Tax Overview - Pakistan

The Islamic Republic of Pakistan (Pakistan) is a federal republic, comprising the provinces of Balochistan, Khyber Pakhtunkhwa, Punjab and Sindh, the federal capital i.e., the Islamabad Capital Territory (ICT); and such states and territories as are included in Pakistan through accession or otherwise. The country is governed by a written constitution.\(^1\) The Constitution contains a Federal Legislative List (FLL) that provides for the matters on which Parliament enjoys an exclusive legislative authority. All residual matters fall within the domain of the Provincial assemblies. The tax structure in Pakistan can therefore be divided into two categories — federal taxes and provincial taxes.

Entries No. 43 to 53 of the FLL are tax entries and include taxes such as income tax, customs and excise duty, and sales tax on goods (all federal taxes). The Provincial Assemblies on the other hand possess the legislative competence on taxes such as the sales tax on services and property tax (provincial taxes).

Following are the important federal taxing statutes:
- Income Tax Ordinance, 2001 (ITO);
- Customs Act, 1969 (1969 Act),
- Sales Tax Act, 1990 (1990 Act)

Services Tax for the ICT is governed by the federal statute i.e. the Islamabad Capital Territory (Tax on Services) Ordinance, 2001 (“The ICT Sales Tax Ordinance”). Administrative oversight of ICT Services Tax is carried out by the Federal Board of Revenue.

The Federal Board of Revenue (FBR) is an autonomous body responsible for implementing and collecting taxes under the aforesaid statutes.

Provincial services tax is governed and implemented under the following legislation:
- The Sindh Sales Tax on Services Act, 2011 (“The Sindh Sales Tax Act”),
- The Khyber Pakhtunkhwa Sales Tax on Services Act, 2022 (“The KP Sales Tax Act”), and

The Federal and Provincial legislatures enact a new statute each year called the Finance Act, which comes into effect from July 1 of that year (the start of a fiscal year), through which amendments are made to inter alia the aforesaid taxing statutes. The latest enactment in this regard is the Finance Act 2023, which came into force on July 1, 2023.

- Federal Board of Revenue — http://www.fbr.gov.pk
- Sindh Revenue Board — https://www.srb.gos.pk
- Punjab Revenue Authority — https://e.pra.punjab.gov.pk/
- Khyber Pakhtunkhwa Revenue Authority — https://kpra.gov.pk
- Balochistan Revenue Authority — https://bra.gob.pk

Pakistan has ratified the Convention on Mutual Administrative Assistance in Tax Matters and is part of the Multilateral Competent Authority Agreement for Automatic Exchange of Financial Account Information, implementing the Common Reporting Standard. Additionally, Pakistan is a signatory to the Multilateral Competent Authority Agreement for the automatic exchange of country-by-country reports and actively participates in the Inclusive Framework on Base Erosion and Profit Shifting, overseeing the OECD/G20 BEPS Action Plan's implementation.

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1. **Income Tax**

1.1. Income for the purposes of tax is broadly categorized under five heads, namely: (i) Income from Salary; (ii) Income from Property; (iii) Income from Business, (iv) Capital Gains and (v) Income from Other Sources.

1.2. **Corporate Tax Rules**

1.2.1. A company is deemed a resident of Pakistan if incorporated under Pakistani law or if its control/management occurs wholly within Pakistan; similarly, an association of persons is considered a resident if its affairs are controlled and management are located wholly or partly in Pakistan during the tax year.

1.2.2. Companies are individually taxed, with distinctions among small companies, banking companies, and others; specialized corporate income tax rules apply to sectors like oil, natural gas production, mineral exploration, banking, insurance, and charitable organizations, while a minimum tax is mandated for resident companies and permanent establishments of nonresident companies under specific conditions.

1.2.3. Nonresident corporations in Pakistan are taxed on income and capital gains from Pakistan sources, as outlined in Section 101 of the Income Tax Ordinance. This includes business income related to a permanent establishment in Pakistan, sales of similar goods, other relevant business activities, any business connection, and the disposal of assets in Pakistan, even if the transaction occurs outside the country.

1.2.4. Under the ITO, a "permanent establishment" for a nonresident includes physical locations like offices, factories, mines, and virtual business presence through electronic transactions. It encompasses places where contracts are negotiated, agricultural properties, and sites or projects lasting over 90 days. Services provided through employees, agents with contracting authority, substantial equipment, and cohesive business operations also qualify. The definition excludes liaison offices engaging in certain commercial, trading, or industrial activities. A liaison office is one that doesn't derive income in Pakistan and is funded externally, provided it's not involved in specified commercial activities, and FBR specifies criteria for its classification.

1.2.5. Pakistan's standard tax year runs from July 1 to June 30, and any deviation from this requires approval from the Commissioner of Inland Revenue. Notably, the FBR designates specific year-end dates for insurance companies (December 31) and certain other industries (September 30).

1.2.6. Corporate income in Pakistan is categorized into four heads: income from property, business, capital gains, and other sources. Each head follows distinct deductibility rules, generally permitting deductions for business-related expenditures. However, non-deductible expenses include fines, penalties, personal, and excessive entertainment costs. The term "profit on debt" is employed instead of "interest" in the taxation context.

1.2.7. Income exempt from federal tax in Pakistan includes agricultural income (taxed by provinces), profits from domestic power projects, Pakistan-source income protected by double tax treaties, income from contractors, consultants, or experts on local projects, and profit on debt and capital gains from government-approved debt for nonresident banking companies under a sovereign agreement.

1.2.8. Corporate taxation includes group treatment options where companies can choose to be taxed as a single fiscal unit. This group taxation is available for locally incorporated companies under the Companies Act 2017, allowing intercorporate dividends within the group to be exempt from income tax. Group relief further permits a subsidiary to surrender assessed losses to its holding company or another subsidiary, subject to conditions like continued ownership and limitations on loss utilization. The definition of a group involves locally incorporated holding and subsidiary companies within a wholly owned group, offering tax benefits under specified conditions.

1.3. **Intercorporate Dividends**

1.3.1. Dividends from a resident company to another are taxed at 15% (30% for non-Active Taxpayer List entities). Intercompany dividends within a fiscal unit are exempt. Independent Power Purchasers' dividends and those from qualified bagasse and biomass-based cogeneration power projects have a
7.5% tax rate. A 25% rate applies to dividends when the paying company hasn't paid tax due to exemptions, and a 35% rate for special purpose vehicles, exempt for Real Estate Investment Trusts (REITs). Tax is withheld at source, and excess withholding can be adjusted for non-ATL entities.

1.4. Special Tax Zones:

1.4.1. Special Tax Regimes in Pakistan include Export Processing Zones (EPZs), Special Economic Zones (SEZs), and Special Technology Zones (STZs).

1.4.2. EPZs offer duty-free imports, exemption from national regulations, capital and profit expatriation, and no sales tax on input goods. Industrial exports from EPZs face a final 1% withholding tax.

1.4.3. SEZs grant customs duties and taxes exemptions for capital goods, and a 10-year income tax holiday for zone enterprises and developers.

1.4.4. STZs provide tax concessions for designated developers and enterprises, including a 10-year exemption from various taxes and duties. Qualifying persons in STZs are exempt from minimum tax provisions for 10 years.

1.5. Double Taxation:

1.5.1. Residents with foreign-source income that is subject to tax under the ITO are provided a credit equal to the lesser of the foreign income tax paid or the Pakistan tax payable. The credit is granted if the foreign tax is paid within two years of the relevant tax year.

1.5.2. Treaties for avoiding double taxation apply, providing relief under the ITO, determining Pakistan-source income for nonresidents, and exchanging information.

1.5.3. Pakistan follows the convention that a tax treaty can only reduce, not increase, the tax burden, with OECD model influence in its treaty interpretations.

1.6. Tax withholding:

1.6.1. Internal withholding taxes in Pakistan involve resident companies withholding 15% tax on profit on debt payments to non-bank entities.

1.6.2. Prescribed persons making payments for services, goods, or contract execution face withholding tax.

1.6.3. For services, rates vary, such as 4% for specific services. Sales of goods attract a 1.5-5.5% withholding tax, and contract execution incurs 7.5-10% withholding.

1.6.4. Income from immovable property is taxed at 15% of gross rent.

1.6.5. Export proceeds face a 1% withholding tax, and advance tax, based on the previous year's results, is payable quarterly.

1.6.6. Penalties apply for nonpayment or concealment of income. The statute of limitations allows authorities to amend returns within five years.

1.7. Corporate Taxes:

1.7.1. The standard corporate income tax rate in Pakistan is 29 percent. However, a "super tax" is applicable to high-earning individuals at varying rates based on income levels, ranging from 1 percent to 10 percent. The super tax covers various sources of income, including profit on debt, dividend, capital gains, brokerage, and commission. From July 1, 2023, the super tax will be included in the requirements for advance tax payments. It may be noted that there were constitutional challenges to the super tax for the tax year 2022, leading to a Supreme Court order capping the rate at 4 percent pending a decision on its constitutionality.

1.7.2. In the context of minimum tax in Pakistan, resident companies and PEs of nonresident companies face a minimum tax rate of 1.25% of turnover if the calculated tax payable is lower than this percentage. Different sectors, such as certain parts of the poultry industry, motorcycle dealers, oil refineries, and oil marketing companies, have specific minimum tax rates ranging from 0.75% to 0.25% of turnover. Any excess minimum tax over the corporate income tax liability can be carried forward for up to three tax years. Additionally, under the Alternative Corporate Tax (ACT) regime, companies calculate their tax liability based on either the standard corporate income tax or the ACT
at a rate of 17% of accounting income, with any excess carried forward for up to 10 years. The ACT regime excludes certain sectors like banks, insurance companies, and the petroleum and mineral exploration sectors.

1.7.3. Small companies registered post-July 1, 2005, in Pakistan pay a reduced 20% tax for the 2023 tax year, meeting criteria like a capital limit of 50 million rupees, up to 250 employees, and an annual turnover below 250 million rupees. SMEs in goods production with turnover up to 250 million rupees choose between standard tax rates or a gross turnover-based optional regime, with exemptions from minimum tax and withholding tax on sales over 75,000 rupees. Online marketplaces also benefit from reduced rates.

1.7.4. Pursuant to recent legislation, the Federal Government can levy a maximum 50% additional tax on those benefiting from economic factors like international price fluctuations or currency differences, leading to windfall income.

1.8. Capital Gains:

1.8.1. In Pakistan, capital gains are taxed based on the type of property and holding period. Capital losses can offset gains, with a carryforward period of up to six years. The tax rates for capital gains on securities vary, with exemptions for certain holding periods. Immovable property sales incur tax based on holding duration. Corporate capital gains involve specific definitions and computation rules, with tax-neutral treatment for mergers and specific conditions for asset transfers. Losses from business operations can be offset against taxable income, with carryforward periods and special considerations for certain industries. Tax rules apply to losses after changes in ownership, allowing adjustments and carryforwards.

1.9. Tax withholding on non-residents:

1.9.1. Corporate withholding taxes on nonresident corporations involve specific rates for different types of payments.

1.9.2. For dividends, the general withholding tax rate is 15%, with variations based on specific conditions and entities.

1.9.3. Interest payments to nonresident corporations are subject to a 10% withholding tax rate.

1.9.4. Royalties attract a 15% withholding tax, and various services provided by nonresident companies have distinct withholding tax rates, such as 15% for technical services and 10% for offshore digital services.

1.9.5. Additionally, other withholding taxes apply to categories like rent, sale of goods, and contract execution, each with its specific rate.

1.9.6. The criteria for tax residency in Pakistan for individuals are based on presence, employment, and citizenship.

1.10. Tax Rates:

1.10.1. Individuals in Pakistan face progressive tax rates based on their taxable income. Currently, for those whose salary constitutes over 75% of their taxable income, rates range from 0% for income up to 600,000 rupees to 35% for amounts exceeding 6,000,000 rupees. Director's fees are subject to a 20% non-final withholding tax. Other individuals and associations of persons have varying rates, starting from 0% for income up to 600,000 rupees and reaching 35% for amounts exceeding 6,000,000 rupees. Those with an annual turnover of 100 million rupees or more are subject to minimum tax requirements. Annual returns must be filed by September 30, and electronic filing is encouraged, with specific mandates for certain income levels and turnover. Advance payments are required for individuals with non-salary taxable income exceeding 1 million rupees.

1.10.2. Dividends from domestic corporations face varying tax rates, including 7.5% for specific dividends from Independent Power Producers, 15% for mutual funds and real estate investment trusts (REITs), 35% for special purpose vehicle dividends (0% for REIT investors), and 25% for dividends when the paying company hasn't paid tax due to exemptions or losses. The tax, withheld by the company, is generally final for those in the Active Taxpayers List (ATL). Dividends from foreign
corporations are taxed at the same rates, with a credit available for foreign tax paid, up to the Pakistan tax payable, subject to applicable tax treaties.

1.10.3. Resident individuals receiving profit on debt up to 5 million rupees face a 15% withholding tax. Amounts exceeding 5 million rupees are taxed under standard rates. Residents investing in government debt through a Foreign Currency Value Account (FCVA) enjoy a reduced 10% withholding tax. Nonresident withholding tax is 10%, with exemptions for certain accounts. Foreign interest received by resident individuals from foreign corporations is taxed similarly to domestic interest, with a credit available for foreign tax paid, up to the Pakistan tax payable, under applicable tax treaties.

1.10.4. Royalties paid to resident individuals are taxed as ordinary income. Rents paid to residents are taxed on a gross basis, with specified categories deducting tax based on gross rent amounts. For nonresidents, royalty payments face a 15% withholding tax, adjustable against final tax liability. The withholding tax rates and amounts for rents paid to nonresident individuals mirror those for resident individuals.

1.11. Transfer Pricing & Anti-Avoidance:

1.11.1. Pakistan's transfer pricing policies empower the Commissioner of Inland Revenue to allocate income between associates for controlled transactions, ensuring compliance with the arm's length standard. Permissible pricing methods include Comparable Uncontrolled Price, Resale Price, Cost Plus, and Profit Split methods. No specific penalties for improper pricing are outlined. Although Pakistan lacks an Advance Pricing Agreement regime, nonresident taxpayers can seek advance rulings. The documentation requirements, including master files, local files, and Country-by-Country reports, align with OECD/G20 BEPS project recommendations. Failure to comply with documentation requirements may incur penalties, with different penalties for record maintenance, non-compliance, and failure by financial institutions to furnish information or CbC reports.

1.11.2. The Commissioner of Inland Revenue is empowered to recharacterize transactions, disregard those lacking economic substance, and treat places of business as permanent establishments. The thin capitalization rules restrict interest deductions for foreign-controlled companies, incorporating a 3:1 debt-to-equity ratio and a fixed ratio test. Controlled Foreign Company (CFC) rules include the inclusion of CFC income in a resident's taxable income, considering factors like capital ownership, taxation, and business activities. Income attribution follows a prorating method, with exemptions based on ownership percentages and de minimis thresholds.

2. Customs Duty

2.1. The Customs Act, 1969 outlines duties on goods in Pakistan. Customs duties are applied to imported goods, those transshipped or transported between customs stations, and those moved in bond between stations. Customs duties are prescribed in the First Schedule or under other laws. The government may impose regulatory duties, not exceeding 100% of the determined value, on specified goods. An additional customs duty, not exceeding 35%, may be levied on specific imported goods. The cumulative incidence of customs duties under various sections should not exceed rates agreed upon in multilateral trade agreements. These duties are in addition to other applicable duties and are effective from the specified day, regardless of the publication date.

2.2. For imported goods, the transaction value, i.e., the price actually paid or payable, is the primary basis. Adjustments are made, including transport, handling, insurance, and additional costs incurred by the importer. Royalties, license fees, and the value of subsequent proceeds accruing to the seller are also considered.

2.2.1. If buyer and seller are related, the transaction value is accepted if it closely approximates certain test values. If not, alternative methods, including the transaction value of identical or similar goods, deductible value, and computed value, are employed. A fall-back method may be applied if none of the previous methods yield a result. The section also addresses the determination of customs value for exported goods, considering market sale conditions, additional costs, and intellectual property rights.
2.2.2. The Customs Act emphasizes the authority of customs officers to access business premises for audit purposes and clarifies terms like "identical goods," "similar goods," and "goods of the same class or kind." The section stresses the right of customs officers to verify information and outlines procedures for cases where the relationship between the buyer and seller may influence the price.

2.3. The law also grants the Director of Customs Valuation the authority to determine the customs value of imported or exported goods. This can be initiated by the Director himself, or in response to a reference from any person or an officer of Customs. The determination follows the methods outlined in section 25. The customs value established through this process becomes the applicable value for assessing the relevant goods. However, if the value declared in a goods declaration or invoice is higher than the determined value, the declared higher value takes precedence. Once determined, the customs value remains applicable unless revised or rescinded by the competent authority.

3. Sales tax on goods

3.1. The Sales Tax Act 1990 is the primary legislation governing sales tax in Pakistan, with its principles implemented through the Sales Tax Rules 2006 and Sales Tax Special Procedure Rules 2007. The Federal Board of Revenue (FBR) oversees administrative aspects of federal sales tax, being an autonomous body responsible for implementing federal fiscal statutes and tax collection.

3.2. Sales tax is imposed on the value of taxable supplies conducted by a registered entity. A taxable supply is any supply of taxable goods made by an importer, manufacturer, wholesaler, distributor or retailer, other than exempt goods. It encompasses both domestic transactions and imported goods, regardless of their final destination within Pakistan.

3.3. Federal sales tax rates include a standard rate of 18%, reduced rates ranging from 1% to 12%, enhanced rates, zero rates, and exemptions. Special rates apply to specific products, and an additional 3% tax is imposed on sales to unregistered persons. There's also a 1% tax on supplies to nonregistered purchasers. Provincial sales tax rates vary across services, with a maximum rate of 19.5%.

3.4. The Sales Tax Act defines a person broadly, encompassing individuals, associations, companies, governments, and international entities. Mandatory registration for federal sales tax is required for those involved in taxable supplies, falling under specific categories such as manufacturers, retailers, importers, wholesalers, exporters seeking refunds, service providers, and those mandated by federal or provincial laws. Taxable activity encompasses economic endeavors, excluding employee services to employers or personal/recreational pursuits. The FBR holds authority for compulsory registration if eligible entities fail to apply voluntarily under the Sales Tax Act.

3.5. Imported goods are generally subject to sales tax unless specifically exempted. Explicit exemptions are detailed in Section 13 and Sixth Schedule of the Sales Tax Act 1990. Various exemptions apply to imports, including those not available locally, imports into free zones, and imports for governmental or diplomatic purposes. Exempted items include goods imported by UN agencies, diplomats, and diplomatic missions, certain imports by charitable hospitals, materials for Gwadar Port, and machinery for authorized financial services providers. Importers should seek advice to determine eligibility for these exemptions due to their detailed requirements.

3.6. Bonded warehousing is available for manufacturer-exporters in Pakistan, allowing storage of nonperishable goods for six months and perishable goods for one month. An extension is possible by prepaying a surcharge on duty and taxes. Sales Tax applies upon goods' removal from the warehouse into free circulation.

3.7. Businesses in the Gwadar Free Zone enjoy a 23-year sales tax exemption, as per Section 100B of the Sixth Schedule. Enterprises in specified Special Technology Zones may be eligible for Sales Tax exemption under the Special Technology Zones Authority Act, 2021. The Sixth Schedule also provides exemptions for machinery, equipment, and materials imported for exclusive use within the Export Processing Zone or for making exports from the Zone, and goods imported for warehousing in the Export Processing Zone by its investors.

3.8. Under Section 7 of the Sales Tax Act in Pakistan, registered persons can deduct input tax (sales tax on supplies to them) during the tax period for taxable supplies made or to be made, subject to certain
3.9. Taxpayers can claim a credit for adjustable input tax up to 90% of output tax collected, except for fixed assets or capital goods. The excess can be carried forward. However, certain restrictions apply, and a registered person cannot reclaim input tax on supplies such as goods or services used for non-taxable purposes, fake invoices, undeclared sales, and more. The Board can specify additional restrictions.

3.10. Section 73 of the Sales Tax Act states that no input tax deduction is generally allowed for supplies of a value greater than 50,000 rupees paid by non-banking methods. Documentary requirements for claiming a refund or credit include a tax invoice, goods declaration for imported goods, and a treasury challan for goods purchased at auction.

3.11. Specific rules apply to locally produced electric vehicles, limiting the input sales tax claimed to not exceed the output sales charged on the sale, with no carryforward or refund allowed.

4. Federal Excise Duty

4.1. Duties of excise are imposed under Section 3 of the Excise Act on goods produced or manufactured in Pakistan, goods imported into Pakistan, certain goods brought from non-tariff areas to tariff areas, and services provided in Pakistan. The duty rate is generally 15% ad valorem, except for goods and services specified in the First Schedule. For imported goods, the duty is collected in the same manner and time as customs duty.

4.2. The Federal Government has the authority to specify goods or services for excise duty, and the duty may be levied based on production capacity or on a fixed basis. Additionally, a further duty of 2% may be charged on excisable goods and services if supplied to an unregistered person.

4.3. Liability to pay duty depends on the origin and nature of the goods or services, including the manufacturer for domestically produced goods, the importer for imported goods, the service provider for services in Pakistan, and the person bringing goods from non-tariff to tariff areas.

4.4. For goods specified in the Fourth Schedule, a minimum production is determined based on input consumption, and if it exceeds actual supplies, duty is discharged accordingly.

5. Provincial Sales Tax on services

5.1. Taxable services under provincial Sales Tax Acts are typically those listed in the second schedule of the relevant act, provided by a registered entity from their registered office or business location in the respective province during economic activities. These services commonly involve transportation of goods or passengers, banking, construction, shipping, telecommunications, advertising, professional services, outsourced business services, event organization, temporary or contract employment, as well as hotel accommodation and catering.

5.2. Under provincial sales tax acts, individuals are typically obligated to register for services tax if they provide taxable services from an office or business location within the province. In some situations, registration is also required if the service recipient resides in an unregistered person.

5.3. While provincial sales tax rules lack detailed regulations on the time of supply, they generally stipulate that if a service is rendered over time with periodic payments, it is considered distinct services, each corresponding to the part of the service linked to the respective payment.

5.4. In the Province of Sindh, services related to the renting, letting, sub-letting, leasing, sub-lease, licensing, or similar arrangements of immovable property for business or commerce are typically subject to Sales Tax on Service. Taxable services under provincial sales tax acts encompass construction services, along with the services provided by developers, architects, dealers, or interior decorators.

5.5. In Balochistan, the rates range from 15% to 19.5% under the Second Schedule of the Balochistan Sales Tax Act. Islamabad generally imposes a 16% tax rate, with specific rates of 15% for call center services and 5% for certain information technology services as per the Schedule of the Islamabad Capital Territory (Tax on Services) Ordinance, 2001. In Khyber Pakhtunkhwa, the sales tax on services falls between 5% and 19.5% under the Second Schedule of The Khyber Pakhtunkhwa Finance Act. The Punjab province
applies sales tax rates ranging from 4% to 19.5% under the Second Schedule of the Punjab Sales Tax Act. Sindh imposes sales tax rates between 13% and 19.5% under the Second Schedule of the Sindh Sales Tax Act.

5.6. Taxpayers in Pakistan can claim provincial sales taxes as input tax, following regulations outlined in specific provincial sales tax acts, such as Section 16 of the Punjab Sales Tax Act, Balochistan Sales Tax Act, and Section 15 of the Sindh Sales Tax Act. Input tax credits reduce the amount of output tax owed to the provincial government. Adjustments are generally allowed for invoices up to six months old, but not permitted for missing or incorrect invoices or if output tax hasn't been paid to the relevant tax authority. Certain services, like capital construction or entertainment, are excluded from input tax adjustments. Input tax credits are typically not granted on services subject to reduced rates. Section 16C of the Punjab Sales Tax Act limits adjusting input tax to 80% of output tax in a tax period, unless the Tax Authority provides an exception. Refunds for excess credit amounts are allowed under specific circumstances, such as errors or tax adjustments, and are processed yearly in the month following the financial year's end.

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