PSEB ADVISORY
on Finance Act 2021

Changes for IT & ITeS Businesses, Startups & Freelancers

TECH destiNATION PAKISTAN

PAKISTAN PSEB SOFTWARE EXPORT BOARD

Ministry of Information Technology & Telecommunication

DIGITAL PAKISTAN

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1. Income Tax Ordinance, 2001

A. Tax Credit Regime for export of IT & ITeS Businesses

- Section 65F was inserted by Tax Laws (Second Amendment) Ordinance 2021 whereby exemption available to IT industry under clause 133, Part IV, Second Schedule was replaced by tax credit regime.

- Exemption regime provided that income of IT & ITeS exports is exempt from income tax subject to only one condition i.e. 80% of proceeds were required to be brought into Pakistan.

- Tax credit regime provided that income of IT & ITeS exports is taxable but 100% tax credit will be granted subject to four conditions mentioned in section 65F.

- However, the conditions were deemed too harsh and there were some drafting issues in section 65F due to which certain taxes became applicable on IT & ITeS exports.

- Now Finance Act 2021 has modified section 65F, removing/softening the conditions and also changing the text of section 65F to ensure that 100% tax credit is available in its true spirit and no hidden taxes are levied.

- Now section 65F provides that income from export of IT & ITeS would be eligible for 100% tax credit subject to the condition that 80% of export proceeds are brought into Pakistan through normal banking channels and following three compliance conditions, where applicable:

    - return has been filed;
    - withholding tax statements for the relevant tax year have been filed in respect of those provisions of the Ordinance, where the person is a with holding agent; and
    - sales tax returns for the tax periods corresponding to relevant tax year have been filed if the person is required to file Sales Tax Return under any of the Federal or Provincial sales tax laws.

- The provisions of section 65F relating to tax credit regime have been made applicable from July 01, 2021 and the exemption provisions have been made applicable till June 30, 2021.

B. Tax Credit Regime for Startups

- Clause 62A of section 2 to Income Tax Ordinance, 2001 provides definition of startup as follows:

  "Startup" means
  (i) a business of a resident individual, AOP or a company that commenced on or after first day of July, 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 one hundred million in each of the last five tax years; or
  (ii) any business of a person or class of persons, subject to the conditions as the Board with the approval of Federal Minister in-charge may, by notification in the official Gazette, specify.

- Clause 143, Part I, Second Schedule, Income Tax Ordinance, 2001 provided exemption to profit and gains derived by a Startup for the tax year in which the start-up is certified by the Pakistan Software Export Board and the following two tax years.

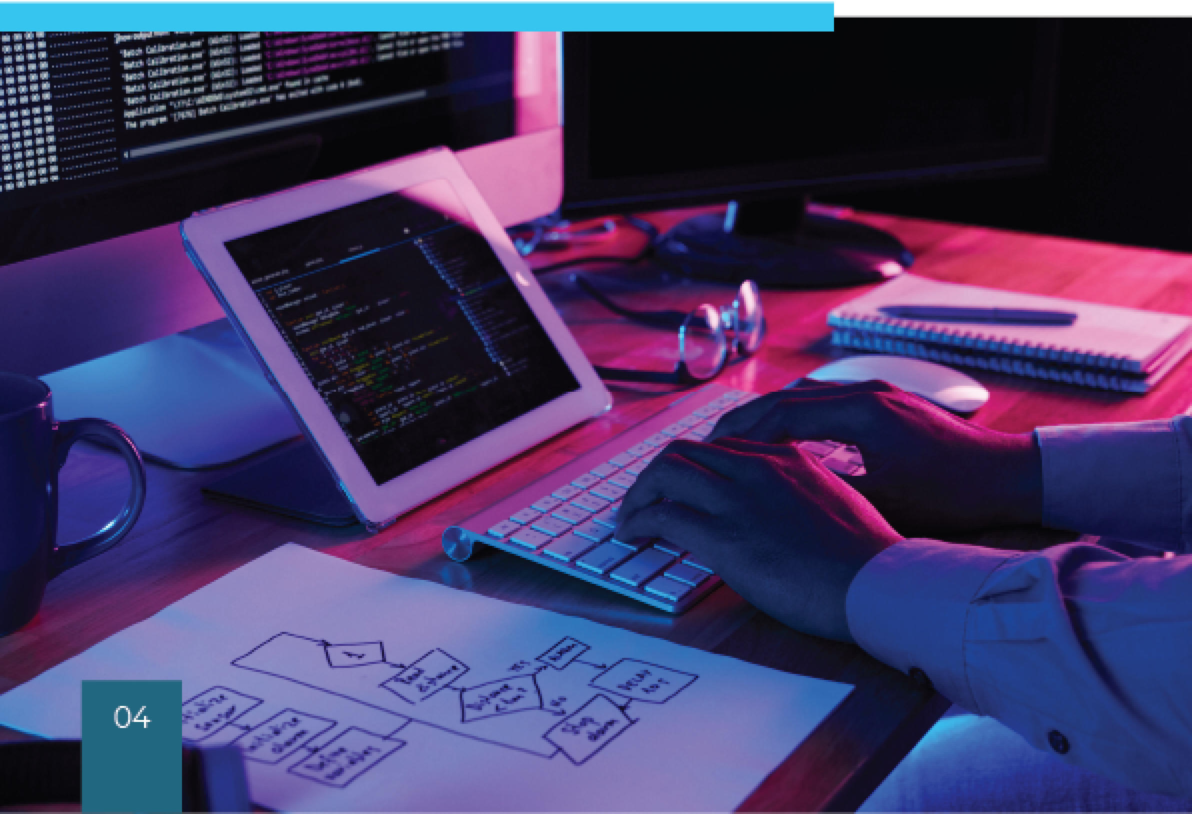
- Exemption to Startup is also replaced by 100% tax credit under section 65F i.e., now a Startup is eligible for 100% tax credit against profit and gains derived by a Startup for the tax year in which the Startup is certified by the Pakistan Software Export Board and the following two tax years. The 100% tax credit is subject to following three conditions, where applicable:
    - return has been filed;
    - withholding tax statements for the relevant tax year have been filed in respect of those provisions of the Ordinance, where the person is a with holding agent; and
    - sales tax returns for the tax periods corresponding to relevant tax year have been filed if the person is required to file Sales Tax Return under any of the Federal or Provincial sales tax laws.

- Clause 43F, Part IV, Second Schedule provides that the provisions of section 153 shall not apply in the case of a Startup, being recipient of payment. This exemption is still intact i.e., no tax deduction is to be made from payments being made to Startup for supply of goods, services or contracts however the Startup is required to be obtain exemption certificate under section 159/ 153. In case of non-availability of exemption certificate, the payer may deduct tax however Startup can claim refunds for tax so deducted by payer.

- The provisions of section 65F relating to tax credit regime for Startup have also been made applicable from July 01, 2021 and the exemption provisions have been made applicable till June 30, 2021.

C. Tax Credit Regime for Freelancers

- Freelancers engaged in export of IT & IT enabled Services are also eligible for 100% tax credit under section 65F subject to the condition that 80% of export proceeds are brought into Pakistan through normal banking channels and following three compliance conditions, where applicable:
  - o return has been filed;
  - o withholding tax statements for the relevant tax year have been filed in respect of those provisions of the Ordinance, where the person is a with holding agent; and
  - o sales tax returns for the tax periods corresponding to relevant tax year have been filed if the person is required to file Sales Tax Return under any of the Federal or Provincial sales tax laws.



D. Final Tax Regime (FTR)

- The income from exports of computer software or IT services or IT enabled services will be under final tax regime under section 154A in case tax credit under section 65F is not available.

- Tax rate shall be one percent of the proceeds of the exports.

- However, in order to be eligible for FTR, the following conditions are required to be met:
  - return has been filed;
  - withholding tax statements for the relevant tax year have been filed.; and
  - sales tax returns under Federal or Provincial laws have been filed, if required under the law.
  - no credit for foreign taxes paid shall be allowed.

- Since the conditions for claim of 100% tax credit and FTR are the same with only one difference i.e., FTR does not require bringing 80% export proceeds into Pakistan. Accordingly, if an entity is engaged in export of IT & IT enabled services and meets all the conditions prescribed under section 65F but does not bring 80% export proceeds into Pakistan than tax deductible under section 154A would be final tax in respect of income of such person from IT & IT enabled Services.

- A person falling under FTR under section 154A can also opt for normal tax regime (NTR) however such option shall be exercised every year at the time of filing of return under section 114 of Income Tax Ordinance, 2001.

E. Exemption Certificate from 1% FTR under section 154A

- Section 154A provides that the Federal Board of Revenue in consultation with State Bank of Pakistan shall prescribe mode, manner and procedure of payment of tax under this section.

- Unless the mode, manner and procedure of payment of tax under section 154A is prescribed, the persons receiving payment against export of IT & IT enabled Services may need to be obtain exemption certificate from the applicability of section 154A and in the absence of such exemption certificates, the banks may proceed to deduct 1% tax from the export proceeds.

- Accordingly, it is advisable for persons engaged in IT & IT enabled Services to seek exemption certificate from FBR till the time such procedure is identified.

2. Sales Tax on Services

Federal & Provincial Sales tax on Services (highlights based on Finance bills, Punjab Finance Act & SRB notifications)

- Persons engaged in export of IT & ITeS in Islamabad are now subject to “zero rate” of sales tax under Islamabad Capital Territory (Tax on Services) Ordinance, 2001 however there is no change in the tax rate for local IT & ITeS i.e., a tax rate of 5% would remain applicable on local services.

- There is no change in sales tax rate in Punjab in respect of IT & IT enabled Services except for call centers where tax rate has been reduced from 19.5% to 16%.

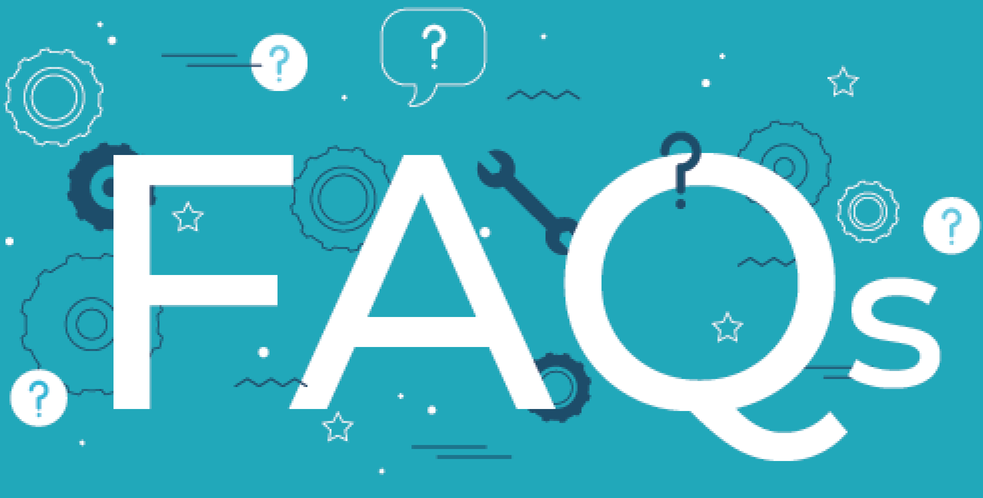
- Export by call centers is now exempted in Sindh instead of 3% earlier rate while there is no change in applicable sales tax rates on IT & IT enabled Services.

- Exemption available to following has been withdrawn in Sindh:

    - Telecommunication Services involving charges payable on the International leased lines or bandwidth services used by software exporting firms regis--tered with the Pakistan Software Export Board;
    - Internet services, whether dial up or broadband, including email services and data communication network services of upto 2 mbps speed valued at not more than 1,500 rupees per month per service recipient.

- There is no change in sales tax rate in KPK for IT & IT enabled Services i.e., 5% reduced rate of sales tax is still applicable.

- In Balochistan, 15% tax rate is now applicable on “cab aggregator” and “online marketplace” while the tax rate on IT & IT enabled Services under tariff heading 9868.0000 is same as earlier i.e., 6%.


FAQs

3. Frequently Asked Questions

1. **Annual tax return for tax year 2021 (year ended June 30, 2021) is required to be filed under new tax credit regime, previous exemption regime or will it be a mix as I understand that changes came in to effect on 22nd March 2021.**

   The filing would be under tax exemption regime as tax credit regime is applicable from July 01, 2021.

2. **Are the conditions of credit regime applicable on the exemption regime as well and will it effect our exemption for tax year 2021?**

   No, the new conditions are not applicable for tax exemption regime and the return for tax year 2021 will be filed claiming exemption subject to only one condition i.e., 80% of export proceeds are brought into Pakistan through normal banking channels.

3. **As per my tax advisor, I am not a withholding agent for any payments as all my employees are below taxable and I am also not required to withhold any tax on rent, goods, services etc. as I do not fulfill the criteria of withholding agent. Am I still required to file withholding statements to claim 100% tax credit?**

   No, the conditions under section 65F only require filing of withholding tax statements where the person is a withholding agent.

4. **I have not filed my withholding statement for previous tax year including tax year 2021. Will this have an impact on my tax credit under section 65F?**

   No, the conditions under section 65F only require filing of withholding tax statements for relevant tax year and since the credit regime starts from July 01, 2021 therefore relevant tax year shall be tax year 2022 and similarly for future years relevant tax year shall be the year in respect of which 100% tax credit is being claimed.

5. **Is filing of sales tax return mandatory for claim of 100% tax credit?**

   No, for claim of 100% tax credit, filing of sales tax return is mandatory only if it is applicable under the relevant Federal & Provincial sales tax law. Accordingly, if a person is only engaged in export of IT & IT enabled Services in Islamabad, for such person filing of sales tax return is mandatory because sales tax is now zero rated on export of services in Islamabad. Zero rating means that the services are taxable albeit @ zero percent and for taxable services, sales tax return is required to be filed.

6. **I don't want to go for tax credit regime, can I avail the option of final tax regime?**

   As per section 154A, a person can opt out of final tax regime but there is no provision which supports that a person can opt in for final tax regime instead of tax credit regime. However, if a person does not bring 80% export proceeds in Pakistan, such person is not eligible for tax credit regime and then comes under final tax regime provided in section 154A subject to fulfilment of conditions under section 154A. A person who comes under the provisions of section 154A can opt out of final tax regime by exercising such option at the time of filing of annual tax return.

7. **Do I have to file an application to be eligible for tax credit regime under section 65F?**

   No application is required, just file annual tax return and take credit available in the tax return.

8. **Why exemption certificate is required if I am eligible for tax credit under section 65F?**

   Banks are required to deduct tax on foreign exchange proceeds in respect of services exported out of Pakistan. Section 154A provides that Federal Board of Revenue and State Bank of Pakistan have to devise a procedure in this regard but till such procedure is devised the banks do not have sufficient clarity to identify exempt and taxable remittances. Accordingly, it is advisable to obtain exemption certificate.

9. **If the Commissioner does not issue exemption certificate though I am eligible for tax credit under section 65F and bank deduct 1% tax than what happens?**

   Such tax can be claimed as refund in the annual tax return.

10. **Our local adviser said that if we opt for the 1% final tax, we would avoid FBR audits. Is that correct?**

    No, there is no such provisions in law which supports this proposition.

11. **If we only remit 80% of our revenue in Pakistan, would we pay 1% final tax on the 80% remitted amount? Would the remaining 20% that is held abroad be tax free or would an adjustment be made to account for 1% tax on the total revenue when we complete our annual Tax Return?**

    The 80% condition is linked with 65F, if the entity is under FTR as per section 154A, the tax is deducted at the time of remittance of amount to Pakistan by banks and tax so deducted is final tax. The amount kept outside Pakistan would not be exempt but subject to tax.

12. **If we decide to claim 100% tax credit and it is not granted e.g., because FBR feels that we have not met all the conditions, would they then apply 1% final tax or would tax be charged at normal rates according to tax bands e.g. 30% or 35% higher rate tax.**

    The conditions for tax credit and FTR are same which means (except for 80% proceeds condition), if an entity does not meet conditions for tax credit then it also cannot claim to be under FTR and in such case the entity would be subject to normal tax regime. As already mentioned, there is only one main difference as to compliance conditions for credit regime and FTR whereby under tax credit regime the entity need to bring 80% foreign remittances in Pakistan while this condition is not mentioned in FTR regime.

13. **How do we apply for the exemption certificate to present to the bank and how long does it take to come through? Is the process all online and self-explanatory or do we need to go to our local FBR office? Is there a chance that they refuse to give us the exemption certificate and what criteria would we need to meet to qualify?**

    The application is to be filed online but FBR has not yet modified its system to enable exemption from 154A. Once enabled, the application would be filed online and the decision is to be made by CIR within 15 days. FBR may make different rules with SBP but those are not yet notified.

14. **Do we need to apply for exemption certificate every year?**

    Yes, may be six monthly but it really depends on the procedure to be notified by FBR and SBP.

15. **Do we have the option to opt in/out of tax credit or 1% final tax each tax year up to 30th June 2025 or do we need to stick to our selection once made?**

    Tax Credit regime is applicable on all IT export entities. If an entity does not qualify for tax credit regime, then it needs to be checked whether it is eligible for FTR. If the entity is eligible for FTR than entity can opt out of FTR and this option is to be exercised annually at the time of filing of tax return.

16. **What if we opt for 1% final tax and FBR establishes that we did not meet one of the qualifying criteria, what would be the tax implications of that? Would they look to apply normal tax rates based on tax bands?**

    If an entity is not eligible for FTR than normal tax rates on profits would apply.

17. **Is there anything we need to worry about or any reason we should not go for the 100% tax credit? Basically, what are the pros and cons of opting for the tax credit or the 1% final tax.**

Since the conditions for both regimes are almost same therefore the entity should go for more favorable regime i.e. tax credit regime because of less cash outflow.

18. **How can I get refund for the 1% tax wrongly deducted from my payments?**

The refund needs to be reflected in the annual tax return filed for the relevant tax year and thereafter it will be processed as per section 170 after filing of refund application. Please note that a new section 170A has been introduced whereby the Board may process and issue refund to the taxpayer who has filed the return of income without requiring refund application by the taxpayer to the extent of tax credit verified by the Board's computerized system as may be prescribed. The refund amount sanctioned under this section shall be electronically transferred in the taxpayer's notified bank account.

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