PTBA – Presentation

Financial Services – Tax Issues

May 14, 2026

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BANKS

BANKING COMPANIES – INTRODUCTION

(i) Banking companies operate under the Seventh Schedule with elevated headline rates.

(ii) Besides elevated corporate tax rate of 43% (for TY 2026), banks are also subject to Super Tax and other levies like windfall tax which is currently in litigation.

(iii) Banks are subject to a special Seventh Schedule regime aligned with prudential regulations issued by the State Bank of Pakistan.

(iv) Encounter layered federal–provincial oversight that materially increases compliance complexity.

(v) Banks are withholding agents for the purposes of various transactions.

BANKS

HEADLINE RATES, SUPER TAX, AND EFFECTIVE BURDEN

(i) For banking companies, the normal corporate tax rate has been increased relative to non-financial corporates.

(ii) Tax rates for banking companies are as follows:

Tax year	Normal rate (banks)	Highest Super tax rate	Indicative Effective tax rate
2025	44%	10%	54%
2026	43%	10%	53%
2027 and onwards	42%	10%	52%

BANKS

BANKING COMPANIES: FRAMEWORK AND SEVENTH SCHEDULE

(i) Taxation under Seventh Schedule to the Income Tax Ordinance

A single-basket approach that aligns tax computation with prudentially regulated financial statements. Banks operate under a special Seventh Schedule regime intended to align tax with regulated financials.

(ii) Purpose of single-basket approach

The purpose of this single-basket approach was to align taxation with the prudentially regulated financial statements of banks (as supervised by the State Bank of Pakistan), minimize book–tax differences, and create a clearer, predictable link between audited results and taxable income.

(iii) Recent amendment to rules

Recent amendments have introduced various rules requiring significant adjustments to the profit of the banking companies to arrive at taxable income. Particularly the adjustments relating to IFRS 9 Expected Credit Losses (ECL) model have to be negated irrespective of which assets it pertains to.

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LITIGATION LANDSCAPE AND APPELLATE POSITIONS

Issues generally decided in favor of banks	Issues decided against banks
Provisioning for bad debts on gross/net advances (1%, 5% bands)	Surcharge under section 4A
Dividend income taxable at concessional rates	Turnover determination for minimum tax under section 113
Concessional employee loans	Claim of general provisioning
Non-withholding on accrued markup	Provision for diminution in value of investments (post-2017 Explanation)
Provisions against other assets	Super tax under section 4B for relevant years
Disallowance of actuarial loss as a mere provision	Leasehold improvements
Provision for diminution in value of investments (prior to addition of Explanation in 2017)	
Treatment of donations and goodwill amortization in line with Seventh Schedule adjustments	

BANKS

ADOPTION OF IFRS 9 BY BANKS – KEY REPORTING CHALLENGES

(i) Deductibility of ECL Provisions

- ECL charges for Advances or any other financial assets are not deductible from TY 2025 under Rule 1(da).
- Only provisions categorized as “Loss” under SBP Prudential Regulations are claimable within the 1%/5% caps.
- Following provisions are not allowed to be claimed:
  - Initial adoption adjustments recorded directly in equity.
  - Stage 1/2 ECL charges, general provisions are not claimable and must be added back.
  - Provisions other than the “Loss” category.

BANKS

CLAIMABILITY OF REVERSALS AND WRITE-OFFS

(i) Claim reversals/write-offs only where the underlying provisions were previously disallowed.

(ii) This would henceforth require maintaining year-wise mapping to original charges.

(iii) Any claims should be supported with the external auditor's certificate with the return to support allowable provisions under Rule 1(c); non-filing or incomplete filing will lead to disallowance.

(iv) For Provisions against Advances, apply the 1% of gross advances and 5% SME caps correctly; and carry forward any excess under Rule 1(c).

(v) When provisions move between categories, downgrades to "Loss" category provisions are claimable and upgrades must be offered back for tax.

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ADJUSTMENTS RELATING TO PROVISION AGAINST DIMINUTION IN VALUE OF INVESTMENTS

(i) Debt instruments classified FVOCI

- OCI fair value movements are not taxed; tax is triggered on disposal when amounts are recycled to P&L.
- Confirm that cumulative OCI is recycled to P&L on disposal and maintain per-security records.

(ii) Equity instrument classified FVOCI

- OCI movements are not reclassified to P&L. Instead, on disposal the cumulative OCI is transferred within equity, but realized gains are taxed.
- Ensure that the amount transferred directly to equity is offered for tax as it has now been disposed and gain realized.
- Keep detailed per-security cost/proceeds records.

(iii) Equity instruments classified FVTPL

- Unrealized gains can be treated as not taxable even if recorded in Profit or Loss account as these are adjustments accounted for under IFRS 9 and nullifiable under Rule 1(da).
- Instead actual realized gain is computed on actual disposal.
- Compute tax gains using the carrying amounts as of December 31, 2023 as the baseline and retain per-security records.

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GENERAL REQUIREMENTS RE DOCUMENTATION AND CONTROLS

(i) Maintain detailed per-security cost, proceeds, and holding-period records for realized gain computations, and a mapping of reversals to original charges to substantiate claims and manage audit risk.

(ii) These disputes often arise with the Tax Department during assessments and are of factual nature that can only be explained or corroborated with documentation and records as stated.

BANKS

WINDFALL LEVY STATUS AND CHALLENGES

(i) The previously controversial “windfall” levy on income on “unexpected” income, profits or gains due to economic factors was applicable for tax years 2022 and 2023.

(ii) The levy has undergone challenge at all high courts level in Pakistan and is currently subjudice before the Supreme Court of Pakistan.

(iii) Judicial Status:

- The Sindh High Court, by short order dated 20 February 2025, dismissed banks’ petitions challenging the levy, following which recoveries proceeded from the Sindh based banking companies.
- Peshawar High Court has confirmed the validity of section 99D and its retrospective nature, but also ruled that the same cannot apply on profits already distributed.
- The favorable interim order earlier issued by the Lahore High Courts was also revoked, following which recoveries proceeded from Punjab based banks as well.
- Petitioner banks in all provinces have approached the Supreme Court, and the eventual ruling will be sector-wide in impact.

BANKS

WITHHOLDING IN THE DIGITAL/PLATFORM ECONOMY

(i) Banks as withholding agents for online marketplace / e-commerce platform.

(ii) As payment intermediaries, Banks are designated withholding agents for payments to sellers on such platforms, requiring withholding at 1% on all such payments.

(iii) Data/reporting requirements require banks to update their systems as follows:

- Banks need to upgrade their IT systems where required.
- Connect all key systems so they work together: merchant KYC and platform onboarding, payment tagging/coding, and the tax engine.
- Make sure merchant onboarding captures the right KYC details for platform sellers.
- Ensure payment codes clearly flag which transactions are platform payments.
- Set up the tax system to automatically spot transactions covered by section 153(2A).
- Apply the correct withholding rate based on the latest rate schedule for section 153(2A).

BANKS

WITHHOLDING AGENT FOR THE PURPOSE OF IPS ACCOUNTS

(i) **Requirement:** Finance Act 2025 introduced the requirement for banks maintaining IPS accounts to withhold 15% tax on capital gains from debt securities.

(ii) **Rationale:** The provision has been introduced to do away with the potential arbitrage where investors were able to do away with the tax withholding by early exiting the market, and to ensure consistency between interest and capital gains tax withholdings.

(iii) **Operational challenge:** There are complications in the way capital gains should be computed to be subjected to tax withholding in certain cases where holders of the security frequently change. The banks' tax system should be able to identify these cases and give appropriate cost reliefs wherever relevant.

BANKS

MULTI-JURISDICTIONAL OVERSIGHT AND COMPLIANCE COMPLEXITY

(i) Banks face layered oversight from federal authorities, four provincial revenue authorities, and revenue bodies in AJK and Gilgit-Baltistan.

(ii) This entails frequent audits, inquiries, and reconciliations across income tax, sales tax on services, and allied levies.

(iii) The resulting compliance cost is non-trivial and warrants a centralized tax governance model and management of tax matters.

(iv) Recently SRB and PRA have issues notices to banks on various matters requiring multi-jurisdictional compliance. These include various issues where taxpayers' and authorities' view is divided, such as:

- Incentive payments under SBP PRI scheme.
- Dining discounts.
- Payments to payment gateways (Visa / Mastercard etc.).
- Merchant Discount and interchange Fee.
- Payments of IT and other expenses.
- Ijarah leasing.
- Inter-segment revenue.

BANKS

OTHER WITHHOLDING OBLIGATIONS

(i) Section 236Y: Collect 5% adjustable advance tax on certain outward remittances via credit/debit/prepaid cards to non-residents.

(ii) Cash withdrawals (non-ATL): Withhold tax when same-day cash withdrawals exceed Rs. 50,000; rate was 0.8% for TY 2025.

(iii) Certain other international payments under section 152 – such as Fee for Offshore Digital Services, Payments to Card Network Companies etc.

(iv) Controls required from the Banks include updation of tax rates on dynamic basis and real-time Active Taxpayer List checks of the customers so that correct rates can be applied.

BANKS

IMPLEMENTATION OF SWAPS WITHHOLDING SYSTEM IN BANKS

A. What is SWAPS?

(i) SWAPS (Synchronized Withholding Administration and Payment Software) is a centralized platform developed with FBR and SBP to digitize and streamline withholding tax deduction, deposit, and reporting for corporate payments.

(ii) The banks who are working on the pilot SWAPS project have encountered multiple technical and operational issues.

- SWAPS integrates only with FBR's invoices; without provincial integration, payments are largely limited to Islamabad-registered vendors.
- SWAPS can't apply province-specific PST withholding rules, so purchases from provinces can't be correctly accounted for.
- Registered vendors aren't required to upload invoices to IMS; as a result of which payments may stall for un-uploaded invoices.
- Currently there is no way to process payments to unregistered suppliers.
- SWAPS system caused excess deductions. There's no standard mechanism to adjust/recover them, and refunds remain pending with FBR to date.

BANKS

MICROFINANCE INSTITUTIONS – TAX STATUS

(i) MFIs are licensed under their separate regulations with SBP oversight.

(ii) Statutory test under Section 5(b) of the Banking Companies Ordinance, 1962: "banking" means accepting deposits of money from the public for lending or investment, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise. SHC treats these elements as the core definition to identify "business of banking."

(iii) Core banking functions highlighted:

- Take deposit accounts.
- Take current accounts.
- Issue and pay cheques, and
- Collect cheques (crossed and uncrossed) for customers.

(iv) SHC relied on this articulation to distinguish banks from non-banks.

(v) Licensing: carrying on "banking business" in Pakistan requires a State Bank of Pakistan (SBP) licence under Section 27 BCO.

(vi) Based on this criteria, microfinance banks meet the SHC's "business of banking" criteria, provided they actually operate deposit accounts (including current/savings) with on-demand or scheduled withdrawal capabilities and are licensed by SBP.

BANKS

MICROFINANCE INSTITUTIONS – PRACTICE

(i) ITO defines "banking company" as:

> *"banking company" means a banking company as defined in the Banking Companies Ordinance, 1962 (LVII of 1962)*

(ii) The words "and includes anybody corporate which transacts the business of banking in Pakistan" have been removed through Finance Act 2025.

(iii) Post this amendment it would be difficult to take the position that Seventh Schedule is applicable on the MFIs as they are regulated under the separate Microfinance Institutions Ordinance, 2001.

(iv) In practice majority MFIs do not apply Seventh Schedule, rather have their income taxed at standard corporate rates under the normal regime.

(v) Seventh Schedule provides the benefit of 1% and 5% provisioning but has elevated tax rates.

BANKS

DIGITAL BANKS: OPERATING MODEL AND TAX IMPLICATIONS

(i) Licensing trend: SBP framework for digital banks (retail/full);

(ii) Treatment similar to banking companies once fully licensed and operating as banks.

(iii) Key tax issues.

(iv) Pre-commencement expenditure and software/platform build – capitalization and amortization policy; treatment under tax law for intangibles.

(v) Cross-border cloud and Software as a Service (SaaS) solutions – WHT on non-resident digital services, potential PE/nexus analysis, and provincial VAT on imported services.

(vi) Indirect tax: card/merchant acquiring, wallet fees, and premium app features typically fall within provincial service tax; interest/mark-up outside scope.

INSURANCE

(i) Applicability of Minimum Tax on turnover being a scheduler regime – and if applicable whether on gross or net turnover.

(ii) Taxation of Policy Holder and Shareholder Fund – dispute on Policy Holder Fund. Due to the peculiar nature of PTF in takaful business and the ambiguities in its legal status, different practices are being followed for taxation of PTF income i.e. on consolidated basis alongwith Operator Fund or on standalone basis.

(iii) Insurance Regulations 2018 – Combined PHF & SHF Presentation Financial statements prepared under the Insurance Accounting Regulations, 2018 present combined results of Policyholders' Fund (PHF) and Shareholders' Fund (SHF). Taxation under Fourth Schedule starts with the surplus transferred from PHF to SHF. At times, Tax authorities add items of PHF to SHF's income, and in certain cases, this addition is made in the ratio of surplus transferred from PHF to SHF, disregarding the fact that it is only surplus of PHF, as recommended by the actuary which is assessable to tax, subject to the adjustments given under the Fourth Schedule.

(iv) Ordinary disallowances – under Fourth Schedule.

(v) Carry forward of losses relating to listed securities – not aligned with section 37A.

(vi) Withholding tax under section 151A – exclusion required to align with section 37A.

(vii) IBNR Claims are recognised on accrual basis for both accounting as well as tax purposes. Tax authorities however tend to disallow the claim treating it as a mere provision, allowable only on reporting basis. The issue is currently pending in SCP.

(viii) Provincial sales tax matters:

- Reverse charge
- Jurisdictional Disputes

DFIs

(i) Allocation of expenses to Dividend and capital gains – still unresolved.

(ii) Withholding of tax under section 151 – resulting in unnecessary refunds.

(iii) Issue of SOE.

MUTUAL FUNDS

(i) Issue of Exemption Certificate can be resolved by amending section 159.

(ii) Withholding under section 151A – Clause (47B) – misinterpretation.

(iii) Provincial Sales Tax – Asset Management Services – jurisdictional dispute.

(iv) VPS – pre-mature withdrawals' – Clause (23A) – adjustability of tax withholding.

(v) Restoration of exemption of PEVF.

REIT

(i) Restoration of Clause (99A) – to allow tax neutral transfer of real estate to REIT.

(ii) Definition of Real Estate.

BROKERAGE HOUSES

(i) Due to the centralized, Sindh-based PSX trading architecture, brokerage services rendered nationwide face double taxation, with multiple provinces asserting jurisdiction over the same transaction. Although the Sindh High Court has held that the branch office from which services are provided determines tax jurisdiction, uncertainty persists due to the expanded definition of "place of business" covering virtual presence and web-portals.

(ii) The Sindh Revenue Board's attempt to classify brokerage houses as financial institutions or commercial establishments for application of the Sindh Workers' Welfare Fund is misconceived. Brokerage houses operate through qualified professionals and do not employ "workers" or "labour" in the statutory sense, rendering such application legally unsustainable.

(iii) Section 4C(2) of the Income Tax Ordinance, 2001 extends super tax to certain income streams otherwise falling under normal tax or the Final Tax Regime, including commission and profit on debt. As commission is the primary income of stockbrokers, super tax is effectively levied on a gross basis without allowance for legitimate business expenses, resulting in a disproportionate tax burden.

LEASING COMPANIES

(i) Loss arising on early termination of the leases is not allowed to be claimed by the leasing companies owing to the provisions of section 77(4) which requires that the residual value plus amounts recovered during the lease toward the asset's cost are at least equal to the asset's original cost.

(ii) Ijara lease – provincial sales tax on gross rentals.

(ii) Vehicles' cost restriction still Rs. 2.5 million

- **Depreciation cap for leased vehicles (for lessor):** Under section 28, the depreciable cost remains capped at Rs. 2.5 million.
- **Depreciation cap for non-leased vehicles (for lessor):** Under section 22, the depreciable cost is capped at Rs. 7.5 million.
- As a matter of policy, these caps should be harmonized to ensure neutral and equitable tax treatment between leased and non-leased vehicles.

THANKS