



**PROPOSALS FOR
FEDERAL BUDGET
2026-27**

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Acknowledgement and Disclaimer

This document, **Proposals for the Federal Budget 2026–27**, has been prepared by the Policy Research and Advisory Council (PRAC). It aims to present research-based policy recommendations for strengthening Pakistan’s fiscal framework, reducing the cost of doing business, supporting productive sectors, enhancing competitiveness, and promoting sustainable economic growth.

The document incorporates stakeholder feedback and practical insights gathered from businesses and sector representatives. These consultations helped identify key challenges faced by taxpayers, industries, exporters, and service providers under the existing fiscal and regulatory framework. PRAC gratefully acknowledges the valuable contributions of participating stakeholders, whose inputs and budget proposals helped shape the recommendations presented in this document.

All data and statistics cited in this document are drawn from the latest available official sources and may be subject to revision. The analysis, interpretations, and recommendations presented herein are solely those of the authors and do not necessarily reflect the views of the institutions, organizations, or data sources referenced.

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Preface

The Federal Budget 2026–27 arrives at a critical juncture for Pakistan’s economy, where fiscal consolidation must be carefully balanced with the need to revive investment, strengthen productive capacity, restore competitiveness, and improve the ease of doing business. As the country continues to face external financing pressures, revenue mobilization challenges, and structural constraints to growth, the forthcoming budget must move beyond short-term revenue extraction and serve as a strategic instrument for sustainable and growth-oriented reform.

Despite an improvement in real GDP growth to 3.8 percent in H1-FY26, compared to 1.9 percent in the same period last year, the macroeconomic environment remains fragile. CPI inflation rose to 10.89 percent year-on-year in April 2026, indicating renewed cost pressures on households and businesses. At the same time, monetary conditions remain tight at 11.5%, reflecting risks from energy prices, freight charges, insurance costs, and broader macroeconomic uncertainty. These risks have been further amplified by ongoing Middle East tensions, which the State Bank of Pakistan has highlighted as a potential threat to the macroeconomic outlook.

The external sector also reflects continued vulnerability. The current account recorded a US\$252 million deficit during July–April FY26, compared with a US\$1,662 million surplus in the corresponding period last year. More critically, the goods trade deficit widened to US\$32.2 billion during July–April FY26, compared with US\$26.6 billion last year, while exports contracted by 6.3 percent year-on-year, reflecting persistent competitiveness challenges amid rising production costs.

In this context, these proposals seek to contribute to a more coherent, equitable, and sustainable framework. The proposed reforms focus on simplifying the tax structure, reducing compliance burdens, broadening the tax base, and rationalizing tax policies to support formalization, investment, export competitiveness, and business expansion. The underlying principle is that revenue generation and economic growth should not be treated as competing objectives; rather, a broader, more dynamic, and more competitive economy provides the strongest foundation for long-term fiscal stability.

It is hoped that these recommendations will support evidence-based policymaking and contribute meaningfully to the formulation of the Federal Budget 2026–27. A well-calibrated budget can play a decisive role in rebuilding investor confidence, strengthening Pakistan’s productive base, and positioning the economy on a more sustainable path of growth, competitiveness, and fiscal responsibility.



**INCOME
TAX
PROPOSALS**

A. Income Tax Proposals

1. Restoring Export Competitiveness through the Final Tax Regime

The shift of exporters from the Final Tax Regime (FTR) to the Normal Tax Regime (NTR) under the Finance Act 2024 has significantly increased the tax burden on exporters. The 1% withholding tax under Section 154 has been converted into a minimum tax, along with an additional 1% advance tax on export proceeds, resulting in a 2% upfront tax burden in addition to 29% corporate tax and super tax of up to 10%. During July–January FY2026, FBR collected Rs. 103.29 billion from exporters in withholding and advance income taxes, while exports declined by approximately 6.3% YoY during the same period. The current regime has also increased compliance requirements through quarterly reporting and refund-based adjustments, creating liquidity pressures for exporters.

Recommendation:

- Restore the option for exporters to choose between FTR and NTR, with a rationalized upward adjustment in the FTR rate to offset revenue implications.
- Provincial levies such as EOBI and WWF should also be integrated into the final tax rate to simplify compliance and reduce cash-flow constraints.

Chamber/Association: PRAC.

2. Phasing Out the Super Tax to Reduce Corporate Burden

The super tax imposed under Section 4C has substantially increased the effective corporate tax burden in Pakistan. Companies with income exceeding PKR 150 million face super tax rates of up to 10%, in addition to 29% corporate tax, 10% income surcharge, 2% Workers' Welfare Fund, and 5% Workers' Profit Participation Fund, pushing the overall effective tax burden close to 60%. Originally introduced in 2015 as a temporary measure, the super tax has effectively become permanent. Following the FCC ruling permitting retrospective application, businesses now face additional liabilities estimated at Rs. 217 billion for Tax Years 2022–2026.

Recommendation:

Rationalize super tax rates, exempt export-oriented and productive sectors, and introduce a sunset mechanism to gradually phase out the levy and restore a competitive corporate tax environment.

Chamber/Association: PALSP, PPEPCA, PHA

3. Maintaining Final Tax Regime for IT and ITeS Exports:

Pakistan's services exports have grown from US\$5.4 billion in 2020 to US\$8.4 billion in 2025, indicating strong growth potential. However, Pakistan's share in global services exports remains significantly below that of regional competitors such as India and Vietnam. The Final Tax Regime and concessional 0.25% tax rate for IT and ITeS exports have provided certainty and encouraged sectoral growth.

Recommendation:

Maintain the Final Tax Regime and extend the concessional 0.25% rate for another five years beyond June 30, 2026, covering Tax Years 2027–2031.

Chamber/Association: PRAC

4. Broadening Pakistan's Tax Base

Pakistan's Tax-to-GDP ratio stands at 11.1% in FY25, with a narrow tax base. This persistent deficit keeps Pakistan far below the World Bank's 15% minimum tax-to-GDP baseline required for developing nations to sustainably finance infrastructure and reduce poverty. Only around 7.2 million individuals file income tax returns out of a population exceeding 240 million, while the informal economy is estimated to be between 35–59% of GDP by various studies. Although POS integration was mandated in 2021, approximately 80% of Tier-1 retailers reportedly remain non-compliant as of February 2026. Meanwhile, sectors such as agriculture and real estate continue to remain undertaxed, placing excessive pressure on documented sectors.

Recommendation:

- Broaden the tax base by integrating agriculture, real estate, and informal retail into the documented economy through strict POS enforcement, digital integration, simplified compliance procedures, and coordinated data analytics.
- It is recommended that the government identify taxable individuals outside the tax net through CNIC-linked data integration, including bank accounts, property, vehicles, travel, utility bills, card usage, and high-value purchases.
- Provinces should also fully implement revised progressive Agricultural Income Tax rates and include livestock income within the agriculture tax net.

Chamber/Association: PRAC, ICCI

5. Providing Relief for the Salaried Class amid Rising Living Costs

The salaried class has experienced a disproportionate increase in tax burden in recent years. Salary withholding tax collections increased by 54.7%, rising from Rs. 391.4 billion in FY2023–24 to Rs. 605.6 billion in FY2024–25, making salaries the second-largest source of withholding tax revenue with an 18% share in total collection. Salaried individuals are also subject to a 9% income surcharge, while inflation and rising utility costs have significantly reduced disposable incomes. The tax-free income threshold has remained stagnant at Rs. 600,000 despite persistent inflation and marginal tax rates reaching up to 35%.

Recommendation:

- Increase the tax-free threshold to Rs. 1,000,000 annually, index tax slabs to inflation to prevent bracket creep, and reduce the maximum marginal rate to 25% to support low- and middle-income households.

Chamber/Association: PRAC, PPEPCA, PHA

6. Rationalize the Tax Rates for Non-Salaried Individuals/AOPs

Non-salaried individuals and Associations of Persons (AOPs) currently face tax rates ranging from 15% to 45%, along with a 10% surcharge under Section 4AB and super tax under Section 4C for higher income brackets. This layered taxation structure pushes the effective burden for high-income AOPs to approximately 61–62%, discouraging formalization and incentivizing informal business arrangements.

Recommendation:

- Increase the exemption threshold from Rs. 600,000 to Rs. 1,200,000, reduce the top marginal rate from 45% to 30%, and withdraw the Section 4AB surcharge for non-salaried individuals and AOPs.

Chamber/Association: ICCI, PRAC

7. Promoting Corporate Formalization through Dividend Tax Relief

Under the Income Tax Ordinance, 2001, dividends paid by companies are subject to tax under Section 5 and deduction at source under Section 150, with the general dividend tax rate set at 15%. In the case of a standard non-banking company, profits are first taxed at the corporate rate of 29%, while dividends distributed from after-tax profits face an additional 15% tax,¹ creating an effective burden of around 40% on distributed corporate profits.

By contrast, under Section 92(1), an Association of Persons is taxed separately, and amounts received by members out of the AOP's income are generally exempt in the members' hands, subject to statutory conditions. This creates an asymmetry between corporate and AOP structures, which may influence entity-choice decisions, incentivizing documented avoidance behavior: shareholders of private limited companies routinely extract value through loans and advances rather than declared dividends to circumvent the additional 15% levy.

Recommendation:

Amend Division I of Part I of the First Schedule to reduce the final tax rate on dividends received from private limited companies from 15% to 7.5% for Tax Year 2026/27, while retaining the existing final tax mechanism under Section 5(2). This narrows the effective rate differential with AOP structures without eliminating it, strengthens incorporation incentives, reduces the documented incentive to disguise distributions as shareholder loans, and preserves a proportionate revenue contribution from documented corporate entities.

Chamber/Association: ICCI

¹ <https://www.moore-global.com/services/tax/international-corporate-tax/pakistan/>



**SALES
TAX
PROPOSALS**

B. Sales Tax Proposals

8. Enhancing EFS through Broader Coverage and Operational Flexibility

The Export Facilitation Scheme (EFS) is a streamlined initiative; however, its effectiveness is limited by the withdrawal of zero-rating on sales tax inputs for locally procured inputs, bank guarantee requirements, a short utilization period of 18 months, and a rigid subcontracting timeline of 90 days. Relaxing these constraints could significantly enhance its impact for exporters.

Recommendation:

- Restore zero-rating on local inputs, extend EFS coverage to utilities, allow low-cost guarantees or post-dated cheques, extend utilization and subcontracting timelines, and introduce AI-based validation systems to reduce discretion and compliance delays.

Chamber/Association: PDMEA, PRAC

9. Ensuring Time-Bound Sales Tax Refunds to Ease Business Liquidity

Delays in sales tax refunds continue to create severe liquidity pressures for exporters and manufacturers. Although FBR guidelines require export refunds through FASTER within 72 hours and excess input tax refunds within 45 days, refund processing delays persist due to system issues and procedural bottlenecks. Following the withdrawal of zero-rating on local supplies, exporters are increasingly dependent on refunds, resulting in working capital constraints and reduced competitiveness.

Recommendation:

- Enforce strict compliance with refund timelines, introduce automatic compensation for delays, publish monthly refund performance data, and permit adjustment of verified pending refunds against future tax liabilities.

Chamber/Association: PDMEA, ICCI and PRAC

10. Reducing Further Tax Burden on Manufacturers through Third Schedule Coverage

Weak enforcement and widespread under-invoicing in the retail sector expose consumers to excessive and arbitrary pricing, particularly in markets dominated by unregistered and non-filer retailers. Expanding the Third Schedule can also address the burden of 4% further tax on supplies to unregistered retailers. Although this tax was intended to encourage retailer registration, it has not delivered the desired result, as a large share of retailers remains undocumented.

In practice, manufacturers often absorb the 4% further tax to protect retailer margins and prevent retailers from refusing to stock their products. This turns further tax into a recurring business cost rather than an effective documentation tool. Placing such products in the Third Schedule will remove the additional tax burden, allowing manufacturers to set more stable prices without reducing their profit margins. Printed retail pricing strengthens enforcement by providing food authorities and price control agencies with a clear, visible compliance

benchmark, improving monitoring, and reducing price violations. This move will also ensure easier tax collection and simpler, more predictable prices.²

Recommendation:

The Third Schedule should be expanded to include essential consumer goods such as cooking oil, milk and dairy products, infant nutrition, frozen foods, flour, noodles, and condiments. Moving suitable FMCG products to the Third Schedule would remove the under-invoicing, price distortion, reduce cost pressure on manufacturers, improve price stability, and allow FBR to collect sales tax upfront in a more predictable manner.

Chamber/Association: Nestlé Pakistan

11. Reduced Sales Tax Rate for All IT Equipment and Hardware

The current sales tax structure for IT hardware creates inconsistencies and raises operational costs for the technology sector. While computers and laptops are taxed at 10%, servers, networking equipment, storage devices, and peripherals are subject to 18% sales tax. This divergence increases capital costs for IT exporters and creates opportunities for misclassification disputes.

Recommendation:

Introduce a uniform 5% sales tax rate on all IT equipment and hardware for both imports and local supplies, while expanding PSEB import exemptions for registered IT and ITeS exporters.

Chamber/Association: ICCI

12. Sales Tax Exemption on Non-Locally Manufactured Plant and Machinery

The import of modern printing, lamination, extrusion, and recycling machinery is currently subject to a significant sales tax burden, increasing the cost of technological upgradation for the packaging and plastics industry. Reduction or exemption of sales tax on such machinery would encourage industrial modernization, promote sustainable and energy-efficient manufacturing practices, improve product quality and export competitiveness, and support investment in environmentally responsible recycling infrastructure in Pakistan. The standard sales tax rate on imported machinery is generally 18%, unless covered under specific exemptions for industrial plant and machinery.

Recommendation:

- Extend sales tax exemption available under existing industrial machinery provisions to the import of plant and machinery not manufactured locally, subject to prescribed conditions and certification requirements.
- Allow a reduced sales tax rate on the import of plant and machinery not manufactured locally to facilitate industrial modernization, improve production efficiency, and lower the cost of technological upgradation for the manufacturing sector.

² <https://www.brecorder.com/news/40418343/mofs-tax-policy-unit-likely-to-continue-with-policy-of-expanding-list-of-fmcm-items-taxed-on-printed-retail-price>



CUSTOMS PROPOSALS

C. Customs Proposals

13. Reassessing Pakistan's National Tariff Policy 2025-30

Pakistan's tariff policy should not be based on unilateral liberalization alone, particularly in a global environment where countries are increasingly using tariffs, export controls, and trade blocs as strategic industrial policy tools. The tariff reduction under the National Tariff Policy 2025–30, which seeks to reduce the average tariff from 10.4% to below 6% by 2030 (which is below the average tariff of 16% in India & 14% in Bangladesh) and lower the maximum slab from 20% to 15%, risks weakening Pakistan's bargaining position in future Free Trade Agreements and Preferential Trade Agreements.³ Past liberalization experience shows that reducing tariffs without a strong industrial base did not significantly expand exports; instead, Pakistan's trade deficit widened, imports grew sharply, and local industry faced premature de-industrialization. While competitors such as India and Bangladesh continue to maintain relatively higher tariff protection and use tariffs strategically, Pakistan's unilateral tariff reduction may expose the domestic industry to import competition without securing reciprocal market access for exports.

Recommendation:

- **Reassess the National Tariff Policy 2025–30** before fully implementing the planned reduction in average tariffs. Tariff policy should be aligned with industrial policy, export strategy, and import-substitution priorities. Pakistan should avoid unilateral tariff liberalization without reciprocal market access and instead use tariff concessions as a negotiating tool in Free Trade Agreements and Preferential Trade Agreements.
- **Maintain lower duties on non-locally manufactured raw materials, intermediate inputs, capital goods, and machinery** to reduce production costs. At the same time, appropriate tariff protection should be retained for finished goods and sectors critical to industrial development, economic security, and areas where domestic industry has existing or potential production capacity.
- **Conduct sector-wise impact assessments** before reducing tariffs on products with domestic manufacturing capacity. Safeguard measures should be introduced where tariff reductions result in import surges or injury to local industry. Tariff reductions should also be reviewed annually against trade deficit, import growth, export performance, and industrial output. At the same time, additional customs duties and regulatory duties should not be phased out without an alternative protection mechanism for vulnerable industries.

Chamber/Association: PRAC

³ <https://www.dawn.com/news/1940660>



GENERAL PROPOSALS

D. General Proposals

14. Regionally Competitive Energy Tariffs for Textile Sector

The textile sector remains the backbone of Pakistan's exports, contributing around 55.8% of total exports, equivalent to nearly US\$17.9 billion in FY2025, while employing 30–40% of the industrial workforce. However, high energy costs continue to undermine export competitiveness, with electricity tariffs around 13 cents/kWh compared to regional competitors charging 6–9 cents/kWh. The suspension of the Duty Drawback of Taxes and Levies (DLTL) has further increased production costs by limiting the recovery of local levies.

Recommendation:

Introduce Regionally Competitive Energy Tariffs (RCET) at 8 cents/kWh for electricity and US\$7/MMBtu for gas for export-oriented textile units, while reinstating DLTL as a percentage of realized export proceeds. The combined restoration of RCET and FTR is projected to generate an additional US\$3 billion in textile exports.

Chamber/Association: KCCI

15. Petroleum Development Levy Reform

The function of the petroleum levy has been inverted; designed to absorb oil-price shocks, it now operates as a unidirectional revenue instrument by the federal government. When crude fell 10% in May 2026, the government raised the petrol levy by Rs 13.91/litre instead of passing consumer relief. Petrol prices have increased by 58.7% since Mid Feb 2026, driving CPI to 10.9% (in April 2026), with fuel contributing over half of inflation. PDL bypasses provincial NFC sharing, allowing the federal government to retain revenues while imposing a flat and regressive charge on all consumers, regardless of income level. This increases fuel prices and fuels cost-push inflation. The government then attempts to control this self-induced inflation through monetary tightening, which suppresses demand but does not address the underlying source of the price increase.

Recommendation:

It is proposed to restore the parliamentary statutory ceiling on PDL (Rs70/litre); reinstitute the countercyclical mechanism requiring automatic levy reduction when global crude rises, preventing executive revenue discretion during normal market conditions. Ring-fence PDL collections into a dedicated strategic petroleum reserve stabilization fund with transparency.

Chamber/Association: PRAC

16. Declining Development Space Amid Rising Infrastructure Needs

On June 4, 2025, the National Economic Council approved a record Rs. 4,224 billion National Development Outlay for FY2025–26, including a Rs. 1,000 billion federal PSDP. However, the PSDP remains constrained at only 5.7% of the total federal budget and around 0.6% of GDP, compared with 22.0% of the budget in FY2010. At the current level of allocation, existing approved projects would take more than a decade to complete, even without the addition of

new schemes or cost revisions.⁴ This persistent decline constrains public investment and weakens welfare delivery despite PSDP being the core vehicle for infrastructure and social development.

Recommendation:

In Budget 2026-27, PSDP allocations should be increased as the total budget to expand fiscal space for development and accelerate project completion timelines. Prioritise multi-year, fully funded project commitments with strict release schedules to reduce delays, cost overruns, and infrastructure delivery gaps.

Chamber/Association: PRAC

⁴ https://pc.gov.pk/uploads/archives/PSDP_2025-26_Final.pdf

Appendix: List of Stakeholders

S. No.	Chambers/ Associations/ Industry
1.	Islamabad Chamber of Commerce and Industry-ICCI
2.	Karachi Chamber of Commerce and Industry-KCCI
3.	Nestle' Pakistan
4.	Memon Professional Forum-MPF
5.	Pakistan Association of Large Steel Producers-PALSP
6.	Flexible Packaging Association of Converters of Pakistan-FLEXPAC
7.	Pakistan Petroleum Exploration & Production Companies' Association-PPEPCA
8.	Pakistan Denim Manufacturers and Exporters Association-PDMEA
9.	Pakistan Hotels Association-PHA