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International Tax
Pakistan Highlights 2017

Investment basics:

Currency – Pakistan Rupee (PKR)

Foreign exchange control – Foreign exchange regulations are issued and administered by the state bank of Pakistan. There generally are no restrictions on the repatriation of income or capital.

Accounting principles/financial statements – IFRS and Companies Ordinance, 1984. All public companies and private limited companies with paid-up capital of PKR 7.5 million or more must file annual financial statements with the Securities and Exchange Commission of Pakistan.

Principal business entities – These are the limited liability company, partnership and branch of a foreign entity.

Corporate taxation:

Residence – An entity is resident if it is registered under the laws of Pakistan or its management and control is situated wholly in Pakistan.

Basis – Resident entities are taxed on worldwide business income; nonresidents pay tax only on Pakistan-source income.

Taxable income – Income generally is taxed under five "heads of income," i.e. business income, rental income, capital gains, salary income and other sources. Business income of a resident entity or a permanent establishment (PE) of a nonresident entity is taxed either on a presumptive/final taxation basis for specified types of income or on a net taxable income basis. Under the final taxation regime, gross income is charged to tax at a flat rate, without any deductions for expenditure or allowances. Net taxable income under the normal regime is computed on the basis of specific rules and principles, and expenses may be deducted from gross income.

For nonresidents without a PE, the final taxation regime applies on royalty, technical service fee, shipping and air transport income. Nonresidents can opt for taxation under the final regime with respect to income from certain construction, assembly and similar projects.

Resident taxpayers, with the exception of companies in certain cases, are taxed under the final taxation regime on income from dividends, property rentals, construction contracts, trading, commercial imports/exports and brokerage and commissions.

Taxation of dividends – A resident entity pays tax at a rate of 12.5% on dividend income. A nonresident pays a 12.5% withholding tax on Pakistan-source dividends, or a reduced rate if so provided by a relevant tax treaty (see "Dividends" under "Withholding tax," below). Intercorporate dividends are not taxed if group taxation relief is available. Tax rates are reduced to 7.5% for power generation projects and 10% for mutual funds.

Capital gains – Capital gains generally are taxed at the normal corporate rate. Gains derived from the sale of capital assets held for more than one year are reduced by 25% for tax purposes and, therefore, 75% of the net gains are taxable at a rate of 31% for corporate bodies, and between 5% to 35% for individuals and others.

Capital gains from the disposal of listed securities have been subject to tax since July 2010. For tax year 2017, listed securities held for less than 12 months are taxed at the rate of 15%. If the shares are held for more than 12 months but less than 24 months, the rate is 12.5%. The tax rate is 7.5% for shares held for 24 months or more, provided the security was acquired on or after 1 July 2012; and 0% where the security was acquired before 1 July 2012.

Losses – Business losses (except losses from a speculative business) may be set off against taxable income earned during the same tax year under any head of income. Excess losses may be carried forward for up to six years following the tax year. Losses from a speculative business and capital losses may be carried forward to the following tax year for set off against speculative business income and capital gains for that year. Losses relating to the disposal of specific securities, including listed shares and securities, may be set off against the relevant gains of the same year; such losses may not be carried forward. Business losses cannot be offset against income that is taxed under the final taxation regime.

Rate – The corporate tax rate is 31% for tax year 2017 and 30% as from tax year 2018, on the net taxable income of a company (reduced from 32% for tax year 2016).

Surtax – No

Alternative minimum tax – A turnover tax of 1% on the declared turnover of a resident company and other specified taxpayers applies. Minimum tax is applicable where taxpayers suffer losses or the tax yield on income is less than 1% of turnover.

An alternative corporate tax applies for tax year 2014 and thereafter: the tax liability of a company is calculated as the higher of the alternative corporate tax of 17% of "accounting income" or the total corporate tax payable (including the tax on net taxable income, minimum tax and final taxes).

Foreign tax credit – A resident entity may claim a credit for income tax paid outside Pakistan on its foreign-source income against its tax liability in Pakistan. The amount of the credit is the lesser of the income tax paid abroad or the Pakistan tax payable on the foreign-source income.

Participation exemption – No

Holding company regime – No, but see under "Consolidated returns," below.

Incentives – To encourage investment in alternative energy power generation, a first- year allowance of 90% of the cost of plant, machinery and equipment is available. In addition, profits and gains from electricity power generation projects set up in Pakistan may be exempt from tax in certain cases.

Accelerated depreciation is available for setting up industrial undertakings in rural and under-developed areas.

A tax credit equal to 10% of the amount invested for the replacement or modernization of plant and machinery is available for investments made between 1 July 2010 and 30 June 2019.

A credit equal to 20% of the tax liability, for the year of listing and the following tax year, is granted to companies that opt to be listed on a registered stock exchange in Pakistan.

A tax credit equal to the equity financed investment proportion of tax payable is available to a new corporate industrial undertaking set up with at least 75% equity raised through the issuance of new shares for cash consideration. This credit is available for companies incorporated and industrial undertakings established between 1 July 2011 and 30 June 2019 provided certain conditions are satisfied.

Industrial undertakings established before 1 July 2011 also are allowed a tax credit for investment relating to the modernization or replacement of plant and machinery, or where they expand using 70% equity financing between 1 July 2011 and 30 June 2019. The credit is allowed against tax payable based on the ratio of equity investment to total investment. The corporate tax rate is reduced to 20% for a company that sets up an industrial undertaking between 1 July 2014 and 30 June 2017, subject to the condition that at least 50% of the project cost (including working capital) is financed through foreign direct investment in the equity of the company.

A tax credit equal to 2% of tax payable for every 50 employees is available to employment-generating companies whose manufacturing unit is setup between 1 July 2015 and 30 June 2019.

Incentives apply to income from exports of computer software, IT services or IT enabled services through 30 June 2019, where 80% of the export proceeds are brought into Pakistan.

Other – A super tax has been levied for the rehabilitation of temporarily displaced persons, for tax year 2016, at the rate of 3% of a company's income where the income is Rs. 500 million or more during the tax year and at the rate of 4% of the income in case of a Banking Company.

For public companies whose undistributed reserves exceed100% of its paid up capital, a tax of 10% is imposed on such excess undistributed reserves.

A Federal Workers Welfare Fund (WWF) assessment is levied on every industrial undertaking, equal to 2% of taxable profit, with the exception of industrial undertakings in the province of Sindh. Sindh WWF is levied at the rate of 2% of taxable income or accounting profit, whichever is higher.

Withholding tax:

Dividends – A 12.5% withholding tax for filers of an income tax return in Pakistan (i.e. taxpayers whose names appear on the active taxpayers list issued by the Federal Board of Revenue from time to time, or that hold a taxpayer's card), and a 20% withholding tax in the case of nonfilers, is levied on dividends, unless the rate is reduced under a tax treaty.

Interest – A 20% withholding tax is levied on interest paid to a nonresident, unless the rate is reduced under a tax treaty. Interest paid to a nonresident that does not have a PE in Pakistan is subject to withholding tax of 10% of the gross amount paid.

Royalties – Royalties paid to a nonresident are subject to a 15% withholding tax, unless the rate is reduced under a tax treaty.

Technical service fees – Technical service fees paid to a nonresident are subject to a 15% withholding tax, unless the rate is reduced under a tax treaty.

Branch remittance tax – The remittance of profits to a head office abroad is treated as dividends, attracting a 12.5% withholding tax on the remittance.

Other – A 7% withholding tax is imposed on construction contracts and contracts for advertising services provided by TV satellite channels in case of a filer and 12% in case of a non-filer; the rate is 10% for advertising services provided by a nonresident media company; and 5% on the payment of insurance premiums. These rates generally apply to income subject to the final taxation regime. For other payments to nonresidents, a general tax withholding tax of 20% applies.

Other taxes on corporations:

Capital duty – A capital authorization fee is levied at varying rates, depending on the authorized capital.

Payroll tax – Payroll tax is levied on different levels of income at rates ranging from 2% to 30% (on salary exceeding PKR 400,000). The employer withholds tax from the salary payment and remits the tax to the government on behalf of the employee.

Real property tax – Property tax is levied at the provincial level.

Social security – The employer contributes up to 6% of wages to the Social Security Institution on behalf of the employee. No contribution is due on wages in excess of PKR 600 per day or PKR 15,000 per month.

Stamp duty – Stamp duty is payable on the issuance and transfer of shares at rates of 0.5% and 1.5%, respectively, of the face value of the shares, subject to a minimum of PKR 1. If the shares are transferred to or through a central depository company (CDC), the duty is applied under the CDC's rules.

Transfer tax – Subject to certain conditions, a 5% tax is levied on the gross sales price of property or goods sold by auction.

Anti-avoidance rules:

Transfer pricing – Under the anti-avoidance rules, the tax authorities are authorized to distribute, apportion or allocate income, deductions or tax credits between associated companies to reflect income that would have been realized in accordance with the arm's length principle. Pakistan tax law provides four methods for determining the arm's length result.

Taxpayers are required to prepare a master file, a local file and a country-by country-report containing information on transactions with related parties, as well as provide and maintain other information and documents.

Thin capitalization – Where a foreign controlled resident company or branch of a nonresident (other than a bank or financial institution) has a foreign debt-to-equity ratio exceeding 3:1 at any time during a tax year, no deduction will be allowed in respect of the interest on the portion that exceeds the 3:1 ratio.

Controlled foreign companies – No

Disclosure requirements – Corporate taxpayers are required to submit audited financial statements along with the income tax return.

Transfer pricing reporting requirements apply (see under "Transfer pricing," above.)

Other – The tax authorities may recharacterize a transaction that was entered into for tax avoidance purposes or where the transaction lacks substance, or may disregard a transaction that has no economic substance.

Compliance for corporations:

Tax year – The law provides for two types of tax years: a normal tax year (for the period ending 30 June) and a special tax year (i.e. a tax year other than the normal year that has been approved by the tax authorities).

Consolidated returns – Holding companies and subsidiaries of a wholly owned group may opt to be taxed as a single fiscal unit under the group taxation concept.

Filing requirements – For a company whose tax year ends between 1 January and 30 June, the tax return is due by 31 December. In all other cases, the return is due by 30 September following the end of the tax year.

Penalties – The penalty for failure to file a tax return is 0.1% of the amount of the tax payable for each day of default. The minimum penalty is PKR 20,000 and the maximum is 50% of the amount of tax payable.

Rulings – A nonresident may obtain an advance ruling on the tax implications of any transaction or contract.

Personal taxation:

Basis – Resident individuals are taxed on their worldwide income; nonresidents are taxed only on Pakistan-source income.

Residence – An individual is considered resident for a tax year if he/she is in Pakistan for 183 days or more in that tax year.

Filing status – Joint returns are not permitted; each individual must file a separate return.

Taxable income – As with corporations, taxable income is divided into five heads of income, which include income from employment (i.e. salary), income from the exercise of a profession, income from property, capital gains and other income.

Capital gains – Capital gains are taxed at the applicable personal income tax rate. Capital gains on the disposal of listed shares and securities are taxed in the same manner as for companies.

Deductions and allowances – Deductions and allowances are available for nonsalaried individuals, but not for salaried individuals, with the exception of Zakat. Further, individuals are also allowed deductions on account of interest paid on house loans and tuition fees paid for their children. The deductions are restricted to the amounts specified in the law.

Rates – Income tax is payable by salaried and nonsalaried individuals if taxable income exceeds PKR 400,000. Rates for salaried individuals range from 2% to 30%, and from 7% to 35% for nonsalaried individuals.

Other taxes on individuals:

Capital duty – No

Stamp duty – No

Capital acquisitions tax – No

Real property tax – A property tax is levied at the provincial level.

Inheritance/estate tax – No

Net wealth/net worth tax – No

Social security – The employer contributes up to 6% of wages to the Social Security Institution on behalf of the employee. No contribution is due on wages in excess of PKR 600 per day or PKR 15,000 per month.

Compliance for individuals:

Tax year – Financial year

Filing and payment – The tax return must be filed by 31 August after the tax year ending on 30 June. Resident individuals are also required to file a statement of wealth and a wealth reconciliation statement as at 30 June.

Penalties – The penalty for failure to file a tax return is 0.1% of the amount of the tax payable for each day of default. The minimum penalty is PKR 20,000 and the maximum is 50% of the amount of tax payable.

Sales tax:

Taxable transactions – Sales tax is levied on the supply and import of goods and on specified services. The federal government normally levies sales tax only on the supply of goods, whereas provincial governments levy sales tax on services rendered in their provinces. The federal government also levies sales tax in respect of services rendered in the Islamabad Capital Territory.

Federal Excise Duty (FED) is chargeable in a similar manner to VAT on certain services.

Rates – The standard sales tax rate is 17% for goods and 13% to 16% for services, depending on the province where the services provider is located or where the services are consumed.

Registration – No

Filing and payment – Sales tax returns and payments must be made on a monthly basis.

Source of tax law: Income Tax Ordinance 2001, Income Tax Rules 2002, Sales Tax Act 1990, Federal Excise Act, 2005, Sindh Sales Tax on Services Act, 2011, Punjab Sales Tax on Services Act, 2012, Khyber Pakhtunkhwa Finance Act, 2013 and Baluchistan Sales Tax on Services Act, 2015 on services

Tax treaties: Pakistan has concluded 67 tax treaties.

Tax authorities: Federal Board of Revenue, Provincial tax authorities

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