

**Prime Minister's Office
Board of Investment**

Streamlining Corporate Taxation in Pakistan

Overview

Pakistan's corporate tax regime contains several structural distortions that collectively suppress investment, push businesses offshore, trap private liquidity, and penalise formalisation. This brief presents seven discrete tax reforms, each independently actionable, for CCoRR's consideration and direction.

Seven Issues at a Glance

1. **Delayed Tax Refunds:** Automate refund processing (S.170A) and integrated tax ledger.
2. **Double Taxation of VC/PE Funds:** Reinstate pass-through treatment under Clause (101) of the Income Tax Ordinance.
3. **Double Taxation of Inter-Corporate Dividends:** Restore Clause 103C ICD exemption for Group Relief companies.
4. **LLP vs. Partnership Tax Disparity:** Reclassify LLPs as AOPs; ensure NTN continuity; exempt conversion from Capital Gains Tax (CGT).
5. **Minimum Turnover Tax (MTT):** Transition from turnover-based MTT to profit-based Minimum Alternate Tax (MAT).
6. **Taxation of Bonus Shares:** Repeal Section 236Z; exempt pro-rata bonus share issues from deemed-income tax.
7. **Differential GST on Medical Devices:** Apply 1% GST (matching pharmaceuticals) to all DRAP-registered medical devices.

Detailed Reform Analysis

1. Delayed Tax Refunds and Adjustments

Description: Refund processing delays exceed 400+ days, locking significant private-sector liquidity. Over-reliance on withholding and advance tax creates systematic overpayments. Weak adjustment mechanisms raise the cost of doing business.

Proposed Reform: Fully operationalize Section 170A through an end-to-end automated refund system. Enforce statutory interest on delayed refunds. Create an integrated tax ledger for automatic cross-tax adjustments.

Benefits: Unlocks PKR 810–880 billion in trapped liquidity (~3.5% of private-sector credit). Saves an estimated PKR 185–220 billion in annual opportunity cost. Improves business cash flow and broadens the formal tax base.

2. Double Taxation of VC & PE Funds

Description: Removal of pass-through treatment has effectively created triple taxation. ~70% decline in startup funding since the change; over 80% of startups are relocating abroad (the "Singapore flip"). Innovation financing, SME growth, and the future tax base are all constrained.

Proposed Reform: Restore permanent pass-through tax treatment by reinstating Clause (101) in the Income Tax Ordinance. Ensure VC/PE funds are taxed only at the investor level.

Benefits: Reverses the ~70% collapse in startup funding. Prevents capital flight offshore, retaining future capital-gains tax revenues in Pakistan. ADB research shows \$3–5 of GDP is generated per \$1 of VC invested. Revives SME financing and domestic innovation ecosystems.

3. Double Taxation of Inter-Corporate Dividends

Description: Inter-corporate dividends are exempt under Group Taxation (100% ownership) but taxed at 15% under Group Relief (<100% ownership), double-taxing the same profits. This inconsistency creates arbitrary tax friction based solely on ownership percentage.

Proposed Reform: Restore Clause 103C, Part I, Sch-II, enabling the ICD exemption for companies eligible for Group Relief under Section 59B.

Benefits: Removes double taxation and tax friction within corporate groups. Encourages corporatisation and formal holding structures. Improves investor confidence and long-term planning predictability. Promotes investment, scale, and long-term growth.

4. Differential Tax Treatment: LLP vs. Traditional Partnership

Description: LLPs are taxed at the corporate rate and treated as bodies incorporate, while Traditional Partnerships are taxed as AOPs at AOP rates. Conversion to LLP requires a new NTN, causing loss of carry-forward losses and other tax history. Capital Gains Tax applies on conversion of a company into LLP. These barriers actively discourage LLP adoption and business formalisation.

Proposed Reform: Reclassify LLPs as AOPs for income-tax purposes. Ensure NTN continuity upon conversion to LLP. Exempt conversion from Capital Gains Tax.

Benefits: Promotes SME formalisation by making LLPs tax-neutral versus traditional partnerships. Reduces compliance costs and avoids double taxation. Aligns LLP taxation with global practice and eases doing business.

5. Minimum Turnover Tax (MTT) Regime

Description: MTT (Section 113) imposes tax liability on gross sales rather than profitability, forcing loss-making and low-margin businesses to pay tax. Businesses pay even when normal tax liability falls below 1.25% of turnover regardless of whether they are profitable. This discourages investment, formalisation, and business growth.

Proposed Reform: Shift from MTT to a Minimum Alternate Tax (MAT) regime, which taxes gross/book profit, not gross income.

Benefits: Restores ability-to-pay taxation linked to actual profitability. Protects working capital for startups and low-margin firms. Improves competitiveness and business sustainability. Avoids tax drag in loss-making years.

6. Taxation of Bonus Shares

Description: Bonus shares are treated as deemed income and taxed at 10% (filer) and 20% (non-filer). Bonus shares are a neutral accounting reclassification of already-taxed profits, not new income. Taxing notional gains imposes double taxation and distorts capital markets.

Proposed Reform: Repeal the taxation of bonus shares under Section 236Z. Exempt bonus shares issued through capitalisation of reserves (pro-rata) at time of allotment.

Benefits: Restores tax neutrality, taxing income at realisation, not capitalisation. Improves market liquidity by removing friction from bonus share issuances. Supports capital formation and efficient reinvestment. Aligns Pakistan with international practice.

7. Differential GST Treatment: Medical Devices vs. Pharmaceuticals

Description: Medical devices are taxed at 18% GST, while pharmaceuticals are taxed at 1% except cardiac instruments and dialysis machines. The high GST rate raises healthcare costs and increases out-of-pocket spending for patients. It inflates public procurement costs and encourages grey-market imports.

Proposed Reform: Apply 1% GST to all DRAP-registered medical devices. Amend the Eighth Schedule of the Sales Tax Act, 1990 accordingly.

Benefits: Corrects the tax distortion in the healthcare sector. Preserves government revenue through formal-channel expansion. Improves hospital affordability for patients. Reduces public procurement costs.