

ADR Tax Exemptions for Banks – A concession in the offing?

The Seventh Schedule of the Income Tax Ordinance, 2001 (“ITO”) governs the taxation framework regarding banking companies. Sub-rule 6A of Rule 6C of the Seventh Schedule to the ITO, 2001 focuses on the taxation of income from investments in Federal Government securities by banks, starting from the Tax Year 2022. The tax rates applied depend on the gross advance-to-deposit ratio (“ADR”) of the banks:

Gross ADR	TAX RATE
Up to 40%	55%
Exceeds 40% but does not exceed 50%	49%
Exceeds 50%	39%

The Tax Rates mentioned above are exclusive of Super Tax.

As per sub-rule 5 of Rule 8, a banking company was exempt from the provision of Sub-rule 6A of Rule 6C for the Tax Year 2024 i.e. Financial Year ended December 31st, 2023.

However, according to an [article](#) published in Tribune on June 27th 2024, an attempt was made to extend the exemption to Tax Year 2024 **and onwards**. Subsequently, Prime Minister Shehbaz Sharif decisively intervened and ensured that the said exemption was not extended beyond Tax Year 2024. Loans and advances has been defined under Section 2(I)(ii) of the State Bank of Pakistan Act, 1956 as:

“(ii) “loans and advances” includes finances provided on the basis of participation in profit and loss, markup in price, leasing, hire –purchase or otherwise;”

Further, the total tax impact of the banks for the Tax Year 2024 is at PKR 612 billion, during which banks have benefited from significant exemptions of ADR under the ITO. Based on their profits of Tax Year 2024, the additional ADR tax liability will be PKR 197 billion for Tax Year 2025. However, considering the projected profit levels of banks for Tax Year 2025, the actual tax potential could exceed this amount.

Key beneficiaries in the commercial banking are receiving a substantial ADR tax concession of PKR 170 billion, with three major banks enjoying reliefs of PKR 25 billion, PKR 24 billion, and PKR 22 billion, respectively. Additionally, one Islamic bank is benefiting from this concession to the tune of PKR 21 billion. These figures have been taken from the Audited published financial statements of 2023.

The impact of the ADR tax is elaborated in the following table:

PKR in thousands

BANKING INDUSTRY DATA			
Description	All Banks	Commercial Banks	Islamic Banks
Total Advances	11,921,161,095	9,736,411,232	2,184,749,863
Total Deposits	28,859,488,789	24,364,523,524	4,494,965,265
Average ADR	45.45	44.08	50.24
Profit/(Loss) Before Taxation	1,221,513,480	959,436,901	262,076,579
Tax For the Year (Current + Deferred)	(479,935,745)	(348,402,536)	(131,533,209)
Current Tax 2024	(612,492,218)	(479,848,096)	(132,644,122)
Tax 2025*	(809,662,544)	(650,383,717)	(159,278,827)
Tax as ADR	(197,170,326)	(170,535,621)	(26,634,705)

**Projected Tax based on current tax reported by the end of Dec, 2023*

It is reliably learnt that the sector is rigorously pursuing exemption of ADR for Tax Year 2025 and onwards. This preferential tax treatment to the banking sector will have a significant impact on Pakistan's revenue collection, exacerbating the fiscal shortfall. Meanwhile, stricter tax conditions are being imposed on salaried classes and other taxpayers, creating an inequitable burden on those least able to absorb it.