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POLICY BRIEF

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Rationalizing IT Taxes for Human Development and Export Growth

INTRODUCTION

Pakistan stands at a critical crossroads, poised to make a significant leap into the digital era. The 'URAAN Pakistan–National Economic Transformation Plan (2024-2029)' articulates a clear and ambitious national vision: to drive sustainable economic growth, foster human development, and position Pakistan as a competitive force in the global economy.

At the heart of URAAN's transformation agenda is the 'E-Pakistan' pillar, which aims to significantly enhance the Information and Communication Technology (ICT) freelancing industry to a $5 billion benchmark, increase the number of computer science and Information Technology (IT) graduates to 200,000 per year, and foster a vibrant startup ecosystem capable of producing Pakistan's first unicorn. Complementing this is the 'Equity and Empowerment' pillar, which directly links digital access to improving universal health coverage, literacy rates, and reducing youth unemployment- recognizing technology as a fundamental driver of human development.

Yet, the transformative vision of URAAN faces a significant bottleneck: the prevailing tax regime on essential IT infrastructure. The 19.5% tax on telecommunication and internet services – a critical backbone for virtually all digital activity – inadvertently works against these national aspirations. This pervasive tax, whether levied as provincial Sales Tax on Services (STS) or Federal Excise Duty (FED), presents a substantial and often unrecoverable cost across the value chain.

This policy brief argues that a strategic rationalization of IT taxes, particularly on telecommunication services, is not merely a fiscal adjustment. Rather, it is a strategic imperative to unlock Pakistan's full potential for human development and to enable digital service exports to be more competitive globally.

- Pakistan's goal of achieving $5 billion in IT exports is hindered by inconsistent tax policies across provinces, which increase costs and reduce global competitiveness.
- In Punjab and Balochistan, IT exports are taxed at domestic rates of 15-16%, creating immediate financial obstacles for service providers targeting international markets.
- In Sindh, KPK, and ICT, exemption or no-adjustment policies – especially on the 19.5% telecom input tax – result in hidden taxes that inflate export costs and reduce competitiveness.
- The absence of full input tax refundability for exported services prevents true zero-rating, discouraging investment and job creation in the IT sector.
- The 19.5% tax on telecom and internet services undermines the URAAN initiative's equity and empowerment goals by limiting affordable digital access.

THE TAX LANDSCAPE

The tax landscape is characterized by varying tax rates, nomenclature, and inconsistent rules regarding input tax recoverability across federal and provincial jurisdictions. This section details these complexities, highlighting how the present tax regime, particularly on telecommunication services, creates unrecoverable costs that directly impede human development and stifle export competitiveness.

The Pervasive and High Burden of Telecommunication Tax

A uniform 19.5% tax is levied on essential telecommunication and internet services across all regions of Pakistan (Table 1). This crucial infrastructure, vital for all digital activities from basic connectivity to advanced IT operations, faces a disproportionately high tax burden. This levy is imposed as Federal Excise Duty (FED) in Islamabad Capital Territory (ICT) and other federal jurisdictions, and as General Sales Tax on Services (GST) by the respective provincial revenue authorities in Punjab, Sindh, Khyber Pakhtunkhwa (KPK), and Balochistan. Regardless of nomenclature, the 19.5% rate stands notably higher than the standard provincial/federal sales tax rates typically applied to most other services (ranging from 15% to 16%), making telecom an expensive outlier in the national tax structure.

Taxation of Domestic IT Services

Service tax rates on domestic IT services vary across provinces: Sindh, Balochistan, and ICT, impose a standard service tax rate of 15%, while Punjab applies a slightly higher rate of 16%. Importantly, the 19.5% telecom tax paid on inputs is generally adjustable against the output tax in Punjab, Sindh, and Balochistan, which helps avoid cascading. However, in ICT, this adjustment is less likely because the telecom tax is levied as FED, whereas IT services are taxed under GST – two separate tax regimes – potentially resulting in embedded costs even for domestic services.

In contrast, KPK uniquely applies a significantly lower 2% sales tax rate on domestic IT services. However, this comes with a critical drawback: the 19.5% telecom tax (and other input taxes) is not adjustable. This policy decision, driven by the provincial government's concern about managing potential net refunds due to the very low output tax rate, inadvertently burdens domestic IT businesses with embedded costs.

Table 1: Tax Rates and Input Recoverability on IT & Telecom Services Across Pakistan

Region	Telecom	IT Services		Input Tax Adjustability
		Domestic	Exports	
Punjab	19.5%	16%	16%	The 19.5% telecom tax (and other relevant inputs) is generally adjustable against the 16% output tax for both domestic and exported IT services.
Sindh	19.5%	15%	Exempt	Generally adjustable for domestic services. For exports, it is **non-refundable**, making it an embedded cost.
KPK	19.5%	02%	02%	For both domestic and exported IT services, the 19.5% telecom tax (and other input taxes) is **non-adjustable,** resulting in embedded costs.
Balochistan	19.5%	15%	15%	The 19.5% telecom tax (and other relevant inputs) is generally adjustable against the 16% output tax for both domestic and exported IT services.
ICT (Federal)	19.5%*	15%	Exempt	The 19.5% FED on telecom taxes, generally not adjustable against GST on domestic IT services due to separate tax natures.

* Federal Excise Duty (FED)
Sources: Finance Acts of the Respective Provincial Governments. FED Act and ICT Services Act for the Federal Government.

Taxation of IT Services Export

Consistent with the globally recognized destination principle – which advocates tax neutrality for exports – URAAN's national objective is to ensure that IT services are exported tax-free. However, the current situation is marked by a fragmented tax system, resulting in either direct taxes or input costs that cannot be recovered, undermining Pakistan's competitiveness in global digital markets.

IT services exported, such as software development and related solutions, are directly taxed at the standard domestic rates of 16% and 15%, respectively. While the 19.5% telecom input tax is adjustable against this output tax, the imposition of a direct sales tax on the export itself makes Pakistani IT services significantly more expensive for international clients compared to competitors operating under zero-rated regimes.

While both Sindh and ICT (Federal) grant an 'Exempt' status to IT exports, resulting in a 0% output tax on the service, this 'exemption' critically means that the 19.5% telecom input tax is not refundable for these exports. In Sindh, exporters cannot reclaim the 19.5% provincial GST applied to telecom and other service inputs. Similarly, ICT-based exporters are unable to offset the 19.5% Federal Excise Duty (FED) on telecom services. This structural gap embeds a significant "hidden tax" in Pakistan's IT export services from these regions, directly eroding profitability and undermining global competitiveness.

In KPK, similar to domestic IT services, IT exports are subject to a nominal 2% tax rate. However, the explicit policy of no adjustment for any input taxes, including the 19.5% telecom tax, means that this input burden translates into an embedded and unrecoverable cost. Consequently, the effective tax burden on IT exports from KPK is significantly higher than the nominal 2%, making them less competitive.

IMPACT OF CURRENT TAX REGIME

Pakistan's intricate and often contradictory indirect tax regime presents a fundamental challenge to realizing the transformative vision articulated in the URAAN Plan. Rather than acting as a catalyst for growth, the current taxation structure serves as a significant impediment, limiting digital inclusion, impeding human development outcomes, and reducing the global competitiveness of IT service exports.

Undermining IT Export Competitiveness

Pakistan's aspiration to achieve $5 billion in IT exports is critically hampered by its fragmented tax landscape. The inconsistent application of taxes across jurisdictions inflates the effective cost for Pakistani exporters, making them less competitive in the global market.

The taxation of IT exports in Punjab and Balochistan- at domestic rates of 15-16% - creates an immediate cost barrier for service providers targeting international markets. Meanwhile, in Sindh, KPK, and the ICT, the prevalence of "exemption" or "no adjustment" policies - particularly for the 19.5% telecom input tax- results in a "hidden tax" on exports. This widespread lack of true zero-rating, where all input taxes for exported services are fully recoverable, significantly inflates the cost of Pakistani IT services for international clients. It undermines global competitiveness, discourages investment, and constrains job creation in a sector defined by low-cost, high-volume service delivery. Even a few percentage points of unrecoverable tax can critically tip the scales between winning and losing a global contract.

Impeding Human Development and Digital Inclusion

The 19.5% tax on telecommunication and internet services has far-reaching negative consequences for human development and digital inclusion, directly contradicting the 'Equity and Empowerment' pillar of URAAN.

Regressive Nature: As a consumption tax, the 19.5% telecom tax is inherently regressive, disproportionately burdening lower and middle-income segments of the population. In today's digital economy, mobile data and internet access are no longer discretionary expenditures; they are essential tools for education, information, financial inclusion, and social connectivity.

Barriers to Digital Access: The high cost of internet and telecom services, exacerbated by this tax, creates significant barriers to digital access. It limits participation in online education platforms, telehealth services, e-commerce, and digital skills training initiatives, particularly in rural and underserved areas. It also widens the digital divide, hindering the development of a digitally literate workforce and equitable access to opportunities essential for human capital formation.

An expensive digital infrastructure discourages widespread adoption of e-governance solutions and digital public services, making it harder for citizens to interact with the government and access essential services efficiently.

Discouraging Investment, Innovation, and Job Creation

A complex and unpredictable tax environment is a significant deterrent to both local and foreign direct investment (FDI) in Pakistan's IT sector. Divergent tax regulations across provinces, coupled with inconsistencies in interpretation and refund mechanisms, creates significant administrative burdens and compliance costs for IT businesses, particularly those operating nationally or aiming for exports. This uncertainty raises the cost of doing business and diverts valuable resources from innovation and growth to tax management.

A less competitive and more burdensome business environment can contribute to a "brain drain," where skilled IT professionals seek opportunities in countries with more favourable operating conditions and higher earning potential, further undermining Pakistan's digital aspirations.

The current tax regime, rather than fostering Pakistan's digital revolution, imposes tangible and hidden costs that directly undermine the national agenda for human development and critically compromise the global competitiveness of its burgeoning IT export sector.

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RECOMMENDATIONS

A strategic and comprehensive overhaul of the current indirect tax regime impacting the IT sector is imperative to unlock Pakistan's digital potential and achieve the ambitious targets set forth in the URAAN National Economic Transformation Plan. The following recommendations offer a roadmap to create an enabling environment for IT exports, accelerate human development through digital inclusion, and attract vital investment.

Reduce the 19.5% Tax on Telecom and Internet Services: The high telecom and internet tax is a major barrier to both affordable digital access and cost-effective IT operations. Reducing this rate to align with standard sales tax levels (15%-16%) would lower operational costs for IT businesses, make internet access more affordable for citizens, support digital inclusion, and advance the equity and empowerment goals of the URAAN initiative.

Implement True Zero-Rating for IT Exports: All IT and IT-enabled services exports should be zero-rated across federal and provincial jurisdictions, with full refundability of input taxes such as the 19.5% telecom tax. This would eliminate hidden costs, improve profit margins, enhance global competitiveness, align the tax regime with international best practices, encourage reinvestment in talent and infrastructure, and simplify tax compliance for exporters.

Develop a National IT Services Tax Framework: Federal and provincial governments should collaborate to develop a unified, simplified, and consistent national framework for taxing IT services. This could involve standardizing definitions and rates (especially for domestic services) and ensuring a uniform scope of input tax adjustability across the country.

Single-Window Operation for IT Exporters: A dedicated and streamlined single-window mechanism should be developed and implemented for IT exporters to manage all their federal and provincial tax obligations related to exports, including registration, filing, and refund claims.