BUSINESS RECORDER
Founded by M.A. Zuberi

6th November, 2019

TAHIR AMIN

Doing business in Pakistan, Taxation causes general discontent

ISLAMABAD: Due to the current regulatory environment, it is not easy for entrepreneurs to do business in Pakistan, but there is general discontent when it comes to taxation.

This has been stated in a joint report of World Bank (WB) and invest2Innovate "Pakistan Startup Ecosystem Report 2019.

The report stated that issues such as opening a bank account, receiving credit, paying taxes, enforcing contracts, etc, are still identified as areas that need to be refined. There is a lack of an efficient taxation process to save time and resources of entrepreneurs and investors. World Bank's Country Director for Pakistan Illango Patchamuthu while sharing the report on social media, tweeted, "Old & tedious procedures barred the entrepreneur's way in successfully Trading Across Borders - till the Reformer brought in the reforms to make this integral part of #DoingBiz a much easier, less costly & time intensive procedure!"

According to the report in 2019, the time required to start a business was reduced by three days while time required to register a property was reduced by 13 days. However, some issues need to be refined.

The report maintained that another important aspect of taxation is the difference among provinces owing to federal taxes and provincial taxes. Each province has its own revenue authority that administers sales tax on services and other provincial duties. Where in reality the recent federal tax exemption for tech startups only meant exemption from taxes at the federal level, many perceived it as an all-encompassing exemption. This exemption (from paying Corporate Income Tax) still meant that startups in different provinces were paying other types of taxes such as (GST, property taxes, Provincial Sales Tax, etc.) and that also at different rates.

Additionally, startups are currently taxed on revenue rather than profits which creates a common misconception that startups do not qualify for corporate income tax because they are not profitable up until a certain point in their lifecycle.

There is a major need for the government to not only make the regulatory processes simpler but to also focus on creating a better user experience for entrepreneurs; i.e. a one-window solution.

The report maintained that while Pakistan's digital startup landscape has grown significantly in the past seven years, the ecosystem has its share of challenges, particularly when it comes to regulations, access to early stage capital, and the gender gap in the entrepreneurship space.

The current policy environment is not favorable for investors. Investors point to unfavorable policies and regulations as a major obstacle for their activities in the Pakistan startup ecosystem.

Currently, there are approximately 20 formal investors in the Pakistan ecosystem and many of these funders cater to startups ranging from pre-seed to pre-Series A stages. Despite this notable increase in activity and players, there are still a number of challenges and gaps that make it difficult for early stage firms to grow and succeed in Pakistan.

Over the past five years, (2015-19), there were a total of 101 deals of Pakistan-based companies, constituting over $165 million, which were raised by 82 companies. While this is positive, Pakistan still has a long way to go compared to its neighbors in South Asia. Based on a score given to the number of venture capital deals per year in 2019, Pakistan ranked at 72, which was below India, 30, and Sri Lanka, 45, but was higher than Bangladesh, 73.

While local venture capital funds are not incentivized to domicile their funds inside Pakistan, foreign investors also need to be provided with further incentives to enter and invest in startups in the country. This, in addition to the stringency and complexity of the regulatory processes, poses a serious challenge to all stakeholders in the ecosystem.

The report recommended that the government needs to continue to improve the business environment, such as those areas covered by Doing Business, to make doing business less cumbersome for investors and startups. Improving fund legislation and compliance, as well as registration and compliance for start-ups is a key. Pakistan's government can play a strong role in providing high-risk no-return capital to startups to reduce the pre-seed and early-stage gap and mitigate risk for investors, to help crowd in private sector investors. Support players need to customize their curriculum keeping local realities in mind and focus on industry-specific mentor matching. A one-window operation for startups to register their businesses and consolidate compliance requirements could avoid delays and additional costs.

The report underscored the need for improving the current regulatory environment for doing business to help startups and investors alike. The government can also do more to improve the environment for local venture capital funds. It can iterate on the current private funds legislation to make it more flexible and cost-effective for venture capital funds to set up inside the country and run their operations seamlessly.