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ICMA Budget Policy Recommendations

Submitted to:

Federal Board of Revenue (FBR)
Government of Pakistan

Submitted by:

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Subject: Budget [2025-26] Proposals for Income Tax, Sales Tax, Federal Excise Duty and ICT [Tax on Services]

Dear Ali Abbas sahib, Aoa

This refers to your circular # 1(2) SA-M(IRP)/2025 dated 7th January, 2025 on the captioned subject.

The Research and Publications (R&P) Committee of ICMA Pakistan is pleased to submit herewith some new and concrete proposals/input on the following policy areas, as indicated in your above-referred circular, for the favorable consideration of the Federal Board of Revenue (FBR):

1. **Broadening of tax base for a wider participation in revenue generation efforts.**
2. **Policy suggestions for bringing entire value chain of all businesses in GST regime.**
3. **Promoting progressive taxation by introducing various measure where incidence of tax is higher on affluent classes.**
4. **Removal of tax distortions, procedural lapses and anomalies.**

To optimize revenue generation and foster economic growth, we propose key reforms, including Green Tax Reform (incentives for renewable energy and digitalization), a phased taxation framework for EV manufacturers, and alignment with OECD's Pillar Two minimum corporate tax. Additional measures include a progressive pension tax, a cap on employer-provided health insurance benefits, expansion of Federal Excise Duty (FED), and full GST integration. Furthermore, the introduction of a Minimum Alternative Tax (MAT), a 2% Wholesale Equalization Tax (WET), and the inclusion of exporters under the regular tax regime will promote equity and fiscal sustainability. These reforms aim to enhance revenue collection, reduce reliance on external borrowing, and improve tax transparency. Detailed proposals are attached.

We trust that these suggested measures will be considered for inclusion in the Budget 2024-25. We would be pleased to visit your office in Islamabad at your convenience to discuss these proposals in further detail and provide any necessary clarifications. Kindly let us know a suitable time for the meeting.

Best regards,

Muhammad Yasin, FCMA
Vice President, ICMA and
Chairman, Research and Publications Committee

(1) Broadening the Tax Base

(A) Green Tax Reform – Introducing a Depreciation Scheme for Green and Digital Practices

The government may consider implementing a Depreciation Scheme that provides tax deductions to companies adopting green energy practices and pursuing digital transformation initiatives, including:

- **50% tax deduction on investments in renewable energy projects and decarbonization technologies.**
- **30% tax deduction on operational costs for maintaining green energy practices.**
- **40% tax deduction on digital transformation investments e.g. cloud infrastructure, automation, and AI.**
- **25% tax reduction for training employees in digital skills to support the transition.**

Justification

This scheme will incentivize businesses to shift towards environmentally friendly and digital practices, ensuring long-term sustainability while fostering innovation. It will also encourage the formalization of operations in these sectors, contributing to economic growth.

Estimated Outcome

- Increase in formalization of businesses in green and digital sectors, adding 0.5%-1% of GDP to tax revenues within 3-5 years.
- Accelerated adoption of green energy and digital transformation, reducing reliance on fossil fuels and enhancing competitiveness in global markets.

(B) Green Tax Reform – Implementing a Taxation Framework for Electric Vehicle (EV) Manufacturers

The government may consider implementing a phased taxation model for EV manufacturers, starting with a 10%-15% tax on profits and gradually increasing it to 20%-25% over a five-year period.

Justification

The EV sector is an emerging industry with significant growth potential. Taxation at an early stage can bring this sector into the tax net without stifling growth. A phased approach ensures that manufacturers can scale operations before bearing higher tax burdens.

Estimated Outcome

- Expansion of the tax base as the EV sector grows, contributing PKR 10-20 billion in tax revenues annually by 2030.
- Enhanced FDI in EV manufacturing, creating jobs and reducing carbon emissions.

(C) Global Tax Reform- Implementing Pillar Two Minimum Corporate Tax for Multinationals

The government could consider adopting Pillar Two of the OECD/G20 BEPS framework, enforcing a 15% minimum corporate tax on multinational enterprises with annual revenues over PKR 21 billion to broaden Pakistan's tax base and enhance revenue collection.

Justification

By setting a global minimum corporate tax rate of 15%, Pakistan can safeguard its revenue base, align with international tax standards, and attract responsible foreign investment. This policy will enhance fiscal stability, broaden the tax base, and improve compliance without imposing undue burdens on smaller businesses.

Estimated Outcome

- Broadening of the tax base through the implementation of Pillar Two, generating an estimated PKR 25 billion in additional annual revenues.
- Enhanced compliance by MNEs, aligning Pakistan's tax regime with global standards and improving investor confidence.

(D) Pension Tax Reform- Ensuring Fair Taxation for Higher-Income Retirees

The government may consider imposing a 10% tax on pension incomes exceeding PKR 200,000/month, exempting lower earners to protect low-income retirees. This policy ensures equitable taxation and generates additional revenue, with compliance facilitated through banks and pension agencies.

Justification

The proposed pension tax targets higher-income retirees, especially from the public sector organizations, without burdening low-income earners. By taxing pension income above PKR 200,000, the policy brings higher earners into the tax net while ensuring protection for vulnerable groups. Collaboration with banks ensures smooth implementation and compliance.

Estimated Outcome

- This policy could generate approximately PKR 25-35 billion per year, depending on the number of pensioners in the taxable bracket.
- Could reduce the fiscal burden on the government's pension liabilities.

(E) Health Insurance Tax Reform- Capping Employer-Provided Benefits for Fairer Taxation

The government may consider capping the tax exclusion on employer-provided health insurance benefits at PKR 500,000 per year for individual coverage, taxing benefits above this cap as ordinary income. This will reduce tax distortions and help control healthcare costs.

Justification

Capping the exclusion will incentivize more efficient spending on health insurance, while generating additional revenue by taxing higher-value benefits. It will also ensures that employer-provided health insurance remains accessible, but at a fairer tax burden.

Estimated Outcome

- This policy could increase tax revenue by PKR 5-10 billion annually, based on the number of employees benefiting from high-cost insurance plans. It would also help reduce unnecessary healthcare spending, benefiting both the tax base and the economy.

(F) Imposing Federal Excise Duty (FED) on Undertaxed and Non-taxed sectors

The government may consider expanding Federal Excise Duty (FED) to include property sales, sugar, acetate tow, and lubricants, harmonizing rates on tobacco products, and increasing FED on cement and airline tickets. Additionally, harmonizing FED rates on locally manufactured cigarettes, e-cigarettes, and nicotine pouches with those on imported cigarettes will ensure equity and minimize market distortions.

Justification

This policy would expand the coverage and enhancing rates will help to diversify fiscal inflows but also aligns taxation with broader economic and social goals.

Estimated Outcome

- Implementation of these measures is expected to elevate tax revenues to 12.3% of GDP, providing additional resources for development initiatives.
- Anticipated revenue generation PKR 1.723 billion, equivalent to 1.4% of GDP, will strengthen government finances and reduce reliance on external borrowing.

(2) Integrating Entire Business Value Chain into GST Regime

(A) Flat GST Policy for Mid-Tier Businesses

The government may consider to impose GST on businesses with annual sales above the lower threshold of PKR 6 million (quarterly) and below 40 million (quarterly) may be required to register for the GST and pay a 'flat' 1 percent tax on sales.

Justification

Integrating the entire value chain of all businesses into the GST regime will enhance transparency, reduce tax evasion, and ensure equitable taxation across sectors. By capturing previously untaxed segments, this policy will not only broaden the tax base but also create a level playing field for businesses.

Estimated Outcome

- By integrating the entire business value chain into the GST regime, an additional PKR 10-15 billion annually could be generated. This estimate considers Pakistan's tax-to-GDP ratio, the size of the informal economy, and potential compliance improvements.
- Formalizing the value chain could contribute to 0.1-0.2% growth in GDP, enhancing business documentation, investment flows, and economic stability.

(B) Flat-Rate Credit Scheme for Non-GST-Registered Sellers

The government may consider a flat-rate credit scheme for non-GST-registered sellers, requiring businesses to collect GST at a standard rate (e.g., 15%). Of this, 8.5% will be credited back to non-registered sellers to account for their input costs, while 6.5% will be remitted to the FBR.

Justification

This policy indirectly incorporates non-registered sellers into the tax system, ensures fair cost recognition, and promotes tax compliance.

Estimated Outcome

- A transitional framework, gradually converting 30-40% of non-GST-registered sellers into fully compliant GST-registered entities over 5-7 years.
- Encouraging formalization in high-growth sectors such as e-commerce, digital services, and small manufacturing could lead to a 0.5%-0.7% GDP contribution to tax revenues.

(C) GST on Low-Value Imported Goods (LVIGs)

The government may consider to make it mandatory for offshore sellers to register and account for GST on low-value imported goods (LVIGs) if their annual sales to domestic consumers exceed a specified threshold (e.g., PKR 9 million).

Justification

As cross-border e-commerce continues to grow, LVIGs often bypass taxation, causing revenue losses and disadvantaging local businesses. This policy will bring offshore sellers under the GST net, enhancing revenue collection while supporting fair competition. It aligns with global practices and addresses the digital economy's unique challenges in Pakistan.

Estimated Outcome

- It could generate an additional PKR 20-30 billion annually through effective taxation of LVIG transactions.
- Level the playing field for domestic businesses, encouraging competitiveness and supporting local industry growth.

(D) Promote Fairness in Taxation via MAT

The government may consider implementing a Minimum Alternative Tax (MAT) at a rate of 18.5% to minimize revenue losses. This measure would ensure that corporations with substantial profits contribute a fair share of taxes, even when utilizing tax incentives, loopholes, or aggressive tax planning strategies.

Justification

For the government, MAT enhances revenue predictability and reduces the fiscal gap by capturing taxes from corporations that otherwise exploit the existing tax structure.

Estimated Outcome

- It is assumed that around 20-25% of corporations with substantial book profits, but low tax liabilities, will be subject to the MAT.
- It is expected that tax evasion will decrease by 5-8% among large corporations.

(E) Levy Wholesale Equalisation Tax (WET) at 2%

The government may introduce a Wholesale Equalisation Tax (WET) at a 2% rate at the wholesale level, in addition to the existing 18% GST. This tax would apply to retailers, wholesalers, processed food industries, and certain agricultural products to enhance revenue collection and ensure fair taxation.

Justification

WET will broaden the tax base, curb tax evasion, and ensure fair contribution from undocumented wholesale and retail sectors. It will also promote transparency by requiring wholesalers and distributors to declare sales and pay taxes properly, reducing loopholes and improving compliance.

Estimated Outcome

- The introduction of WET could increase tax revenue by 10-15% by capturing transactions at the wholesale level. This additional revenue is expected to contribute 0.1-0.2% to GDP, bolstering government finances, reducing the fiscal deficit, and enhancing the efficiency and transparency of the tax system.

(3) Incidence of Tax on Affluent Classes

(A) Integrating Exporters into the Regular Income Tax System- Corporate and Personal Income Tax

The government may consider integrating exporters into the regular income tax system, streamlining tax collection from this traditionally under-taxed sector. Simplifying the Personal Income Tax (PIT) structure by reducing the number of slabs to five and raising the maximum tax rate for non-salary individuals (NSI) to 45% would ensure that high-income individuals contribute a fairer share of their earnings to national revenue.

Justification

Pakistan has a highly skewed income distribution, with the richest 10% controlling more than 30% of the country's wealth. A higher tax rate on non-salary individuals (NSI) who fall within the upper-income brackets especially in the private/ corporate sector is an effective way to reduce income disparities and promote a more equitable society.

Estimated Outcome

- The 45% tax rate will primarily affect the top earners and businesses, ensuring that the burden is proportionate to their ability to pay, without stifling growth or investment.
- The higher taxes on affluent individuals and the inclusion of exporters in the regular tax system, could lead to a 0.5-0.7% increase in the tax-to-GDP ratio over the next few years.

(B) Progressive Wealth Tax on Wealthiest 0.5% Households

The government may consider introducing a progressive wealth tax targeting the wealthiest 0.5% of households, inspired by Spain's "featherlight" model. This tax would apply to assets above a predetermined high net-worth threshold, excluding the middle class to ensure fairness. A sliding scale ranging from 1.7% to 3.5% can be used to calculate the tax, with higher rates applied to greater levels of wealth.

Justification

Inspired by Spain's "featherlight" model, this policy ensures that the tax burden is borne by those most capable of contributing, without affecting the middle class or essential economic activities.

Estimated Outcome

- It could generate revenue equivalent to 1% of GDP, potentially raising Pakistan's tax-to-GDP ratio from the current 10.3% to approximately 11.3%.
- By adopting manageable rates (1.7%-3.5%) and implementing robust enforcement measures, the policy can minimize capital flight and administrative costs.

(C) Real Estate Wealth Tax- Introducing to protect Lower-Income Household

The government may consider implementing a real estate wealth tax targeting individuals with real estate assets exceeding a high-value threshold (e.g., equivalent to PKR 50 million). With rates ranging from 0.5% to 1.5%, this tax would generate revenue, promote progressive taxation, and focus solely on affluent individuals, ensuring fairness while protecting lower-income households.

Justification

Pakistan's wealthiest 10% hold a major share of urban real estate, while lower-income groups face housing challenges. A 0.5% to 1.5% tax on properties over PKR 50 million would ensure equitable contribution from high-value asset holders to national revenue.

Estimated Outcome

- A 1% tax on properties valued over PKR 50 million could yield billions in revenue without increasing direct tax burdens on salaried individuals or low-income households.
- These funds can be reinvested into social housing, urban infrastructure, and public services to bridge the growing economic divide.

(D) Public Broadcasting Contribution Tax on Digital Earnings & Subscription Services

The government may consider imposing a 3.5% tax on earnings from social media platforms like YouTube, Instagram, and TikTok for creators earning over PKR 5 million annually. Additionally, a tax on digital subscriptions (Netflix, Disney+, Hotstar) could ensure fair contribution from the growing digital economy, with exemptions for low-income users and minors.

Justification

These platforms are reshaping traditional economic models, contributing significantly to the global economy. By taxing earnings from these platforms, the government can tap into this growing digital economy, ensuring that creators contributing substantial wealth to the system.

Estimated Outcome

- With Pakistan's GDP estimated at around $350 billion, or approximately PKR 87.5 trillion, the additional PKR 52.5 billion would contribute about 0.06% to the GDP.
- This viable strategy could help to increase tax revenues and support public broadcasting in Pakistan.

(E) Standardized Tax Rate of 15% on Exempted Sectors

The government may consider taxing sectors predominantly associated with higher-income groups through a standardized tax rate of 15% on profits and gains derived from electric power generation projects, investments in real estate and jewelry (both directly and indirectly), income from cinema operations, venture capital companies, and tourism.

Justification

These sectors are underutilized in Pakistan's current tax framework despite their potential for high returns. By taxing profits from real estate investments directly or indirectly, the policy ensures that these high-yield activities contribute fairly to public finances.

Estimated Outcome

- A 15% tax on sector profits could generate substantial revenue, especially from real estate, which contributes less than 1% to direct taxes despite its size.
- The additional revenue from this policy could increase the ratio by approximately 0.3-0.5%

(4) Removal of Tax Distortions, Procedural Lapses and Anomalies

(A) Compliance Risk Management (CRM) framework- Enhance Tax Compliance

The government may consider implementing the Compliance Risk Management (CRM) framework in Islamabad, Karachi, and Lahore, utilizing third-party data, cross-checks, and data analytics to enhance tax compliance. This approach will help identify high-risk taxpayers, improve audit efficiency, and increase overall tax collection in key markets.

Justification

This would help eliminate discrepancies between reported and actual earnings. This ensures that all taxpayers, particularly high-risk individuals and businesses, are taxed fairly, preventing the distortion of the tax base caused by under-reporting or misclassification of income.

Estimated Outcome

- The expected increase in tax collection from large markets could add approximately 0.2-0.3% to Pakistan's tax-to-GDP ratio over the next 2-3 years.
- This could lower the overall rate of tax evasion in the targeted regions by 5-7% annually.

(B) Tax Planning Unit (TPU) within the Ministry of Finance

The government may consider establishing a specialized Tax Planning Unit within the Ministry of Finance, staffed with experts, including cost and management accountants. This unit will exclusively concentrate on developing and implementing effective tax policies which should align with economic growth goals as well as enhance tax administration.

Justification

It can help in identifying under-performing sectors or areas of the economy where tax compliance is low, allowing for more effective targeting of resources. This strategic allocation will enable the Ministry of Finance to focus efforts on high-impact sectors or regions, thereby reducing wasteful spending and optimizing tax collection.

Estimated Outcome

- By introducing cost-effective and management-accounting techniques, the TPU will foster a more sustainable tax structure that maximizes revenues while minimizing inefficiencies.
- This will help resolve anomalies in tax collection by ensuring consistency in how taxpayers are treated across different sectors and regions.

(C) Enhancing the Tajir Dost Portal

The government may consider enhancing platforms like the Tajir Dost Portal by simplifying tax structures, automating calculations, and introducing sector-specific modules to ensure uniformity and clarity. Streamlining procedures through pre-filled tax returns, integrated payment gateways, incorporating tools for data reconciliation and cross-verification can improve transparency and reduce fraud.

Justification

Features like pre-filled tax returns, automated payment gateways, and clear guidance eliminate these issues, ensuring businesses can file their taxes more efficiently, reducing both government administrative costs and taxpayer frustration.

Estimated Outcome

- Simplified procedures and transparency will encourage voluntary compliance, expanding the tax net and increasing revenues.
- Transparent processes and user empowerment will strengthen the relationship between traders and tax authorities, reducing tax evasion and disputes.

(D) Streamlining TDS/TCS Compliances

The government may consider improving compliance with Tax Deduction at Source (TDS) and Tax Collection at Source (TCS) regulations in Pakistan by streamlining processes. By introducing automated systems within the FBR and provincial tax portals to calculate TDS/TCS based on applicable rates, reducing manual errors. Secondly, deploy AI and data analytics to identify non-compliance or anomalies in TDS/TCS deductions and deposits.

Justification

Automated calculations and pre-filled forms have been successfully implemented in countries like India through the TDS Reconciliation Analysis and Correction Enabling System (TRACES), significantly reducing errors.

Estimated Outcome

- Computerization and integration will minimize errors, delays, and disputes in tax deductions and collections.
- Standardized rates and transparent procedures will ensure a level playing field for all taxpayers.

(E) Cross-border implementation of VAT & GST

The government may consider applying VAT or GST on cross-border online sales to help the FBR address gaps in the current tax framework that lead to revenue leakage and unequal treatment of domestic and international e-commerce. This policy would ensure a more streamlined and equitable tax system while improving revenue collection efficiency, directly supporting the outlined goal.

Justification

It would capture transactions from international sellers like Amazon, AliExpress, and other global e-commerce giants facilitate transactions without remitting taxes. By taxing international e-commerce transactions, Pakistan asserts control over its economic activities, reclaiming revenue that would otherwise benefit foreign jurisdictions exclusively.

Estimated Outcome

- It would gains access to previously untapped revenue streams, significantly reducing leakage from the growing digital economy.
- Leveling the tax field fosters competition, innovation, and growth among local sellers.

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