DOING BUSINESS IN PAKISTAN

Introduction

Beginning with liberalization of the economy in the 1990s, Pakistan has actively sought to promote and attract foreign investment in the country. Pakistan has one of the most liberal foreign investment regimes in the region along with a robust legislative framework, which not only protects but also guarantees foreign investment in the country.

Haroon Jan Baryalay

Founding Partner
Baryalay.law, Advocates & Consultants

Cell: +92 317-5099555

Email: haroon@baryalay.law

Investment Policy

In order to encourage foreign investment inflows into the country, the Government of Pakistan introduced a new investment policy in 2013 which replaced the earlier Investment Policy of 1997. Under the new Investment Policy of 2013, the Government has sought to remove barriers to foreign investment and promote Pakistan’s image as a competitive investment destination offering high returns. Amongst other initiatives, the Investment Policy 2013 proposes initiatives to reduce government red tape and streamline setup procedures by designating the Board of Investment (BOI) as a single window point of contact for foreign investors. Other notable initiatives include the introduction of special economic zones (discussed below), fostering greater coordination amongst the various ministries and departments, and enhancing the role, resources and capacity of the BOI. According to the BOI website, Pakistan has seen a significant increase in foreign capital inflows under the new policy, increasing from USD 1.4 billion in 2012-2013 to over 2.4 billion in 2016-2017.

Over the past decade, China has become the single largest foreign investor in Pakistan's economy, whose inflows have more than offset the decline in investment from the United States, the largest investor 10 years ago. Power, construction and oil and gas sectors have been the three top recipients of foreign investment.

Protection of Foreign investment and Repatriation of Capital

In order to encourage foreign investors to invest in the country, two principal laws have been enacted which seek to protect foreign investment; the Foreign Private Investment (Promotion and Protection) Act 1976 (FPIPPA) and the Protection of Economic Reforms Act 1992 (PERA).

Under the FPIPPA, foreign investment is given protection from nationalization by the State, except under due process of law and for adequate compensation. Under PERA, all local and foreign investment is now given blanket protection from nationalization by the State. PERA also removed restrictions on movement of foreign currency and made it possible for individuals to open foreign currency accounts with banks in Pakistan and remit foreign currency out of the country through banking channels.

Foreign capital investment along with profits earned, disinvestment proceeds and capital gains are given statutory protection under these laws and can be repatriated freely outside the country. Similarly, principal and interest payments on foreign loans may also be freely repatriated. The relevant investment / loan facility must be registered with the State Bank of Pakistan at the outset and must be made in foreign currency and routed through banking channels into Pakistan.

Pakistan has also signed bilateral investment treaties for the promotion and protection of foreign investment with almost 50 states. These agreements seek to protect investors of contracting states by:

a. guaranteeing equal treatment and prohibiting discrimination between local and foreign investments;
b. allowing free repatriation of capital, including profits, dividends, interest income, disinvestment proceeds etc.; and
c. providing for a dispute settlement mechanism to settle any investment disputes between a host country and an investor belonging to the other contracting state.

Foreign Ownership

Pakistani laws permit 100% foreign ownership in all sectors of the economy, except in certain specified sectors where foreign ownership is restricted. The restricted sectors include arms and ammunitions, high explosives, radioactive substances, printing securities, currency and mint, and consumable alcohol.

Foreign ownership in the following sectors, although not restricted, is capped or is subject to governmental approval:

a. Airline industry. Foreign ownership is limited to 49% and management control must be vested in Pakistani nationals.

b. Banks and financial institutions. Where an investor (whether local or foreign) acquires more than 5% of the shares of a bank or financial institution, it must obtain consent of the State Bank and fulfill the fit and proper criteria laid out by the State Bank.

c. Media. Foreign companies and nationals are prohibited from holding a license to provide broadcast media or distribution services in Pakistan. A media license may only be granted to a Pakistani individual national or a locally incorporated company majority owned and controlled by Pakistani nationals.

d. Insurance. An insurance company must be established under the laws of Pakistan and branches of foreign insurance companies are disallowed. Foreign insurance companies must therefore set up subsidiaries which are licensed locally in order to provide insurance services in the country.

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Corporate forms

The most common forms of corporate entities used by foreign investors seeking to invest in Pakistan is by incorporating a subsidiary as a private limited company, or by establishing a branch or representative office.

A private limited company can be set up with a minimum of two and a maximum of 50 shareholders. Under the new Companies Act 2017, a company must specify a principal line of business in its memorandum, although its activities need not be limited to a single activity. A private limited company does not have a minimum share capital, although each member must subscribe to at least one share and the shares must be fully paid. The company may issue different classes of shares with varying rights. The time and process for incorporating a private limited company has been simplified and it usually takes less than two (2) weeks to incorporate a private limited company.

A single member company is a private limited company but with a single shareholder. It can be established in a manner similar to a private limited company.

A branch is not a separate legal entity and is simply an extension of the parent. The new Companies Act 2017 seeks to regulate foreign companies, which also includes providing the Securities and Exchange Commission of Pakistan (SECP) with details of beneficial ownership of foreign companies doing business in Pakistan. As of the date of writing, the SECP is in the process of reviewing to limit some of the disclosure requirements for foreign companies.

The other corporate entity which can be incorporated under the new Companies Act is a public limited company, which is any company other than a private company. A public limited company may be listed or unlisted. An unlisted public limited company must have at least three shareholders and does not have a minimum share capital requirement.

Other commonly used corporate forms include a general partnership, which can be formed under the Partnership Act 1932. Recently, limited liability partnerships (LLP) have been introduced through the Limited Liability Partnership Act 2017. An LLP is similar to a partnership but limits the liability of the partners to the amount of capital invested. An LLP is required to have at least one designated partner who must be a Pakistani national and resides in Pakistan. Foreign limited liability partnerships are permitted to carry on business in Pakistan subject to local registration.

The new Companies Act 2017 also includes two new specialized forms of companies, real estate companies and agriculture promotion companies. A company engaged in the real estate business is now required to include "real estate activities" in its memorandum as its principal line of business. Such companies are prohibited from announcing, promoting or publicizing any real estate project, or accepting deposits for investment in projects without seeking prior approval from the relevant authorities. As of the date of writing, the provisions on real estate companies are not in effect.

Share transfer restrictions

Under the new Companies Act 2017, existing members have rights of first refusal on transfer of shares of a private limited company. Previously such pre-emption rights would need to be set out in the company's articles or a shareholders' agreement. The pre-emption rights do not apply where the shares are pledged as security. Pre-emption rights do not apply on share transfers of public (listed or unlisted) companies.

Special Economic Zones

In 2012, the Special Economic Zones Act 2012 (SEZ Act) was enacted, which is a framework law seeking to imitate the success of the free zone model in other countries. This law empowers the Federal or Provincial Government to establish a special economic zone (SEZ) to channel local and foreign investment for the promotion and development of industrial and services sectors in specially designated areas across the country. Each province is empowered to establish its own SEZ authority, whereas the BOI is nominated as the authority for the Federal Capital. To date, a total of seven (7) SEZ's covering a total area of over 8,000 acres have been established under the new investment policy.

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Under the SEZ law, any plant, machinery and equipment imported into the SEZ is exempted from customs duties. The SEZ is also permitted to offer ten (10) year tax exemptions for businesses established in the zone prior to 13 June 2020, and a five (5) year tax exemption thereafter. A five (5) year tax exemption is also granted to any entity involved in the development of the SEZ. The benefits of an SEZ cannot be withdrawn and are subject to legislative protection under the laws of Pakistan and treaties signed by the Government of Pakistan.

Double Tax Treaty Network

Pakistan has entered into double tax treaties with close to 70 countries. Most of these treaties are based on the OECD form model agreement. The double tax treaties prevail over the Pakistani tax laws and enable foreign resident tax-payers to avoid or reduce the incidence of taxation in Pakistan.

Pakistan has signed DTTs with approximately 25 European countries and around 16 countries in the MENA region. The low tax jurisdictions with which Pakistan has signed DTTs include the GCC countries and Mauritius. The Emirate of Dubai and Mauritius tend to be the most favoured offshore jurisdictions for channeling investments into Pakistan. The DTTs with UAE and Mauritius cap tax on dividends and interest payments at 10%, and capital gains tax is levied at the rate applicable in the investee company's jurisdiction. The upshot of structuring an investment into Pakistan through these jurisdictions is that foreign investors can avoid paying capital gains tax on their divestment proceeds; CGT in Pakistan currently stands at between 15% to 20%.

Conclusion

Pakistan's current foreign investment regime is not only one of the most liberal in the region, it also offers some of the highest returns in the region, even after adjusting for exchange rate fluctuations. The Pakistan Stock Exchange was the best performing exchange in Asia last year, and the fifth best performing market in the world, with an annual rate of return of over 40 per cent. Sectors such as infrastructure and construction, power, oil & gas, consumer goods, education and healthcare are experiencing substantial investment, as growth in these sectors is fueled by the demands of a growing population that has already crossed 200 million. In the power sector, payments under power purchase agreements are US dollar denominated, which removes much of the exchange rate risk.

Pakistan is also party to numerous double tax treaties and bilateral investment agreements, which gives foreign investors an array of options to establish their investment vehicles in the most favourable jurisdiction. Perhaps not as well recognized in comparison to its neighbours, much of Pakistan's potential remains untapped; however, those foreign investors that have effectively managed the country risk are reaping the benefits.