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FINANCE BILL 2023

HIGHLIGHTS & COMMENTARY

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Finance Bill 2023

Executive Summary

Pakistan is currently facing one of its most severe economic crises in decades. With a low Tax to GDP ratio and various challenges, the country is grappling with soaring inflation rates, a dwindling foreign reserve position, and a history of recurring economic crises. In response to these issues, the Federal Government has presented its second and crucial budget for the year 2023-24.

The significance of this budget cannot be overstated as it aims to address the pressing issues that are plaguing the economy. One critical step towards alleviating the financial strain and stabilizing the economy is securing a deal with the International Monetary Fund (IMF). The government recognizes the need for economic reforms and is expected to implement measures to improve the Tax to GDP ratio, enhance revenue generation, and attract investment. The stability of Pakistan's economy is also of interest to global powers like the United States and China, who have a vested interest in avoiding a default. Thus, the presentation of the budget for the upcoming fiscal year holds significant implications for the country's economic trajectory.

First PDM’s budget (2022-23)

In the previous fiscal year, the Pakistan Democratic Movement (PDM) government faced challenges while presenting the federal budget amidst negotiations with the IMF. The budget aimed to ensure economic stability through various measures such as the revival of the petroleum levy, withdrawal of incentives for construction and real estate, and additional taxes collected by the Federal Board of Revenue (FBR).

The budget 2022 included several major steps to address different aspects of the economy, including the Finance Bill has introduced several changes and revisions to the tax regime. Slab rates for super tax have been adjusted, with a threshold of Rs 150 million instead of the earlier proposed Rs 300 million, and a standard rate of 2%. The super tax rate has been increased to 10% for certain specified sectors for the tax year 2022, and for banking companies, this enhanced rate will apply from the tax year 2023. The proposal for a final tax regime for commercial importers has been withdrawn, keeping them under the minimum tax regime. The income tax holiday for certain Independent Power Producers (IPPs) has been retained, and the standard tax rate for banking companies has been revised to 39%.

Revisions have also been made to the slab rates for salaried individuals, with the taxable limit set at Rs 600,000 instead of the original proposal of Rs 1,200,000. The tax rates proposed in the Finance Bill have been reversed, resulting in an increase in tax incidence compared to the pre-Finance Bill position. The right to carry forward minimum tax has been retained, but the period has been reduced from five to three years. The tax credit on contributions to the Voluntary Pension Scheme has been retained as well. The definition of a resident individual has been expanded to include a citizen of Pakistan who was not in any one foreign country for more than 182 days.

Further amendments include the requirement of CNIC/NTN for issuing invoices to unregistered persons and the restriction of input tax attributed to such supplies. The sales tax regime for the pharma sector has been revamped, with a 1% final sales tax on manufacturers and importers without input adjustment. Fixed tax rates for retailers not appearing on the Active Taxpayer List will be increased by 100%. Fertilizers have been exempted from sales tax, and the value of supply will not include the subsidy provided by the government to electricity consumers.

There have been changes proposed for the taxation of coal, sales tax rates for natural gas and phosphoric acid, electric vehicles, mobile/satellite phones, and online marketplaces. The rate of Capital Value Tax (CVT) for motor vehicles will be 1% instead of the proposed 2%. CVT on foreign assets will be applicable from the tax year 2022 based on the cost translated into rupees at the latest exchange rates. These revisions and amendments aim to refine the tax structure and streamline the taxation process for various sectors and individuals.

Supplementary budget in February 2023

In February 2023, the PDM government introduced a supplementary budget through the Finance Supplementary Act. This mini-budget included several amendments in taxation laws to generate additional revenue and meet the requirements of the IMF bailout program. The amendments included the imposition of a 20% or Rs. 50,000 (whichever is higher) Federal Excise Duty (FED) on first-class and business-class air travel, a 10% adjustable withholding tax on marriage halls, an increase in FED on cigarettes and sugary drinks, an increase in FED on cement, and adjustments in the General Sales Tax (GST) rates.

Federal Minister for Finance and Revenue presented the Finance (Supplementary) Bill in the National Assembly, emphasizing the need for additional taxes to secure IMF funding. Discussions between the IMF and Pakistani authorities resumed virtually, aiming to reach an agreement on the bailout program. The Federal Cabinet approved the Finance Supplementary Bill, which included levying additional taxes on luxury items and a one percent increase in GST.

To implement the mini-budget, the government took several steps. Starting from February 14, 2023, the Federal Excise Duty on cigarettes was doubled to generate additional revenue. Gas prices for domestic consumers were also increased to address the circular debt in the gas sector, a condition set by the IMF.

These measures were introduced to bolster revenue and meet the financial obligations of the government, while also addressing the conditions set by the IMF. However, in addition to these immediate measures, various proposals have been put forward by different forums to the government for the upcoming budget of 2023-24. These proposals aim to tackle key issues and provide a comprehensive framework for economic stability and growth. Some of the significant proposals including imposing restrictions on cash usage to curb the cash economy and promote digital transactions, renegotiating the Afghan Transit Trade Agreement to combat smuggling and impose duties and GST on imports, and incentivizing provinces to crack down on smuggling by facilitating raids on shops dealing in smuggled goods. Additionally, promoting digitization, abolishing the super tax, bringing more sectors into the tax net, and simplifying the withholding tax regime are suggested to formalize the economy and reduce tax evasion.

The proposals also aim to increase the tax-to-GDP ratio, broaden the tax base, and set a higher tax target to boost revenue collection and reduce dependence on external funding. Restoring tax credits to incentivize investment, removing conditions for greenfield industrial projects, and empowering the Commissioner Appeals to ensure a fair appeal process are other measures suggested. Further suggestions include serving notices before recovery actions, removing disallowance of commission expenses, providing clarity for

Workers' Welfare Fund and Workers' Profit Participation Fund, and amending the FBR Act for a transparent tax administration.

To simplify tax collection, the consolidation of federal and provincial taxes is recommended, while special attention to the agriculture sector through cost reduction, access to credit, and modern farming techniques would support its growth. By implementing these proposals, the government can address key challenges, promote economic stability, and pave the way for sustainable growth. The upcoming budget for 2023-24 presents a crucial opportunity to enact these measures and steer Pakistan towards a stronger and more resilient economy.

Budget 2023-24

The Federal Government has announced the budget for the fiscal year 2023-24, along with several proposed amendments to the Customs Act 1969, Sales Tax Act 1990, ICT (Tax on Services) Ordinance 2001, and Income Tax Ordinance 2001.

An overview

Income Tax

- Bonus shares treated as "income" with a 10% withholding tax and shareholders are required to pay a 10% tax on the bonus shares' value.
- Changes in super tax rates based on income brackets and rationalized for certain sectors.
- Expanded definition of "small and medium enterprises" (SMEs) to include IT services, increased turnover threshold, and proposed exemptions for agro-based SMEs.
- Relaxation of conditions for taxation of exporters of computer software, IT and IT-enabled services.
- Introduction of additional tax on income, profits, and gains, to be prescribed by FBR, not exceeding 50%.
- Special minimum tax rate of 1% for listed companies on the Pakistan Stock Exchange.
- Broadened definition of "permanent establishment" for non-resident persons, eliminating the requirement for a "fixed" place of business.
- Expanded definition of "Associates" with additional criteria to determine associate relationships.
- Tax credit for individuals constructing residential houses during tax years 2024-2026.
- Inclusion of the Prime Minister's Relief Fund and the Film and Drama Finance Fund in the Thirteenth Schedule for tax credit eligibility.
- Increased limit for immunity from source of income inquiries on foreign remittance.
- Time limit has been prescribed for issuance of exemption certificates for withholding tax on payments to non-resident persons.
- Increase in advance tax rate for commercial importers from 5.5% to 6%.
- Alignment of withholding tax and final taxation on exports with the Export Facilitation Scheme, 2021.
- Withholding tax @ 0.6% on cash withdrawals exceeding fifty thousand rupees in a day.
- Inapplicability of withholding tax on property purchase by non-resident Pakistanis through foreign remittance.

Sales tax

- Production, transmission, and distribution of electricity excluded in the definition of 'goods' and 'supply' for sales tax purposes.
- Removal of certain types of retailers from the definition of tier-1 retailers.

- The Directorate General of Digital Initiatives, meant for expanding digital transformation efforts in tax administration.
- Proposed zero rating for imports or supplies related to qualified investments specified in the Foreign Investment Act, 2022.
- Changes to exemptions, including sales tax exemptions for certain goods and extensions of exemptions for specific industries and areas.
- Rationalization of 1% sales tax rate for drugs as a final discharge of tax in the supply chain.
- The provisions of the Sales Tax Act, 1990 regarding classification, services, and withholding tax will apply to services taxable under the ICT (Tax on Services) Ordinance.
- Freelance exporters of IT and IT-enabled services in the definition of "cottage industry" if their annual turnover is below a specified threshold.
- Different sales tax rates for services provided by hotels, motels, guest houses, and other establishments, based on payment methods.
- Sales tax on services of Software or IT-based system development consultants changed from 16% to 15%.
- The sales tax rate for electric power transmission services has been set at 15% under the ICT (Tax on Services) Ordinance.

Federal Excise Duty

- Implementation of FED on energy inefficient fans at a rate of Rs. 2000 per fan and on incandescent bulbs at 20% ad valorem.
- Expansion of the scope of FED on services to include royalty and fee for technical services.
- Alignment of the procedure for the publication of general orders, departmental instructions, and rulings of the Board on the official website, in accordance with the provisions under the Sales Tax Act, 1990.

Income Tax

Tax on bonus shares - Section 2(29), 39(lb), 236Z

The Bill has proposed to treat the bonus shares issued by the companies as “income” in the definition provided under section 2(29) of the Income Tax Ordinance, 2001.

The bonus shares were specifically excluded from the definition of “income” until the Finance Act, 2014, after which the definition of “income” included the amount subjected to withholding tax on bonus shares under sections 236M and 236N. This position prevailed until the Finance Act 2018 deleted sections 236M and 236N. Now, this Bill has proposed to introduce the withholding tax on the issuance of bonus shares by the companies once again under a newly proposed section 236Z of the Ordinance, with the following structure:

- Every company that issues bonus shares to its shareholders is required to withhold 10% of the bonus shares to be issued.
- For a shareholder to receive the withheld bonus shares, the company must collect a tax payment equal to 10% of the value of the bonus shares, including the withheld shares.
- The value for this purpose will be the day-end price on the first day of closure of books for listed companies, and for other than listed companies, the value as prescribed by FBR.
- The company must deposit the tax amount within fifteen days of the closure of books, regardless of whether the tax has been collected from the shareholder or not.
- A company that is liable to deposit tax under this section has the right to collect and recover the deposited tax from the shareholder before issuing the bonus shares.
- If a shareholder fails to make the tax payment to the company or neglects to collect the bonus shares within fifteen days of the issuance of the shares, the company has the authority to dispose of the bonus shares to the extent that tax has been paid on behalf of the shareholder.
- The issuance of bonus shares is considered as income for the shareholder, and the tax collected by the company or the proceeds from disposed bonus shares paid under this section are treated as if they have been paid on behalf of the shareholder.
- The tax paid under this section is regarded as the final tax on the income of the shareholder that arises from the issuance of bonus shares.

Super Tax – Section 4C of the Ordinance

Rates

The Bill has proposed the following changes in the rate of super tax under section 4C of the Ordinance.

Income	Existing		Proposed
	Tax Year 2022	**Tax Year 2023**	**For Tax Year 2023 and onwards**
0 – 150,000,000	0% of the income	0% of the income	0% of the income
150,000,001 – 200,000,000	1% of the income	1% of the income	1% of the income
200,000,001 – 250,000,000	2% of the income	2% of the income	2% of the income
250,000,001 – 300,000,000	3% of the income	3% of the income	3% of the income
300,000,001 – 350,000,000	4% of the income	4% of the income	4% of the income
350,000,001 – 400,000,000	4% of the income	4% of the income	6% of the income
400,000,001 – 500,000,000	4% of the income	4% of the income	8% of the income
Above 500,000,000	4% of the income	4% of the income	10% of the income
For persons engaged, whether partly or wholly, in the business of airlines, automobiles, beverages, cement, chemicals, cigarette and tobacco, fertilizer, iron and steel, LNG terminal, oil marketing, oil refining, petroleum and gas exploration and production, pharmaceuticals, sugar and textiles the rate of tax shall be 10% where the income exceeds Rs. 300 million	10% of the income	Above slab rates	Above slab rates
For Banking Companies, where the income exceeds Rs. 300 million	Exempt	10% of the income	N/A
For Banking Companies TY 2024 and onwards	N/A	N/A	10% of the income

Super tax to be made part of the advance tax under section 147

The Bill explicitly states that the super tax under section 4C should be included in the calculation of the advance tax liability. This clarification will help eliminate any confusion or differing interpretations regarding the treatment of super tax in relation to advance tax under section 147. Amendments have also been proposed under section 147, in order to require the taxpayers to include super tax in the estimated tax liability for the tax year.

Super tax under section 4C to be computed, collected and paid by NCCPL

The Bill has proposed that the National Clearing Company of Pakistan Ltd. shall compute and collect tax under section 4C at the applicable rates on the amount of capital gains computed under the Eighth Schedule.

Small and Medium Enterprises

Definition

The proposed amendment to the definition of "small and medium enterprises" under section 2(59A) of the Ordinance signifies a significant expansion in the criteria for qualifying as a small and medium enterprise (SME).

The previous definition limited SME status to persons engaged in manufacturing, with a business turnover not exceeding two hundred and fifty million rupees in a tax year.

The new definition broadens the scope by including persons engaged in providing or rendering IT services or IT-enabled services, as defined in clauses (30AD) and (30AE) of section 2 of the Ordinance.

The threshold for business turnover has also been increased from two hundred and fifty million rupees to eight hundred million rupees in a tax year.

While this expanded definition acknowledges the evolving landscape of businesses, particularly in the IT sector, it is crucial to consider the potential implications. The increased threshold may result in more entities being classified as SMEs, which could have consequences for various aspects such as tax benefits, access to funding, and eligibility for government support programs specifically tailored for SMEs.

It is important to monitor the implementation of this new definition and assess its impact on the SME sector. Regular evaluation and adjustment of the criteria may be necessary to ensure that the definition remains aligned with the evolving needs and dynamics of small and medium enterprises in the country. Additionally, providing clear guidelines and support mechanisms to assist businesses in understanding and complying with the revised definition will be essential for a smooth transition.

Registration

Small and medium enterprise are required to register with FBR on its IRIS web portal or Small and Medium Enterprises Development Authority on its SME registration portal (SMERP).

Taxation

The Bill has proposed that the small and medium enterprise engaged in IT services or IT enabled services shall register themselves with and duly certified by the Pakistan Software Export Board, in addition to registration on SMERP.

Small and medium enterprise are currently subject to income tax at the rate of 7.5%, where the annual turnover does not exceed Rupees 100 Million, and at the rate of 15%, where annual turnover exceeds Rs. 100 Million but does not exceed Rupees 250 Million.

The Bill has proposed the tax rate of 20% of taxable income where annual turnover exceeds Rupees 250 Million but does not exceed Rupees 800 Million.

Alternatively, the small and medium enterprise may opt for final taxation at the rate of 0.25% of gross turnover, where the annual turnover does not exceed Rupees 100 Million, and 0.5% of gross turnover, where annual turnover exceeds Rs. 100 Million but does not exceed Rupees 250 Million.

The Bill has proposed the final tax rate of 0.75% of gross turnover, where annual turnover exceeds Rupees 250 Million but does not exceed Rupees 800 Million.

Exemption to small and medium enterprise setup exclusively as agro based industry in a notified rural area

The Bill has proposed exemption to profits and gains of a small and medium enterprise setup exclusively as agro based industry in a rural area duly notified for a period of five tax years commencing from tax year 2024 and up to tax year 2028, provided that such enterprise is setup on or after 1st day of July, 2023 and is not formed by the transfer or reconstitution or reconstruction or splitting up of an existing business.

Taxation by the exporters of computer software and IT services and IT-enabled services

The proposed change in the Finance Bill regarding Section 154A is aimed at removing the requirement for exporters of computer software, IT services, or IT-enabled services to file sales tax returns under Federal or Provincial laws. Currently, these exporters are subject to final taxation on their income if they are registered with and certified by the Pakistan Software Export Board (PSEB). By eliminating the need to file sales tax returns, the proposed change seeks to simplify the taxation process for such exporters.

These services are currently subject to reduced rate of tax under the final tax regime at the rate of 0.25% of the proceeds in foreign exchange. The Bill has proposed to restricted the applicability of this reduced tax rate up to 2026.

Additional tax on certain income, profits, and gains from specific economic factors

The proposed section 99D seeks to address income, profits, and gains resulting from specific economic factors and introduces an additional tax on such amounts. The effectiveness and fairness of this proposed section will depend on the clarity of its implementation guidelines and the careful consideration of its impact on taxpayers.

The proposed section 99D of the Income Tax Ordinance, 2001 introduces an additional tax on certain income, profits, and gains. The introduction of an additional tax is aimed at capturing income, profits, or gains that have arisen due to unexpected economic factors. The proposed section grants the Federal Government the authority to determine the economic factors that will trigger the additional tax. This includes factors such as international price fluctuations or foreign currency fluctuations. It also allows the government to set the rate of the additional tax, not exceeding fifty percent.

The proposed section calls for the government to provide clarity regarding the scope, time, and payment of the tax, as well as any conditions that may exempt certain individuals or types of income. This requirement for clear specifications is essential to ensure transparency and fairness in the implementation of the additional tax.

Potential impact on taxpayers: The imposition of an additional tax on unexpected income, profits, or gains may have implications for taxpayers. It is important to carefully consider the criteria and factors that would trigger this tax to avoid unintended consequences or undue burden on individuals or businesses.

The Bill has also proposed that this section shall also be applicable to the insurance companies and oil and gas exploration and production companies, and banking companies.

Minimum tax – Section 113

The Finance Bill has proposed to introduce special minimum tax rate of 1% for the companies listed on Pakistan Stock Exchange, if not engaged in:

- Sui Southern Gas Company Limited and Sui Northern Gas Pipelines Limited (for the cases where annual turnover exceeds rupees one billion.)
- Pakistani International Airlines Corporation; and
- Poultry industry including poultry breeding, broiler production, egg production and poultry feed production
- Oil refineries
- Motorcycle dealers registered under the Sales Tax Act, 1990
- Oil marketing companies
- Oil refineries
- Distributors of pharmaceutical products, fast moving consumer goods and cigarettes;
- Petroleum agents and distributors who are registered under the Sales Tax Act, 1990;
- Rice mills and dealers
- Tier-1 retailers of fast-moving consumer goods who are integrated with Board or its computerized system for real time reporting of sales and receipts
- Person’s turnover from supplies through e-commerce including from running an online marketplace as defined in clause (38B) of section 2.
- Persons engaged in the sale and purchase of used vehicles and
- Flour mills

Adjustment of minimum tax under section 113

The Bill proposes and explanation to be inserted in section 113, dealing with “minimum tax”, that the minimum tax paid in a tax year can be adjusted against the normal tax liability of the subsequent tax years.

Definition of “permanent establishment” of non-resident persons

The Bill aims to expand the scope of the definition of "permanent establishment" for non-resident persons. The suggested change involves the removal of the term "fixed" from the existing definition, which currently refers to a "fixed place of business through which the business of the person is wholly or partly carried on." By eliminating the requirement for the place of business to be "fixed," it opens the possibility for even temporary business locations to be considered as a "permanent establishment."

The internationally recognized definition of "permanent establishment" has traditionally emphasized the need for a certain degree of permanence in the place of business to qualify as such. However, the proposed amendment would remove this requirement, potentially allowing temporary business locations to be treated as a "permanent establishment".

Definition of "Associates"

The proposed change to the definition of "Associates" in the Finance Bill expands the criteria for determining associate relationships between two persons. The existing definition states that two persons are associates if they can reasonably be expected to act in accordance with each other's intentions or the intentions of a third person.

The proposed definition introduces additional conditions for determining associate relationships. Firstly, it includes the condition where one person sufficiently influences the other person, either individually or with the help of other associates. The explanation provided clarifies that sufficient influence exists when one or both persons are economically and financially dependent on each other, and decisions are made based on mutual directions, instructions, or wishes for a common economic goal.

Secondly, the proposed definition includes a condition where one person enters into a transaction, either directly or indirectly, with the other person who is a resident of a jurisdiction with a zero-taxation regime. FBR will prescribe the definition of “the jurisdiction with zero taxation regime”.

These amendments aim to provide a more comprehensive understanding of associate relationships, taking into account economic dependency and transactions with residents of zero taxation jurisdictions. The proposed definition expands the scope for identifying associates and strengthens the provisions related to associate transactions in the law.

Tax credit to individuals on construction of residential house

The Finance Bill has proposed tax credit for construction of house for individuals to claim a tax credit for constructing a new house during the tax years 2024 to 2026.

To be eligible for the tax credit, the house must be completed within the specified tax year, and a completion certificate must be provided along with the tax return. The law defines a new house as a residential house for which the layout plan has been approved by the relevant authority on or after July 1, 2023. The amount of tax credit allowed is determined as the lesser of ten percent of the person's assessed tax for the year or one million rupees.

Tax credit on donations

The Bill has proposed to add following entities in the Thirteenth Schedule. The donation to these entities shall be eligible for tax credit under section 61 of the Ordinance:

- The Prime Minister's Relief Fund for Flood, Earthquake and Other Calamities with effect on and from the 5th August, 2022
- Film and Drama Finance Fund

Enhancement of amount of foreign remittance for immunity from question regarding source of income

The proposed enhancement of the limit in Section 111(4) from Rs. 5 million to the rupee equivalent of one hundred thousand United States dollars brings about a significant change in the immunity provided for questions regarding the source of income on foreign remittance. Here are comments on this proposed enhancement along with the rationale behind it is encouraging foreign remittances, i.e., increasing the limit for immunity from questioning the source of income on foreign remittances can serve as an incentive for individuals to bring more foreign funds into the country.

Recovery of liability outstanding under other laws

The Bill proposes to empower the Commissioner Inland Revenue to collect the liability in or under any other law.

Time limit for the issuance of exemption certificate for withholding tax on payments to non-resident person

The Bill has proposed that the Commissioner shall be deemed to have issued the exemption certificate upon the expiry of thirty days and the certificate shall be automatically processed and issued by IRIS subject to the condition that in computing the said period of thirty days, there shall be excluded days taken for adjournment by the applicant.

The Commissioner may modify or cancel the certificate issued automatically by Iris on the basis of reasons to be recorded in writing after providing an opportunity of being heard.

Special income tax rates for banking company on certain investments in the FG securities

Currently, the banking companies are subject to special income tax rates on income from deposits and investments in the FG securities. These special rates have been proposed to be made inapplicable to tax year 2024.

International Centre of Tax Excellence

The establishment of the International Centre of Tax Excellence is proposed under the Finance Bill.

The proposed Institute will have various functions related to tax policy development, conducting research in tax administration and policy, facilitating international tax cooperation, organizing seminars and conferences, and providing capacity building for Inland Revenue Officers, among others.

The Institute's Executive Committee, consisting of key officials and independent members, will oversee its operations and make necessary appointments. The Executive Director, who will also serve as the Chief Executive, will ensure efficient functioning and day-to-day administrative tasks. The Committee will assign the Institute's tasks for each fiscal year, and rules will be prescribed for employee recruitment.

A significant portion of the employees are expected to be serving or retired Inland Revenue officers. The remuneration and employment terms of the Institute's employees will be determined by the Federal Government.

The Board will monitor the Institute's establishment and may establish a committee for this purpose. Data necessary for analysis and processing will be provided to the Institute, but it will be anonymized to ensure taxpayer confidentiality. The Executive Committee will have the authority to make rules to fulfill the objectives of this section.

Withholding taxes and advance taxes

Withholding tax on commercial imports

Currently, persons importing goods classified in Part II of the twelfth Schedule to the Ordinance are required to pay advance tax on the clearance of imports @ 5.5% of the import value as increased by the duties and taxes. The Bill has proposed that the commercial importers, importing these goods, shall pay advance tax @ 6% of the import value as increased by the duties and taxes.

Withholding tax on certain types of payments to PE of non-residents – Section 152(2A)

The following changes in the rates of withholding tax under section 152(2A) have been proposed:

	Existing	Proposed
PE of a non-resident person – Companies - Sale of goods	4%	4.5%
PE of a non-resident person – Other than companies - Sale of goods	4.5%	5%
PE of a non-resident person – Companies & other than Companies providing following services: Transport services, freight forwarding services, air cargo services, courier services, manpower outsourcing services, hotel services, security guard services, software development services, IT services and IT enabled services, tracking services, advertising services (other than print or electronic media), share registrar services, engineering services, car rental services, building maintenance services, services rendered by Pakistan Stock Exchange Limited and Pakistan Mercantile Exchange Limited inspection, certification, testing and training services, oilfield services.	3%	4%
PE of a non-resident person - Other than above services – For Companies	8%	9%
PE of a non-resident person - Other than above services – For Other than companies	10%	11%
PE of a non-resident person – Contracts	7%	8%

Withholding tax on certain types of payments to residents – Section 153

The following changes in the rates of withholding tax under section 152(2A) have been proposed:

	Existing	Proposed
Companies - Sale of goods	4%	4.5%
Other than companies - Sale of goods	4.5%	5.0%

Companies & other than Companies providing following services: Transport services, freight forwarding services, air cargo services, courier services, manpower outsourcing services, hotel services, security guard services, software development services, IT services and IT enabled services as defined in section 2, tracking services, advertising services (other than print or electronic media), share registrar services, engineering services including architectural services, warehousing services, services rendered by asset management companies, data services provided under license issued by the Pakistan Telecommunication Authority, telecommunication infrastructure (tower) services, car rental services, building maintenance services, services rendered by Pakistan Stock Exchange Limited and Pakistan Mercantile Exchange Limited, inspection, certification, testing and training services, oilfield services, telecommunication services, collateral management services, travel and tour services, RIET management services, services rendered by National Clearing Company of Pakistan Limited.	3%	4%
Other than above services – For Companies	8%	9%
Other than above services – For Other than companies	10%	11%
Companies – Contracts	6.5%	7.5%
Other than companies – Contracts	7.0%	8%

Withholding tax on amount of remittance abroad through debit, credit, and prepaid cards

These payments are currently subject to withholding tax to be deducted by the banking company @ 1%. This tax is an adjustable tax. The Bill has proposed to increase this withholding tax to 5%.

Withholding tax on Exports

With an aim to ensure consistency and alignment between the tax regulations and the export facilitation policies, the Bill has proposed to include the expression "and Export Facilitation Scheme, 2021" after "Customs Rules, 2001", which would have the effect of incorporating the provisions of the Export Facilitation Scheme into the existing tax laws.

This means that the tax obligations, deductions, and procedures related to direct exporters, export houses, and indirect exporters would be governed by both the Customs Rules and the Export Facilitation Scheme.

Withholding tax on cash withdrawals

The proposed new withholding tax on cash withdrawal aims to encourage tax compliance and discourage excessive cash transactions. Under this provision, every banking company will be required to deduct an advance adjustable tax of 0.6% on cash withdrawals exceeding fifty thousand rupees in a single day from individuals whose names are not appearing in the active taxpayers' list.

The intention behind this measure appears to incentivize individuals to become active taxpayers and discourage excessive reliance on cash transactions, which can potentially be associated with tax evasion or informal economic activities. By implementing this withholding tax, the government aims to broaden the tax base and increase revenue collection.

This withholding tax was previously implemented vide Finance Act 2005 but later removed by the Finance Act 2021. There is a fear that this tax may discourage individuals from engaging in formal banking activities, which could hinder efforts to promote digital payments and financial inclusion.

Advance tax on foreign domestic workers

The proposed new section 231C of the Income Tax Ordinance, 2001, introduced by the Finance Bill 2023, pertains to the collection of advance tax on foreign domestic workers. According to the proposed section, any authority issuing or renewing a domestic aide visa to a foreign national as a domestic worker shall collect a tax of two hundred thousand rupees from the agency, sponsor, or the employing person. This tax is deemed as adjustable advance tax for the relevant tax year on the income of the agency, sponsor, or employer.

Advance tax on purchase of immovable property by non-resident Pakistanis

The Finance Act 2021 allowed the withholding tax on purchase of immovable property by non-resident individual holding Pakistani POC, NICOP, or CNIC, out of the foreign remittance through FCVA and NRVA. This tax is currently treated as final tax.

The Bill has proposed to make this tax inapplicable to non-resident individuals, holding POC, NICOP, or CNIC, out of the foreign remittance through FCVA and NRVA.

Exemptions, benefits, and special taxation

Exemption to certain welfare and charitable entities

The Bill has proposed the exemption from income tax to the following:

- The Prime Minister's Relief Fund for Flood, Earthquake and Other Calamities with effect on and from the 5th August, 2022.
- Film and Drama Finance Fund
- Export-Import Bank of Pakistan
- Shaheed Mohtarma Benazir Bhutto Institute of Trauma, Karachi
- Shaheed Zulfikar Ali Bhutto Institute of Science and Technology

The Bill has also proposed exemption from minimum tax under section 113 of the Ordinance to the Prime Minister's Relief Fund for Flood, Earthquake and Other Calamities with effect on and from the 5th August, 2022.

Exemption to profits and gains on sale of immovable property to REIT scheme

Profits and gains accruing to a person on the sale of immoveable property or shares of Special Purpose Vehicle to any type of REIT scheme under the Real Estate Investment Trust Regulations, 2015 are exempt from income tax up to the 30th day of June, 2023.

The Bill has proposed to extend this exemption to the 30th day of June, 2024.

Exemption to persons in Tribal Areas

Persons in Tribal Areas forming part of the Provinces of Khyber Pakhtunkhwa and Balochistan under paragraph (d) of Article 246 of the Constitution are exempt from income tax with effect from the 1st day of June, 2018 to the 30th day of June, 2023 (both days inclusive).

The Bill has proposed to extend this exemption to the 30th day of June, 2024.

Exemption to Builders

The Bill has proposed exemption for tax year 2024 to tax year 2026, tax payable on profits and gains derived from business chargeable to tax under the head “Income from Business” by a builder registered with Directorate General of Designated Non-Financial Business and Professions from a new building construction project, shall be reduced, not below zero, by ten percent or rupees five million whichever is lower for the tax year in which the builder furnishes along with return the completion certificate issued by the concerned regulatory authority.

For this purpose, “new building project” means a project for the construction of building excluding a land development project, layout plan of which is approved by the authority concerned on or after the 1st day of July, 2023.

Exemption to youth enterprise

For tax years 2024 to tax year 2026, tax payable by a youth enterprise on profit and gains derived from business chargeable to tax under the head “Income from Business”
shall be reduced not below zero –

(i) in case of an individual or an association of person by fifty percent or rupees two million
whichever is lower; and

(ii) in case of a company, by fifty percent or rupees five million whichever is lower;

For this purpose, youth enterprise means a startup established on or after first day of July, 2023
as sole proprietorship concern owned by a youth individual or an AOP all of whose members are youth or a company whose hundred percent shareholding is held or owned by youth individual:

Provided that the startup is not formed by the transfer or reconstitution or reconstruction or splitting up of an existing business; and

"Youth individual" means a natural person up to the age of thirty years as on first day of the commencement of the relevant tax year; and

This clause shall not apply where the startup is covered under clause (19) of Part III of the Second Schedule.

Exemption to non-resident banking company

Profit on debt and capital gains from Federal Government's sovereign debt or a sovereign debt instrument shall be exempt from tax chargeable under this Ordinance, derived by any non-resident banking company approved by the Federal Government under a sovereign agreement for the
purpose of this sub-rule.

Exemption under Foreign Investment (Promotion and Protection) Act, 2022

The proposed new section 44A of the Income Tax Ordinance, 2001, introduced by the Finance Bill, outlines exemptions and provisions related to the Foreign Investment (Promotion and Protection) Act, 2022 (XXXV of 2022).

According to the proposed section, taxes on income, including capital gains, withholding taxes, minimum and final taxes under the Ordinance, will be exempted to the extent provided in the Second and Third Schedule of the Foreign Investment (Promotion and Protection) Act, 2022. This exemption applies to qualified investments as specified in the First Schedule of the Act.

Additionally, the proposed section states that investors, shareholders of qualified investments, their associates, and companies specified in the Second and Third Schedule, including third-party lenders on account of any loan, will also be exempt from taxes and other provisions of the Ordinance as provided in the Second and Third Schedule of the Act.

Furthermore, the proposed section clarifies that certain provisions of the Ordinance relating to Anti-Avoidance, specifically sections 106, 106A, 108, 109, and 109A, will not apply to the individuals and entities mentioned in subsections (1) and (2) of section 44A.

Lastly, the proposed section specifies that the rates of depreciation, initial allowance, and pre-commencement expenditure under sections 22, 23, and 25, as applicable on March 20th, 2022, will continue to be valid for a period of thirty years as provided in the Third Schedule of the Foreign Investment (Promotion and Protection) Act, 2022, for the individuals and entities mentioned in subsections (1) and (2) of section 44A.

Overall, the introduction of section 44A aims to establish a framework for tax exemptions and provisions related to the Foreign Investment (Promotion and Protection) Act, 2022, providing clarity and incentives for qualified investments while specifying the applicability of certain provisions of the Income Tax Ordinance, 2001, to the individuals and entities covered by the Act.

The Foreign Investment (Promotion and Protection) Act, 2022

The Foreign Investment (Promotion and Protection) Act, 2022 was passed by both houses of parliament. The law aims to facilitate a settlement deal between the government of Pakistan and Canadian company Barrick Gold regarding a mining initiative in Balochistan's Chagai district. It seeks to provide protection to investors by minimizing court proceedings and other complications. However, there have been objections from certain political parties, including key allies, who believe it undermines the rights of the people of Balochistan. To address these concerns, amendments to the law were proposed, specifically limiting its application to the qualified investment of the Reko Diq project in Balochistan. The amendment bill needs approval from the National Assembly before it can be finalized. Despite opposition uproar during the proceedings, the bill for the amendment was passed, with the Finance Minister emphasizing its significance for the Chagai district and the protection of business.

Reduced rate of income tax on banking companies on income from additional advances to information Technology Services and Information Technology Enabled Services

The Bill has proposed reduced rate of taxation of 20% on income (to be determined according to the prescribed formula) of a banking company derived from additional advances (any average advances disbursed in addition to average amount of such advances made in such sector by the bank for the immediately preceding tax year starting from 2023) to Information Technology Services and Information Technology Enabled Services during the tax years 2024 and 2025.

Sales Tax

Production, transmission and distribution of electricity

The Finance Act 2022 added “Production, transmission and distribution of electricity” in the definition of ‘goods’ and ‘supply’ in order to enforce the Federal Government’s stance that the electricity was to be treated as goods and thus the jurisdiction of sales tax is with the Federal Government.

Th Bill has proposed to exclude the aforementioned specific inclusion of “Production, transmission and distribution of electricity” in the definition of ‘goods’ and ‘supply’. This has reportedly been in consequence of the decision made in the National Tax Council in respect of the powers of imposition of sales tax on electricity.

Tier-1 retailer

The definition of tier-1 retailer includes, among other kind of retailers:

- a retailer, whose shop measures one thousand square feet in area or more 103[or two thousand square feet in area or more in the case of retailer of furniture, and
- a person engaged in supply of articles of jewellery, or parts thereof, of precious metal or of metal clad with precious metal excluding a person whose shop measures three hundred square feet in area or less.

The Finance Bill has proposed to remove the above types of retailers from the definition of tier-1 retailers, meaning thereby that the certain special requirements, including installation of POS for real-time reporting of the transactions to FBR, applicable to tie-1 retailers shall now not be applicable to these types of retailer.

Directorate General of Digital Initiatives

The Finance Bill proposes to substitute section 30CA with a new provision that establishes the Directorate General of Digital Initiatives. This change expands the scope of the existing Directorate General of Digital Invoicing and Analysis, indicating a more comprehensive approach towards digital transformation in tax administration.

The inclusion of additional positions and officers recognizes the importance of specialized expertise in digital taxation.

Zero rating

The Finance Bill has proposed zero rating for the imports or supplies made by, for or to a qualified investment as specified at Serial No.1 of the First Schedule to the Foreign Investment (Promotion and Protection) Act, 2022 for the period as specified in the Second Schedule to the said Act.

The Foreign Investment (Promotion and Protection) Act, 2022 was passed by both houses of parliament. The law aims to facilitate a settlement deal between the government of Pakistan and Canadian company Barrick Gold regarding a mining initiative in Balochistan's Chagai district. It seeks to provide protection to investors by minimizing court proceedings and other complications. However, there have been objections from certain political parties, including key allies, who believe it undermines the rights of the people of Balochistan. To address these concerns, amendments to the law were proposed, specifically limiting its application to the qualified investment of the Reko Diq project in Balochistan. The amendment bill needs approval from the National Assembly before it can be finalized. Despite opposition uproar during the proceedings, the bill for the amendment was passed, with the Finance Minister emphasizing its significance for the Chagai district and the protection of business.

Exemptions

Currently, the law grants sales tax exemption to red chillies, ginger, turmeric, excluding those sold in retail packing bearing brand names and trademarks. The proposed change in the Finance Bill seeks to modify this exemption to these goods excluding those sold under brand names and trademarks. This amendment aims to eliminate ambiguity regarding the exemption of sales tax for these goods sold in bulk packing under a brand name and trademarks.

Similarly, following goods have been made taxable if sold under a brand name, whether in retail packing or otherwise:

- Yogurt
- Butter
- Desi ghee
- Cheese
- Processed cheese not grated or powdered
- Products of meat or meat offal
- Meat of bovine animals, sheep, goat and uncooked poultry meat
- Fish and crustaceans

The Bill has proposed an explanation for removal of doubt, that the blood transfusion sets not packed in aluminum foil imported with blood bags CPDA-1, in corresponding quantity in same consignment are also exempt.

The Bill has proposed extension in exemption of sales tax on import of plant, machinery, equipment for installation in Tribal area and of industrial inputs by the industries located in these areas as defined in the Constitution of Pakistan from June 30, 2023 to June 30, 2024.

Currently, exemption from sales tax is provided to the supplies of electricity, as made from the day of assent to the Constitution (Twenty-fifth Amendment) Act, 2018, till 30th June, 2023, to all residential and commercial consumers in tribal areas, and to such industries in the tribal areas which were set and started their industrial production before 31st May, 2018, but excluding steel and ghee or cooking oil industries. The Finance Bill has proposed to extend this exemption to June 30, 2024.

Exemptions have been proposed for the following:

- Contraceptive and accessories thereof 3926.9020 and 4014.1000
- Bovine semen 0511.1000
- Saplings Respective heading
- Combined Harvester ‑ Thresher 8433.5100
- Dryer for agricultural products 8419.3400
- No-till-direct seeder, planters, trans-planters and other planters 8432.3100 and 8432.3900
- Import of goods as mentioned under S. No. 159 of Part III of Fifth Schedule to the Customs Act, 1969 (IV of 1969) chargeable to customs duty at the rate of zero percent, subject to the conditions, [7471.3010, 8471.3020, 8471.3090, 8471.4110, 8471.6010, 8471.6020, 8471.6090, 8471.7040, 8471.9020, 8471.7020, 8471.5000 and 8517.6270, subject to restrictions and limitations mentioned therein, by the software exporters registered with the Pakistan Software Export Board.

Special rates – Eighth Schedule

The following goods are subject to sales tax at the rate of 1% as final discharge of tax in the supply chain, without deductibility of input tax by the manufacturers and importers:

- Manufacture or import of substances registered as drugs under the Drugs Act, 1976 (XXXI of 1976)
- Active Pharmaceutical Ingredients, excluding excipients, for manufacture of drugs registered under the Drugs Act, 1976 (XXXI of 1976) or raw materials for the basic manufacture of pharmaceutical active ingredients

The Finance Bill has proposed changed description of these goods as follows:

- Substances registered as drugs under the Drugs Act, 1976 (XXXI of 1976) and medicaments as are classifiable under chapter 30 of the First Schedule to the Customs Act, 1969 (IV of 1969) except the following, even if medicated or medicinal in nature, namely:

(a) filled infusion solution bags imported with or without infusion given sets;

(b) scrubs, detergents and washing preparations

(c) soft soap or no soap;

(d) adhesive plaster;

(e) surgical tapes;

(f) liquid paraffin;

(g) disinfectants, and

(h) cosmetics and toilet preparations.

This substitution shall be deemed to have been made from the 1st day of July, 2022.

- Raw materials for the basic manufacture of pharmaceutical active ingredients and for manufacture of pharmaceutical products, provided that in case of import, only such raw materials shall be entitled to exemption which are liable to customs duty not exceeding eleven per cent ad valorem, either under the First Schedule or Fifth Schedule to the Customs Act, 1969 (IV of 1969) or under a notification issued under section 19 thereof.

  This substitution shall be deemed to have been made from the 1st day of July, 2022.

Islamabad Capital Territory Sales Tax on Services

Provisions of the Sales TaxAct, 1990

The Bill has proposed that the provisions of section 3 of the Sales Tax Act, 1990 pertaining to the powers of FBR to provide rules for the purpose of classification of persons, services, and withholding sales tax, shall apply to the services taxable under the Islamabad Capital Territory (Tax on Services) Ordinance, 2001.

Freelance exporter

The Bill has proposed that the freelance exporter exclusively dealing in export of IT and IT enabled services shall fall in the definition of “cottage industry” as defined under section 2(5AB), if the annual turnover from all sales does not exceed Rs. 8milion.

For this purpose, the freelance exporter means a person who works on per job and on self-employed basis without being attached to or under employment of any other person, having the liberty to work on various tasks simultaneously

Hotels, motels, guest houses, farmhouses, marriage halls, lawns, clubs and caterers

The Finance Bill has proposed that for services provided or rendered by hotels, motels, guest houses, farmhouses, marriage halls, lawns, clubs and caterers, and services provided by restaurants including cafes, food (including ice-cream) parlors, coffee houses, coffee shops, deras, food huts, eateries, resorts and similar cooked, prepared or ready-to-eat food service outlets etc., the rate of sales tax shall be the following, as against the current flat rate of 15%:

(i) Fifteen percent

(ii) Five percent where payment against services is received through debit or credit cards, mobile wallets or QR scanning subject to the condition that no input tax adjustment or refund shall be admissible; and

(iii) Fifteen percent where payment received in cash.

Services provided by Software or IT based system development consultants [9815.6000]

These services are currently taxable at the rate of 16%. The Bill has proposed to change the rate to 15%.

The IT services and IT-enabled services [Respective Headings] have been proposed to be taxable at Five percent subject to the conditions that no input tax adjustment or refund shall be admissible. For this purpose, the Bill has proposed to provide the following definitions:

"IT services" include but not limited to software development, software maintenance, system integration, web design, web development, web hosting and network design; and

"IT enabled services" include but not limited to inbound or outbound call centres, medical transcription, remote monitoring, graphics design, accounting services, human resources (HR) services, telemedicine centres, data entry operations, cloud computing services, data storage services, locally television programs and insurance claims processing.

Electric Power Transmission Services

The sales tax rate has been proposed at 15% consequent to the decision of NTC to treat the electric supply as services.

Federal Excise Duty

The proposed budgetary measures for the Federal Excise Duty (FED) in the fiscal year 2023-24 are as follows:

- Implementation of FED on energy inefficient fans at a rate of Rs. 2000 per fan and on incandescent bulbs at 20% ad valorem, as approved by the Federal Cabinet in Case No. 01/01/23, dated 03.01.2023.
- Expansion of the scope of FED on services to include royalty and fee for technical services.
- 3. Addition of a new clause (e) to sub-section (1) of section 3 to provide further clarity on the applicability of federal excise duty on goods and services.
- Alignment of the procedure for the publication of general orders, departmental instructions, and rulings of the Board on the official website, in accordance with the provisions under the Sales Tax Act, 1990.

Customs Duty

The proposed budgetary measures under the Customs Act 1969 for the fiscal year encompass various significant aspects aimed at promoting trade facilitation, providing relief measures, reviewing the regulatory regime, making miscellaneous changes, implementing revenue measures, and introducing legislative amendments.

The guiding principles underlying these measures emphasize important objectives such as ensuring that there is no increase in duties on the import of essential items, facilitating trade and enhancing the ease of doing business, encouraging industrialization and investment, providing incentives for the agriculture sector, promoting energy efficiency and conservation, and fostering the growth of Information Technology (IT) and IT-enabled services.

To provide relief to specific sectors, the proposed measures include the exemption of customs duties on specific papers and materials used for printing the Holy Quran, offering incentives to the pharmaceutical sector by adding more items to the existing duty-free regime, and providing incentives for the manufacturing of solar panels and related equipment by exempting customs duties on the import of necessary machinery, equipment, and inputs.

Furthermore, the proposed measures aim to support exporters in the IT and IT-enabled services industry by allowing duty-free import of IT-related equipment equivalent to 1% of their export proceeds. There are also reductions in customs duties and additional customs duties on the import of intermediary and industrial inputs falling under specific PCT codes.

The budgetary measures also seek to streamline the regulatory regime by exempting customs duties on raw materials and inputs for various industries, including diapers, sanitary napkins, adhesive tape, capacitors, and machine tools. Additionally, efforts are made to align the Fifth Schedule to the Customs Act with the Auto Industry Development and Export Policy (AIDEP) 2021-26, and exemptions are proposed on the import of seeds for sowing and shrimps/prawns/juveniles for breeding in commercial fish farms and hatcheries.

The review of the regulatory regime involves the removal or reduction of regulatory duties on various goods, such as second-hand clothing, IT-related equipment, synthetic filament yarn, parts for flat panels and monitors, silicon steel sheets, and special steel round bars and rods. Moreover, the measures include changes in PCT codes and the conversion of specific CD rates to ad-valorem rates for certain goods.

In terms of revenue measures, the proposed changes include the withdrawal of fixed duties and taxes on the import of used vehicles above 1300 CC of Asian makes, the increase of regulatory duty on tungsten filament incandescent bulbs to discourage their use, and the increase of export regulatory duty on molasses. These measures aim to generate revenue while balancing economic considerations.

Lastly, the proposed legislative amendments include rephrasing the definition of smuggling to enable Customs to conduct anti-smuggling operations within the country's territorial limits, including provincial levies and Khasadar Force as government agencies assisting Customs in anti-smuggling operations, and strengthening penalties for offenses related to smuggling, evasion of duty and taxes, and the smuggling of essential, banned, and contra-banned goods. The amendments also seek to streamline trade procedures, enhance the warehousing period for perishable items, rationalize penalties, facilitate adjudication through the Customs Computerized System, and allow representatives to file baggage declarations on behalf of group passengers.

Disclaimer

This publication provides an overview of important tax amendments that are proposed in the Finance Bill 2023 regarding taxation laws. It serves as a general summary for informational purposes only. To obtain more detailed information, please consult the Finance Bill, the specific provisions of the laws intended to be amended, and seek advice from your advisor. Please note that we cannot be held responsible for any loss resulting from actions taken or not taken by individuals relying on this document.

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