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Pakistan Software Houses Association for IT & ITES

Tax **Analysis**

Mapping Cost of Doing Business for IT & ITeS in Pakistan

Nov 2022

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Tax Analysis

Mapping Cost of Doing Business for IT & ITeS in Pakistan

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Message by the Chairman

As the licensed representative body for the IT and ITeS industry, P@SHA represents thousands of IT and IT-enabled service companies and has been at the forefront of the #DigitalPakistan revolution. P@SHA has been actively involved in policy advocacy—recommending policies and suggesting implementation process—with the government bodies.

Previously, P@SHA has rigorously lobbied with the relevant stakeholders on improving the Ease of Doing Business (EoDB) to translate progress into double-digit growth. At the core of our policy mandate is the demand to realize policy continuity at the national level. With the consistent policy in place Pakistan can establish a mature tech ecosystem.

The IT & ITeS industry is an interesting intersection—with the potential to bring in billion-dollar revenue and foreign direct investments, it is the only sector with a trade surplus of 77% in the FY22. However, the current growth trend cannot exponentially grow without addressing critical policy measures like cost of doing business. The sudden regulatory changes especially related to taxation regime create uncertainty and anxiety in the ecosystem. The removal tax exemption in 2022, and shift from tax credit regime to final tax regime in 2022 have a larger trickle-down effect on the growth of IT industry. The report articulates the tax regime for the industry, maps the cost of doing business across provinces, and suggests favorable practices.

P@SHA acknowledges the continued support from the Federal Ministry of Information Technology and Telecommunications (MoITT) and Pakistan Software Export Board (PSEB) for helping advocate for and implement conducive policies for the industry and build an organized ecosystem.

I am extremely pleased for P@SHA to launch Mapping Cost of Doing Business for IT &ITeS in Pakistan. P@SHA's Policy Research Team has worked extensively on it to deliver an evidence-based snapshot of the taxation data points which would help decision-makers make informed policies. I note with conviction that this report will present a blueprint for conducive tax practices for the IT & ITeS industry in Pakistan. This would further provide a stimulus to the growth of local industry (Make in Pakistan) and export services of Pakistan, ultimately mapping it on the global tech landscape.

Muhammad Zohaib Khan
Chairman, P@SHA

Foreword

I am pleased to present the **'Tax Analysis: Mapping Cost of Doing Business for IT & ITeS in Pakistan',** an effort of P@SHA to create a better understanding of applicable taxes and analyze the impact of inconsistent taxation policies on the IT and ITeS industry in Pakistan.

In 2022, the IT industry has crossed USD 2.6 billion in exports and has the unique distinction of being Pakistan's only export industry with a **77% trade surplus.** Supporting the livelihoods of 600,000 professionals & freelancers and over 10,000 companies, the IT industry has proven to be the highest-growing industry in Pakistan. It has demonstrated the **potential to address the current account deficit** and restore the financial future of Pakistan. In 2022, the IT industry has **become 2nd largest export sector** crossing all traditional sectors (while 1st position is maintained by Textile Industry). Pakistan has a growing youth population, and hence IT industry is evidently the future of Pakistan. With a higher export yield per worker, the IT industry has the potential to generate jobs and contribute to poverty alleviation and move the majority of families to the middle-income sector.

However, the IT industry is not like traditional sectors! Unlike other industries which grew in the industrial era, the IT industry requires the ecosystem to be built with a Knowledge Economy mindset, with a focus on country perception, policy continuity, and incentivizing instead of regulating. The IT industry represents the potential to grow exponentially in a favorable ecosystem.

In 2021, P@SHA released Impact Analysis of Removal of Tax Exemption which included a brief comparative analysis of taxation policies for the IT and ITeS industry. Earlier in 2022, P@SHA released a Comparative Analysis of Policies in the IT and ITeS industry in Pakistan which divided policies into four categories: fiscal, monetary, human capital, and investment climate, to compare different comparable countries and their policies for the IT and ITeS industry.

P@SHA has been actively representing and advocating policies on the behalf of the IT industry on all government levels. We felt the need to analyze the factors contributing to the **cost of doing business in Pakistan for the IT and ITeS industry** and create awareness of inconsistencies and **lack of harmonization in taxation regimes** on both government and industry levels. While the positive growth has attracted global investors and improved Pakistan's competitiveness in the global market, inconsistent tax policies while withdrawing support mechanisms can negatively affect and can further complicate the investment opportunities —and potentially discourage investors as well as new entrants in the future.

I would like to express gratitude to all industry leaders, tax consultants, and the research team for sharing their valuable feedback that helped us develop the report. The data gathered has been collected through rigorous tax analysis by using both primary and secondary sources of taxation laws, ordinances, and companies' acts after detailed discussions with tax consultants and industry experts.

We hope that you find **Tax Analysis: Mapping Cost of Doing Business for IT & ITeS in Pakistan helpful,** and that it serves as a cornerstone for drafting policies and giving incentivization measures to the IT industry. We at P@SHA look forward to playing a proactive role in working with the government and industry for making it a success. If you have any queries, comments, or suggestions, please feel free to reach out to us at services@pasha.org.pk.

Hira Zainab
Secretary-General, P@SHA

Acknowledgements

P@SHA acknowledges these companies for providing insights and detailed feedback on the report through interviews with policy and financial experts.

KHILJI & CO. Chartered Accountants

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S&P Global

Sybrid

stewart

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Methodology

The tax analysis was based on primary and secondary research, particularly of the taxation laws, income tax ordinance, Companies' Act amongst other data sources. The primary data related to the tax percentages was consulted with the tax consultants. Given the budgetary changes every fiscal year, the data mentioned is not absolute and subject to changes. Also, the analysis was informed after elite interviews with representatives from industry, especially finance and taxation experts in the industry.

Understanding Tax Regime for **IT & ITeS**

Types of Taxes levied on IT & ITeS

Taxation Process in Pakistan

- Tax Reporting Authorities and relevant taxes
- Taxation Authorities: Registration and Procedure
- Procedural Challenges for Companies

Cost of Doing Business for IT & ITeS in Pakistan

Tax Regime for IT & ITeS & Finance Act 2022-2023

Tax Incentives in Special Technology Zone(s)

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Understanding **Taxes**

Types of **Taxes**

IT & ITeS Companies

Sales Tax

- **On Goods**
- **On Services**
- **On Electricity**

Income Tax

- **Advanced Income Tax**
  - Withholding Tax
  - Electricity
  - Phone & Internet
  - Imports
- **Annual Income Tax**
  - Alternate Corporate Tax
  - Normal Tax
  - Minimum Tax

Other

- **Professional/Payroll Tax**
- **Outward Remittances**
- **Sale & Purchase of IT Equipment**
- **Tax on Dividend**
- **Export Services/Export proceeds**
- **Super Tax**
- **Employee Benefits cost**

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Tax Reporting Authorities and **relevant taxes**

Utilities Tax

Telecom Companies

- Monthly Tax - Phone
- Monthly Tax - Internet

Power Companies

- Monthly Tax - Electricity

Income & Sales Tax

FBR PAKISTAN

Annual Tax

- On Income
- Professional Tax
- Outward Remittances
- Sale & Purchase of IT Equipment

Monthly Tax

- On Sales Tax returns (Goods & Services)
- Sales Tax on Electricity
- Export Proceeds

Provincial Revenue Authorities

Annual Tax

- Professional Tax
- On Income

Monthly Tax

- On Sales Tax returns (Goods & Services)
- Sales Tax on Electricity
- Export Proceeds

Taxation **Process**

Taxation Authorities: Registration

01. STEP 1
Income and Sales Tax

02. STEP 2
Company registration, exemption certificate, final tax over IT export receipts

03. STEP 3
Utilities Tax

04. STEP 4
Export tax exemption

05. STEP 5
Sales Tax on Services

Challenges in Taxation **Process**

01. STEP 1
Double taxation

02. STEP 2
Unjustified notices

03. STEP 3
Negotiations with tax officers

04. STEP 4
Getting PRC for rebate scheme

05. STEP 5
Coordinate application and documentation requirements/ hurdles related to company registration/rebates

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Procedural Challenges for **Companies**

Filling to 5 Differrent Tax Authorities

Lack of trainings of tax officers

Lack of fixed rates across provinces

Harassment by FBR officials

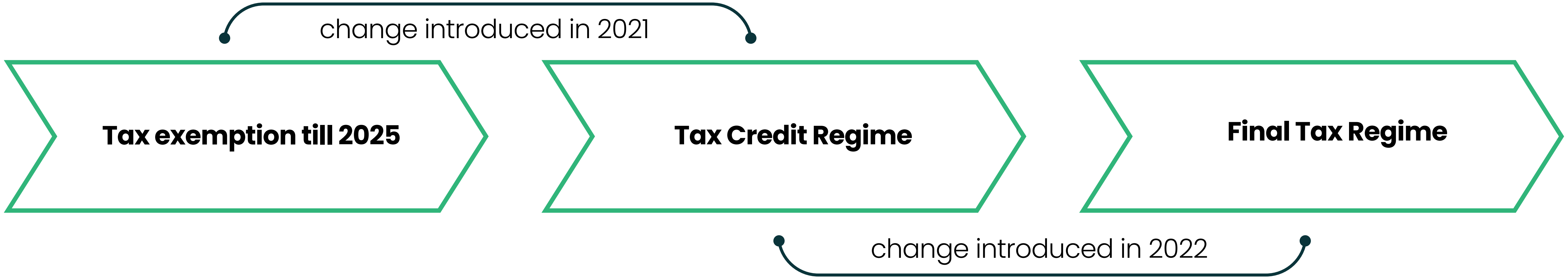
Applying for tax exemption certificates for exports

Double taxation by FBR and PRA

Cost of Doing **Business**

- Sales Tax on Electricity (FBR)
- Sales Tax on Electricity: Extra GST (provincial)
- Withholding Tax
- Sales Tax on Phone and Internet
- Tax on Imports
- Tax on Dividend
- Annual Income Tax
- Professional Tax
- Sales Tax on Services (without adjustment)
- Sales Tax on Exports services
- Outward Remittances
- Income Tax on Electricity (not refundable)
- Employee's Benefits Cost

Tax Regime for IT & ITeS **Exports**



In the past two years, there have been abrupt changes made in the tax regime for the IT & ITeS sector. The IT & ITeS were given a fiscal incentive of 100% tax exemption on income tax for the next 10 years. While the incentive was provided, companies experienced procedural challenges in acquiring exemption certificates. For instance, companies were not given tax exemption certificates even after applying and waited for over six months to acquire certificates.

It's critical to be noted that such **frequent regulatory changes imply uncertainty** in the already evolving ecosystem of Pakistan. The anxiety in the system discourage the foreign clients to bring revenue in Pakistan. Importantly, the changes have a larger trickle-down effect on the growth of IT industry. Compared to FY 2020-2021, the growth of annual IT exports has dropped down from 47% to 23% in the year 2021-2022.

Tax Exemption: **Case Studies**

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 research, software development and customer/product support. This **Lack of understanding of how captive offices work** 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 operations in Pakistan. 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 in form of 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 ease of doing business even in the existing tax regime.**

Removal of Tax Exemption: **Implications**

- Besides the case studies mentioned, **hundreds of other companies experienced similar challenges even during the exemption regime**. The sudden change from exemption to tax credit created panic amongst the companies regarding the negotiation process. The process in which negotiation with the revenue authorities became an integral part led to dismay amongst the companies.

- The continued challenges from the regulatory authorities **discouraged new companies to report and register**.

- The **lack of consistency made companies consider shifting operations out of Pakistan.** Many companies prefered to keep profits abroad and send only cost of operations to Pakistan – hence reducing export growth.

- Had tax exemption been continued till 2025–complemented by policy measures—Pakistan's annual growth rate could have potentially crossed USD 10 billion.

Note: for detailed information on tax exemption removal and its implications, read the report:

| *https://www.pasha.org.pk/impact-of-tax-exemption-removal/*

Removal of Tax Exemption: **Implications**

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 (EODB)**
- **Decrease in market competitiveness**
- **Increase in cost of doing business**
- **Decrease in reporting**
- **Conflicts with incentivization and EB strategy of Special Technology Zones (STZ)**

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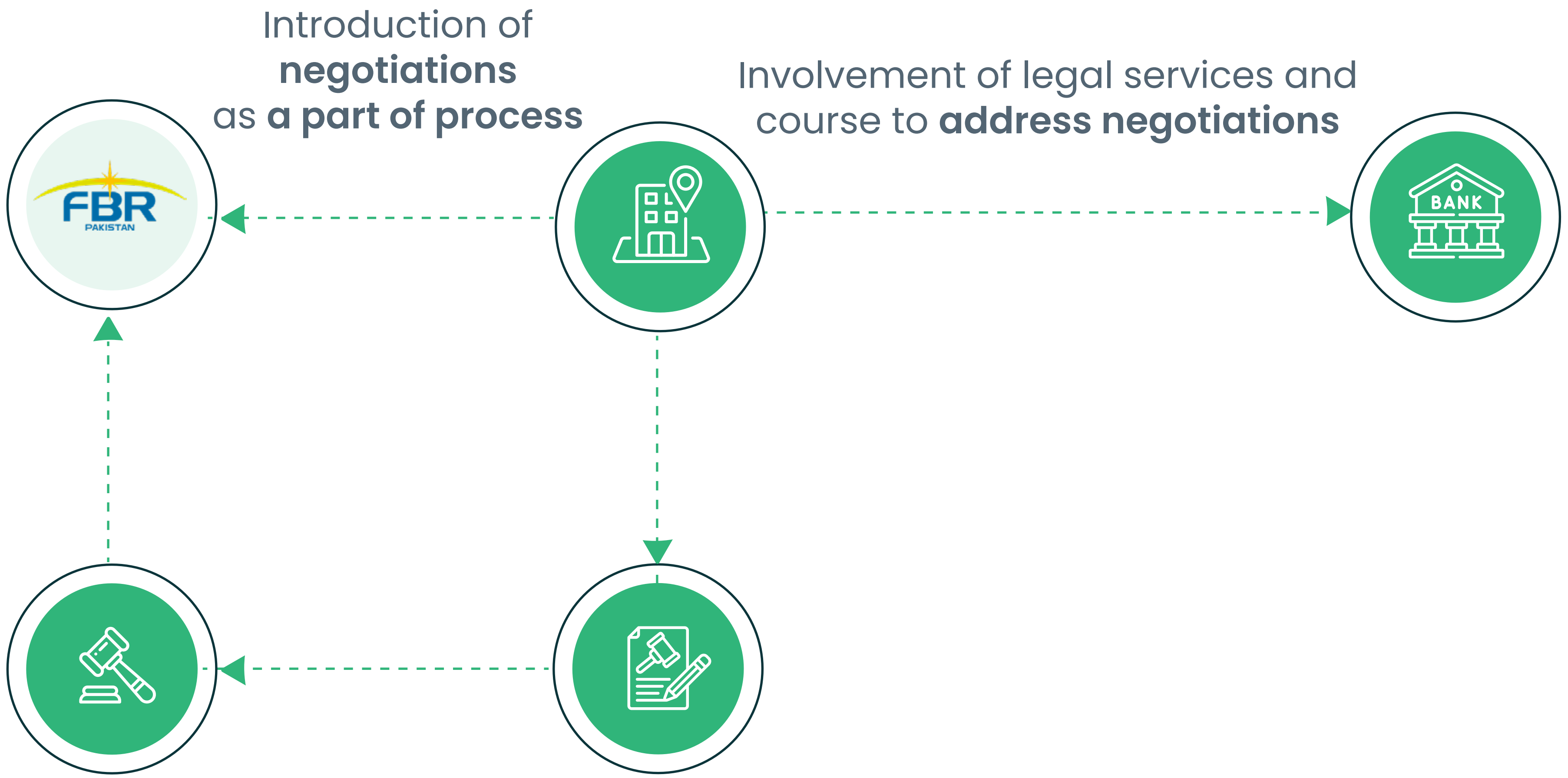
Tax Credit Regime **FY 2021-2022**

In July 2021, there was a policy shift from tax exemption to tax credit regime. To ease the burden of taxes on companies, Income Tax Ordinance, 2001 (i.e. the local tax law) provides for exemptions of whole or part of taxes, thereby reducing the tax liability. Under the Section 65F of the ITO 2001, 100% Tax credit was made available to the IT and ITeS companies. To be eligible for the credit, companies had to first apply to FBR and **justify that they meet the criteria of IT Company**. The lack of standard updated definition of IT/ITeS services led to lack of understanding of the tech industry amongst the FBR officials. After the policy shift to tax credit, the companies which provide export services were given 100% tax credit on withholding, and annual income tax.

This announcement remains an ideal **case of inconsistency in policy**. While tax exemption was committed till 2025, it was replaced with the controversial tax credit regime in early 2021. The process for tax credit application remaind cumbersome and the policy shift created uncertainty and frustration.

| *For more details, see Impact Analysis of Tax Credit Regime.*

Implications of Tax Credit **Regime**



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

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Implications of Tax Credit **Regime**

During tax credit regime, it was mandatory for Federal board of revenue to issue tax exemption certificates within 15 days, however, it was not properly implemented. There was a **delay in provision of exemption certificates**. While the regime was changed on July 1, 2021, the option to apply on the FBR portal was added on August 4, 2021. The delay precipitated uncertainty and anxiety in the IT and ITeS industry. Additionally, banks were deducting 1-2% Withholding tax causing further panic amongst companies.

Instead of receiving the exemption certificates, the companies were exposed to the **process of negotiations with the revenue authorities.** For instance, companies had to provide proof of being an IT company to the tax officers. Companies' approval of exemption certificate was dependent on the discretion of the of tax officers who resorted to their limited understanding of IT & ITeS industry.

It must be noted that the nature of business operations is different for tech sector as compared to the traditional industries. With consistent changes made in the policy measures, companies can easily withdraw operations and move to countries with relatively favorable investment climate. This understanding of business operations and the need to introduce support policies is crucial for the growth of tech industry.

Finance Act 2022: **Final Tax Regime**

Under the Budget 2022-2023, the Tax Credit Regime has also been revoked. Introduced as Final Tax Regime, the finance bill suggests that export of IT and IT enabled services will be subjected to 0.25% of export proceeds subject to fulfilment of following conditions:

- Registration with PSEB
- Annual tax return has been filed
- Withholding statements have been filed
- Sales tax returns for Federal & Provincial tax authorities (whichever is applicable) have been filed

It is critical to be noted that the aforementioned tax is conditional. For instance, if a company does not meet the condition "a" i.e. PSEB registration, tax deduction rate will be 1% but would still be Final Tax Regime (FTR).

Finance Act 2022: **Normal Tax Regime**

In case a company does not fulfil the previously mentioned requirements, it will fall under the Normal Tax Regime (NTR). Under NTR, the following taxation will be applicable:

Small Company: Tax liability is higher of following under NTR:

20% of taxable income

17% of accounting income

1.25% of turnover

Other than Small Company: Tax liability is higher of following under NTR:

29% of taxable income

17% of accounting income

1.25% of turnover

Individual/ AOP with more than Rs.100 million gross sales/ revenue/ turnover in any year 2017 and onwards:

% of taxable income as per slab rates – highest slab is 35%

Individual/ AOP with less than Rs.100 million gross sales/ revenue/ turnover:

Tax liability is percentage of taxable income as per slab rates – highest slab is 35%

Finance Act 2022: **Tax Credit for Startup(s)**

Under the Budget 2022-2023, the Tax Credit Regime remains intact for the startup(s) in Pakistan. Under Section 65F of the Income Tax Ordinance 2001, 100% tax credit is available to the startup(s) on withholding and annual income tax. However, to avail the credit, **Startups are required to obtained Exemption Order from FBR to save withholding of taxes at advance stage.**

The tax credit will only be available if startups justify the following conditions:

Conditions for a Startup:

- a business of a resident individual, AOP or a company that commenced on or after first day of July, 2012 and the person is engaged in or intends to offer technology driven products or services to any sector of the economy provided that the person is registered with and duly certified by the Pakistan Software Export Board (PSEB) and has turnover of less than one hundred million in each of the last five tax years; or
- any business of a person or class of persons, subject to the conditions as the Board with the approval of Federal Minister-in-charge may, by notification in the official Gazette, specify.

The tax credit under sub-section (1) shall be available subject to

- return has been filed;
- withholding tax statements for the relevant tax year have been filed in respect of those provisions of the Ordinance, where the person is a withholding agent; and
- sales tax returns for the tax periods corresponding to relevant tax year have been filed if the person is required to file Sales Tax Return under any of the Federal or Provincial sales tax laws.

Finance Act 2022: Exemption of Capital Gains Tax for Startup VCs

An incentive given in the finance Act 2022 for Startups venture capitalists is exemption on the capital gains tax. The exemption is conditional to the venture capital and fund registered under relevant Venture Capital Companies and Funds Management Rules issued by Securities and Exchange Commission of Pakistan.

Initially VC backed Pakistani startups, based within the jurisdiction of Pakistan, were subjected to capital gains tax of 29%. This discouraged the investors from making investments in Pakistan. The concern stems from the fact that venture capital investments are high-risk investments, often less than 15% of the startup's scale into profitability. If this high-risk is coupled with capital gain tax of 29%, investors are discouraged to bring in investments. This is primarily the reason why most of this funding done in startups was later incorporated into other countries.

The exemption on capital gains tax is a positive development. The VC funding for Pakistani startups increased to USD 375 Million in FY 2020-21 as comapred to USD 75 million in FY 2019-20. In the next five years, this investment is expected to reach US$ 2-3 Billion. Such exemptions encouraged investors to bring revenue along with costs in the country and places Pakistan favorably on the digital landscape in the region. It is highly encouraged that the government makes similar exemptions for the IT & ITeS sector.

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Finance Act 2022: **Super Tax on IT & ITeS Services**

Under the Finance Act 2022-2023, a super tax has been imposed on large-scale industries **through insertion of section 4C. Applicable on every person's income exceeding limits as per below table, the act provides slab rates for super tax to be levied on every person.** According to the government, the super tax is "one-time tax needed to curtail the previous four record budget deficits." For the **IT & ITeS persons** providing **local services**, the following slab would be applicable:

Super Tax on IT Local services

Income under section 4C	Rate
Where income does not exceed **Rs 150 million**	0% of the income
Where income exceeds **Rs 150 million** but does not exceed **Rs 200 million**	1% of the income
Where income exceeds **Rs 200 million** but does not exceed **Rs 250 million**	2% of the income
Where income exceeds **Rs 250 million** but does not exceed **Rs 300 million**	3% of the income
Where income exceeds **Rs 300 million**	4% of the income

The super tax will applicable on the IT & ITeS providing **export services*** depending on the gross turnover of the company and conditions associated with final tax regime (FTR). However, for startups and freelancers, the gross revenue is not enough to attract super tax.

Super Tax on IT Export services

FTR Rate	Gross Revenue (turnover) likely to attract super tax	Starting Rate
0.25%	Rs. 17.7 billion (Sales)	1% of income
1%	Rs. 4 billion (Sales)	1% of income

*Disclaimer. conditions apply**

Tax Regime: **Comparison**

	Tax Exemption	Tax Credit	FTR
Announcement	Original commitment till June 30, 2025	Announced suddenly in 2021, applicable till June 30, 2025	Announced suddenly in 2022
Annual Growth in Exports	47% (crossed target) FY 2020 - 2021	23% (below target) FY 2021 - 2022	Expect further & steep decline
Tax applicable (IT & ITeS Exports)	0%	0% if exemption certificate is issued 1% if exemption certificate is not issued	0.25% on turnover with compliance + PSEB 1% on turnover with compliance - PSEB
Tax applicable – on FBR officer's discretion / understanding of IT industry	20 % - 35%	20 % - 35%	20 % - 35%
Applicable on	Company, AOP, Freelancers	Company, AOP, Freelancers	Company, AOP, Freelancers
FBR intervention	Unjustified notices with lack of understanding of the IT industry – asking companies to prove that they're an IT company despite endorsement / verification of company from P@SHA, PSEB & MoITT	Same as exemption regime with an additional intervention that IT industry has to seek for Exemption certificates as well which were promised to be issued within 15 days automatically though the actual time taken was much more and many haven't even received any exemption certificate from 10 months	Same as an exemption and credit regime except that exemption certificates are not applicable as now IT sector has to pay taxes
Conditions for regime	80% export proceeds required to be brought into Pakistan	80% export proceeds required to be brought into Pakistan Sales Tax Returns WHT Statement PSEB Certificate (procedural requirement)	Same as of tax credit regime
Comments	Showed government's commitment to the growth of the IT/ITeS industry	Abrupt change – raising questions on policy continuity and consistency. Replaced original commitment with a controversial and tedious process – affecting ease of doing business	Drastic policy change – discouraging companies internally and internationally

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Tax Incentives in Special Technology **Zone(s)**

Exemption from all taxes under the Income Tax Ordinance, 2001.

Exemption from tax on Import of Capital Goods

Exemption from Property Tax

Exemption from Sales Tax under Sales Tax Act, 1990

- 100% INCOME TAX EXEMPTION for 10 years
- EXCISE DUTIES exempt for 10 years
- SALES TAX EXEMPTION for 10 years
- ROYALTIES (WITHHOLDING TAX) exemption for 10 years

- REMITTANCES: Full repatriation of invested capital,profits, and dividends
- MINIMUM ALTERNATE TAX
- CAPITAL GAINS TAX exemption for 10 years
- CUSTOMS DUTY EXEMPTION for 10 years

- DIVIDENED DISTRIBUTION TAX (DDT) exempted for 10 years
- 100% PROFIT TAX RATE for 10 years
- DUTY REBATE SCHEMES
- TAX HOLIDAYS FOR SEZ DEVELOPERS
- SUBSIDIZED LAND: Land lease at govt. rates much lower than market value

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Snapshot of Taxes on various **Sectors**

Capturing the taxes paid by IT& ITeS Industry, the industry has been divided into four major sectors. The report analyzed how taxes vary between each sector. The excel sheet provides a detailed snapshot of four sectors:

IT& ITeS Companies | **BPO(s)** | **Startup(s)** | **Freelancers**

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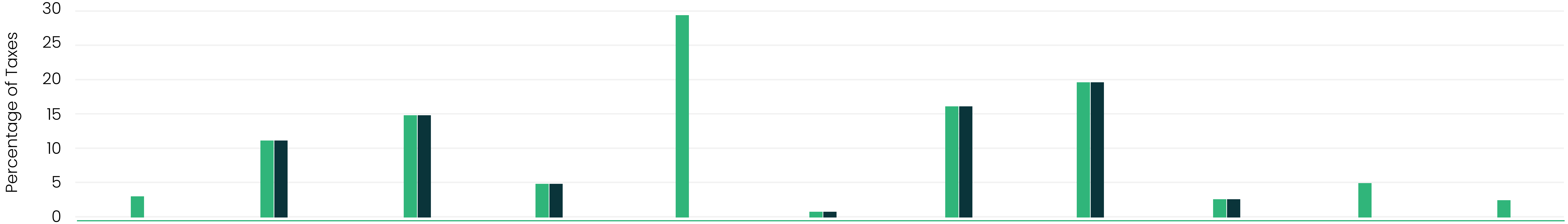
Snapshot of Taxes on various **Sectors**

Breakdown of Taxes paid by different sectors

IT& ITeS **Companies**

The income tax is usually fixed for all companies, with the exception of annual income tax varying for small to big companies. Sales tax on companies varies according to location in which company is registered. Other taxes such as professional tax and outward remittances differ based on the operations of the companies. The graph gives a breakdown of the taxes levied on the IT& ITeS companies, including the super tax and income tax on export services introduced in Finance Act 2023. The professional tax is not mentioned in the graph because it varies according to the paid up capital of the companies.

Total Cost | Domestic Services **113%** | Export Services **73.5%**



	Withholding Tax	Sales Tax on Electricity	Income Tax on Phone & Internet	Imports	Annual Income Tax	Super Tax	Sales Tax Electricity (FBR)	Sales Tax Phone & Internet	Sales Tax Electricity (Provincial)	Sales Tax On Services	Outward Remittances
Domestic	3	12	15	5.5	29	1	17	19.5	3	5	3
Export	0.25	12	15	5.5	0.25	1	17	19.5	3	Exempt	Exempt

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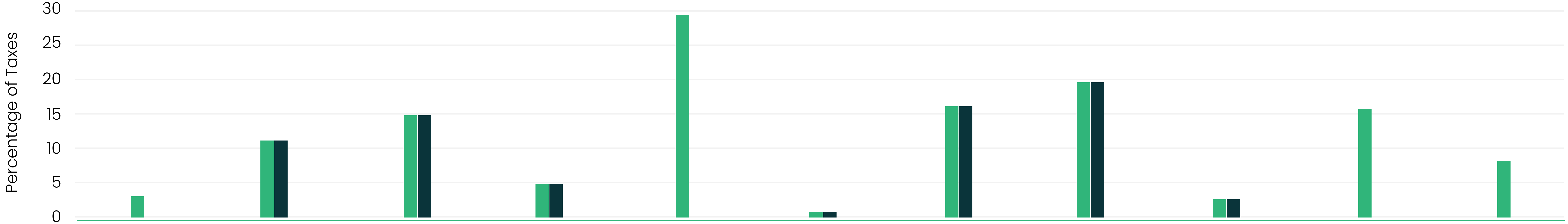
BPOs

For BPO(s), the value of sales tax on companies varies according to location in which company is registered. However, in the graph the highest value is mentioned. The tax on outward remittances is highest for BPO as compared to other IT& ITeS sectors. Other taxes such as professional tax differ based on the operations of the companies. In the graph below, types of taxes levied on BPO sector are mentioned, with the exception of professional tax because it varies according to the paid up capital of the companies.

Total Cost | Domestic Services **129%** | Export Services **73.5%**



	Withholding Tax	Sales Tax on Electricity	Income Tax on Phone & Internet	Imports	Annual Income Tax	Super Tax	Sales Tax Electricity (FBR)	Sales Tax Phone & Internet	Sales Tax Electricity (Provincial)	Sales Tax On Services	Outward Remittances
Domestic	3	12	15	5.5	29	1	17	19.5	3	16	8
Export	0.25	12	15	5.5	0.25	1	17	19.5	3	Exempt	Exempt

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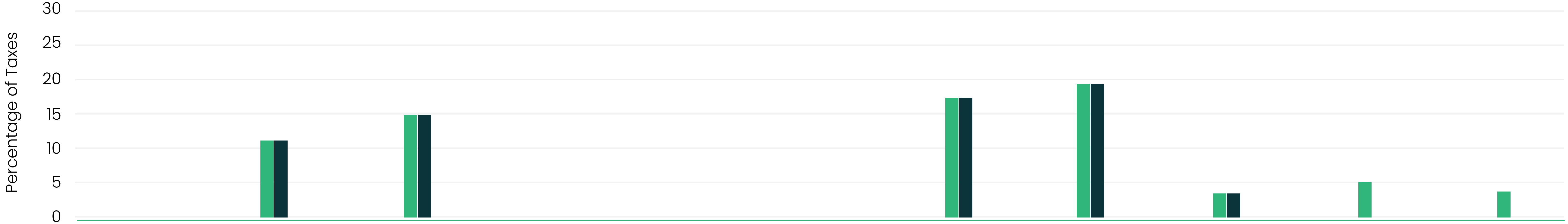
Startups

Startup(s) companies are given 100% tax credit subject to the provisions of the Section 65F of the ITO 2001 on income tax, and imports. For companies not registered with FBR have to pay sales tax on electricity of thirty-five percent. The graph below illustrates the percentages of taxes the sector is subjected to, with the exception of professional tax because it varies according to the paid up capital of the companies. Under the Finance Act 2023, all IT sectors have been subjected to super tax. It is to be noted that while super tax is applicable on startups, the gross turnover/ imputable income is not sufficient to meet the slab requirement of super tax.

Total Cost Domestic Services 74.5% Export Services 66.5%



	Withholding Tax	Sales Tax on Electricity	Income Tax on Phone & Internet	Imports	Annual Income Tax	Super Tax	Sales Tax Electricity (FBR)	Sales Tax Phone & Internet	Sales Tax Electricity (Provincial)	Sales Tax On Services	Outward Remittances
Domestic	100% Tax credit	12	15	100% Tax credit	100% Tax credit	Not applicable	17	19.5	3	5	3
Export	100% Tax credit	12	15	100% Tax credit	100% Tax credit	Imputable income not enough	17	19.5	3	Exempt	Exempt

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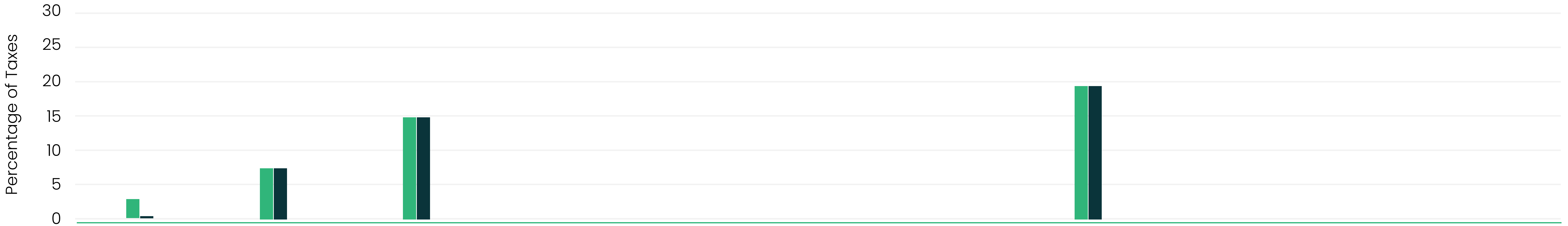
Freelancers

Most of the taxes do not apply on the freelancer(s), with the exception of the tax on utilities and income. Similar to startups, the super tax is not likely to be applicable on freelancers due to imputable income calculations. In the Budget 2023, export services have been subjected to income tax of .25% of the proceeds, which was previously not levied on freelancers.

Total Cost | Domestic Services **45%** | Export Services **42.25%**



	Withholding Tax	Sales Tax on Electricity	Income Tax on Phone & Internet	Imports	Annual Income Tax	Super Tax	Sales Tax Electricity (FBR)	Sales Tax Phone & Internet	Sales Tax Electricity (Provincial)	Sales Tax On Services	Outward Remittances
Domestic	3	7.5	15	Not Applicable	Not Applicable	Imputable income not enough	Not Applicable	19.5	Not Applicable	Not Applicable	Not Applicable
Export	0.25	7.5	15	Not Applicable	Not Applicable	Imputable income not enough	Not Applicable	19.5	Not Applicable	Not Applicable	Not Applicable

Employee Payroll **Tax**

According to section 149, part 1 1st Schedule, the payroll tax is a fixed tax levied on the employees of the company. The taxes are imposed against the income slab of the employees. The payroll tax is deducted from employee's salary and paid through the company to federal revenue authority. While payroll tax is not considered as cost for the company in the books, it is considered an indirect cost.

Slab		**Tax Rate**		
Up to 600,000		**0%**		
600,001	1,200,000	2.5% of the amount above 600,000		
1,200,001	2,400,000	15,000	**Plus**	12.5% of the amount > 1.2 M
2,400,001	3,600,000	165,000		20% of the amount > 2.4M
3,600,001	6,000,000	405,000		25% of the amount > 3.6M
6,000,001	12,000,000	1,005,000		32.5% of the amount > 6.6 M
Above 12,000,000		2,955,000		35 % of the amount > 12 M

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Cost of Doing Business **Scenarios**

Cost of Doing Business

- Domestic & Export Services
- Employee Benefits Cost
- Professional Tax

Cost of Doing Business: Sectoral Comparison

Cost of Doing Business: Provincial Comparison on Sales Taxes

Cost of Doing Business: **Domestic Services**

	IT & ITeS	BPOs	Freelancers	Startups
Withholding Tax	3%	3%	3%	100% tax credit
Income Tax on Electricity	12%	12%	7.5%	12%
Income Tax on phone & Internet	15%	15%	15%	15%
Tax on Imports	5.5%	5.5%	-	-
Annual Income Tax	29%	29%	-	-
Super Tax	1%	1%	-	-
Sales Tax Electricity (FBR)	17%	17%	-	17%
Sales Tax (phone & internet)	19.5%	19.5%	19.5%	19.5%
Sales Tax Electricity (PRA)	3%	3%	-	3%
Sales Tax on Services	5%	16%	-	5%
Outward Remittances	3%	8%	-	3%

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Cost of Doing Business: **Export Services**

	IT & ITeS	BPOs	Freelancers	Startups
Withholding Tax	0.25%	0.25%	0.25%	-
Income Tax on Electricity	12%	12%	7.5%	12%
Income Tax on phone & Internet	15%	15%	15%	15%
Tax on Imports	5.5%	5.5%	-	-
Annual Income Tax (inwards remittances)	0.25%	0.25%	-	-
Super Tax	1%	1%	-	-
Sales Tax Electricity (FBR)	17%	17%	-	17%
Sales Tax (phone & internet)	19.5%	19.5%	-	19.5%
Sales Tax Electricity (PRA)	3%	3%	-	3%

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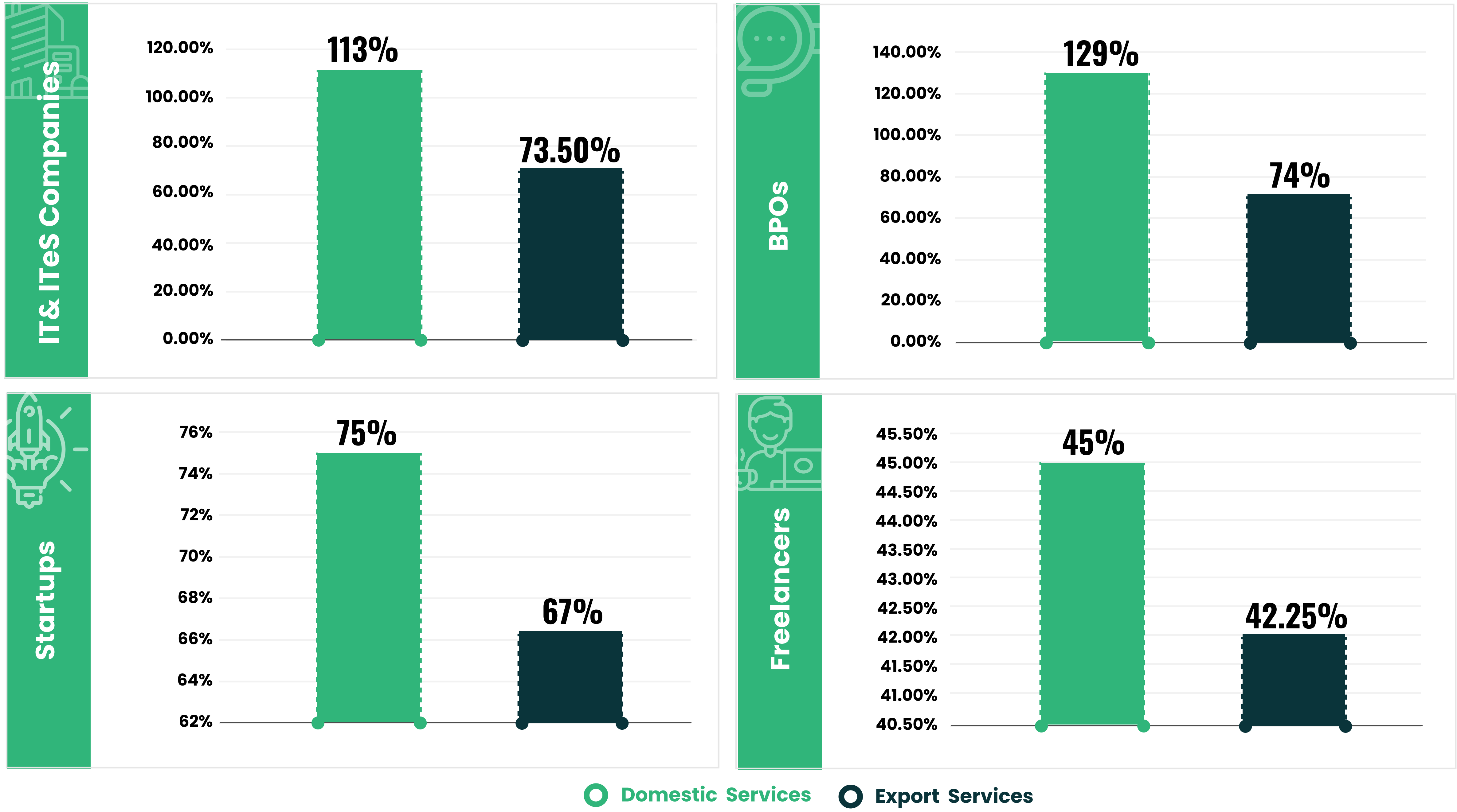
Cost of Doing Business: Employee Benefits as Per Labor Laws of **Pakistan**

	ICT	Sindh	Punjab	KPK	Baluchistan
Minimum Wage Rate Minimum Wage Rate for Unskilled Labor	**PKR 25,000**	**PKR 25,000**	**PKR 25,000**	**PKR 25,000**	**PKR 25,000**
Employees' Old-Age Benefit Institution (EOBI) Employer Contribution Per Employee	**PKR 1,000**	**PKR 1,000**	**PKR 1,000**	**PKR 1,000**	**PKR 1,000**
Employees' Social Security Employer Contribution Per Employee (6% of Minimum Wage)	**PKR 1,250**	**PKR 1,250**	**PKR 1,250**	**PKR 1,250**	**PKR 1,250**
Retirement Benefits Upon Resignation / Termination of an Employee (for any reason other than Misconduct)	**Either Gratuity or Provident Fund**				
Worker's Welfare Fund (WWF) & Workers Profit Participation Fund (WPPF)	**WWF @ 2% of taxable income and WPPF @ 5% of accounting profits will be applicable as per respective Federal & Provincial WWF and WPPF laws.**				

The table on the left demonstrate the contribution made by the company to provide employee benefits as per labor laws of Pakistan. It is to be noted that the employee contribution is not mentioned. The employee benefits ultimately become cost for the companies.

In similar vein, the worker's welfare fund is considered a liability by companies. This is attributed to lack of transparency and accountability of the funds. Importantly, the employees of the tech companies are not recipient of the fund's dividends. For effective utility of WWF for the IT industry, the fund should be separated and redirected for industry development programs such as skills development or cash rebate.

Cost of Doing **Business** (Sectoral Comparison)



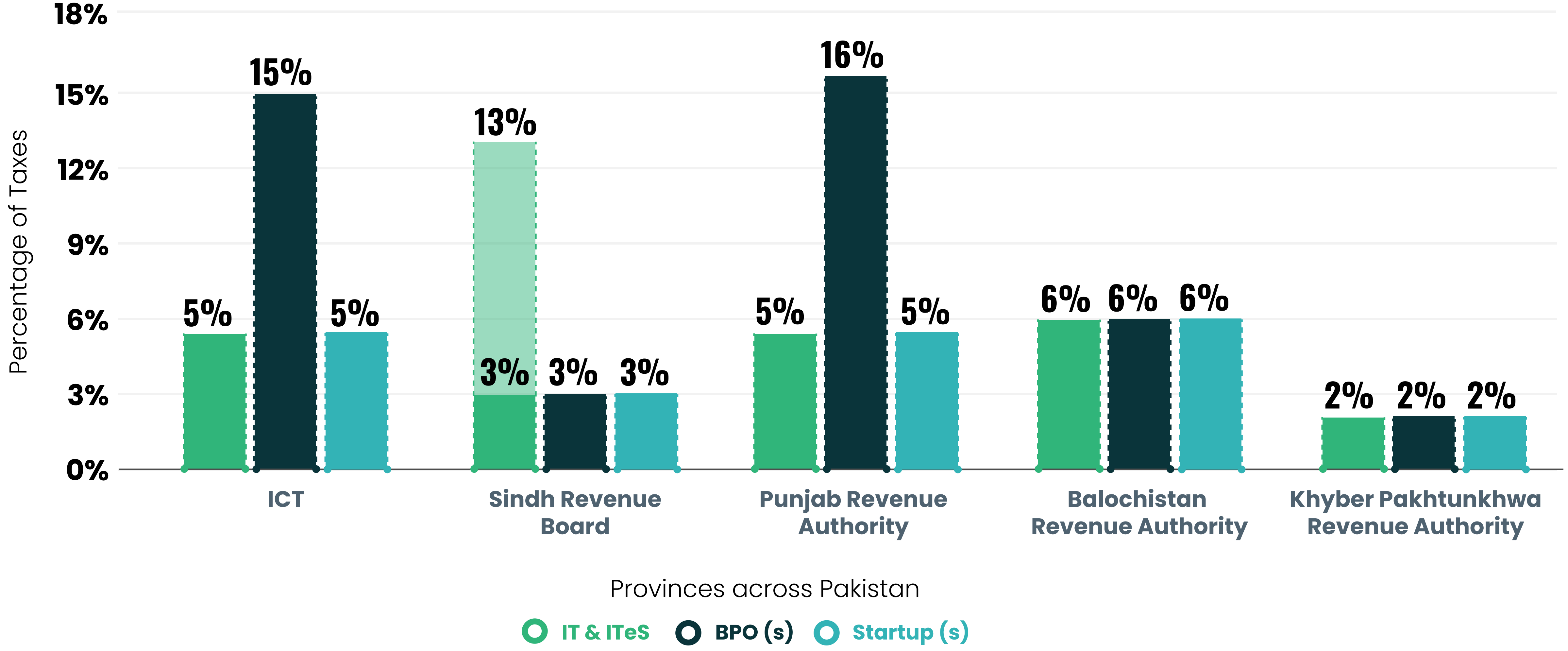
The data suggests that BPO sector has to pay the highest percentage of taxes, followed by broader IT&ITeS companies.

Domestic Services experience higher cost of operations than the export services. For freelancers the cost of doing business is primarily utilities cost.

Importantly, in the Finance Act 2023, income tax on export services have been introduced which has increased the cost of doing business for IT & ITeS.

i Disclaimer: percentages exclude the professional tax and the sales tax (without input adjustment)

Cost of Doing **Business** (across provinces)



The graph analyzes the sales tax (local services) levied on three main IT services across different provinces in Pakistan. The data suggests Khyber Pakhtunkhwa to be the most favorable province towards the IT Industry in term of percentage of taxes applied on services.

In the Finance Act FY23, the Sindh government has given the software/IT based consultants the option to choose either 13% sales tax with input adjustment or 3% sales tax without input adjustment.

i Note: The data shown is for domestic services. Export Services are exempt from Sales Tax on IT Services.

Tax incentives: IT vs. Other industries in **Pakistan**

Comparison: Fiscal benefits for Textile vs. IT Industry

Comparison: Fiscal benefits for Textile vs. IT **Industry**

	Textile Industry	IT/ITeS Industry	Policies to Adopt
Sales tax on input goods	Refund on sales tax on ▪ Acquisitions of tax paid input goods ▪ Electricity/ gas/ services utilized as input goods for manufacture of output goods to be exported. (Export facilitation Scheme 2021) 100% GST return.	Sales tax on Electricity	Similar relaxation/refund should be extended to IT
Rebate Scheme	Refund system: fast track channel for manufacturers-cum-exporters to refund within 3 months.	Cash Reward Program(Getting PRC: 1 month Rebate: **3 months**)	Adopt a fast-track channel for rebate cases
Subsidy on Utilities	Fixed rate of utilities / Subsidized cost of electricity and gas	No subsidies on utilities	Subsidies on cost of utilities/ land/ rent should be extended to IT
Import Duty	Duty free import of machinery under Textiles Policy 2009-14. (carried forward in policy 2020-2025)	**5.5%** of the import value	Duty free import of equipment for IT exports required
Finance Scheme	Long-term financing facility (5%) + Export Finance Facility (3%)	**No such policy**	Export finance facility for IT industry needed
Finance Scheme	Enhancement of LTFF disbursements by Rs. 100 billion per annum	Anything closer to this is the financial incentive on export remittances amounting 4 Billion for 2020-2021 – but hasn't distributed yet	Fair share needed for IT industry, the fasest-growing industry and only industry with a trade surplus

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Fiscal Incentives: Assessing tax practices for **IT in Indo-Pacific**

Fiscal & Monetary **Policies**

India

Exemption from income tax

Under **special economic zones**, IT companies are exempt:

- 100% of profits for the first five years of operations.
- 50% for the next five years.'
- 50% for a further five years
(depending on investment of the tax benefits back into business)

Exemption from custom duty

Under **India Customs Tariff 2021**, IT related imports are exempt from custom duty.

Exemption from withholding tax

Software imports are also **exempt** from withholding tax since 2003.

Vietnam

Import duty exemptions are applied to:

- Imported goods that are used to build fixed assets
- Imported raw materials and supplies that have not been manufactured locally within a five-year period

Preferential Tax Treatment

Support for IT firms in areas with difficult socio-economic conditions:

- Income from the transfer of hi-technology in such areas is tax-exempt
- Preferential tax rates may be extended to 15 years.

Subsidy on Land Rental

Possibility of land rental exemption for up to 15 years or entire project duration (subject to govt. approval)

Malaysia

Pioneer Status (PS)

Tax exemption for companies participating in promoted activities or producing promoted products

- Exempted for 5 to 10 years

Investment Tax Allowance (ITA)

- Granted on the basis of capital expenditure for promoted activities
- Valid for 5 to 10 years
- Unutilized ITA can be carried forward until fully utilized

Monetary Rebates in **India**

IT and ITeS

- For companies creating **333 jobs per acre**, cost of land is subsidized by GoI
- Stimulus package announced for IT industry to counteract effects of COVID-19

Startup(s)

- Startups are exempted from **capital gains tax**
- **Startup Seed Fund** worth INR 1,000 crore announced as part of Startup India Initiative

BPO(s)

India BPO Promotion Scheme (IBPS)

- Incentivize BPO operations across India for the creation of employment opportunities for the youth
- New businesses eligible for **5% financial assistance** for setting up BOPs as a consortium with local entrepreneurs.

Fiscal & Monetary **Policies**

Malaysia

- **50% reimbursable grant** for the costs of preparing and submitting bids for overseas projects
- **50% reimbursable grant** for **undertaking trade promotion activities overseas**, such as trade fairs, trade missions, opening up of representative offices overseas, and market research
- **100% reimbursable grant** for Malaysian IT firms undertaking feasibility studies

Indonesia.

Access to Finance Program

- Developing a **network of "brokers"** that will link SMEs and banks.
- Has seen **US$4.5 million of loans approved** and US$6.2 million being processed in 1 year
- **Credit facility** of up to US$100 million created **for commercial banks** for **lending to SMEs.**
- Workshops for more than 200 businesswomen on financing options.

Fiscal **Policies**

	Direct Tax Waivers	Indirect Tax Waivers
	▪ Income tax exemption for 10 years	▪ Firms in hi-tech parks exempt from VAT on electricity and other utilities ▪ Accelerated depreciation on machinery ▪ No import duty on capital expenses ▪ If paid, tariff refund on import of raw materials
	▪ Income tax exemption for FDI-backed businesses	▪ Omnibus Law Company's income tax subject to deductions based on how much is invested in R&D
	▪ 100% income tax exemption in special economic zones for 5 years ▪ 50% income tax exemption thereafter	▪ IT parks subject to tax rebates ▪ India Customs Tariff: IT related imports are exempt from custom duty ▪ Software imports exempted from withholding tax since 2003
	▪ 5-10 year income tax exemption for promoted activities	▪ Investment tax allowance for promoted activities ▪ Import duty exemption on raw materials for IT sector ▪ 60% reinvestment allowance on capital
	▪ Income tax exemption for 2 years ▪ Preferential income tax after exemption ends	▪ Information Technology Agreement allows several IT products to be imported duty-free, including computers, network equipment, monitors, optical disc storage units and printed circuit assemblies
	▪ Final tax regime. ▪ Efforts underway to restore tax exemption for the industry in Pakistan	▪ **No exemption** from custom duty/VAT

For detailed comparison of tech ecosystem, read the comparative analysis report. | *https://www.pasha.org.pk/pashapk/Policy-Comparative-Analysis-by-P@SHA.pdf*

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Monetary **Policies**

Subsidies	Grants/Financial Support
▪ **100% VAT exemption on IT/ITeS office rents** ▪ 80% VAT exemption on utilities in HTPs ▪ Accelerated depreciation on machinery	▪ Startup Bangladesh offers BDT 500 crore for eligible startups

	▪ IFC PENSA Programs
	▪ **Access to Finance Program**
	  ▪ Develop linkages between SMEs and banks.
	  ▪ Credit facility of up to US$100 million created for lending to SMEs.
	  ▪ Financial literacy workshops for businesswomen.

▪ Monetary rebate on cost of land for every job created, subject to **333 jobs created per acre** by the firm	▪ Startups are exempt form capital gains tax
	▪ Stimulus package for IT industry to counteract effects of COVID-19
	▪ **India BPO Promotion Scheme (IBPS)**
	  ▪ Incentivize BPO operations across India for the creation of employment opportunities for the youth
	  ▪ New businesses eligible for 5% financial assistance for setting up BOPs as a consortium with local entrepreneurs.

	▪ 50% reimbursable grant for the costs of preparing and submitting bids for overseas projects ▪ 50% reimbursable grant for undertaking trade promotion activities overseas, such as trade fairs, trade missions, opening up of representative offices overseas, and market research ▪ 100% reimbursable grant for Malaysian IT firms undertaking
	▪ Startup Research Grant Program: Early-stage startup support for product R&D and market validation studies announced by Department of Science and Technology (DOST)
▪ No subsidy on job creation/rent/utilities	▪ Recently announced support for marketing and research through PSEB (but no program to help companies get funding for growth initiatives, feasibility, etc.) ▪ Cash reward announced but not yet distributed

For detailed comparison of tech ecosystem, read the comparative analysis report: *| https://www.pasha.org.pk/pashapk/Policy-Comparative-Analysis-by-P@SHA.pdf*

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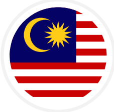
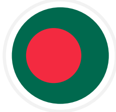
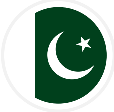
In Comparison

Countries Comparison						
Exemption from income tax on profits	✓	◉	◉	◉	✓	!
Exemption from custom duty	✓	✓	---	✓	✓	!
Exemption from capital gains tax (startups)	✓	---	---	◉	✓	✓
Exemption from withholding tax	✓	◉	---	✓	---	✓
Preferential tax rates		✓	---	✓	---	---
Subsidies on Land rental	✓	✓	---	◉	✓	---
Buffer against impact of COVID-19	✓	---	---	---	---	---
Reimbursable grant forundertaking trade promotion activities	---	---	✓	---	---	---
Reimbursable grant or undertaking feasibility studies	---	---	✓	✓	---	---

◉ **Partial Exemptions** ! **Not Implemented**

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Policy Recommendations on Tax Practices in **Pakistan**

Policy Recommendations for tax practices in **Pakistan**

After assessing the cost of doing business within the country and evaluating the global practices, the following recommendations are suggested to the policymakers in Pakistan:

Structural Recommendations

Ensure policy consistency:

Policy inconsistency is one of the major challenges faced by the IT and ITeS industry. The exemptions revoked in the current budget reiterates lack of policy continuity practiced by the government. The sudden regulatory changes especially related to taxation regime create uncertainty and anxiety in the ecosystem. To establish an organized tech ecosystem in Pakistan, policy continuity is essential.

Nominate exclusive commissioners for IT & ITeS:

It is recommended that FBR nominates commissioners for the IT and ITeS sector in three major cities: Islamabad, Karachi, and Lahore. These commissioners will be responsible to resolve the issues faced by the IT companies and will facilitate them for any FBR-related matter. For ease of the companies, there must be a separate wing at FBR for the IT companies.

Policy Recommendations for tax practices in **Pakistan**

Taxation Procedural Recommendations

Automate tax regime for IT/ITes sector:
The tax procedure should be automated to ensure ease of doing business for the companies. Similarly, one-window operation should be finalized.

Allow 50% Forex Retention to IT & ITeS companies:
Allow 50% forex retention with hassle-free & efficient in/out-flow. Allowing at least 50% of the contract value to be retained in the foreign currency and allowing unrestricted movement of the same foreign currency amount will help companies set up offices in Pakistan. Companies experience the challenges to repatriate their profits/dividends or make payments against invoices to their head offices or relevant vendors within the mentioned time frame. Due to these restrictions, companies are often unable to comply with their corporate rules which are highlighted as noncompliance by their head offices, making Pakistan an unfeasible destination to set up such operations.

Enable ease of Doing Business (EoDB) through STZs:
Operationalize and fast-track STZs for existing IT & IT-enabled services industry to ensure ease of doing business. 90% of the IT industry consists of SMEs and their biggest challenge is ease and cost of doing business.

High powered dispute resolution committee for tax disputes relating to IT:
Unjustified notices increase the cost of doing business, compliance activities and breach the trust of the industry. It also discourages unregistered companies to get registered. There should a high-level committee to resolve the issues of the industry on fast-track basis to ensure ease of doing business .

Resolve issue of double taxation of IT at Federal and Provincial levels on all instances:
GST on electricity should be lifted. Currently, it is double taxation by FBR and provincial authorities.

Policy Recommendations for tax practices in **Pakistan**

Fiscal and Monetary Recommendations

Harmonization of taxes between the provinces and federal authorities:
Across the provinces and federal units, tax harmonization should be encouraged. Ideally taxes on the domestic services should be reduced to 5% with adjustment.

Refund on sales tax on input goods:
Introduce refund on sales tax on electricity/ gas/ services utilized as input goods for manufacture of output goods to be exported. A similar incentive was provided to textile industry in the Export facilitation Scheme 2021; under which textile companies request refund on the electricity/gas/services used for the production of goods which are exported. Parallelly, IT industry provides export services and therefore can be incentivized to avail refund on sales tax on electricity/gas used. Currently, the GST on electricity is a cost for companies in the form of double taxation paid not to federal board of revenue but also to provincial revenue authorities.

The tax on dividend should be exempted:
Currently the tax on dividend is 25% (or 15% depending on the type of taxable entity) which discourages companies to bring money to Pakistan. Therefore, it is suggested that there should be zero tax on dividend given that it remains an obstacle in conversion of sole/ AOP business to corporates.

The minimum tax applied under the annual income tax should be lifted:
Companies have to pay a minimum tax of 3% along with the normal tax on annual income. After the Financial Act FY2022-2023, an additional super tax is added on the income. Minimum tax is an added cost and therefore should be lifted.

Annex I. Important terms defined in Income Tax **Ordinance** 1/2

TERMS DEFINED IN INCOME TAX ORDINANCE 2001

Term(s)	Definitions
Accounting Income	Accounting Income means the accounting profit before tax for the tax year, as disclosed in the financial statements or as adjusted under sub-section (7) or sub-section (11) excluding share from the associate recognized under equity method of accounting;
Alternative Corporate Tax	Alternative Corporate Tax means the tax at a rate of seventeen per cent of a sum equal to accounting income less the amounts, as specified in sub-section (8), and determined in accordance with provisions of sub-section (7) hereinafter.
Corporate Tax	Corporate Tax means higher of tax payable by the company under Division II of Part I of the First Schedule and minimum tax payable under any of the provisions of this Ordinance.
Information Technology Services	Information Technology (IT) services include software development, software maintenance, system integration, web design, web development, web hosting and network design.
IT Enabled Services	IT enabled services include inbound or outbound call centres, medical transcription, remote monitoring, graphics design, accounting services, Human Resource (HR) services, telemedicine centers, data entry operations, cloud computing services, data storage services, locally produced television programs and insurance claims processing.
Minimum Tax	Minimum Tax is computed on the aggregate of the person's turnover for the tax year shall be treated as the income of the person for the year chargeable to tax. For details please refer to Section 113.
Online Marketplace	Online marketplace means an information technology platform run by e-commerce entity over an electronic network that acts as a facilitator in transactions that occur between a buyer and a seller.
Small and Medium Enterprise	Small and medium enterprise means a person who is engaged in manufacturing as defined in clause (iv) of sub-section (7) of section 153 of the Ordinance and his business turnover in a tax year does not exceed two hundred and fifty million rupees: Provided that if annual business turnover of a small and medium enterprise exceeds two hundred and fifty million rupees, it shall not qualify as small and medium enterprise in the tax year in which annual turnover exceeds that turnover or any subsequent tax year.

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Annex I. Important terms defined in Income Tax **Ordinance** 2/2

TERMS DEFINED IN INCOME TAX ORDINANCE 2001

Term(s)	Definitions
Small Company	Small Company means a company registered on or after the first day of July, 2005, under the Companies Act, 2017 (XIX of 2017), which,— ▪ has paid up capital plus undistributed reserves not exceeding fifty million rupees; ▪ has employees not exceeding two hundred and fifty any time during the year; ▪ has annual turnover not exceeding two hundred and fifty million rupees; ▪ is not formed by the splitting up or the reconstitution of company already in existence; and ▪ is not a small and medium enterprise as defined in clause (59A).
Startups	Startup means,— ▪ a business of a resident individual, AOP or a company that commenced on or after first day of July, 2012 and the person is engaged in or intends to offer technology driven products or services to any sector of the economy provided that the person is registered with and duly certified by the Pakistan Software Export Board (PSEB) and has turnover of less than one hundred million in each of the last five tax years; or ▪ any business of a person or class of persons, subject to the conditions as the Board with the approval of Federal Minister in-charge may, by notification in the official Gazette, specify.

TERMS NOT DEFINED IN INCOME TAX ORDINANCE 2001

Term(s)	Understanding
Freelancers	In Pakistan, freelancers are considered as Business Individuals who are engaged in provision of IT & IT ES Services across the globe including Pakistan.

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