

DOING BUSINESS IN PAKISTAN

COMPENDIOUS STUDY ON
STATUTORY STIPULATIONS

3rd Edition



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WORDS FROM PRESIDENT

We are pleased to issue **Doing Business in Pakistan – Compendious Study on Statutory Stipulations (3rd Edition)** which gives overview of fiscal and other laws guiding investments in Pakistan. The effort is to give a quick glance to key decision makers, given their precious time and information need without going to minute details.



We hope this issue will serve as a promoting tool for attracting investments in Pakistan as it will assist in better understanding the investment impacts on net taxation of the investors.

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EXECUTIVE SUMMARY

In this era of globalization, a distinguishing feature is cross-border flows of foreign direct investment (FDI) and creation of footprints by multi-national companies. Every developing nation is striving to implement investment liberalization policies to enhance growth by attracting FDI. In Pakistan, the Investment policies are directed towards opening services, social, infrastructure and agricultural sectors for both local and foreign nationals by reducing cost of doing business, reducing processes of doing business, easing of doing businesses with creation of industrial clusters and Social Economic Zones and Linkages of trade and industrial and monetary policies for greater convergence.

This document is prepared to provide information on a number of subjects relevant for investment planning or doing business in Pakistan. The guide provides a summary of rules, regulations, and tax laws applicable in Pakistan.

Taxes in Pakistan are categorized into two types: Direct and Indirect Taxes. Direct Tax consists of Income Tax which is federal subject as per Constitution of Pakistan and its being administered by Federal Board of Revenue" FBR" under Income Tax Ordinance, 2001 and related rules. The Indirect taxes consist of Sales Tax on Goods and Services, Excise Duty and Customs Duty etc. All the indirect taxes, except sales tax on services, are federal subject matter and being administered by FBR. Sales tax on goods is governed under Sales Tax Act, 1990 and related rules, excise duty on goods and services is covered under Federal Excise Act, 2005 and related rules, Custom duty and regulatory duty covered under Customs Act, 1969 and Pakistan Customs Tariff. Sales tax on services is a provincial subject and all the four provincial tax authorities have promulgated their respective sales tax on services acts and rules of which brief overview has been given in document. It is to be noted that only sales tax on service within Islamabad Capital territory is within domain of FBR for which FBR has issued Islamabad Capital Territory (Tax on Service) Ordinance, 2001.

The Foreign Direct Investment (FDI) in Pakistan is governed under policies issued by Board of Investment(BOI) from time to time including privatization, liberalization and deregulation, which is in line with existing transformation of Pakistan as regional trade hub and increased regional connectivity through China-Pakistan Economic Corridor(CPEC), political stability and revival of economic growth to catch up with the Eastern Asian economies. Some of the relevant portions of BOI policy has also been described in document. If foreign investment and local investment is made in corporate sectors, consideration is also required to be given to Companies Act, 2017, other related laws and rules governed by Securities Exchange Commission of Pakistan (SECP). When cross border transactions are involved, the Foreign Exchange Regulations issued by State Bank of Pakistan (SBP) comes into play of which some relevant provisions have also been discussed in main document.

Although covering many relevant areas, this document should not be considered as exhaustive since it has not been designed to provide complex and detailed information required for decision-making in relation to investment.

➤ PROLOGUE

After its independence in 1947, Pakistan has been a federal republic governed under a Parliamentary system. Pakistan is a multilingual and a multi-ethnic society. Pakistan has always been a capitalist country with a belief in a free market system and has huge potential for economic growth.

Pakistan is amongst the fastest growing economies in the world. Its rapidly growing youth population and infrastructure development combined with an increasingly stable political situation has contributed to a 5.5% growth rate. Combine this with one of the most liberal approaches to repatriating profits and it is not hard to see the advantages of investing in Pakistan. The Government of Pakistan has also taken steps to encourage investment especially in the area of industrial sector. The infrastructure, thanks to CPEC has been greatly improved resulting in a more efficient transportation system across the country.

Pakistan's investment policy has been formulated to create an investor-friendly environment with a focus on further opening up the economy and marketing the potential for direct foreign investment. Various incentives have been offered to attract foreign investment including full repatriation of capital, capital gains, dividends and profits. Furthermore, according to various economic commentators, Pakistan has one of the most liberal investment policy regimes and public-private partnership frameworks in the entire South Asian region.

Legal protection to Foreign investment in Pakistan is fully protected by following Acts:

- Foreign Private Investment (Promotion and Protection) Act, 1976.
- Protection of Economic Reforms Act, 1992.

➤ DEMOGRAPHICS OF PAKISTAN

According to provisional summary results of 6th Population and Housing Census 2017, the latest estimated population is 207,774,520 excluding Azad Jammu and Kashmir and Gilgit-Baltistan making it world's sixth most populous country. The Azad Jammu and Kashmir and Gilgit-Baltistan population are estimated to be 211.819 million and 1.8 million respectively. The average population growth rate from 1998-2017 stood at 2.40%.

Pakistan has witnessed rapid urbanization and emergence of megacities with currently 36% of population residing in Urban areas leading to second largest urbanized nation in South Asia with 50% of Pakistanis now residing in towns of 5,000 people or more. Pakistan has the largest young population as well as largest refugees' population in the world. The following table depicts the age wise and gender wise distribution of population according to latest consensus.

Age group	Male	Female	Total	Percent
0-14	32,130,198	30,220,789	62,350,987	41.61%
15-64	41,951,884	40,618,318	82,570,202	55.10%
65+	2,775,655	2,163,544	4,939,199	3.30%

The main ethnic groups in Pakistan are Punjabi (44.68%), Pashtun (15.42%), Sindhi (14.10%) Saraiki (8.38%), Muhajir (7.57%), Baloch (3.57%) and other 6.28%. The Human Development Index (HDI) according to United Nations Development Program (UNDP) Human Development Report 2009, 60.3% of Pakistanis live on less than \$2 a day. The report shows Urban Pakistan HDI stood at 0.656 which is



medium human development on scale, whereas Rural Pakistan HDI stood at 0.496 which is low human development. The literacy rate stood at overall 60% of population, with Male at 69% and female 45%.

➤ INVESTMENT POLICIES

In order to protect and stimulate investment (both local and foreign) in Pakistan, The Investment Policy 2013 has been designed to provide a comprehensive framework for creating a conducive business environment for the attraction of FDI. For implementation of the policy, FDI Strategy for Pakistan, 2013-2017, outlining a detailed plan for structuring the platforms has been formulated.

Following basic principles provide theme of the Policy

- a. Reducing the cost of doing business in Pakistan
- b. Reducing the processes of doing business
- c. Ease of doing business with creation of industrial clusters and Special Economic Zones.
- d. Linkages of trade, industrial and monetary policies for greater convergence.

All these advantages combined, shows that the time is ripe for foreign investment, resulting in Pakistan's major economic growth. This handy tax guide will allow to access how the taxation system is also aligned with the above.

➤ TAX OVERVIEW

There are two types of duties and taxes applicable in Pakistan, which are hereunder:

	FEDERAL TAX	PROVINCIAL TAX
<u>Direct Tax</u> A tax on the profits of individuals, corporations and other entities	Income tax This tax contains 5 heads of income. These are: <ul style="list-style-type: none"> ● Salary ● Income from property ● Capital gains ● Income from business ● Income from other sources 	Agriculture Tax, Professional Tax etc.
<u>Indirect tax</u> Tax on the final consumer when they pay for goods and services	<ul style="list-style-type: none"> ● Sales tax on goods ● FED on Goods and Services ● Customs Duty 	Sales tax on Services

Since the issuance of our Second Edition on 11th October 2019, the major developments in taxation were: Sales Tax Refunds processing through FASTER, special instructions regarding books of accounts, documents to be maintained by designated persons (DPs) and reporting of suspicious transactions, Tax Laws (Second Amendments) Ordinance, 2019, SECP amendments in the Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) Regulations, 2018, Tax Laws (Amendment) Act, 2020, and Finance Act 2020. We have incorporated these amendments in this document so the same is up-t-date.

In addition to above regular monthly newsletters are also issued namely Tax Pak and Pakonomics. Other publications are also issued on major tax and economic developments in the country which can be accessed through our website www.tolaassociates.com, or Android and iOS mobile applications. Mobile applications may be downloaded from the links below:

1. <https://goo.gl/QDM4ZM> (iOS)
2. <https://goo.gl/LFiWyx> (Android)



INCOME TAX

1. INCOME TAX

➤ INTRODUCTION:

In Indo-Pak Subcontinent, the history of levy of taxes is very old. The Income Tax Act of 1886 was a general income tax that had been imposed on traders by some of the provinces beginning in 1878, Its basic scheme, by and large, survives till today. It introduced the definition of ‘agricultural income’ which is almost the same as in Income Tax Ordinance, 2001. This Act continued for 32 years, until repealed by the Income Tax Act of 1918.

The 1918 Act consolidated a number of wartime amendments. A graduated super tax on income over Rs 50,000 and on the undistributed profits of the corporations and other entities was introduced by the Super Tax Act of 1917 and continued in force through modifications by the Super Tax Act of 1920. The Income Tax Act and Super Tax Act were later on consolidated in another Act i.e. the Income Tax Act of 1922. This Act remained in force in Pakistan till 30th June 1979, when General Mohammad Zia ul Haq, in his capacity as President-cum-Chief Martial Law Administrator, decided to enforce a new law, the Income Tax Ordinance, 1979 with effect from 1st July 1979.

The 1979 Income Tax Ordinance was amended through innumerable Presidential Ordinances, annual Finance Acts/ Ordinances and Statutory Regulatory Orders (SROs) issued by Executive under delegated authority enjoyed by it and thus many of its lacunae were removed over a long period of time.

After 23 years of its existence when substantive amendments and judicial pronouncements made it a workable, better understandable and acceptable piece of legislation for everybody, in 2001 the then Military Ruler decided to abandon the time-tested law without any valid justification and Promulgated the New Ordinance on 13th September 2001 and made effective from 1st July 2002 vide SRO 381(I)/2002 dated 15th June 2002 before it went through 600 amendments made through Finance Act 2002.

1.1. RESIDENTIAL STATUS

Income Tax is levied under the Income Tax Ordinance, 2001 which is administered by the Federal Government. It applies to all individuals, companies, firms, association of persons and other artificial judicial persons. A Normal tax year runs from 1st July to 30th June in Pakistan. Taxability of an entity in Pakistan depends on its residential status.

It can be determined as under:

Category	Condition for qualifying as a ‘Resident’
Individuals	<ul style="list-style-type: none"> ● Present in Pakistan for 183 days or more in tax year or ● Present in Pakistan for 120 days or more in a tax year plus total 365 days in last 4 tax years or ● Is an employee of the Government whether physically in Pakistan or not.
Companies	<ul style="list-style-type: none"> ● Companies incorporated in Pakistan ● A company incorporated outside Pakistan, if control and management of the company affairs is situated wholly in Pakistan at any time of the year ● It is a Provincial or Local Government ● A company as defined in the Companies Act, 2017 including a small company ● A body corporate formed by or under any law in force in Pakistan ● A modaraba ● A co-operated society, a finance society or any other society

	<ul style="list-style-type: none"> • A non-profit organization • A trust, an entity or a body of persons established or constituted by or under any law for the time being in force • A foreign association, whether incorporated or not, which the Board has, by general or special order, declared to be a company for the purpose of this Ordinance.
Association of Persons	An association of persons shall be a resident association of persons for a tax year if the control and management of the affairs of the AOP situated wholly or partly in Pakistan

1.2. TAXABLE INCOME

Residential status	Income taxable in Pakistan
Resident	Domestic income + Global income (subject to tax treaties)
Non-resident	Income that arises in Pakistan (subject to tax treaties)

1.3. RESIDENTIAL STATUS AND TAXABILITY IN PAKISTAN

- A resident person is liable to be taxed on his world income.
- A Non-Resident person is liable to be taxed for his Pakistan source income only.

1.4. HEADS OF INCOME

Income is classified and accordingly taxable under the following heads:

Head of Income	Description of Income
Income from Salaries	Income arising on account of employment is taxable in the hands of the employee
Income from Properties	It is a charge on the potential of a rented property to generate rental income i.e Fair Market rent not merely the actual rent
Income from Business	Income earned by a taxpayer on exercise of a business or profession less deductible tax credits and allowances
Capital gains	Capital gains are gains arising on the disposal of specified capital assets
Income from other sources	Income which does not fall in any of the other heads falls in this head.

1.5. EXPATRIATES -TAXABILITY

It is a common trend for expatriates to take up employment in Pakistan. Strategic investors also depute (under a secondment arrangement) senior level personnel to take up key managerial positions in their Pakistan venture.

Every expatriate engaged as an employee by Liaison Office and Branch Office operating in Pakistan is required to obtain work visa prior to commencement of employment in Pakistan.

Common concerns of such expatriates are Taxability in Pakistan. A resident individual shall be exempt in respect of his foreign-source income which is not brought/ received in Pakistan if he is resident only by reason of his employment and he is present in Pakistan for not exceeding 3 years.

1.6. TAX RATES

The tax rate for companies in Pakistan does not differentiate between foreign and domestic firms. This once again underlines the fact that Pakistani laws are very favorable towards foreign investment (under Pakistani law, there is no distinction between tax on profits of domestic and foreign companies)

1.7. TAX RATE FOR COMPANY

Financial Year 2019-2020 and on wards

Type of Company	Tax Rate
Domestic Company	29%
Foreign Company	29%
Small Company	122%

1.8. TAX RATES FOR INDIVIDUALS

- Category 1 (non-salaried case i.e. where taxable salary is nil or up to 75% of taxable income)

S.NO	TAXABLE INCOME	RATE OF TAX
1	Up to Rs. 400,000	0%
2	Where the taxable income exceeds Rs.400,000 but does not exceed Rs.600,000	5% of the amount exceeding Rs. 400,000
3	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	Rs. 10,000 plus 10% of the amount exceeding Rs. 600,000
4	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 2,400,000	Rs. 70,000 plus 15% of the amount exceeding Rs. 1,200,000
5	Where taxable income exceeds Rs. 2,400,000 but does not exceed Rs. 3,000,000	Rs. 250,000 plus 20% of the amount exceeding Rs. 2,400,000
6	Where taxable income exceeds Rs. 3,000,000 but does not exceed Rs. 4,000,000	Rs. 370,000 plus 25% of the amount exceeding Rs. 3,000,000
7	Where taxable income exceeds Rs. 4,000,000 but does not exceed Rs. 6,000,000	Rs. 620,000 plus 30% of the amount exceeding Rs. 4,000,000
8	Where taxable income exceeds Rs. 6,000,000	Rs. 1,220,000 plus 35% of the amount exceeding Rs.6,000,000

- Category 2 (salaried case i.e. where taxable salary exceeds 75% of taxable income)

S.NO	TAXABLE INCOME	RATE OF TAX
1	Where taxable income does not exceed Rs. 600,000	0%
2	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	5% of the amount exceeding Rs. 600,000
3	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,800,000	Rs. 30,000 plus 10% of the amount exceeding Rs. 1,200,000
4	Where taxable income exceeds Rs. 1,800,000 but does not exceed Rs. 2,500,000	Rs. 90,000 plus 15% of the amount exceeding Rs. 1,800,000
5	Where taxable income exceeds Rs. 2,500,000 but does not exceed Rs. 3,500,000	Rs. 195,000 plus 17.5% of the amount exceeding Rs. 2,500,000
6	Where taxable income exceeds Rs. 3,500,000 but does not exceed Rs. 5,000,000	Rs. 370,000 plus 20% of the amount exceeding Rs.3,500,000
7	Where taxable income exceeds Rs. 5,000,000 but does not exceed Rs.8,000,000	Rs. 670,000 plus 22.5% of the amount exceeding Rs. 5,000,000
8	Where taxable income exceeds Rs. 8,000,000 but does not exceed Rs. 12,000,000	Rs. 1,345,000 plus 25% of the amount exceeding Rs. 8,000,000
9	Where taxable income exceeds Rs. 12,000,000 but does not exceed Rs.30,000,000	Rs. 2,345,000 plus 27.5% of the amount exceeding Rs. 12,000,000

¹ Amended vide Finance Act 2020

10	Where taxable income exceeds Rs. 30,000,000 but does not exceed Rs.50,000,000	Rs. 7,295,000 plus 30% of the amount exceeding Rs. 30,000,000
11	Where taxable income exceeds Rs. 50,000,000 but does not exceed Rs.75,000,000	Rs. 13,295,000 plus 32.5% of the amount exceeding Rs. 50,000,000
12	Where taxable income exceeds Rs.75,000,000	Rs.21,420,000 plus 35% of the amount exceeding Rs. 75,000,000

1.9. TAX RATES FOR ASSOCIATION OF PERSONS

S.NO	TAXABLE INCOME	RATE OF TAX
1	Up to Rs. 400,000	0%
2	Where taxable income exceeds Rs. 400,000 but does not exceed Rs. 600,000	5% of the amount exceeding Rs. 400,000
3	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	Rs. 10,000 plus 10% of the amount exceeding Rs. 600,000
4	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 2,400,000	Rs. 70,000 plus 15% of the amount exceeding Rs. 1,200,000
5	Where taxable income exceeds Rs. 2,400,000 but does not exceed Rs. 3,000,000	Rs. 250,000 plus 20% of the amount exceeding Rs. 2,400,000
6	Where taxable income exceeds Rs. 3,000,000 but does not exceed Rs. 4,000,000	Rs. 370,000 plus 25% of the amount exceeding Rs. 3,000,000
7	Where taxable income exceeds Rs. 4,000,000 but does not exceed Rs. 6,000,000	Rs. 620,000 plus 30% of the amount exceeding Rs. 4,000,000
8	Where taxable income exceeds Rs. 6,000,000	Rs. 1,220,000 plus 35% of the amount exceeding Rs.6,000,000

1.10. SUPER TAX

A Super Tax at 4% for rehabilitation of temporarily displaced persons is imposed only for banking companies for the year² 2021:

Person	2021
Banking Company	4%
Person other than a banking company, having income equal to or exceeding Rs. 500 million.	0%

1.11. TAXABILITY OF DIVIDEND

Taxability is in hands of company declaring the dividend only as tax is required to be deducted from dividend income which is taxable under FTR as full and final tax liability for shareholder including a corporate shareholder and no expense or deduction is allowable from such income.

Rate of tax	Industry
7.5%	Independent Power Purchasers where such dividend is a pass-through item under an Implementation Agreement or Power Purchase Agreement or Energy Purchase Agreement and is required to be re-imbursed by Central Power Purchasing Agency (CPPA-G) or its predecessor or successor entity.
15%	Dividend received from Mutual Fund and other cases not mentioned above and below dividend from a company where no tax is payable by such company, due to exemption of income or carry forward of business losses under Part VIII of Chapter III or claim of tax credits under Part X of Chapter III
25%	

² Amended vide Finance Act 2020

1.12. CAPITAL GAINS

Capital gains are taxed at certain specified rates depending on several factors- such as nature of asset, duration for which it is held before transfer, Status of transferor, relationship with transferor or transferee etc.

Type of asset	Holding period before sale/ Amount of gain	Formula	Rate of Tax for Filer	Rate of Tax for Non-Filer
Capital Assets u/s 37 <ul style="list-style-type: none"> • Shares of a private company • Membership card • Share in a partnership firm • Mining rights; and • Certain personal assets 	Less than year	(Consideration-Cost of asset) * Relevant Rate as per 1.8 or 1.9.	N/A	
	More than a year	(Consideration-Cost of asset) * ³ / ₄ * Relevant Rate i.e. as per 1.8 or 1.9.	N/A	
<ul style="list-style-type: none"> • ³Immoveable properties 	Where the gain does not exceed Rs. 5 million	Gain * Relevant Rate	2.5%	
	Where the gain exceeds Rs. 5 million but does not exceed Rs. 10 million	[if holding period does not exceed 1 - year full gain will be accounted, if holding period exceed 1 year but not exceed 2 years 75% of gain will be taxable, if holding period exceed 2 year but not exceed 3 years 50% of gain will be taxable, if holding period exceed 3 year but not exceed 4 years 25% of gain will be taxable,	5%	
	Where the gain exceeds Rs. 10 million but does not exceed Rs. 15 million	if period exceeds 8 years then no gain will be taxable)	7.5%	
	Where the gain exceeds Rs. 15 million		10%	
Capital Assets u/s 37A <ul style="list-style-type: none"> • Shares of a public company • Voucher of PTCL • Modaraba Certificates • An instrument of redeemable capital as defined in the Companies Act 2017 • Debt securities; and • Derivative products 	Acquired before 1.7.2013	(Consideration- Cost of asset) * Relevant Rate	0%	
	Acquired between 1.7.2013 and 30.06.2016 and holding period is	(Consideration- Cost of asset) * Relevant Rate		
	• less than 12 months		15%	30%
	• 12 months or more but less than 24 months		12.5%	25%
	• 24 months or more		7.5%	15%
	Acquired on or after 1.7.2016	-	15%	30%
Future commodity contracts entered by the members of Pakistan Mercantile Exchange. Cash settled derivatives traded on stock exchange	-		5%	10%

- Choice of Investment Vehicles for foreign investors

³ Amended vide Finance Act 2020

Forms of Entity	Taxability
Liaison Office ("LO")	<p>The activities of a LO of a foreign entity are restricted to undertaking promotional activities, provision of technical assistance, exploring the possibility of collaboration and export promotion on behalf of its parent company in Pakistan. Such an office is strictly restricted from entering revenue generating activities and is required to meet its operational expenses through remittances from its parent company through normal banking channel and converted to local currency account</p> <ul style="list-style-type: none"> • Requirements for approvals for liaison offices of foreign companies shall be permitted by BOI. • A foreign company LO is required to file prescribed returns/ documents with Registrar of Companies as per Provisions of Companies Act, 2017 after obtaining permission from BOI. • The requirements relating to accounts, audit, and submission of accounts to Registrar of Companies are also applicable. • LO is required to be registered with the tax authorities.
Branch Office ("BO")	<ul style="list-style-type: none"> • A foreign entity can operate in Pakistan by establishing a BO. A BO is set up specifically to execute the contracts awarded to the foreign entity, therefore, activity is restricted to the extent stated in the signed agreement / contract. A BO cannot indulge in commercial / trading activities. • Revenue generated / profit earned from BO activities can be repatriated to the Head Office, subject to payment of applicable taxes. Such repatriation should be in compliance with the procedure mentioned in the Foreign Exchange Regulations of the SBP through an authorized dealer (banker) under normal banking channels and Tax regulations. • All expenses incurred from BO activities will be met out of funds transferred from abroad through normal banking channel and converted to local currency account, or from the amounts received through execution of the agreement / contract. • A foreign company desirous of setting up a BO in Pakistan is required to apply for permission to the BOI on a specified application format along with the prescribed documents / information. • Permission for opening of branches of foreign banks is granted by the State Bank of Pakistan. • A foreign company BO is required to file prescribed returns/ documents with Registrar of Companies as per Provisions of Companies Act, 2017 after obtaining permission from BOI. • The requirements relating to accounts, audit, and submission of accounts to Registrar of Companies are also applicable.
Pakistan Subsidiary/ Joint Ventures	<p>A foreign company can set up its own wholly owned subsidiary in Pakistan or establish a joint venture company with a Pakistani or foreign partner, subject to fulfilling the policies for FDI and requirements of the Companies Ordinance, 2017. A subsidiary or a joint venture company can be formed as a private company or a public company.</p>
Permanent Establishment ("PE")	<p>A PE is a place of business through which the business of a non-resident is wholly or partly carried out, including:</p> <ul style="list-style-type: none"> • A place of management, branch, office, factory or workshop, premises for soliciting orders, warehouse, permanent sales exhibition, or sales outlet, except a liaison office. • An agriculture, pastoral, or forestry property. • A mine, oil or gas well, quarry, or any other place of extraction of natural resources. • A building site, a construction, assembly, or installation project; or supervisory activities connected with such site or project if such activity continued for more than 90 days within any 12-month period. • The furnishing of services, including consultancy services, by any person through employees or other personnel engaged by the person for that purpose.

- A person acting in Pakistan on behalf of the person, other than an agent of independent status (excluding a person acting exclusively/almost exclusively on behalf of such person) in the ordinary course of business.
- Any substantial equipment installed, or other asset or property capable of activity giving rise to income.
- A person who habitually exercises authority to conclude contracts on behalf of another person or plays a principal role in execution of contracts that are concluded without any material variations and these contracts are:
 - in the name of the person
 - for the transfer of the ownership of or for the granting of the right to use property owned by that enterprise or that the enterprise has the right to use, or
 - for the provision of services by that person.
- A fixed place of business that is used or maintained by a person if the person or an associate of a person carries on business at that place or at another place in Pakistan and:
 - that place or other place constitutes a PE of the person or an associate of the person under this sub-clause, or
 - business carried on by the person or an associate of the person at the same place or at more than one place constitutes complementary functions that are part of a cohesive business operation.

The definition of a PE provided in a Double Taxation Treaty “DTT” will prevail in cases where a DTT is executed by Pakistan with the related country of origin of the PE.

Controlled Foreign Company (“CFC”)

There is said to be a general tendency that Pakistani Residents make investment in offshore companies in foreign countries having tax exemption or lower tax rates and then the profits of such offshore companies are not repatriated in Pakistan.

Section 109A, appears to be a part of the overall scheme to bring into tax ambit the income earned through offshore entities owned by Pakistani residents.

This scheme is termed as CFC regime is summarized as under:

- (a) A company shall be considered CFC if
- i. Capital or voting rights of the non-resident company is held directly or indirectly by the persons resident in Pakistan:
 - More than 40% in case of single person;
 - More than 50% in case of two or more persons.
 - ii. Tax paid, after rebate, on the income of the non-resident company outside Pakistan is less than 60% of tax otherwise payable on the said income in Pakistan assuming that the company is a resident company taxable in Pakistan under the Income Tax Ordinance, 2001.
 - iii. The non-resident company is not listed in any stock exchange outside Pakistan, and
 - iv. The non-resident company does not derive active business income.
- (b) The income of CFC taxable in the hands of Pakistani residents shall be as per the following

$$A*(B/100)$$

<p>Where A= income of CFC B=% of capital or voting rights whichever is higher held by the resident person in CFC</p> <p>(c) Income of CFC shall be calculated in foreign currency but for the purpose of inclusion in the income of the resident person it shall be converted into Rupees at the State Bank of Pakistan rate applicable on the last day of the tax year.</p> <p>(d) The income taxable under this section shall not be taxable again when received in any subsequent tax year. A tax credit shall be allowed in case of tax paid on dividend income in the foreign country in any subsequent tax year as lower of following:</p> <ul style="list-style-type: none"> - Foreign tax paid - Pakistan tax payable on such dividend income in the tax year in which the dividend is received <p>(e) These provisions shall not apply in the following cases:</p> <ul style="list-style-type: none"> - Income of CFC is less than Rs. 10 million - Capital or voting rights of the resident person in CFC is less than 10%.

1.13. TAXATION OF BUSINESS TRUSTS

Real Estate Investment Trusts (REIT) Collective/ Investment Schemes

REIT makes Direct investment in Real Estate properties/ Stocks Shares listed on recognized stock exchange which generates rent, dividends and capital gain. REIT may also invest in SPVs (acquire controlling stake) which are holding rent producing real estate properties. REIT issue units to unit holders which may be or may not be listed in Pakistan stock exchange.

Stakeholders	Income Source	Taxability	
REIT/Collective Investment Schemes	<ul style="list-style-type: none"> • Rental income • Interest on loans to SPV • Dividend from SPV Shareholding • Capital Gain on property sale 	Exempt	Taxable (In case of dividend, bonus etc.)

1.14. MINIMUM TAX

There are certain provisions whereby a business entity's tax liability shall not be less than the specified amount or percentage of turnover/ net profit etc. The provisions of minimum tax are as under:

- a) The following business entities shall pay tax at the rate of 1.5% of turnover if their tax liability is nil or less than 1.5% of turnover. This section shall apply even if the income of the business entity is exempt from income tax or no tax is otherwise payable on account of loss for the tax year, brought forward loss, tax credit, depreciation etc.:
 - i. A resident company
 - ii. An Individual or AOP having turnover of Rs 10 million or above in the tax year 2017 or in any subsequent tax year.
 - iii. ⁴Permanent Establishment of non-resident.

⁴ Amended vide Finance Act 2020

- b) Turnover has been defined as:
- i. Sales exclusive of
 - Sales tax;
 - Excise duty;
 - Trade discount shown on invoices; and
 - Sales/ receipts taxable under FTR.
 - ii. Gross fee for services, commission and gross receipts from contracts excluding covered under FTR.
 - iii. The Company's share of turnover, fees for services, commission and gross receipts from contracts of any AOP of which the company is a member excluding those covered under FTR.
- c) Minimum tax in excess of normal tax liability shall be carried forward and adjusted against the tax liability of subsequent 5 tax years.
- d) This minimum tax provision shall not apply in certain cases e.g. modaraba, non-profit organization – clause 11A Part IV 2nd Schedule.

EXAMPLE

Turnover for Tax Year 2020	Rs 60,000,000
Taxable income	Rs 1,500,000
Income tax calculated as per 1 st Schedule	Rs 115,000
1.5% of turnover	Rs 900,000

Income Tax payable on taxable income of Rs 1,500,000 will be Rs 900,000 instead of Rs. 115,000 and minimum tax [Rs 900,000] in excess of income tax calculated as per applicable tax rates [Rs 115,000] amounting to Rs 785,000 will be carried forward in the following 5 years for adjustment against the income tax payable calculated as per applicable tax rates on taxable income, to the extent it exceeds the minimum tax of that year.

1.15. ALTERNATIVE CORPORATE TAX

Corporate taxpayers are liable to pay higher of the following:

Tax liability calculated under General Provisions

- Computed at 29% of taxable income as applicable
- Taxable income computed under normal provisions of ITO 2001

Alternative Corporate Tax

- Means tax calculated at the rate of 17% of the accounting income of the firm
- Accounting income means the accounting profit before taxes as disclosed in the financial statements

In case ACT liability exceeds Corporate Tax, the excess will be carried forward to the following year for a period of no more than 10 years.

EXAMPLE

Total Receipts:	200
Total Expenses	50
Accounting Income as per accounts	150
Taxable Income	25
<u>Breakup of total receipts</u>	
Export Sales	20
Contract Receipts	30



Business Receipts	130
Dividend Receipts	10
Exempt Income	10

Computation of Accounting Income for calculating ACT

- Total Receipts in the accounts 200
- Less amounts covered under exemption/ FTR 113C (8)

Export Sales	20
Contract Receipts	30
Dividend Receipts	10
Exempt income	<u>10</u>

- Receipts pertaining to accounting income for section 113C(a-b) = $200 - 70 = 130$

Less: apportionment of expenses

Percentage of receipts of accounting income u/s 113C	65%
d. 65% of total expenses	32.5
Accounting income for ACT = (c-d) = (130-32.5)	97.5

Computation of total tax liability

A. Tax Liability under ACT @ 17% of 97.5	16.575
B. Corporate Tax @ 29% of 25	7.25

As A is higher, A or tax liability under ACT will apply

C. Final tax liability	
Export sales @1%	0.2
Contract Receipts @ 7.5%	2.25
Dividend @15%	<u>1.5</u>
Total Final Tax	3.95
Total tax payable (A+C) (16.575+ 3.95)	= 20.525

1.16. FINAL TAX REGIME

In order to bring an ease in determination of tax liability and in undertaking tax compliances, certain specified businesses/professions are permitted to pay tax on a small percentage of their gross receipts, thereby dispensing any need to prepare detailed accounts or to undergo tax audit. The requirements of maintenance of minimum books of account and records under Rule 30 of the Income Tax Rules, 2002 are not attracted in case of business income where tax collectible or deductible is the final tax.

Head of Income	TAX RATE
Dividend Income of Shareholders from Independent Power Purchasers where such dividend is a pass-through item under an Implementation Agreement or Power Purchase Agreement or Energy Purchase Agreement and is required to be re-imbursed by Central Power Purchasing Agency (CPPA-G) or its predecessor or successor entity.	7.5%

Dividend received from mutual fund and other than above	15%
Dividend from a company where no tax is payable by such company, due to exemption of income or carry forward of business losses under Part VIII of Chapter III or claim of tax credits under Part X of Chapter III	25%
Non-Resident person carrying on Shipping activities/ air transport income	8% in case of shipping income, 3% in case of air transport income, of the gross amount of freight received or receivable on account of carriage of passengers, livestock, mail or goods shipped at any port in/outside Pakistan.
⁵ Resident person carrying on Shipping business not company registered with SECP after 15 th November 2019	one US \$ per gross registered tonnage per annum
⁶ Resident person carrying on Shipping business registered with SECP after 15 th November 2019	75 US Cents per gross registered tonnage per annum.
Exports	1% on export proceeds from direct exporters and indirect exporters.
Petrol Pump Operators	12% on gross amount of commission for filers (24% for non-filers)
Income of non-resident media persons	10% of the gross amount
Income of foreign produced commercials	20% of the gross amount (40% for non-filers)
Sale of right to collect tolls	10% (20% for non-filers)
⁷ Income of builders and Developers	As per rates given in Eleventh Schedule of ITO on basis of basis of covered area and location.

1.17. TAX DEADLINES

Every taxpayer is required to submit number of returns and statements, such as:

- Annual filing of:
 - Return of Income
 - Wealth Statement (if applicable)
 - Wealth Reconciliation Statement (if applicable)
 - Foreign income and Assets statement
- Quarterly deposition of advance tax by each company/AOP and individual having latest taxable income exceeding 1 million.
- ⁸Quarterly deposition of withholding tax statements by withholding agents on or before 20th October, 20th January, 20th April and 20th July each year.
- Statements of final taxation
- Notice of Discontinued Business

To be submitted by:

- **30th September for**
 - Return of income/Statement of final taxation by an individual or AOP.
 - Return of income and statement for Final Tax Regime by a company having year end between 1st July to 31st December

⁵ Amended vide Finance Act 2020

⁶ Amended vide Finance Act 2020

⁷ Amended vide Finance Act 2020

⁸ Amended vide Finance Act 2020

- **31st December for**

- Return of income and statement for Final Tax Regime by a company having year end between 1st January and 30th June.

1.18. TAXATION OF PERSONS (INDIVIDUAL, AOP AND COMPANIES) NOT APPEARING ON ACTIVE TAXPAYERS LIST[ATL]

A new 10th Schedule have been included in ITO, whereby rules has been prescribed for persons not appearing in ATL issued by FBR as follows:

- The rate of withholding tax for certain provisions will be enhanced by 100%.
- Person not liable to file Return of Income can get exemption certificate from Commissioner to avoid enhanced withholding. If the Commissioner not issue exemption certificate within 30 days, permission not to deduct tax at 100% enhanced rate shall be deemed to be granted.
- If enhanced tax has been deducted and person still does not file return, the commissioner can pass provisional assessment order within time limit prescribed.

1.19. PURCHASING OF ASSETS THROUGH BANKING CHANNEL

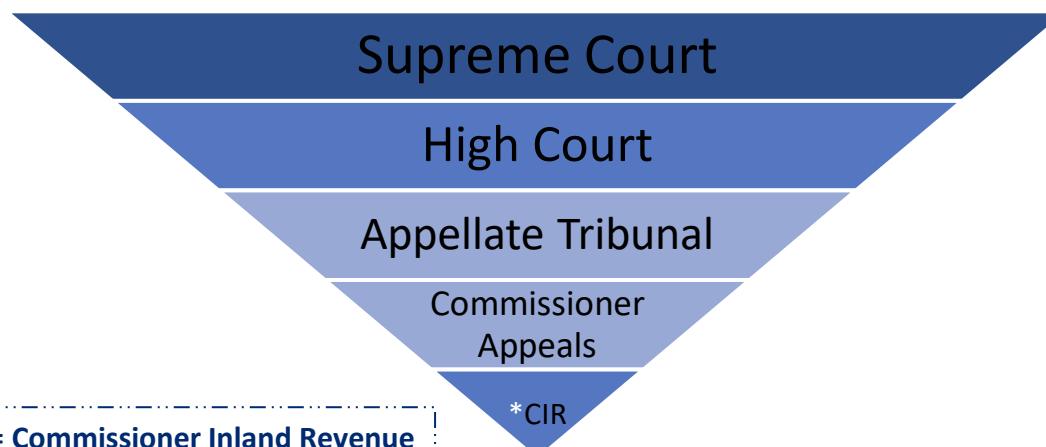
In order to discourage cash transaction and to document the economy, the purchase of following assets is required to be made only through crossed cheque drawn on a bank or through crossed demand draft or crossed pay order or any other crossed banking instrument showing transfer of the amount from one bank account to another bank account:

- Immovable property having fair market value greater than Rs 5 million; or
- Any other asset having fair market value more than Rs 1 million

If transaction does not adhere to above requirement, the depreciation/amortization and cost for computation of capital gain will be disallowed in addition to a penalty amounting to 5% of the purchase value.

1.20. TAX ADMINISTRATION AND DISPUTE RESOLUTION

- In certain circumstances, the Board shall subject the taxpayer to an audit. This process is called an assessment under Pakistani law
- If a taxpayer is unhappy with the assessment, he can challenge the assessment in the appeals process as under



* CIR = Commissioner Inland Revenue

1.21. ALTERNATIVE DISPUTE RESOLUTION

Alternative dispute resolution mechanism, “ADR” as the term denotes, is a system that operates side by side with the existing conventional appellate system but with simple procedures and lesser technicalities.

If any taxpayer, decides to opt for ADR regime instead of appellate regime then the recommendations of ADRC will be binding on both the parties.

1.22. AVOIDANCE OF DOUBLE TAXATION AND UNILATERAL RELIEF

Pakistan has entered into agreements for avoidance of double taxation with following countries, including those where the conventions restrict the taxation of income from international air / shipping traffic.

A. FULL SCOPE TREATY:

S. NO	Country	Maximum Tax Rate		
		Interest Rate	Royalties	Fee for Technical Services
1	Hong Kong	10	10	12.5
2	Brunei Darussalam	15	15	15
3	Czech Republic	10	10	10
4	Nepal	15	15	15
5	Ukraine	10	10	N/A
6	Kyrgyz Republic	10	10	N/A
7	Spain	10	7.5	10
8	Serbia	10	10	10
9	Yemen	10	10	10
10	Vietnam	15	15	15
11	United State of America	N/A	N/A	N/A
12	Uzbekistan	10	15	0
13	United Arab Emirates	10	12	12
14	United Kingdom	15	12.5	12.5
15	Turkmenistan	10	10	0
16	Tunisia	13	10	0
17	Turkey	10	10	0
18	Tajikistan	10	101	0
19	Thailand	25	20	0
20	Saudi Arabia	10	10	0
21	Syria	10	18	0
22	Switzerland	10	10	10
23	Sweden	15	10	10
24	Sri lanka	10	20	0
25	Singapore	12.5	10	10
26	Romania	10	12.5	0
27	Qatar	10	10	10
28	Portugal	10	10	10
29	Poland	0	15	0
30	Philippines	15	25	0
31	Oman	10	12.5	12.5
32	Norway	10	12	12
33	Nigeria	15	15	0
34	Netherlands	15	15	0
35	Morocco	10	10	10
36	Mauritius	10	12.5	0

S. NO	Country	Maximum Tax Rate		
		Interest Rate	Royalties	Fee for Technical Services
37	Malta	10	10	0
38	Malaysia	15	15	0
39	Lebanon	10	7.5	0
40	Libya	N/A	N/A	N/A
41	Korea	12.5	10	0
42	Kazakhstan	12.5	15	0
43	Kuwait	10	10	0
44	Jordan	10	10	10
45	Japan	10	10	10
46	Italy	30	30	0
47	Ireland	10	10	10
48	Iran	10	10	0
49	Indonesia	15	15	15
50	Hungary	15	15	15
51	Germany	20	10	10
52	France	10	10	10
53	Finland	15	10	10
54	Egypt	15	15	15
55	Denmark	15	12	12
56	China	10	12.5	12.5
57	South Africa	10	10	10
58	Canada	25	15	0
59	Bosnia and Herzegovina	20	15	0
60	Belarus	0	15	0
61	Belgium	15	20	0
62	Bangladesh	15	15	0
63	Bahrain	10	10	10
64	Azerbaijan	10	10	0
65	Austria	15	10	10

B. LIMITED SCOPE TREATY

Sr #	Countries
1	India (Air Transport Agreement)
2	Saudia Arabia
3	Kenya
4	Jordan (Treaty Partners)

When a person who qualifies as a non-resident (under ITO, 2001) but is a tax resident of a country with which Pakistan has entered into a Double Taxation Avoidance Agreement [DTAA] and the terms of such DTAA are beneficial to him (in comparison to the ITO,2001), he can opt to be governed by the same instead of ITO, 2001.

If there is no tax treaty with any jurisdiction, A resident taxpayer shall be entitled to tax credit in respect of foreign source income chargeable to tax in Pakistan, if foreign income tax has been paid in respect of foreign source income, equal to the lesser of:

- The foreign income tax paid, or
- Pakistan income tax payable in respect of the net foreign source income at different rate of tax.

A credit shall be allowed under this provision only if the foreign income tax is paid within two years, after the end of the tax year in which the foreign income to which the tax relates was derived by the resident taxpayer.

The most common income of nonresidents comprises are of interest, dividends, royalties, fee for technical services and capital gains. Above table depicts the maximum tax rate which the contracting states in tax treaties with Pakistan can charge to nonresidents. There is no such limit on capital gain therefore not presented.

1.23. ANTI-AVOIDANCE

In order to avoid evasion of revenue through various tax avoidance techniques, following special provisions are present in ITO,

- In respect of transactions between associates, the Commissioner may distribute, apportion or allocate income, deductions or tax credit between the persons as is necessary to reflect the income that the persons would have derived in an arm's length transaction.
- The Commissioner may recharacterize a transaction or an element of a transaction that was entered as part of a tax avoidance scheme.
- The Commissioner may disregard a transaction that does not have substantial economic effect.
- The Commissioner may recharacterize a transaction where the form of the transaction does not reflect the substance.

1.24. ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT

Over the last 50 years, the Organization for Economic Cooperation and Development (OECD) has led the way on tackling various tax issues. This work is the result of global dialogue, now directly involving more than 150 countries and jurisdictions from across the world. The exchange of information has been found as the corner stone of this co-operation and relationship against the cross-border tax evasion. This is the context in which the OECD has developed the Multilateral Convention for Mutual Administrative Assistance in Tax Matters (MAC) and its ancillary Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (MCAA) and a global model of Common Reporting Standard (CRS) for the automatic exchange of information with respect to financial accounts.

Pakistan has joined both MAC and the CRS MCAA. For implementation of CRS in Pakistan, necessary legislative changes have been made in the Income Tax Ordinance, 2001 and the Income Tax Rules, 2002 as to collect and provide relevant financial accounts information to the foreign tax jurisdictions. Hence, Pakistan has put in place all the necessary legislative and administrative measures and other relevant safeguards to implement the CRS and is exchanging financial accounts information with partner jurisdictions since September 2018.

1.25. ATOMATIC EXCHANGE OF INFORMATION

The Multilateral Convention of OECD by virtue of its Article 6 requires the Competent Authorities of the Parties to the Convention to mutually agree on the scope of the automatic exchange of information and the procedure to be complied with. Against this background, the OECD has developed the Multilateral



Competent Authority Agreement on Automatic Exchange of Financial Account Information (the "CRS MCAA") and the Common Reporting Standard (CRS).

In the Finance Acts of 2015 and 2016, Pakistan introduced section 165B and made certain amendments to section 107 of the Income Tax Ordinance, 2001 respectively, thus providing primary legislation for the purpose of automatic exchange of information in line with international standard. Similar kinds of changes were also incorporated in the Sales Tax Act, 1990 and Federal Excise Act of 2005. Further, through Finance Act 2017, an explanation was inserted in Section 165B of the Income Tax Ordinance, 2001 in order to bring more clarity and to quell any hint of ambiguity involving the terms "reportable person" and "financial institution" as assigned in the CRS.

1.26. MUTUAL LEGAL ASSISTANCE

A mutual legal assistance treaty (MLAT) is an agreement between two or more countries for the purpose of gathering and exchanging information in an effort to enforce public or criminal laws.

Pakistan is a party to one multilateral convention that could be used to provide extradition and Mutual Legal Assistance (MLA) in corruption cases, namely, the **United Nations Convention against Corruption (UNCAC)**. It has signed but it has not ratified the **United Nations Convention against Transnational Organized Crime (UNTOC)**. Pakistan has only one bilateral Mutual Legal Assistance (MLA) treaty in force (with Kazakhstan, a member of the ADB/OECD Initiative).

1.27. BENAMI LAW

In Pakistan Benami Transactions (Prohibition) Act, 2017 was enacted to curb black economy. The Act provided mechanism and procedure for confiscation of property held as Benami and for matters connected therewith or incidental thereto. To provide the procedural framework for implementation, Federal Government [FG] has enacted Benami Transactions Rules vide SRO 326 dated 11 March 2019.

1.28. ANTI MONEY LAUNDERING LAW

Pakistan introduced first standalone Anti Money Laundering law in September 2007 through promulgation of Anti-Money Laundering Ordinance 2007. This was followed by Anti-Money Laundering Ordinance 2009 and Anti-Money Laundering Act 2010. Presently, the Pakistan AML/CFT regime is regulated through following legislation:

- The Anti-Money Laundering Act 2010 (AML Act)
- The Anti-Terrorism Act 1997 viz. basic legal framework for counterterrorism prosecutions in Pakistan.
- The Anti-Money Laundering Regulations 2015

The Securities and Exchange Commission of Pakistan (Anti Money Laundering and Countering Financing of Terrorism) Regulations 2018 is applicable to SECP regulated entities. SECP has also issued Guidelines on implementation of Regulations.

1.29. THRESHOLD ON IMMUNITY ON FOREIGN REMITTANCE

Prior to Income Tax (Amendment) Ordinance, 2018, any amount of foreign exchange remitted from outside Pakistan through normal banking channel and encashed into Pak Rupees could not be subject to any enquiry for income tax purposes. Currently the above blanket exemption is unavailable for remittances above Rs 5 Million per person in a tax year.

1.30. THIN CAPITALIZATION AND RESTRICTION ON DEDUCTIONS OF PROFIT ON DEBT PAYABLE TO ASSOCIATED ENTERPRISES.

The concept of thin capitalization has been brought in Pakistan tax legislation so as to refrain foreign companies from injecting debt instead of equity in their subsidiaries formed in Pakistan. Thin capitalization rules apply to Foreign Controlled Resident Company (FCRC), in which 50% or more of the underlying ownership is held by a non-resident person (either alone or together with an associate), other than the financial institution or banking company.

Where foreign debt to foreign equity ratio of a FCRC, at any time during a tax year, exceeds 3:1, profit on debt paid by the company in that year on the part of the debt exceeding 3:1 ratio will not be allowed as deduction, while computing income of the FCRC. This rule is also applicable to the Pakistan branch of a foreign company.

Thin capitalization is inapplicable, if interest on foreign debt is chargeable to tax under the Ordinance and does not enjoy any exemption or reduced rate applicability.

⁹If profit on debt claimed as a deduction is more than 10 million, effectively 15% of foreign profit on debt payable to non-resident person or associate will be disallowed in computing income of FCRC. It may be noted that the higher of amount disallowed under this rule and thin capitalization rules discussed above will be considered. This is in line with international best practices, many countries have introduced a fixed ratio test based on a subsidiary company's interest deduction to taxable income/accounting profits ratio instead of debt to equity ratio given in thin capitalization rules, which has been found to be a better tool for combating base erosion and profit shifting.

1.31. ADVANCE RULING

The concept of Advance Ruling was brought to facilitate foreign investors. However, a foreign company with a permanent establishment in Pakistan is taxed as a “resident company” and Advance Ruling in such cases is likely to be attracted in the cases of resident companies also. Therefore, in order to bring clarity in the application of Advance Ruling regime, a non-resident taxpayer with permanent establishment in Pakistan shall not be entitled to Advance Ruling with effect from 1st July 2011.

The law is silent about the situation where non-resident taxpayers after obtaining the ruling becomes resident, whether ruling be still binding or not? The detailed procedure is on FBR website link <https://www.fbr.gov.pk/Contents/introduction-procedure-of-advance-ruling/156>.

1.32. DIRECT TAX INCENTIVES FOR INVESTORS

1.32.1. Generating Employment

Where a new manufacturing unit is set up, the owner can avail tax breaks for 10 years equal to 2% of tax for every 50 employees registered with social security for a maximum of 10% starting from the year in which production has commenced.

1.32.2. Enlisting in Stock Market

Where a company enlists in Pakistan Stock Exchange in Pakistan, it shall be allowed a tax credit equal to 20% of the tax payable for initial 2 years and 10% for last 2 years.

⁹ Amended vide Finance Act 2020

1.32.3. Investment to Extend, Expand, Modernize or Replace Industrial Equipment

Where a company invests in purchase of plant and machinery for the purposes of extension, expansion, Balancing, Modernization and Replacement etc. they will be allowed a tax credit equal to 10%(5% for Tax Year 2019) of their investment, if company is setup or investment is made up to 30th June 2019. However, the carry forward of unabsorbed tax credit relating to prior years shall continue to apply after June 30, 2019.

1.32.4. Investment for new Industrial Undertaking

If a company owns at least 70% of equity in a new industrial undertaking, it shall be allowed a proportionate tax credit according to equity-investment ratio.

1.32.5. Taxation of Income of a Company being a Member of an Association of Persons

An Association of Persons is liable to tax at specified rates. The share of a member of an Association of Persons is exempt from tax. However, the same shall be added in partners' income for rate purpose only.

1.32.6. Minimum Tax Regime

The minimum tax regime has also been lowered to a certain extent in some industries such as 0.75% for oil industry and poultry breeder and 0.25% for distributors of pharmaceutical products, fast moving consumer goods and cigarettes, rice and flour mills, sugar, cement and edible oil.

1.32.7. Shariah Compliant Listed Company

Tax rate for a listed company shall be reduced by 2%, if:

- It fulfils prescribed shariah compliant criteria approved by State Bank of Pakistan, SECP and FBR,
- Derives income from manufacturing activities only,
- Has declared taxable income for the last 3 consecutive tax years; and
- Has issued dividend for the last 5 consecutive tax years.

1.32.8. Start-Ups

Startup means a business of a resident individual, AOP or a company that commenced on or after 1.7.2012 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 Rs 100 Million in each of the last five tax years.

Profits derived by a start-up is exempt for the tax year in which the start-up is certified by the PSEB and the following two tax years. Minimum Tax and withholding tax provision are not applicable.

1.32.9. Online Market place

Online Market place 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.

Minimum tax shall be 0.75% and tax rate on commission and brokerage shall be 5%

1.32.10. Import of Goods

Advance tax at the time of Import of goods where title passes outside Pakistan and is supported by import document is exempt from tax deduction.

1.32.11. Educational and Medical

If education or medical expenses are remitted abroad by the individual to non-resident, exemption against withholding tax will be allowed.

1.32.12. Tax Credits for Profit on Behbood Savings Certificates or Pensioners' Benefit Account

The Behbood Certificates are not subject to withholding tax and subject to maximum rate of tax of 10%. If income falls in slabs on which tax rate is higher than 10%, a tax credit equal to additional tax above 10% will be available.

1.32.13. Tax Credits for Teachers

Full time teachers are allowed tax credits to the tune of 25% of tax payable, other than teachers of medical profession who derive income from private medical practice or who derive income from private medical practice or who receive share of consideration received from patients.

1.32.14. Tax Credits for Person Employing Fresh Graduates in addition to deduction of salary expenditure

Employer employing freshly qualified graduates from a university or institution recognized by Higher Education Commission allowed a tax credit computed on basis of annual salary up to lower of 15% of total employees' salary or 5% of employers' taxable income for the year.

1.32.15. Advance Tax at Import Stage

¹⁰A new regime for advance tax has also been put into effect decreasing the tax rate for raw materials and machinery listed in part 1 and 2 of twelfth schedule of ITO to 1% and 2% respectively. In case of manufacturers covered under rescinded Notification No. S.R.O. 1125(I)/2011 dated the 31st December, 2011 as it stood on the 28th June, 2019 on import of items covered under the aforementioned S.R.O. shall be 1%. in case of persons importing finished pharmaceutical products that are not manufactured otherwise in Pakistan, as certified by the Drug Regulatory Authority of Pakistan shall be 4%.

1.32.16. Exemptions for Mutual Funds

Mutual funds are exempt from income tax if UPTO 90% of its income is distributed as dividend subject to provisions in Pakistani law.

1.32.17. Exemptions for Fruit Processing Plant

Under the 2014 Finance Act, profits from a fruit processing plant set up in Baluchistan, Malakand Division, Gilgit or FATA are exempt from tax for 5 years provided the taxpayer is engaged in the process of locally grown fruits.

1.32.18. Coal Plants

Coal plants in Sindh for supply of coal exclusively to power stations have been exempted from tax. Furthermore, these companies also have their dividend tax reduced to 7.5%.

1.32.19. Developmental REIT Scheme

A developmental REIT scheme established by 30th June 2020 will have reduced rate on dividend by 50% on recipient for three years from setting up of the scheme.

¹⁰ Amended vide Finance Act 2020

1.32.20. Allowance for Manufacturer of Cell Phones

Companies manufacturing cell phones will be allowed a first-year allowance and an exemption of tax for 5 years from the month of commencement of production.

1.32.21. Filmmaking Exemptions

Tax payable by foreign and local filmmakers is reduced by 50%.

1.32.22. Immunity from Probing

Immunity from probing has been provided to investments made by an individual in a Greenfield industrial undertaking provided that the investment is made on or after January 1, 2014 and commercial production is commenced by June 30, 2019. This exemption is subject to certain conditions.

1.32.23. Future Exemptions

Exemption to Profits and gains derived by a refinery set up between the 1st day of July 2018 and the 30th day of June 2023 with minimum 100,000 barrels per day production capacity for a period of twenty years beginning in the month in which the refinery is set up or commercial production is commenced, whichever is later is available. Exemption under this clause shall also be available to existing refineries, if—

- a) existing production capacity is enhanced by at least 100,000 barrels per day;
- b) the refinery maintains separate accounts for income arising from aforesaid additional production capacity; and
- c) the refinery is a deep conversion refinery.

1.32.24. Loan to SME - Tax Reduction

Under the existing regime, all income of banking companies is subject to uniform rate of tax of 35%. It is now provided that 'income' from advances to the following will be subject to reduced rate of 20% for tax years 2020 to 2023:

- a) Micro and small enterprises;
- b) Low cost housing finance; and
- c) Farm credit.

The above terms are defined as per State Bank of Pakistan's Prudential Regulations. With regard to farm credit and low-cost housing finance, advances would not qualify for the above concessional rate and the same is subject to submission of details of advances along with gross and net margin earned from such advances.

The above concessional rate is available on 'additional advances', which term has been defined as advances in addition to average amount of advances to the above sectors for tax year 2019.

A new clause in Second Schedule has been inserted to exempt the above income from Super Tax too for tax years 2020 to 2023.

1.32.25. ¹¹Builders and Developers- Tax concessions

If a company with single object as a builder or developer is incorporated on or before 31st December 2020, the following benefits are available:

- The tax rate will be fixed tax rate based on area of project
- The Dividend income paid to shareholder out of profits will be exempt from withholding tax on dividend.

¹¹ Amended vide Finance Act 2020

- Minimum tax under section 113 of the Ordinance shall not be applicable on turnover of a builder or developer in respect of a project registered under the scheme.
- The profit can be incorporated in Balance Sheet i.e. white money, of company upto 10 times of tax paid.
- The company shall not be liable to withhold tax under Section 153 on payments made to vendors on purchase of building material except cement and steel and on services of plumbing, electrification, shuttering and other similar services provided by individuals or AOP.
- A builder or developer falling under this scheme shall pay advance tax equal to one-fourth of the tax liability for the year as determined under the scheme in four equal installments. Builders and developers opting for the scheme shall only be eligible for availing tax credit for tax collected under section 236A and 236K of the ITO from such builders or developers pursuant to the commencement of the Tax Laws (Amendment) Ordinance, 2020 (I of 2020) i.e. from 17th April, 2020 onwards on the purchase of immovable property utilized in a project registered under the scheme.
- The scheme provides immunity from the provisions of section 111 of the Ordinance, and no questions will be asked regarding nature and source of funds from investors making capital investment in NEW construction projects in the form of money or land, either as an individual, as an association of persons or a company, subject to the conditions:
 - Such amount invested through crossed banking instrument deposited in the bank account of new company on or before 31st December 2020
 - Land is owned by the company as on 17.04.2020 shall be transferred to such company on or before 31st December 2020.
- In case the actual profits of the company are more than 10 times of the taxes paid, the excess profits will be required to be offered for tax at normal rates (i.e. 29% for companies) under normal tax regime.
- The first purchaser of a building or a unit in the building is not required to explain the source of funds used for purchase from a project registered with FBR under this scheme if the complete payment is made before 30.09.2022 and is made through banking channels.
- In case of a builder, the project shall be treated as complete on the date of completion of the grey structure. Moreover, the roof of the top floor has been laid as per the approved plan. Furthermore, the map approving authority or NESPAK shall certify that the grey structure as per the approved map has been completed by the builder on or before the 30th day of September, 2022.

(See detailed comments through link <https://bit.ly/35HEYhq>)

1.32.26. ¹²Greenfield Industrial Undertaking

Profits and gains of a company from a greenfield industrial undertaking for a period of five years incorporated on or after the first day of July 2019 are exempt from normal tax and minimum tax. The green field industrial undertaking is not formed by the splitting up or reconstitution of an undertaking already in existence or by transfer of machinery or plant from an undertaking established in Pakistan before the commencement of the new business.

¹² Amendment vide Finance Act 2020

SALES TAX ON GOODS

2. SALES TAX ON GOODS

Sales tax in Pakistan was a provincial tax at the time of partition. It was being administered in the provinces of Punjab and Sindh as a provincial levy. Sales tax was declared as federal subject in 1948 vide General Sales Tax Act 1948 and this levy was transferred permanently to the Central Government in 1952. Sales Tax was levied at the standard rate of 6% at every stage of sale.

Later on, system of licensed manufacturers and wholesalers was instituted through the Sales Tax Act 1951, whereby they were allowed to purchase goods free of Sales Tax from each other and pay tax on sales to unlicensed traders. Imports were chargeable to Sales Tax but the licensed manufacturers and wholesalers were allowed to import goods without payment of Sales Tax. Later on Sales Tax became chargeable on locally produced and imported goods at the time of their sales and import, respectively. The sales tax was collected, under the Finance Ordinance 1956 on goods which were chargeable to Excise Duty, as if it were a duty of Excise. In 1981, by virtue of an amendment in the Sales Tax Act 1951, the collection of Sales Tax on non-excisable goods was also entrusted to the Excise Department.

In the late eighties, Sales Tax was replaced with the Value Added Tax in the country and accordingly new enactment titled Sales Tax Act 1990 replaced Sales Tax Act 1951 with effect from November 01, 1990.

2.1. FEDERAL SALES TAX SALIENT FEATURES

Sales tax is a Value Added Tax (VAT) system. It is an indirect tax collectable from the whole supply chain i.e. importers, manufacturers, wholesalers (including dealers and distributors) and retailers with certain exceptions. Therefore, the sales tax is a multi-stage tax payable on value of:

- Taxable supplies by a registered person in respect of any taxable activity carried on by him;
- Goods imported into Pakistan; and
- Specified taxable services.

VAT is a percentage tax levied on the price each registered person charges for goods supplied or taxable services rendered by him.

VAT normally utilized a system of tax credit (called input tax adjustment) to place the ultimate and real burden of tax on the final consumer and to relieve the intermediaries from any tax burden.

2.2. RETAILERS

Under the new procedures, retailers have been segregated into 2 categories:

1. Retailers who are subject to tax under the normal tax regime. These are called Tier 1 and include:
 - National or international chains
 - Retailers operating in air-conditioned malls
 - Retailer who has a credit and debit card machine
 - Retailers whose cumulative electricity bill exceeds Rs. 11,200,000 for a 12-month period
 - Wholesaler-cum-retailer who engages in bulk import of goods and supply of consumer goods on wholesale basis to retailers as well as on a retail basis to the general body of the consumers.
 - A retailer whose shop measures one thousand square feet in area or more.

These retailers will be charged tax under regular procedures of law. This means sales tax to be charged at 17% with the relevant input adjustment.
2. Retailers other than Tier-1 retailers are not required to be registered and they shall pay sales tax with their monthly electricity bill as under:
 - 5% where the monthly bill does not exceed Rs 20,000; and

¹ Amended by The Tax Laws (Amendment) Act, 2020

- 7.5% where the monthly bill exceeds Rs 20,000.

The above sales tax is the final discharge of their sales tax liability and they are not allowed to claim input tax adjustment. Monthly sales tax return is not required to be filed and they are not subject to audit.

2.3. TAX RATE

Sales tax is applied at the rate of 17%. Further tax at 3% shall also be charged when the goods are supplied to unregistered persons. It means that the tax rate is 17% + 3% on supplies of goods to unregistered persons. However, further tax shall not be charged in the following cases:

- Supply of goods directly to end consumers including supplies by retailer (however CNIC of buyer is required in case of sales amount greater than Rs 2100,000)
- Items that fall under the 3rd Schedule
- Electricity supplied to domestic and agricultural consumers
- Natural gas supplied to domestic consumers and CNG stations
- Supply of second-hand worn clothing and other work articles
- Goods falling under zero rating
- Fertilizers
- Supplies by steel millers, re-rollers and ship breakers and few other items specified in the notification.
- Supplies made to Government, semi-government, and statutory regulatory bodies.
- Supply of white crystalline sugar.
- Supplies of foam or spring mattresses and other foam products for household use.

Further tax shall not become part of output tax, which means that further tax is payable to the FBR as a bottom-line figure. It should however be noted that sales through factory outlets means sales to end users and therefore further tax is not chargeable. Likewise, sales to employees, educational institutions, hospitals government department and so on will not be subject to further tax being end users.

FBR with the approval of Federal Minister in charge has power to fix a lower or higher rate on specified items. Examples of lower rate of sales tax is petroleum products through notifications issued by the FBR from time to time.

The 8th schedule specified imports or supply of certain goods on which sales tax is chargeable at reduced rates subject to certain conditions. Few examples are:

- 10% on import of raw cotton (Local supply of raw cotton is exempt)
- 10% on flavored milk, milk and cream concentrated or containing added sugar or other sweetening matter, cheese, butter etc. if sold in retail packing under a brand name
- 10% on import of plant and machinery not manufactured locally and having no compatible local substitutes.

FBR has the authority to levy and collect sales tax on fixed basis or on the basis of capacity of plant in lieu of sales tax on the basis of value of supply of goods (may also be called as capacity tax)

The 9th Schedule specifies imports or supply of certain goods on which sales tax is charged on fixed basis. Fixed sales tax has been imposed under 9th Schedule as under:

- On activation of SIM card by a Cellular Mobile Operator("CMO")
- On mobile phones including smart phones and satellite phones ranging from Rs.³130 to Rs. 9,270.
- Fixed sales tax under 9th Schedule shall be paid by the CMO, importer or manufacturer, as the case may be, and the purchaser is not entitled to claim input tax of such fixed sales tax paid by him. CMO is not entitled to claim any input tax against fixed sales tax charged by it from its customers.

² Amended through Finance Act, 2020

³ Amended through Finance Act, 2020

2.4. SALE TAX ON FIVE EXPORT-ORIENTED ITEMS AND OTHERS

Now Sales Tax on five export sectors i.e. Textile, carpets, leather, sports, and surgical goods on local supplies is under normal tax regime @ 17% which was previously covered under SRO 1125 dated 31.12.2011. The facility of supply of zero-rated electricity, gas, diesel oil, furnace oil and coal to registered manufacturers has also been withdrawn. However, if supplied goods are finished fabric, and locally manufactured finished articles of textile and textile made-ups and leather and artificial leather from retail outlets as are integrated with FBR's computerized system for real time reporting subject to the condition that they have maintained 4% value addition during the last six months the tax rate will be 12% instead of 17% [entry no. 66, 8th Schedule].

2.5. IMPORTED GOODS- SALES TAX TO BE CHARGED ON RETAIL PRICE

Sales tax is charged by a manufacturer @17% in respect of goods falling under third schedule of Act on the recommended retail price which shall be legibly printed on the label etc. along with the amount of sales tax. After charging such sales tax by a manufacturer, the same amount of sales tax will be charged by the wholesaler of finished goods and retailer from their customers. This concept is now applicable on imported products as well **viz.** sales tax at import stage will be charged at retail price printed label of imported goods.

2.6. WHO IS LIABLE TO PAY SALES TAX?

Liability to pay the sales tax to the tax department shall be of the person:

- Making the supply, in the case of supply of goods (it means that the purchaser who pays sales tax, does not pay sales tax to FBR, instead he pays sales tax to the supplier and the supplier pays sales tax to FBR after making his input adjustment)
- Importing the goods, in the case of goods imported into Pakistan and
- Providing taxable services

However, FBR with the approval of the Federal Minister-in-charge may specify the goods in respect of which liability to pay sales tax to FBR shall be of the person receiving the supply [Reverse charge].

The **Cottage Industry** is not required to register and pay sales tax, means a manufacturer who does not have an industrial gas or electricity connection, is located in residential area whose annual taxable turnover during the last 12 months ending any tax period does not exceed Rs 3 million and does not have a total labour force of more than ten workers.

2.7. GST RETURNS

Under Pakistani law, the standard operating procedure has been to file monthly tax returns by the 18th of the month.

1.	Standard Procedure	Monthly Returns	18 th of every month
2.	Private or Public Limited Company (in addition to Point 1)	Annual Return	By 30 th September

2.8. GST EXEMPTIONS AND INCENTIVES

2.8.1. Zero Rated Supplies

Supplies which are chargeable at zero percent exist. This means tax does exist. There is a tax, but it is charged at 0%. **Note this only applies to output tax.** Input tax will still be levied. Exports to any country are zero rated supplies. This covers a wide variety of goods and services, examples are supply to diplomats, diplomatic missions and duty-free shops, stationery, and bicycle industries. Refund on zero rated supplies because of input tax will be made in 72 hours in new Fully Automated Sales Tax eRefund (FASTER). Some important examples of zero-rated supplies are:

- Supply to diplomatic mission and privileged persons
- Supply of raw materials and components for further manufacture of goods in export processing zone
- Supply of locally produced plant, machinery, and equipment in EPZ subject to certain conditions including that the purchaser is EPZ shall submit an indemnity bond that the machinery shall not be sold or otherwise removed from EPZ without permission from the Commissioner
- Import of supplies made to the Gwadar Special Economic Zone excluding vehicles (vehicles imported by China Overseas Holding Company Ltd and its operating companies for use in Gwadar are exempt for a period of 23 years)
- Supply to exporters under Duty and Tax Remission Rules 2001 (DTRE)
- Supply to duty free shops
- Supply of stores and provisions for consumption abroad conveyance proceeding outside Pakistan e.g. international flight or ship (however, items used in the port area e.g. welding electrodes are not the items of such conveyance and therefore cannot be zero rated).
- Packing materials used for zero rated supplies.
- Electric and gas consumed by manufacturer-exporters
- Other specified items subject to certain conditions including bicycles

2.8.2. Exempt Supplies

Exempt supplies are supplies which fall outside the purview of sales tax and therefore not subject to sales tax. Important exempt items are:

- Live animals
- Agricultural produce not subject to any further manufacture
- Edible oil, vegetable ghee and cooking oil on the part of the importer and manufacturer (FED is applicable on these items)
- Holy Quran and other holy books or recorded in audio or video cassettes
- Imported samples (local samples of taxable items are subject to sales tax)
- Goods imported by diplomats, diplomatic missions or privileged person
- Personal baggage imported by overseas Pakistanis
- Import of machinery and materials for EPZ
- Goods imported temporarily for subsequent exports
- Import of replacement goods supplied free of cost in lieu of defective goods imported
- Goods produced in and exported from Pakistan which are subsequently imported in Pakistan within one year of their export
- Goods imported by or donated to government hospitals and non-profit educational and research institution
- Goods supplied to government hospitals, charitable hospitals of 50 beds or more of the teaching hospitals of statutory universities of 200 or more beds
- Supply of fixed assets otherwise than stock in trade against which input tax adjustment is not available e.g. resale of car, furniture, or office equipment being a depreciable asset
- Specified goods including
 - Energy saver lamps and tube light
 - Pharmaceutical raw materials and finished products with few exceptions
 - Laptops, computers, and notebooks

- Specified machinery and capital goods subject to certain conditions such as
 - Equipment's for coal firing system
 - Machinery for power generation
 - Networking equipment's for educational and training institution
 - Machinery imported for setting up of a Special Economic Zone (SEZ) as prescribed in the SEZ Act, 2012
- Raw materials or intermediary goods produced (or services provided) by a registered person used by himself in the manufacture of taxable goods. Such in-house consumption is a supply as per the definition and shall itself be a taxable supply if used for any purpose other than taxable supply.

2.8.3. Input Tax Adjustment

Pakistani tax law restricts admissibility of input tax with respect to

- Goods and services not related to taxable supplies
- Commodities acquired for personal or non-business use.
- Goods used in immovable property
- Vehicles, their parts, their electrical appliances, furniture, furnishings, office equipment other than goods for sale or resale

2.8.4. Restriction on input tax

A registered person shall not allow to adjust input tax in excess of 90% of the output tax for a particular tax period. Therefore, in case of lower profit margin he is required to pay 10% of his output tax to FBR.

It means that if his input tax during a tax period exceeds his output tax as a result of loss or overbuying (closing stock), he is not entitled to get refund instead he will pay 10% of his output tax to FBR.

Input tax disallowed due to this restriction shall be carried forward to the next period and shall be treated as input tax of that period.

Input tax on acquisition of fixed assets or capital goods, if any, is claimable in the same tax period and restriction of the said 90% is not applicable in this case.

⁴Input tax allowed in case of locally manufactured electric vehicles subject to reduced rate of tax under the Eighth Schedule shall be limited to the extent of amount of output tax and no refund or carry forward of excess input tax shall be allowed.

⁵FBR has power to increase the limit from 90% to 95% in any particular case. FBR has specified the following cases where the limit is 95%:

- All Tier-1 retailers who have integrated all their point of sales (POS) with the FBR
- Wholesalers of yarn.
- Automobiles manufacturing companies which are listed on PSX till December 2020.

⁶In case a Tier-1 retailer does not integrate his retail outlet in the manner as prescribed under sub-section (9A) of section 3, during a tax period or part thereof, the adjustable input tax for whole of that tax period shall be reduced by 15%.

⁴ Amended through Finance Act, 2020

⁵ Through SRO 1190 dated 2.10.2019

⁶ Amended by Finance Act, 2019

➤ **Exceptions:**

This restriction of 90% is not applicable in the following cases i.e. they can adjust input tax from output tax without any restriction:

1. Persons registered in electrical energy sector and gas distribution companies
2. Oil marketing companies, petroleum refineries and Pakistan Steel Mills
3. Fertilizers manufacturers
4. Distributors
5. Commercial importers provided the value of imports subjected to 3% value addition as per Twelfth Schedule, where commercial imports exceed 50% of value of all taxable purchases in a tax period.
6. Persons making zero rated supplies provided value of such supplies exceeds 50% of value of all taxable supplies during a tax period.
7. Telecommunications
8. Registered persons other than manufacturers, making supplies of items covered under the third schedule to the Sales Tax Act, 1990 on which sales tax has been paid by manufacturers or importer on retail price, provided that value of such supplies exceeds 80% of value of all taxable supplies in a tax period.
9. ⁷CNG dealers provided the value of natural gas on which sales tax is charged on the basis of value notified by FBR exceeds 50% of all taxable supplies.
10. Petroleum dealers of licensed oil marketing companies.

⁷ Through SRO 1190 dated 2.10.2019



FEDERAL EXCISE DUTY

3. FEDERAL EXCISE DUTY

Sections 3 of the Federal Excise Duty Act provides that all goods and services are subject to FED at general rate of 15% except those specified in 1st Schedule on which FED shall be charged on specific rates as per 1st Schedule. However, Section 16 provides that all goods and services are exempt except goods and services specified in 1st Schedule. this means the FED is applicable only on goods and services specified in 1st Schedule whereas sales tax is chargeable on all goods unless specifically exempt.

3.1. SALIENT FEATURES

- FED is not taxable on services which are already taxable under provincial sales tax except
 - carriage of passengers by air within or outside Pakistan at fixed rates
 - inland carriage of goods
 - services provided by port and terminal operators
 - chartered flight
- Goods which are manufactured in the non-tariff areas including Azad Jammu and Kashmir and brought to the tariff areas shall be leviable for duty. examples are vegetable ghee and cigars and cigarettes.
- Goods which are imported irrespective of their final destination in Territories of Pakistan including non-tariff areas shall be charged FED duty.
- FED on the goods shall be charged on either of the following basis depending on the category of goods:
 - Ad valorem
 - Retail price
 - weight or quantity
 - measurement
 - Units
 - Charges, bill of lading and premium
 - Production capacity, machinery, undertakings establishment or installation
 - on fixed basis on any goods or services

3.2. APPLICATION OF SALES TAX ACT 1990

Provisions of the Sales Tax Act 1990 will apply to the goods and services in VAT mode specified under the FED Act 2005. This means the registered person, in respect of goods and services under VAT mode is entitled to adjust the amount of input tax paid under the Sales Tax Act against FED payable by it under the FED Act. Conversely the amount of FED paid on such goods/ services can be adjusted against the output tax payable by the registered person under the Sales Tax Act 1990. Therefore, FED charged by the registered person is regarded as output tax in accordance with the Sales Tax Act and he is entitled to claim as input tax inter alia the following amounts:

- Sales tax if any, in relation to purchase/ import of goods liable to sales tax e.g. raw materials, utility bills, stationery
- FED, if any, in relation to acquiring of services liable to FED under the Federal Excise Act in the sales tax mode e.g. insurance, advertising, telecommunication services etc. and
- Sales tax if any on identifiable services subject to provincial sales tax e.g. advertising on TV, radio and services provided by courier services and customs agent

3.3. ADJUSTMENT OF FED

Adjustment of duty is allowed on excisable goods used as direct input for further manufacture of such goods liable for FED provided that the registered person has a proof

- In the form of purchase invoice, goods declaration or any other lawful document issued in his own name
- That he has paid the price of goods inclusive of FED through banking channels including online payment
- That he has received the price of goods sold by him inclusive of FED through banking channels including online payment

It should be noted that input tax adjustment is only available to

- Manufacturer
- In respect of goods used as direct input for manufacture of excisable goods only

3.4. FEDERAL EXCISE DUTY INCENTIVES

- Zero rate of duty is allowed on the goods
 - Exported out of Pakistan
 - Specified by the Federal Government
- Pakistan's Federal Board of Revenue may, by notification and subject to such conditions and rates as may be prescribed, allow drawback of duty paid on goods used for the manufacture of goods
 - Manufactured in and exported outside Pakistan
 - Shipped as provisions or stores for consumption in board of a ship or aircraft proceeding to a destination outside Pakistan
- Adjustment of FED will be available to zero-rate excisable goods

FBR may prohibit and restrict payment of duty drawback, refund or adjustment of FED in respect of export of goods or any specified goods to any specified foreign country



SALES TAX ON SERVICES

4. SALES TAX ON SERVICES

The provincial sales tax is a tax levied by the provinces on services provided only, as opposed to the sales tax levied by the government which is taxed on goods. Provincial sales is based on the idea of self-assessment, self-compliance and self-reporting by the taxpayer themselves with the revenue authorities having the ability to conduct an audit as they see fit. The taxpayer is himself responsible to issue tax invoices, assess his tax liabilities, file sales tax returns, make tax payments, keep proper records and accounts of his taxable transactions and comply with other legal obligations. The tax schemes do not cause double taxation generally as agreements are reached on the relevant areas by the provincial and federal authorities.

There are indeed some differences between the provincial tax schemes but generally they are quite similar with only minor adjustment. All provincial sales tax is governed by the Acts passed by the Provincial Parliaments and by Statutory Regulatory Orders. There is also a withholding tax that is present in provincial sales tax. Among the more interesting aspects of tax law is the point at which the tax is liable. There are 2 major point in provincial tax law where tax arises. These can be called the point of termination and point of origin. A point of service is where the service being taxed is finished. For example, if a courier is delivering a letter from Sindh to a city in Punjab, where the letter is received is where the service has concurred and that is where the tax is applicable. A point of origin is where the service has arisen. Taking the same example as earlier, if a courier is delivering a letter from Sindh to a city in Baluchistan, the service will be taxed in Sindh.

This table which scheme is applicable where:

Revenue Authority	Scheme Type
Punjab Revenue Authority	Point of destination
KPK Revenue Authority	Point of destination
Baluchistan Revenue Authority	Both
Sindh Revenue Board	Point of origin
Islamabad Capital Territory (FBR)	Point of destination

All the provincial sales tax has their own tax rates and usually a penalty on withholding tax for non-registered parties

Tax Authority	Sales Tax Rate for Active	Sales Tax Rate for Non-Active	Withholding Tax Rate for Active	Withholding Tax Rate for Non-Active
Punjab Revenue Authority	16%	16%	0%	16%
Sindh Revenue Board	13%	13%	20% of prevailing rate of tax	13%
KPK Revenue Authority	15%	15%	20% of prevailing rate of tax	13%
Baluchistan Revenue Authority	15%	15%	20% of prevailing rate of tax	15%

4.1. REVERSE CHARGE:

If a taxable service is provided to a resident person by a non-resident person in the course of an economic activity, including the commencement or termination of activity, the liability to pay the tax shall be on the person receiving the service.



4.2. EXPORT OF SERVICES

Generally, export of services is exempt from charging of sales tax, however the Sindh Revenue Board [SRB] is currently collecting sales tax on the exports of all categories of services, except those relating to information technology and chartered accountancy etc. which are exempted.

4.3. NEGATIVE LIST/ TAXABLE SERVICES

Currently there is no negative list of taxable services as only the services which are enlisted in second schedule are chargeable to tax only.



CUSTOMS DUTY

5. CUSTOMS DUTY

The Customs Act 1969 even though, amended many times is still the primary source for dealing with matters pertaining to customs duty of Pakistan. Customs duty deals with goods being imported or exported from Pakistan; goods brought from any foreign country to any Customs station and without payment of duty is transported there and goods bought in from bond from one custom station to another. The Federal Government has the power to decide whether any goods can be exempt. The Act generally levies custom duties at rates prescribed under the Finance Act or any other law in force at the time which deals with imports and exports.

5.1.SALIENT FEATURES

- Pakistan uses the Harmonized System to classify goods. Customs duties are levied on ad-valorem basis under First Schedule of Customs Act, 1969, at duty rates specified in Pakistan Custom Tariff which is divided in 99 Chapters. The rate of duty ranges from 0% to 100%.
- The custom value of imported goods is transaction value, that is the price actually paid or payable for the goods when sold for export to Pakistan, plus cost of transport, excluding inland freight after importation, of the imported goods to the Port, Airport or place of importation, loading, unloading, handling charges associated with the transport of the imported goods to the Port, Airport or place of importation and cost of insurance.
- To extend benefits of reduce rates of duty on import of raw material to support local industries, the goods specified under Fifth Schedule of Customs Act, 1969 are chargeable to reduce rates of duties subject to such conditions, limitations and restrictions mentioned in the schedule.
- The Federal government is empowered u/s 18(5) of Customs Act, 1969, to impose additional customs duty on imported goods specified in First Schedule through a notification in official gazette. The average Additional duty on various items is currently 2%. The additional customs duty should not exceed 35% of the goods value.
- To make short term adjustments in imports to create favorable balance of payment, the Federal government is empowered u/s 18(3) of Customs Act, 1969, to impose regulatory duty on all or any of the imported or exported goods through a notification in official gazette subject to limitations and restrictions. The regulatory duty on various items is currently 0-100%. The regulatory duty should not exceed 100% of the goods value, as specified under Section 25-1B or Section 25A.
- Pakistan does not levy an export duty.
- Where goods are imported with a view to exporting them later, the Chief Customs Authority has the power to exempt them from duty subject to preconditions as under the rules.
- Where goods are imported with the purpose of being used in production, manufacture, repair or refitting the *Chief* Customs Authority with the permission of the Federal Government and subject to such terms and conditions as it sees fit to impose, can exempt goods from duty, and authorize repayment in full or in half of duty already paid.
- Where customs duty has already been paid off on imported goods and they are subsequently exported, seven-eighths of such duties shall be repaid as drawback subject to the fact that goods are identified by an officer of Customs not below rank of Assistant Collector of Customs at same Customs Station through which goods had been imported and goods are entered for export within 2 years of date of their importation as shown by records of Customs House or if such time is extended by Central Board of Revenue or Collector of Customs shall not extend time beyond three years beyond importation of such goods.



CORPORATE LAWS

6. CORPORATE LAWS

6.1. COMPANIES REGULATORY REQUIREMENTS

Business activities may be carried out through a company, modaraba, branch, partnership or sole proprietorship. Companies incorporated in Pakistan and branches or liaison / representative offices of foreign companies are regulated by the Companies Act, 2017 [CA], and Rules framed there under, administered by Securities and Exchange Commission of Pakistan (SECP).

6.1.1. Forms of Companies

The CA mentions the following types of companies:

▪ **Company limited by shares**

The personal liability of shareholders is limited to the amount (if any) unpaid on their shares. Effectively, the shareholder's liability does not exceed the amount committed, when taking up the shares in the company.

▪ **Company limited by guarantee**

In this type of company, the memorandum binds each member to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year afterwards, for payment of the debts and liabilities of the company contracted before he ceases to be a member, and of the costs, charges and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount.

▪ **Unlimited company**

- The law also allows formation of company with unlimited liability of its members.
- From a practical perspective, the limited liability company with share capital would be the type of company contemplated by a non-resident interested in investing in Pakistan.
- A company incorporated in Pakistan, may either be a "Public Company" or a "Private Company". A public company can also be a listed company.

Companies are required to get themselves registered under the tax laws and obtain a National Tax Number (NTN).

▪ **Private Company**

A private company can be easily formed by a minimum of two members (except for a single member company) and may commence its business immediately after its incorporation. A private company, through its Articles of Association (AoA):

- Restricts its members to transfer shares
- Limits the number of its members to fifty
- Prohibits any invitation to the public to subscribe for its shares or debentures.

▪ **Single-Member Company**

An individual is entitled to obtain corporate status by forming a single member company and avail privileges of limiting the liability. The introduction of the concept of a single member company has facilitated sole proprietorships to obtain corporate status, giving them the privilege to limit the liability of their proprietors.

All the shares are vested with single member; however, he / she is required to nominate two individuals, one of whom shall become nominee director in case of death of the single member and the other shall

become alternate nominee director to work as nominee director in case of non-availability of the nominee director.

Single-Member Company is required to appoint a qualified company secretary and to write “SMC” in addition to Private Limited with its name.

▪ Public Company

A public company can be formed by three members or more. It is entitled to commence business after obtaining a Commencement of Business Certificate from the Registrar of Companies.

A public company does not have restrictions with regard to maximum number of members and transferability of the shares. A public limited company should have a minimum of three members. Public companies have the option to get their securities listed on a stock exchange.

A company cannot be listed, unless it has made a public issue which is subscribed by at least 500 members. However, this is applicable for listing of shares. For listing of securities other than shares, minimum number of members is three.

A listed company may buy back its own shares, subject to conditions specified in the CA.

Key differences between a public company and private company are highlighted below:

Particulars	Private Company		Public Company	
	Single member	Other private	Unlisted-	Listed
Minimum number of members (shareholders)	1	2	3	7
Maximum number of members (shareholders)	1	50	Unlimited	Unlimited
Minimum number of directors	1	2	3	7
Limitations for share transfer	Restricted	Restricted	Allowed	Allowed

6.2. ADDITIONAL CONSIDERATIONS FOR FOREIGN COMPANIES

Foreign companies incorporated outside Pakistan can invest in Pakistan and operate as body corporate subject to approval of Board of Investment (BOI) and requirement of CA and SECP regulations as above. Below table provides guidance in this regard.

Policy Parameters	Manufacturing Sector	Agriculture	Infrastructure and Social	Services including IT and Telecom Services
Govt. Permission	Not required except 4 specified industries *	Not required except specific licenses from concerned agencies.		
Remittance of capital, profits, dividends, etc.	Allowed	Allowed		
Upper Limit of foreign equity allowed	100%	100%**	100%	100%
Customs duty on import of Plant Machinery and Equipment	5%	0%	5%	0-5%
Tax relief (Initial Depreciation Allowance, % of Plant, Machinery and Equipment cost)	25%	25%		
Royalty and Technical Fee	No restriction for payment of royalty and technical fee.	Allowed as per guidelines - Initial lump-sum up to \$100,000 - Max Rate 5% of net sales - Initial period 5 years		

* Specified Industries:

- Arms and ammunitions
- High Explosives.

- *Radioactive substances*
- *Security Printing, Currency and Mint.*
- *No new unit for the manufacturing of alcohol, except, industrial alcohol*
- *** Only for CAF (Corporate Agriculture Farming)*

(Source: BOI)

6.2.1. Remittance of dividend

Companies are required to nominate a bank through which they would like to make remittance of dividends to non-resident shareholders. On receipt of nomination of a bank from the company, SBP authorizes the concerned bank to effect remittance of dividends to the non-resident shareholders of the company without its prior approval.

6.2.2. Royalty and technical fee

▪ Manufacturing sector

The SBP has laid down certain conditions for remittance of Royalty and Technical Fee by the manufacturing sector to facilitate the execution of agreements for transfer of technology. The local firm would designate any of the Authorized Dealers (Banks) in foreign exchange in Pakistan, through whom payments will be made.

▪ Non-manufacturing sector

Payment of royalty, franchise / technical fee by the non-manufacturing sector opened for foreign direct investment like International Food Franchises is permissible, subject to the maximum limit of USD 100,000 as the initial lumpsum payment, irrespective of number of outlets, and maximum 5% of net sales.

6.2.3. Repatriable foreign currency loans by foreign controlled companies for working Capital

Foreign controlled companies (i.e. branches of foreign companies and companies incorporated in Pakistan with 50% or more foreign shareholding, or 50% or more directors of foreign nationality) are allowed to contract foreign currency loans from banks / financial institutions abroad or from their HO or from other overseas branches / associates abroad for meeting their working capital requirements, subject to the conditions that the repayment period should not exceed twelve months and the interest should not exceed 1% over LIBOR. Such loans can however be rolled over for further periods not exceeding 12 months each (branches of foreign companies are not allowed to pay interest on such loans).

6.2.4. Lending to foreign controlled companies for capital expenditure

Foreign controlled companies engaged in manufacturing are allowed to obtain Rupee loans for meeting capital expenditure requirement from banks, development financial institutions and other financial institutions or by issuing Participation Term Certificates, etc. However, other foreign controlled companies require special permission to obtain medium and long-term Rupee loans.

6.2.5. Loans against guarantees of non-residents

Authorized Dealers have general permission under the Foreign Exchange Regulations to grant Rupee loans to their clients (including foreign controlled companies) against guarantees of non-residents / guarantees received from banks functioning abroad subject to compliance with the Prudential Regulations of SBP.

6.3. FOREIGN NATIONALS AS DIRECTORS

The company's law in Pakistan does not bar foreign nationals to become directors in Pakistani companies. A foreigner or a non-resident Pakistani may become an executive or a non-executive / independent director of Pakistani companies whether public or private.



Required Documents for Foreign Director:

There are certain things that should be kept in mind before proceeding with registration of company with foreign directors.

1. The first thing required to register the company with foreign directors is the clear scanned copies of their passports.
2. The second thing required is their personal profile. Personal profile is same like resume whereby all the history of a foreign person is written so that it can be assessed that whether he has the required capabilities to run the organization or not.
3. The last thing is an affidavit whereby it is stated by the foreign director that if he is not security cleared by the Interior Ministry of Pakistan all his shares will be subsequently transferred to some other person. For any person that is not National of Pakistan and wants to operate a business in Pakistan that person need security clearance from Interior Ministry of Pakistan. Such security clearance is directly sought by the Securities and Exchange Commission of Pakistan once the documents for company registration are submitted.

The following documents are required to be filed with the SECP/registrar concerned:

1. Copy of passport, in case of foreigner, of each subscriber and witness to the memorandum and article of association,
2. Memorandum and articles of association four printed copies of Memorandum and Articles of Association in case of offline submission and one copy for online submission, duly signed by each subscriber in the presence of one witness. In order to facilitate the general public, the standardized specimen of Memorandum of Association of various sectors has been provided on the Commission's Website.
3. Form – 1 Declaration of applicant for compliance
4. Form – 21 Notice of situation of registered office of the company
5. Form – 29 Particulars of first directors of the company
6. Registration/filing fee Original paid challan evidencing the payment of fee as prescribed in Table – II, in any of the authorized branches of MCB Bank Limited.



FOREIGN EXCHANGE LAW

7. FOREIGN EXCHANGE LAW

7.1. FOREIGN EXCHANGE REGULATIONS

Foreign exchange dealings are regulated under the Foreign Exchange Regulation Act, 1947. Foreign currencies are made available to persons / companies doing business in Pakistan for all purposes under rules which have been clearly defined by SBP. Foreign investment in Pakistan enjoys full protection and repatriation facilities.

Ministry of Finance has tightened regulations for the non-filer Pakistanis having foreign currency accounts in the country. The Finance Ministry issued foreign currency account rules 2020 which have been enforced from October 9, 2020. The rules governing the foreign currency account of individual noted that a foreign currency account of an individual may be credited with the remittance received from abroad through banking channel except;

- Payment of goods exported from Pakistan
- Payment for services rendered in or from Pakistan
- Proceeds of securities issued or sold to non-resident
- Any foreign exchange borrowed from abroad under any general or special permission of the State Bank of Pakistan; provided that the SBP may issue any general or special permission for credit the account.

The individuals having foreign currency accounts in Pakistan now cannot credit remittance received on account of payment of goods exported from Pakistan; payment for services rendered in or from Pakistan; proceeds of securities issued or sold to non-resident and any foreign exchange borrowed from abroad. Under the new regulations, a foreign currency account shall not be credited with any foreign exchange purchased from an authorized dealer, exchange company or money changer except as allowed by the SBP through general or special permission under any law.

The Foreign Private Investment (Promotion and Protection) Act, 1976 provides guarantees for repatriation of foreign investment to the extent of original investment, profits earned on such investment, and appreciation of capital.

The important foreign exchange regulations pertaining to foreign investment are covered briefly as below.

7.2. POSSESSION OF FOREIGN CURRENCY

There is no restriction on residents and non-residents on bringing in and holding foreign currency. However, there is a ceiling of USD 10,000 on taking foreign currency out of Pakistan.

7.3. FOREIGN CURRENCY ACCOUNTS (FCA)

Branches of Foreign Firms and Companies and individuals are allowed to maintain foreign currency accounts with banks in Pakistan, subject to certain conditions specified in the Foreign Exchange Manual

7.4. ROSHAN DIGITAL ACCOUNT AND DISINVESTMENT WITHOUT SBP APPROVAL

The SBP took initiative to boost the injections of investments from Overseas Pakistanis in the Pakistan's Economy w.e.f. 10 September 2020. The initiative was launched in collaboration with major commercial banks present in Pakistan. The main purpose for taking the initiative was to synchronize and integrate Non-Resident Pakistani's (hereinafter as "NRPs") with Pakistan's Banking and payments system.

The main highlight of the scheme is that the NRPs will be able to open an account in Pakistan without the need of Physical Presence in Pakistan or any embassy or consulate. Through this scheme, the Overseas

Pakistanis will be able to invest in stock market as well as real state funds from outside Pakistan without the need of Physical presence, from wherever they live. The investors can also invest in the Naya Pakistan Certificates issued by the Government of Pakistan. Funds in the accounts opened by the NRPs will be fully repatriable and can be remitted back without any prior approval from SBP vide “Roshan Digital Account”.

Opening of Roshan Digital Account requires basic set of information and documents. SBP and the designated commercial banks are committed to provide a world-class user experience into proactively resolving any problems the NRPs may encounter during the roll-out of the initiative. The NRPs will be provided dedicated customer support and monitoring system established by the SBP and designated commercial banks.

In context of the above, as per previous mechanism the designated banks required prior approval from SBP for remittance of disinvestments proceeds above market value, for listed securities and, above breakup value for unlisted securities. This requirement presented various constraints for investors. Now the SBP has introduced new mechanism which enables companies in Pakistan to conveniently remit disinvestments proceeds to their foreign shareholders without prior approval from SBP.

In addition to above, the bank designated by the company has now been delegated the authority to remit the entire disinvestment proceeds to Non-resident shareholders prior to which they would be required to submit some documents without the involvement of SBP. The number of required documents would depend on the size of the transaction.

In case of disinvestment proceeds not exceeding the market value / break-up value, the required documents would include:

- Copy of Share Purchase Agreement,
- broker’s memo in case of quoted shares/break-up value certificate of a QCR rated practicing Chartered Accountant in case of unlisted shares,
- Latest audited financials of the company,
- Signed M-Form,
- In case the transaction is between related parties an undertaking from the buyer that the same has been concluded at an arms-length basis.

In case of disinvestment exceeding the market value / break-up value, the required documents would include:

- Detailed valuation/ transaction due diligence by the buyer showing basis, methodology and key valuation metrics used for valuation.
- In case the total remittance of disinvestment proceeds exceeds US Dollar 50 million (or equivalent in other currencies) during a span of six months, the applicant shall submit an independent review of the buyer’s valuation, from QCR rated practicing chartered accountant that shall be assessed by the designated bank without needing to send to the SBP.

The main purpose of these initiatives by the SBP is to increase the investor’s confidence and to facilitate the start-ups of local companies by attracting more foreign investment for their business.

8. KEY INSTITUTIONS

Website's Name	Website	Telephone
Board of Investment in Pakistan	www.pakboi.gov.pk	(+92) 51 922 4101
Competition Commission of Pakistan	www.cc.gov.pk	(+92) 51 9100260-3
Ministry of Finance	www.finance.gov.pk	(+92) 13204 / (+92) 03687
Federal Board of Revenue	www.fbr.gov.pk	(+92) 51 111 772 772
NEPRA	www.nepra.org.pk	(+92) 51 2013200
Securities & Exchange Commission of Pakistan	www.secp.gov.pk	(+92) 51 9207091-4
State Bank of Pakistan	www.sbp.org.pk	(+92) 21 111 727 111
Sindh Revenue Board	www.srb.gos.pk	(+92) 21 99217800-09
Punjab Revenue Authority	www.pra.punjab.gov.pk	(+92) 42 99205476-7
Baluchistan Revenue Authority	www.bra.gob.pk	(+92) 81 9204181-2
Khyber Pakhtoon Khuwa Revenue Authority	www.kpra.kp.gov.pk	(091) 9216112
Pakistan Stock Exchange	www.psx.com.pk	(+92) 21 111 001 122

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