Semi-skilled & skilled employment pool

US\$ 20,000



Knowledge Worker



Highly-skilled knowledge worker pool



Modalities of IT Industry

- Industrial-Era Mindset vs. Knowledge-Economy Mindset - Normal company vs. IT Company
- Impact of sudden changes and inconsistent policies -> easier to wrap-up business and withdrawal

Industrial Era Mindset vs. Knowledge Economy Mindset


	Industrial Era Mindset – Other Companies 	Knowledge Economy Mindset – IT Companies 
Regulations	Physical in Nature <ul style="list-style-type: none"> • Easy to Regulate 	Virtual in Nature <ul style="list-style-type: none"> • Difficult to Regulate -> Need to incentivize
Business Withdrawal	Country-specific Infrastructure intensive <ul style="list-style-type: none"> • Fixed once deployed 	Global in nature <ul style="list-style-type: none"> • Easy to move out
Access to Market	Movement of physical goods and containers	Movement of people / IP visas
Political Stability	Transactional Contracts <ul style="list-style-type: none"> • Instability has lesser impact 	Long-term Relationships <ul style="list-style-type: none"> • Political stability matters significantly!
Business Disruption	Low impact of temporary disruption <ul style="list-style-type: none"> • Account freeze, shops seal is routine by enforcement agencies FIA/FBR/EOBI etc. 	Temporary disruption results in permanent business loss <ul style="list-style-type: none"> • SEA-ME-WE BPO Fiasco • Websites/networks shutdown etc.
Demands	Electricity & Infrastructure	Improved country perception & foreign policy

It's **easier** for IT companies to withdraw their business and move to another country.



Solution: Instead of trying to regulate, **incentivize** for people to register, continue operations & benefit the country!

Initial Proposed Solution: Special Technology Zones (STZ)

- 
- **Ensures** reporting
 - **Ensures** ease of doing business
 - **Reduces** cost of doing business
 - **One-window operation** for all government bodies

Recent change of events created a sudden state of panic and uncertainty.

Effect and magnitude of the impact are subject to considerable **uncertainty**.

Federal Cabinet passes Presidential ordinance to debar income-tax exemptions

Govt proposes withdrawal of corporate income tax exemptions

Hafeez Shaikh presents Income Tax Amendment Bill in Senate; says govt will remove corporate sector exemptions to generate more revenue



IT industry, unlike traditional industries, **operates differently**.

Changing the tax regime in **the mid of the fiscal year**, despite the original commitment till 2025, not only creates uncertainty and a state of panic about **inconsistent policies** but also raises questions about the understanding of government about the gravity of the situation of how it will jeopardize the growth.

Abrupt changes in tax policies will **scare away new entrants**.

It's a fragile industry with higher likelihood of moving business to **more industry destinations**.

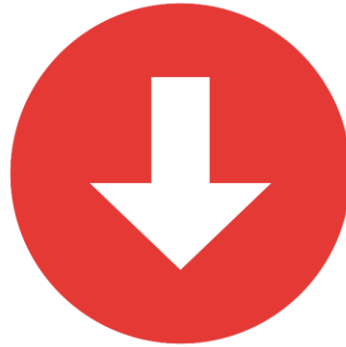


Understanding Tax Regime Change

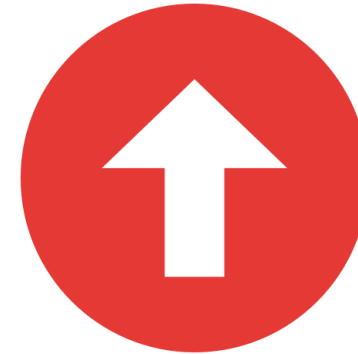
Tax regime has been changed from exemption to credit regime.



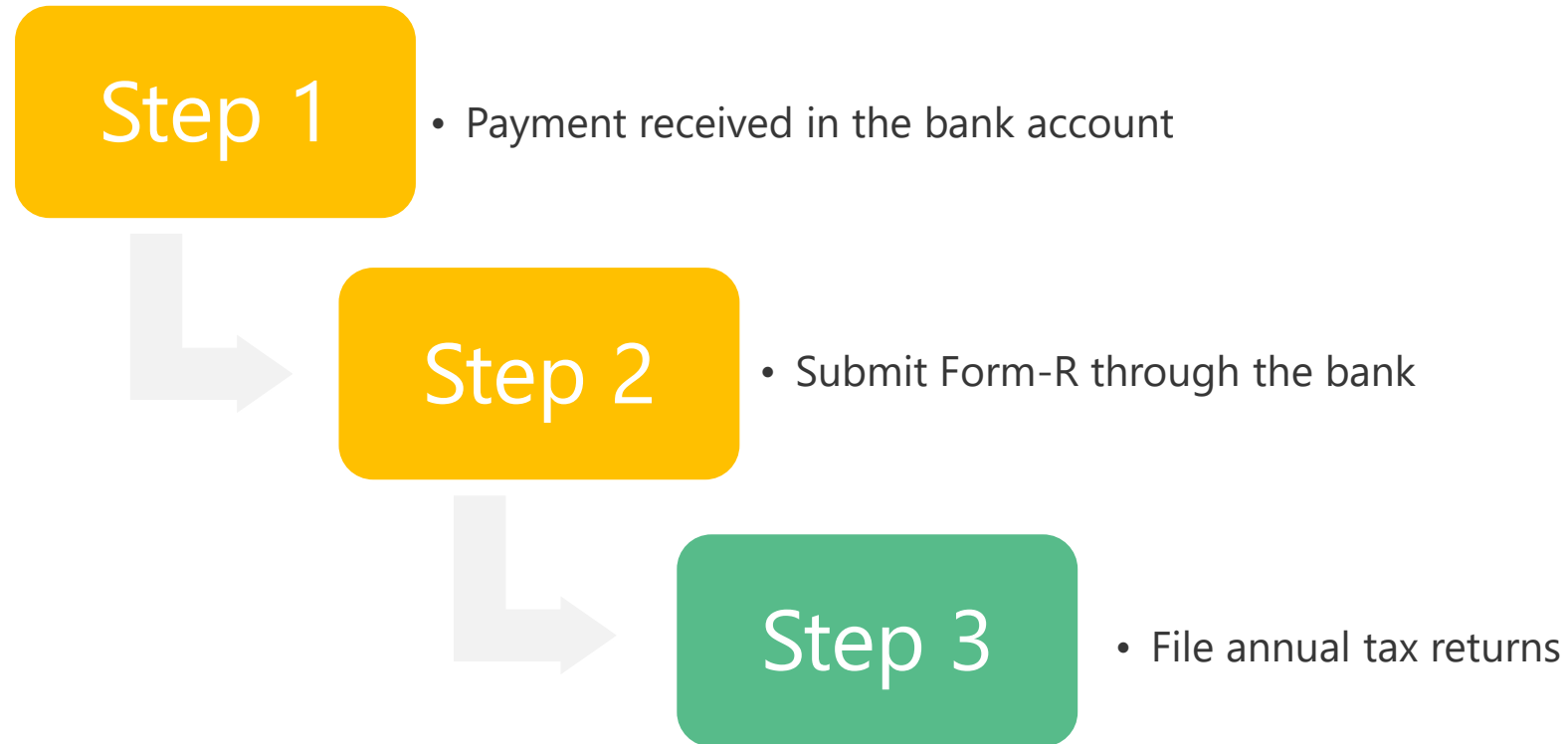
NO increase
in revenue



Significant
decrease in ease
of doing business



Significant
increase in cost of
doing business





Simple reporting process



Recurrent cases of **unjustified notices**
in this simple process



Expected involvement of legal services
and course to **address negotiations**



Introduction of
negotiations as a
part of process



FBR Officer



Each case and unjustified discussion creates frustration, additional **unnecessary expense** and desire to take business outside Pakistan

Ease of doing business refers to steps involved in setting-up and running a business.

- **Gap** between policy intent and implementation
- Attitude and **lack of industry knowledge** of tax officers
- Increase in **discretionary powers** of the tax officers
- Increase in business **risks' exposure**
- Unjustified notices resulting in frustration and **non-ending litigations**

*Note: Companies will be required to have a dedicated accountant and legal service **for compliance and negotiations for the new tax regime!***

Only 20% companies are reporting at the moment, and they end-up paying **10% of their revenues** compared to non-reporting companies.

With additional steps and negotiations, the cost will only go higher.

Legal	1%
Compliance	1%
GST + Withholding	1%
EOBI + Social Security	0.6%
Payroll Tax	2%
Dollar exchange rate	1%
Cost of commercial utilities and office space	3%
Total cost of reporting	10%



DPL was asked to pay **Rs. 14 million** sales tax on services in 2016 even though 100% of its revenues had come from exports of IT services. DPL won the case in its favor from appellate tribunal II in 2017 but still after spending more than **Rs. 700,000** and a huge amount of distress, the case file has not been closed and every year there is a new notice of hearing on the said case. This is a **typical case of increasing the cost of doing business** and creating difficulties for registered firms in the operations of their business.



S&P Global has been asked to pay **Rs. 440 million** in sales tax on services even though 100% of its revenue falls under export. Additionally, the company was notified of an income tax demand of Rs. 188 million with a claim that the business operations do not fall under IT and ITeS services even though S&P Global was recognized amongst the top three IT exporters by PSEB and is actively involved in data entry operations, software development/maintenance, and call center operations. This **lack of understanding of the industry of the tax officers** has resulted in the company's expense of **Rs. 10 million**.



Teradata opened their first offshoring office in Pakistan, however, due to unfavorable circumstances, they haven't been able to expand here. Being unable to remit any money out of the country, Teradata Pakistan has incurred **foreign exchange loss of up to Rs. 2 billion**. Not only the expansion was put on hold which has resulted in a loss of additional **Rs. 0.5 Billion per annum** (USD 3 million per annum) to Pakistan as foreign revenue, but also 20% incremental planned growth (new jobs) has been put on hold. **This represents a huge loss of opportunity due to a lack of low ease of doing business even in the existing regime.**

And the list goes on...

Hundreds of such cases exist – in the exemption regime!

The change has created panic amongst companies about what will happen after negotiations become part of the defined process?

- **New companies** are **discouraged** to report and register. Out of potentially 10,000 IT companies, **only** 2,500 are registered.
- **Existing companies** are **further burdened** and will take their HQ outside Pakistan facilitated by their virtual nature of business. Many companies will be encouraged to keep profits abroad and send only cost of operations to Pakistan – hence reducing export growth.
- **Lack of faith** in long-term government commitments in strategic projects like Special Technology Zones (STZ)

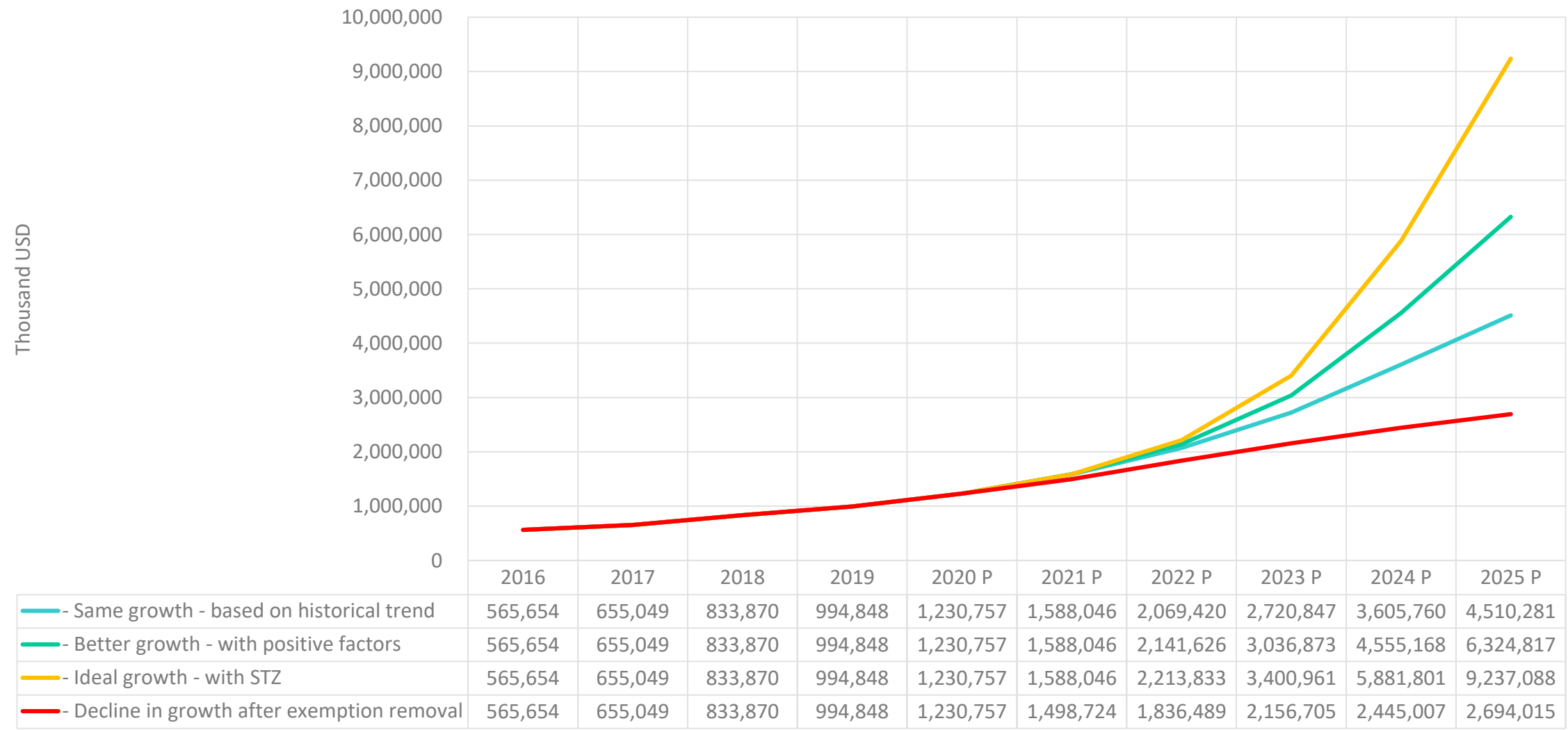


Impact Analysis of Removal of Exemption

To see how tax exemption can play a role in the future, the projections can be seen in four categories:

1. The exemption **continues** till 2025: the same growth continues based on historical trend
2. The exemption **continues** till 2025: growth is improved due to better conditions and an increase of opportunities for export after Covid-19 (15% annual growth)
3. The exemption **continues** till 2025: ideal growth with Software Technology Zones (STZ) (30% annual growth)
4. Exemption **discontinued** in 2021: a decline in the growth trend (25% yearly decline)

Impact of exemption **continual** vs. **removal**





Decrease in projected
Export Growth



Decrease in job
creation opportunities



Decrease in positive market
perception in other countries
about consistency of policies
and market opportunities

Decrease in ease of doing business (EOB)

Decrease in market competitiveness

Increase in cost of doing business

Decrease in reporting

Conflicts with incentivization and EOB strategy of Special Technology Zones (STZ)






























Potential promotion of opportunities of **corruption** in negotiations

- **Revenue** – No increase in revenue
- **Reporting** – Companies will be discouraged to report and existing companies may take their business outside Pakistan



Regional Comparison of IT Industry Benefits

Regional Comparison of Benefits for IT Industry

Facility	India 	Philippines (BPO) 	China (Chengdu) 	Bangladesh 	Pakistan 
Tax Exemption on Exports					
Special Economic Zones <i>113 Zones in India - where they're allowed to keep 100% in convertible foreign exchange</i>					
Tax and Duty Free Imports					
VAT Zero Rating of local purchases including services, telecommunication, electric power, water bills					
Exemption from labor laws for IT & BPO Companies					
Exemption from any local government fees and taxes					
Exemption from withholding tax					
Exemption from all local and national taxes for SEZ Developer					
5% Cash Rebate					
10% Cash Award on ICT Exports					
Power on Industrial Rates					

IT/ITeS INDUSTRY IS AT A **TIPPING POINT!**



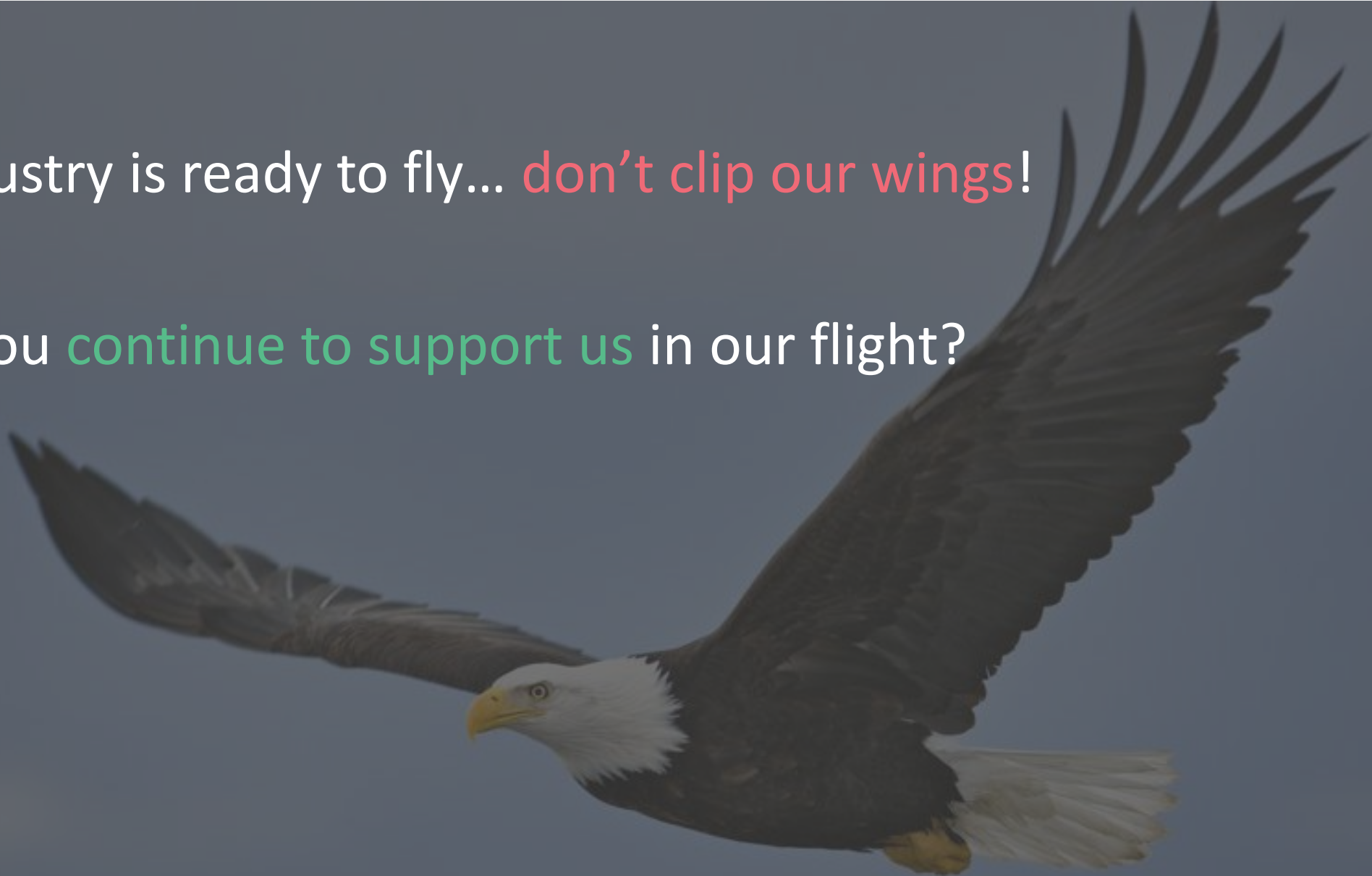
Reverse the change for IT industry: resume exemptions as committed until 2025 to avoid the damage and ensure consistency in policies



Obtain intended results from STZ – as planned initially

IT Industry is ready to fly... **don't clip our wings!**

Will you **continue to support us** in our flight?



- Barkan Saeed (P@SHA)
- Hira Zainab (P@SHA)
- Syed Ahmad (DPL)
- Mujeeb Zahoor (S&P Global)
- Naseer A. Akhtar (InfoTech)
- Haroon Kanth (Teradata)
- Abid Muhammad (S&P Global)

Acknowledgements:

Dr. Ayub Alvi (FAST) – for providing OSP case-study

Osman Nasir (PSEB) – for providing historical data on the exports