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P@SHA

Pakistan IT Industry Association

Unleashing the potential of
IT & ITeS industry in Pakistan!

Annual Budget Recommendations for IT/ITeS Industry 2024-25

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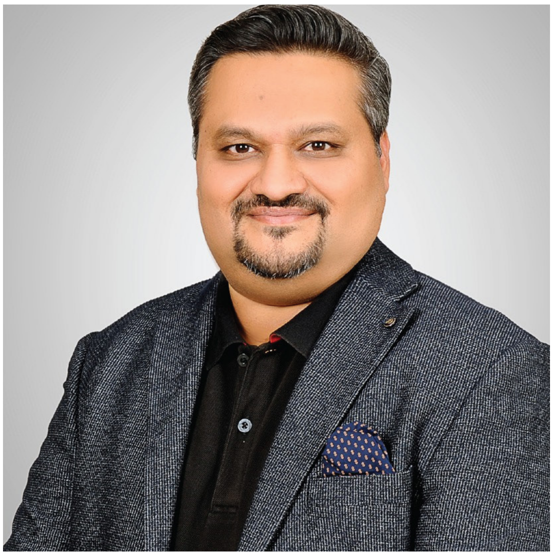
P@SHA's Annual Budget Recommendations for
IT and ITes Sector FY 2024-2025

Foreword by

Chairman P@SHA



I am pleased to present P@SHA's Annual Budget Recommendations for IT& ITeS Sector for the year 2024-25. This document lays the groundwork for strategic interventions required to make Pakistan an attractive Tech Destination and to create a robust framework that will drive the growth and development of Pakistan's IT/ITeS industry. The IT industry in Pakistan which has the largest share in services exports achieved remarkable milestones, crossing USD 2.6 billion in exports in 2023. Notably, it holds the unique distinction of being Pakistan's only export industry with a 77% trade surplus. Supporting the livelihoods of 800,000 professionals and freelancers, as well as over 10,000 companies, the IT industry has proven to be the fastest-growing sector in our nation. It has demonstrated the potential to address the current account deficit and shape the financial future of Pakistan.

We believe that P@SHA's annual budget recommendations serve as the guiding force that will propel Pakistan's tech industry toward greater heights of innovation, economic prosperity, and societal impact. These recommendations not only outline the financial allocations necessary for the development and advancement of the sector but also reflect a deep understanding of the industry's evolving needs and challenges. By advocating for strategic investments in research and development, infrastructure enhancement, and digital literacy initiatives, P@SHA ensures that the industry remains at the forefront of global technological advancements.

At P@SHA, we are committed to taking Pakistan's IT sector to unparalleled heights, and to making it a symbol of national excellence. In this spirit, we have actively represented and advocated for policies on behalf of the IT industry at all levels of the government.

I extend my gratitude to all the stakeholders, including the government, industry players, and the dedicated policy team at P@SHA, for their unwavering support and expertise in the development of this comprehensive framework. Last year's Budget Recommendations can be accessed here.

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Ease of doing business

High-impact areas

Following are the High Impact areas, requiring immediate action.

Tax Exemption for IT/ITeS Industry

Providing tax incentives and ensuring their consistency is imperative to create a favorable business environment for the IT/ITeS industry. While there are numerous types of taxes, we recommend policy measures for the following tax categories specifically for the IT/ITeS industry.

Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues
Federal Direct and Indirect Taxes	
Income Tax Ordinance, 2001	
01 Section 149	Income tax is deducted by the employer from employees' salaries however remote workers for foreign companies are taxed under section 154A at a much lower rate hence the local entities are at a disadvantage in hiring good human resource.

Proposed Changes

The rate of tax on salaries of persons employed by PSEB & P@SHA registered companies shall not exceed 5% of their salaries.

A proviso may be added after the table in First Schedule as follows:

"Provided that the maximum rate of tax applicable on the salary of an individual shall not exceed 5% if such individual is receiving salary from a person registered PSEB and P@SHA."

Rationale

Supporting the exporters to be able to hire good human resources while being competitive with foreign companies hiring remote workers. A complete note on remote workers is given in Annexure 1 to these proposals.

02 Section 4C	Super tax clarification

Proposed Changes

A clarification shall be added in section 4C to identify that super tax is not applicable on exporters of IT & IT-enabled services for tax year 2022 as they were eligible for 100% tax credit under section 65F. The following is the proposed text:

Explanation: For the removal of doubt it is hereby clarified that any income eligible for 100% tax credit under any provisions of this Ordinance shall be eligible for 100% tax credit against super tax.

The super tax exemption shall also be extended to persons engaged in the rendering of IT & ITeS services locally if such persons are registered with PSEB and P@SHA. The following proviso may be added:

"Provided that the provisions of section 4C shall not be applicable to a person engaged in the rendering of Information technology (IT) and IT enabled services as defined in section Section 2(30AD) and Section 2(30AE) where such person is duly registered with PSEB and P@SHA."

Rationale

Currently the tax officers are creating illegal demands on this issue, the clarification will help in resolving the issue.

Although a decision has been issued by the Tribunal in favor of an IT company, in order to avoid further litigation an explanation may be inserted.

Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues
03 Clause 133, Part I, Second Schedule	Exemption from income tax

Proposed Changes

Exemption from income tax shall be restored for IT sector exporters. However, the exemption may only be made available for such exporters registered with PSEB and P@SHA. No exemption certificate from FBR shall be required for such exemption.

The following clause may be inserted in Part I Second Schedule as clause 133:

"The income from export of Information Technology (IT) and IT-enabled services as defined in section Section 2(30AD) and Section 2(30AE) shall be exempt from tax subject to the condition that the person is registered with PSEB and P@SHA."

Another clause may be inserted in Part IV:

"The provisions of section 154A shall not apply to income exempt under clause 133, Part I, Second Schedule where such persons provide their certificate of registration with PSEB and P@SHA to the bank."

Clause 11A, Part IV, Second Schedule shall also be modified to provide an exemption from section 113 in respect of income exemption under clause 133 ibid.

Rationale

Currently IT exporters are under the Final Tax Regime and reversion to the Exemption regime will reflect the will of the Government to facilitate IT exporters as it will restore the facility that was available to exporters two years ago and was promised till June 30, 2025. Restoration of exemption will be a big boost for the industry's confidence that we are back on track. The tax cost in any case is not too high for the Government as currently only 0.25% tax is being collected by the Government.

04 New Proposed	Exemption on capital gains.

Proposed Changes

Capital gain on disposal of shares of start-up companies and export-oriented IT & ITeS companies shall be exempted through the insertion of the appropriate clause in Part I of the Second Schedule while withholding tax exemption shall also be given through the insertion of the appropriate clause in Part IV of Second Schedule.

Rationale

Encourage corporatization and attract investors in the IT sector. The current policy is pushing in a direction that does not encourage corporatization. There is a discrepancy in taxes between the AOPs and the Private Limited Companies.

05 New Proposed	Exemption on dividend.

Proposed Changes

Dividend paid by start-up companies and export-oriented IT & ITeS companies to their shareholders shall be exempted through insertion of appropriate clause in Part I of Second Schedule while withholding tax exemption shall also be given through insertion of appropriate clause in Part IV of Second Schedule.

Rationale

Encourage corporatization. Tax applicable on payment of dividend discourages corporatization.

06 New Proposed	Currently, Pakistan's IT sector heavily relies on adapting existing technologies, limiting its potential for long-term, sustainable growth. A robust domestic innovation ecosystem is crucial for developing indigenous solutions and competing effectively in the global market.

Proposed Changes

We recommend the introduction of a tax deduction scheme specifically designed to incentivize R&D activities within IT companies. This scheme could offer deductions for a specific percentage **(e.g., 30%)** of qualifying R&D expenses incurred by IT companies.

Rationale

A focus on R&D creates a more attractive environment for highly skilled researchers, engineers, and scientists, fostering a talent pool for continued innovation.

Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues
07 Fourteenth Schedule	SME status

Proposed Changes

Modification shall be made in Fourteenth Schedule so that benefits provided to manufacturers are also extended to IT & ITeS businesses in the SME sector. The threshold for SME shall also be increased to Rs.800 million for IT & ITeS sector businesses.

The definition of SME under section 2(59A) may be modified to include the following:

"Provided that effective from July 01, 2024, small and medium enterprises shall also include any person registered with PSEB or PASHA where annual turnover of such person does not exceed Rs. 800 million in a tax year."

Fourteenth Schedule shall also be amended as follows:

Rule 3 & 4 shall be modified to provide for three categories by adding a line item in tables given below rule 3 & 4.

The third category shall be for SMEs having turnover in excess of Rs.250 million but not exceeding Rs.800 million.

The rate of tax under rule 3 on taxable income of third category shall be fixed at 20%, however if they opt for final tax regime under rule 4 then the rate shall be fixed at 1% of gross turnover for third category.

A proviso shall be added to Rule 8 as follows:

Provided that the provisions of section 153 shall not apply to SMEs registered with PSEB.

Rationale

The IT sector is fast becoming the largest sector to provide white collar jobs in Pakistan and considering the need to further boost this sector and bring forex in Pakistan, it is necessary to facilitate SMEs in this sector.

08 236Y (Income tax)	The current policy imposes a 5% tax on corporate debit cards linked to ESFCAs on each transaction on time of payment.. However, IT companies already pay 0.25% in Final Tax Regime (FTR) on their export proceeds.

Proposed Changes

We propose exempting corporate debit card transactions from the additional 5% tax to avoid double taxation and promote the use of ESFCAs.

Rationale

The rationale of the proposition for the IT industry is two-fold: to avoid double taxation and promote the use of Export-Oriented Foreign Currency Accounts.

By exempting debit card transactions from the additional tax, the proposal aims to make ESFCAs more attractive for IT companies. This can lead to improved efficiency in managing foreign currency and potentially provide some financial benefits.

09 152 (2A)	The current legislation withheld a **15% tax on making payments to the non-resident** (vendor or contractors).

Proposed Changes

We propose that this taxation percentage shall be **waived for IT companies,** considering that those individuals or companies are not obliged to file their tax returns in Pakistan.

Rationale

IT companies are continuously obtaining such contractual services and is a business as usual requirement. Such high taxation is a burden on the businesses.

Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues
	Federal Direct and Indirect Taxes
	Income Tax Ordinance, 2001
10 Omission of Clause 94 of Part IV of 2nd Schedule	Specified sectors were incentivized and reduced rate of 2% was required under second schedule, however, Finance Act 2019 has omitted the said clause and now IT and IT enabled services are taxed at increased rate of 4% under section 153B
Proposed Changes	Local IT companies are currently operating on thin margins, with some even on the brink of losses. Therefore, implementing an initial 2% tax withholding deduction could provide much-needed relief and incentivize growth within the local IT sector.

Rationale

A reduced tax rate can attract more investors and sole proprietors to establish companies, thereby bolstering overall tax revenue in the long run.

11 Reduction in useful life of Intangible Assets. Section 24	The Federal Government through Finance Act, 2019 has increased the useful life of Intangible Assets having indefinite useful life from 10 years to 25, thereby, reducing the tax amortization expense for tax payers. Intangible Assets (Intellectual properties) are main assets of IT companies, hence reduction in amortization expense would significantly impact on taxable profit and tax liability.
Proposed Changes	Intangible Assets are the main assets in the IT Sector therefore, to provide tax relief, an amortization expense should be allowed over the previously allowed 10 years.

Rationale

The relief sought will improve profitability and economic progress considerably, reduce the burden of tax on the taxpayers and attract more investment in the IT sector.

12 Payment for goods, services and contracts Section 153	The tax deducted u/s 153 of Income Tax Ordinance 2001 is levied on the amount inclusive of sales tax which is alike tax over tax.
Proposed Changes	It is proposed to substitute the word 'Inclusive' with 'Exclusive' in section 153(7)((v)(a). It will curb the FBR practice that charges tax on gross invoice.

Rationale

It will reduce the adverse effect on the IT Industry which operates on thin margins and larger scale.

13 165 (8) Statement	A statement in the prescribed form reconciling amounts mentioned in annual statement filed and amount declared in return is required to be e-filed by every prescribed person
Proposed Changes	A time period ranging 30-60 days should be specified in the law to accept/reject the reconciliation attached along with ITR. Where reconciliation has been accepted by CIR or rejection order is not issued within 60 days, proceedings under Rule 44 read with Section 161 should have been considered completed for that tax year. No separate proceeding under Rule 44 should be started subsequently for that tax year.

Rationale

It will reduce the tax compliance burden of the Taxpayers

Foreign Exchange Manual

Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues	Responsible Department

Federal Direct and Indirect Taxes

Foreign Exchange Manual

01	Chapter 12 (Exports), Para 12	The retention limit in ESFCAs has been increased from 35% to 50% of the export proceeds and the utilization of the retained funds has been further liberalized.	SBP

Proposed Changes

it is permissible for exporters of software to retain amount up to 50% of their export earnings in Exporters' Special Foreign Currency accounts opened with the Authorized Dealers.

This limit should be increased to 100% inorder for exports to boost their export earnings and bring additional foreign exchange into the country.

Rationale

A higher retention limit would allow exporters, especially leading IT companies, to hold more foreign currency for essential business activities, to tap into new markets, and to stay competitive in the global IT landscape

02	Chapter 12 Section 40(ii)	While Section 40(ii) of the circular allows equity investment abroad, the current limit based on Para 13, Chapter 20 of the FE Manual (10% of the last 3 years' average remittances) is insufficient for leading IT exporters to engage in M&As or establish subsidiaries. Similarly, the limit for smaller companies is even more restrictive.	SBP

Proposed Changes

We recommend revising the retention limits to 35% to better reflect the investment needs of IT companies while maintaining a healthy balance of payments. Additionally, streamlining the approval process for utilizing retained funds would significantly improve efficiency.

Rationale

The rationale behind this proposition is to enhance the competitiveness and growth of the IT industry by providing greater flexibility in retaining and utilizing earnings for investment purposes for different business activities including; funding for mergers and acquisitions (M&As), Establishing subsidiaries abroad

03	Chapter 12 Section 40(I)(a) and (c)	Section 40(I)(a) and (c) allow payments for imports and IT/digital services. However, the current process involving extensive documentation and lengthy approval times (45-90 days) creates significant obstacles for companies like Systems Ltd., an authorized distributor struggling to pay vendors like SAP, Microsoft, and AWS.	SBP

Proposed Changes

We urge the State Bank to consider either exempting these routine payments from prior approval requirements or significantly reduce processing times to ensure smooth business operations.

Rationale

Delays in payments can disrupt business continuity for IT companies. They may struggle to maintain critical services or software licenses if payments are stuck in prolonged approval processes. Thus, Faster approvals would ensure smoother operations.

Medium Impact

Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues
Federal Direct and Indirect Taxes	
Income Tax Ordinance, 2001	
01 170	Refunds

Proposed Changes

The payment of refunds is a very cumbersome and long process. It is suggested that the automated issuance of refund shall be made effective immediately.

Rationale

The cash flow problems arising out of non-issuance of genuine refunds create a lot of hurdles particularly for small businesses while auto issuance of refunds will be a confidence booster for the taxpayers.

02 159 **(Optional if exemption proposal is accepted otherwise may be modified)**	Withholding taxes like advance tax on imports, electricity, phone and internet, credit card payments, etc. are required to be paid by IT exporters because of the absence of enabling provisions for issuance of exemption certificates.

Proposed Changes

Section 159 needs to be modified to provide for the issuance of exemption certificates in respect of all taxes for IT exporters other than section 154A.

Rationale

The IT exporters are now under FTR however there are several taxes against which they are unable to obtain exemption certificates due to non-availability of appropriate enabling clauses whereby the Commissioner can issue exemption certificates.

03 Section 154A **(Optional only in case of exemption proposal is not accepted)**	FTR regime to be modified: ▪ Sales tax filing requirement to be deleted retrospectively. ▪ Clarification of the regime for persons bringing remittance through Wise, Payoneer, etc. needs to be addressed retrospectively.

Proposed Changes

In section 154A (2)(c), the filing requirement of sales tax returns shall not be applicable to persons engaged in the export of IT & IT-enabled services. Although this requirement has been deleted by the Finance Act 2023 however the deletion has not been given retrospective effect which may likely lead to litigation.

The current FTR regime does not appropriately discuss the persons earning through Payoneer, Wise etc. The tax regime shall be clarified to bring all IT exporters under the FTR regime irrespective if they are bringing export proceeds through bank or similar legal mechanisms.

Rationale

Bring clarity in the regime to avoid any untoward interpretation.

The Sales Tax Act, 1990

	Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues
01	Sixth Schedule	Software sales are not exempt.

Proposed Changes

In the Sixth Schedule, in Table 1, serial # 41 shall be modified and reinstated to read as follows:

41	Computer software in any form whether supplied or installed online, through a hard drive, cloud, or any other medium	Respective headings

Rationale

The taxpayers are facing issues of double taxation by treatment of software as goods by Federal and services by Provincial tax authorities.

02	Sixth Schedule	Laptops, computers, and other IT equipment are currently taxable

Proposed Changes

A suitable entry shall be made in the Sixth Schedule to provide sales tax exemption on imports and local supply.

Rationale

The rates have gone too high due to dollar rate change and exemption from sales tax will help to bring the prices down for this important requirement of IT industry.

The Islamabad Capital Territory (Tax On Services) Ordinance 2001

	Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues
01	Table 2	A reduced rate of 5% is to be reinstated with a retrospective effect.

Proposed Changes

Serial # 11 needs to be changed and brought back to an earlier position so that a 5% reduced rate is applicable on IT & IT-enabled services.

Rationale

To reintroduce the reduced rate facility which was withdrawn without industry consultation.

All Provincial sales tax laws

	Relevant Section / Schedule No. / Tariff Heading No. / Rule No. / Para No. Involved	Current Legislation / Issues
01	Second Schedule	Reduced rate applicable but without input tax adjustment

Proposed Changes

The rate of sales tax may be brought to zero percent or input tax shall be allowed in the supply chain. A standard rate and policy shall be used across Pakistan.

Rationale

The rate of 5% becomes a cost for the receiver of services while the input tax is also not allowed to the supplier of services increasing its cost of doing business hence the real benefit of a reduced rate is lost

02	Definition of IT & ITeS services	Definition of IT & ITeS services

Proposed Changes

The definition needs to be aligned in all Federal & Provincial tax laws. The definition may be provided in PSEB regulations and same may be referred in all tax laws instead of rewriting so that in case PSEB changes the definition in regulations, tax laws reflect the change accordingly.
The text of definition clause may be as follows:

“Information technology (IT) services and IT enabled services shall have the same meaning as defined under (refer relevant PSEBregulations).”

Rationale

Different definitions in all laws is leading to confusion and different interpretations hence hampering progress of IT industry.

Chapter 2: The Growth of IT Industry

Human Capital & Skill Development

Despite a growing IT industry and a large pool of graduates, Pakistan faces a significant skills gap. This means many graduates lack the specific skills and knowledge required by IT companies. While graduates are abundant, a large number remain unemployed due to a mismatch between their skills and industry needs.

Allocated Budget

Allocate **PKR 10 billion** for all initiatives, ensuring sufficient resources to drive impactful improvements in education and skills development.

Demand-Based Nationwide Skills Development Program for Graduates

Proposed Reforms

- Implement a scale up of Techlift Program which will be a demand based nationwide skills development program focusing on graduate-level Bootcamps training. MOITT and PSEB will collaborate with P@SHA to identify skill gaps and design training modules tailored to meet industry demands. Create Industry led training models and execute all over Pakistan to ensure graduates are well-equipped for the job market. Allocation of international curriculum and certifications to be ensured. 20,000 students will be trained through this program. **Budget: PKR 4 billion**

- Co-Op program for the industry exposure of graduates and University students from 6th 7th and 8th to equip them with the skills required to work in the industry and to give them early introduction to working in the technology sector. **Budget: PKR 1 billion**

Responsible Department

MoITT PSEB

Upskilling of Existing Resources

Proposed Reforms

- Launch comprehensive upskilling programs for professionals across various industries. Offer diverse training modules using a blended learning approach, combining online resources and workshops. Provide incentives such as subsidies and tax incentives to encourage participation and enhance workforce productivity. **Budget PKR 2 Billion.**

Responsible Department

MoITT PSEB

Train The Trainer Program for University Faculty

Proposed Reforms

- Launch a Train the Trainer program that will include a faculty training program to overcome the challenge of lack of industrial exposure of university professors. The training will include exposure to industrial practices and introduction and familiarity to the latest trends in technology. **Budget PKR 3 Billion**

Responsible Department

MoITT PSEB HEC

Incentivizing the IT Industry

Pakistan's IT exports have witnessed steady growth, reaching approximately $2.6 billion in FY 2021-22. However, this growth pales in comparison to regional competitors like India. To compete globally and attract foreign investment, Pakistan needs to actively incentivize rapid expansion within its IT sector. Another key purpose of financial incentive (cash reward) is to encourage export remittances through formal banking channels and to improve reporting of export remittance receipts in purpose codes assigned by the State Bank of Pakistan for IT & IT-enabled Services.

Proposed Reforms

We propose a revised cash reward system with **10% cash reward** that directly incentivizes significant growth in IT/ITeS exports.

This system could take two potential forms:

Option 1: Tiered Reward System

- Establish tiers based on percentage increase in export value compared to the previous year.
- Higher tiers offer a progressively larger percentage cash reward on the incremental export value achieved.

Option 2: Milestone Reward System

- Set specific export value milestones (e.g., $5 million, $10 million) for achieving cash rewards.
- Companies exceeding each milestone receive a predetermined cash reward.

Responsible Department

MoITT National Assembly MoF

Brand Pakistan

Promoting a Soft Image of Pakistan

Despite boasting a competitive IT industry with a growth rate exceeding 10% annually, variably, Pakistan struggles to attract significant foreign investment. This can be attributed to various factors. Pakistan's international image, often associated with security concerns and political instability, deters foreign investors from exploring the IT sector's potential. Similarly, while efforts have been made to improve the ease of doing business, the positive aspects of Pakistan's IT environment, such as more flexible processes compared to India (World Bank, 2024), are not effectively communicated on a global scale. There's also a lack of strategic communication campaigns specifically targeting the tech industry to brand Pakistan as a leading tech destination.

Proposed Reforms	Responsible Department
Allocate **PKR 3 billion** to enhance the image of Pakistan by taking the following steps: ■ Work on TechDestination as a National Tech Branding Strategy, in collaboration with industry leaders and branding experts, and should craft a compelling narrative that highlights Pakistan's IT strengths, like a skilled workforce, competitive costs, and government support. ■ Actively promote success stories of established and emerging Pakistani IT companies to demonstrate the industry's potential and attract foreign investors. ■ Showcase Pakistani technological innovations at international forums and events. Funding for these initiatives can be sourced through public-private partnerships to ensure sustainability and maximize impact. Given that the USA market represents a half-million-dollar opportunity, it should be a key focus for these showcases.	MoITT, PSEB, MoF, TDAP

Make in Pakistan

The government is facing a major deficit in imports/exports balance. While the current government policies are developed to discourage the public from consuming imported goods and services and to prefer locally made products, government departments themselves prefer to procure from international vendors and import IT products and services. In the absence of IT business opportunities, local companies find it hard to develop and mature their products and services on a sustainable basis. On the contrary, other countries are following protectionist approaches towards their local companies, preferring them in government procurement.

Preference to Local Vendors

Many government departments procure IT/ITES products/solutions and services from international vendors giving rise to the imports of the country. The local IT industry of Pakistan is producing solutions that are being exported to other countries.

Proposed Reforms	Responsible Department
■ Public Procurement Regulatory Authorities shall revise procurement rules to facilitate companies with products with IP that is "Make in Pakistan" and ensure extra points that provide at least **15%** benefits in procurement to companies with local IP. ■ A target of **20% "Make in Pakistan"** for each federal procurement department should be defined, and IP should be reserved with a 5% increase every year from the date of implementation of this policy with a maximum of 50%. ■ The pre-qualification process outlined in the provided document can be amended to include additional criteria that specifically encourage and prioritize manufacturing capabilities. ■ A **new sub-rule after Rule 16B** can be added to introduce preferential treatment or additional benefits during the pre-qualification process for suppliers or contractors demonstrating significant manufacturing capabilities within Pakistan. ■ **A new provision after Rule 37** can be introduced in procurement contracts aimed at promoting domestic manufacturing, the procuring agency may provide preference to bids submitted by manufacturing entities within Pakistan. ■ In cases where local capability for IT products or services is not available, it is encouraged to require technology transfer (IP ownership) components to locally registered partners. International vendors may only bid on the project while partnering with a locally registered and established entity.	MoITT, PPRA

Establishment of Tech Products base

Largely because of the successive governments' lack of vision and support to set up required Research and Development (R&D) requirements and infrastructure to establish a tech product base, there is almost no tech product manufacturing in Pakistan. Even though tech products as compared to services yield greater margins, for several obvious reasons the majority of the Pakistani IT industry has only been able to deliver label services-based products.

Allocated Budget:

Allocate 10% of the Revenue of USF grants for R&D.

Proposed Reforms	Responsible Department
■ In order to promote innovation, the government needs to provide tax credits for companies engaging in R&D activities, allowing them to offset a portion of their tax liability. ■ There is a need to develop specialized research parks and innovation incubators equipped with state-of-the-art facilities, and provide rent-free spaces, mentoring, and access to funding for startups engaged in R&D activities. ■ Streamlining of the patent registration process and reducing associated costs to encourage companies to protect their intellectual property is equally significant with the offering of legal support and incentives for the enforcement of intellectual property rights.	MoITT FBR MoF USF

Quota for local companies

Many countries in the world have laws of protection to favor their local industry such as "America First" and "Make in India". In Pakistan, support for the "Make in Pakistan" regime is required and the procurement laws should be updated for the inclusion of the Pakistani local companies.

However, the definition of a Pakistani local companies should be clear enough to include at least 60% of Pakistani ownership.

Proposed Reforms	Responsible Department
■ 30% of all IT-related projects/services should be procured from local companies. ■ The bigger projects can be divided into smaller projects for the sake of micro-procurement.	MoITT PPRA

STZs Initiative

Enabling STZs for IT and ITES Industry

Pakistan's IT industry faces challenges related to the ease and cost of doing business. Special Technology Zones (STZs) were established in August 2020 with the Special Technology Zones Authority (STZA) launching in January 2021. However, as of April 2024 (over three years later), existing IT/ITeS companies are still unable to leverage the benefits of STZs.This delay denies the existing IT industry crucial benefits offered by STZs, including; Tax exemptions (income tax, sales tax), simplified regulatory environment, access to subsidized infrastructure and utilities and streamlined customs procedures leading to hindering the growth and competitiveness of Pakistan's IT sector on the global stage.

Proposed Reforms	Responsible Department
▪ Establishment of Virtual Zones and their governing rules and facilitate the enablement of STZA benefits for the entire IT and ITes industry. ▪ Integration of STZs into the master plans and land development regulations across various governmental bodies (LDA, KDA, CDA, KPKDA, FDA). The establishment of a legal framework that recognizes the priority status of STZAs nationwide is critical. ▪ Implementing a rent control mechanism for the allocation of free/subsidized government land will provide a significant boost to SMEs, fostering the development of emerging IT com. ▪ Equipping the P@SHA help desk with comprehensive knowledge of STZA procedures and regulations will streamline member facilitation. ▪ Proposed adjusting the minimum required area for STZA applications from 250,000 sq. feet to 100,000 sq. feet, facilitating the inclusion of mid-tier cities in the STZ development process and promoting a more inclusive technological ecosystem. ▪ Non-encumbrances certificates clause must be relaxed in line with rental premises zone notification. Rental companies will have serious problems acquiring non-encumbrance certificates.	MoITT, STZA, PM office

AnnexureA

Policy Position Paper and Legal Framework for Taxation on Remote Workers.

Problem Statement

It is pertinent to note that a remote worker is working under an employment contract, unlike a freelancer who is working under a consultancy agreement with one or more entities. Whether a contract is in the nature of "employment" or "consultancy," would depend on the terms of the contract on a case-to-case basis. However, the remote workers hired by foreign entities are likely to avail of the following benefits as compared to benefits available to employees working with Pakistani entities:

- The salary terms are defined in foreign currency and due to continuous devaluation in Pakistan currency, this helps such employees safeguard from currency devaluation and to an extent dilutes inflation impact.
- Pay lower taxes as discussed later in this working paper.

Foreign companies can hire remote employees from Pakistan at a much lower cost than having such employees physically present at the foreign company offices therefore the phenomenon of remote workers is increasing. The increase in remote workers leaving jobs from Pakistan entities has a severe effect on operations of Pakistan entities particularly because most of them are very senior employees while the entity also starts facing pressure from other similar level employees of the company to increase their salaries at a level earned by remote workers.

Scope of the problem

Due to this disparity, a concerning trend is emerging within the IT export sector. Companies are increasingly reclassifying senior employees as freelancers. This could have significant consequences. If this trend continues, the entire sector could transition to a remote-based workforce. While overall IT export revenue might not be impacted, the government could face a substantial loss of tax revenue due to the change in employee classification.

It's also worth noting that a company's per capita productivity is significantly higher when it invests in employee training and fulfills its tax obligations at a higher rate. It typically oversees a team of 3 to 4 individuals, facilitating on-the-job training and nurturing the next wave of IT professionals. In contrast, remote workers operate autonomously, primarily contributing financial gains without directly promoting local talent. This approach risks hindering the long-term growth of skilled resources. A cohesive team within a company generates higher revenue, whereas independent remote workers may diminish the overall net USD revenue flowing into the country.

Tax calculation under export FTR	Tax Disparity
Average Salary of a Remote Worker: 5000 USD per month 5000 USD to PKR = 1,401,015	**Payroll tax on employees of companies having similar income:** 4,879,263 (1,095,000 + 35% of the amount exceeding 6,000,000)
Income per year: 16,812,180 Tax on income: 168,121.8	**Income per year:** 16,812,180 **Tax on income:** 4,879,263
Tax on Remote Workers: 1 percent if not registered with PSEB, 0.25 if registered with PSEB.	On top of this, they are also subject to 1 percent if not registered with PSEB, 0.25 if registered with PSEB.

Pakistan income tax law on remote workers

The income earned from an employment contract is covered in the definition of salary provided under **section 12 of Income Tax Ordinance 2001 while section 101 of ITO 2001** provides that salary shall be Pakistan source income if the employment is exercised in Pakistan.

Given legal provisions, remote employees are obliged to pay taxes on their salary income like other salaried employees however remote employees generally avoid such taxes by using different means:

- Receive salary through their relatives outside Pakistan or even directly but bring the amounts in Pakistan declaring them as family remittances free of any taxes. Although section 111 requires an explanation of such income if the annual remittance exceeds Rs.5,000,000 in a year however by the time any such violation comes under the radar, Pakistan is likely to have lost a lot of ground already.

- Open bank accounts outside Pakistan and place their salaries outside Pakistan in those bank accounts without declaring such accounts. The remittances are brought into Pakistan, as to when required basis as home remittances or **section 154A provisions** hence leading to loss of substantial tax revenue.

- Declare the remittances as export of services and pay taxes under section 154A at a very reduced rate of 1% of the export proceeds.

As a result of the above, we now have to address the following two problems. Firstly, Pakistani entities suffer the loss of business leading to lower export of products & services from Pakistan and secondly, the Government of Pakistan losing on due tax revenue from salary income of remote employees.

Detailed comparison

To further shed light on the issue, here is a detailed version of the comparison between the IT Corporate Employee and a Remote Worker.

Aspect	Corporate IT Employee	Remote Worker
Inflation Protection	As salaries are usually in PKR, companies need to have special arrangements if PKR depreciates and increases inflation as a result.	Remote workers get their salaries in USD/Euro/Other currencies. In case of rupee devaluation, they are protected from the direct effects of inflation on their net income.
Tax	They pay between 5% to 35% payroll tax on their monthly salary. They also pay tax on any bonus etc	Remote workers only pay 1% on the remittance they receive which can be further reduced to 0.25% if they register with PSEB as a freelancer (which is not approved easily by PSEB)
Salary Levels for Staff Augmentation	A corporate company charges X value per month in case of staff augmentation and gives a Y salary after excluding business overheads, charging their profit, etc.	A remote employee almost gets X value per month without any deduction as there is no company/entity in between. Roughly they get a 35% to 100+% increase in salary if they move from a Corporate IT job to a remote job.
Salary Transfer Methods	Local Bank Transfer after deducting the payroll taxes	Local Bank Transfer in case of WISE/Payoneer/etc (Not classified as IT Exports Proceeds) SWIFT transfer In case of direct bank transfer (Classified as IT Export Proceeds)
Schedule Flexibility	Some days work from the office (in most cases)	Complete Work from Home model

Propose legal framework

The proposed solution to this problem—crafted after careful legal implications and findings— is mentioned below.

Proposal	Legislative framework	Pros & cons
Reduce the cost of business for Pakistani businesses by providing reduced income tax rates to their employees	The rate of tax on salaries of persons employed by PSEB & P@SHA registered companies shall not exceed 5% of their salaries. A proviso may be added after the table in First Schedule follows: “Provided that maximum rate of tax applicable on salary of an individual shall not exceed 5% if such individual is receiving salary from a person registered PSEB and P@SHA.”	**Pros** ▪ Encourages more and more people to join the IT sector ▪ May even attract persons outside Pakistan to come and join IT companies in Pakistan. ▪ Pakistan may be even able to attract remote workers from other friendly countries to work from Pakistan and enjoy a reduced rate of tax. ▪ Increase in export of services from Pakistan and may resolve the IT sector problem of attracting high-quality resources. **Cons** ▪ The Government of Pakistan will lose tax revenue on salaries but that is likely to be offset by above benefits. ▪ Other sectors may call this discrimination and the Government of Pakistan may have to face litigation.

Conclusively, the corporate sector excels in creating intellectual property, developing human resources, and achieving higher export yields per employee, it contends with a disproportionately higher taxation rate. This disparity has led to a talent drain from the corporate sector to illegal remote working structures. Thus, the proposed framework provides a detailed insight into how the remote worker force can be put under the tax bracket for the greater benefit of protecting the IT industry.

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Pakistan IT Industry Association

Do you have a recommendation for the growth of the IT and ITeS industry?
Share your recommendations with us!

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