Pakistan IT Industry Association

Position Paper & Legal Framework for Taxation on Remote Workers 2024-25

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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 **Income per year:** 16,812,180 Tax on income: 168,121.8 **Tax on Remote Workers:** 1 percent if not registered with PSEB, 0.25 if registered with PSEB.	**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:** 4,879,263 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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