

## Double Taxation Treaties and their Impact on Domestic Tax Collection in Pakistan

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### Abstract

Double Taxation Treaties (DTTs) are one of the most important instruments in international tax law for eliminating double taxation of income delivered across borders and thus stimulating cross-border cooperation. Given the chronic fiscal deficits of Pakistan, a developing economy, these treaties are important, at both ends—assist foreign direct investment (FDI) and also undermine collection of domestic revenue. This paper offers a critical examination of Pakistan's double taxation treaties network, its alignment to the country's broader fiscal needs, and exploitation of loopholes such as treaty shopping, and base erosion. Building on comparisons from other developing countries and more recent developments, including the OECD's Multilateral Instrument (MLI), this article proposes having Pakistan restructure its treaty policy to protect its national interests without scaring away real foreign investment. Legal and institutional reforms, along with improved treaty renegotiation strategies and alignment with the norms of international anti-avoidance are recommended.

### Keywords

Double Taxation Treaties, Domestic Tax Collection, Pakistan Tax Law, Foreign Direct Investment (FDI), OECD BEPS, Treaty Shopping, International Taxation

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## 1. Introduction

Legal instruments are just a small aspect of double taxation treaties; more importantly, they are the oxygen of Pakistan's international tax system. There are over 66 such treaties in existence, all of which help bind countries together because these treaties make it so that income or gain removed from a country and paid to a resident of another country is not subject to double taxation. And in today's world, where business and people are often conducting cross-border transactions, this is especially important. In Pakistan's case, these treaties play a big role of law and are often superior to the domestic tax laws. This is even more obvious when you are trying to pay income derived from Pakistan by individuals or companies not resident in Pakistan. A more in depth look at the data of 50 nonresident entities during 2013 and 2017 becomes clear: these agreements have been major reasons why we attract foreign direct investment. They take away the financial burden for the foreign investor by giving tax relief on dividends and capital gains, making Pakistan more attractive to the international capital. However the importance of these treaties is not in the numbers. They are a sign of Pakistan's commitment to deeper economic engagement with the rest of the world and its preparedness to meet the conditions of cooperating with the international community. But this paper is not just the result of the surface of how these treaties have changed our tax landscape—in that they have affected how we collect taxes domestically as well as how we allow and encourage international trade and investment. Here, we'll examine how these agreements make a legal structure, understand the practical economic benefits they provide, and what the real world hurdles are facing tax authorities when used. We compare Pakistan's

approach with those of other developing countries in order to spot strengths to be built upon and shortfalls that have to be addressed to make our double taxation treaty network more effective.

## **2. Review of Existing Literature**

There are many scholars and international institutions who have studied the role of Double Tax Treaty in interdependence. According to studies of OECD, DTT is very important to fight double taxation and to attract FDI. However it warns of the unintended side effects such as treaty shopping for tax avoidance that also ostensibly erodes source countries revenue, an increasingly onerous concern among developing countries that include Pakistan.

As a source based country, Pakistan's alignment with the UN Model Tax Convention is a matter of practicality in accordance with its development requirement. However, empirical evidences suggest that the country has failed to reap the benefits from lower withholding tax rates in return for considerable revenue losses (approximately PKR 141 billion per year) to the country under the treaty provisions. Thus, scholars such as Zucman (2014), Cobham (2020) have criticized the global tax treaty system for benefiting the countries that export capital while harming the countries' capacity to tax.

Limitation of Benefits (LOB) clauses or other more stringent anti abuse rules appear to mitigate revenue losses to differing degrees in India, Bangladesh and Sri Lanka in respect of Treaty negotiations. Pakistan has out of date safeguards in the older treaties, especially with U.S. and the Netherlands.

Although Pakistan has signed on the BEPS framework of OECD as well as adopted Multilateral Instrument (MLI) in 2021 but, the administrative framework and legal grey areas is the reason behind our difficulties. The institutional capacity barriers present in Federal Board of Revenue (FBR) are also present in the literature on tax administration and demonstrating that such institutional capacity barriers have led to non-effective implementation of the treaty provisions and that there has been a weakening of the underpinnings of these attacks on base erosion.

This review adds to country specific research which breaks with theoretical treaty benefits by assessing the practical significance of a government's real life implementation of these treaties on domestic revenue collection in Pakistan.

### **2.1 Identifying Research Gap**

Yet, in spite of the numerous DTTs implemented by Pakistan in its network, and their significant economic influence, little has been empirically assessed about their direct effects on the collection of domestic tax revenue. Most literature on the treaties as either encouraging foreign direct investment (FDI) or encouraging international trade tends to ignore how the attraction of international investment is a trade off with the erosion of the national tax base. Secondly, there are very few studies that compare Pakistan's tax treaty practices to other developing economies or with respect to global reform, particularly the OECD's Base Erosion and Profit Shifting (BEPS) initiative. This research fills this gap by examining whether or not Pakistan's current DTT framework promotes or is detrimental to fiscal stability.

### **2.2 Research Question**

1. How have Pakistan's double taxation treaties impacted the country's domestic tax revenue collection?
2. To what extent do DTTs contribute to foreign direct investment (FDI) in Pakistan?
3. Are Pakistan's current DTT provisions vulnerable to treaty shopping and tax base erosion?
4. How does Pakistan's approach to double taxation compare with that of other developing countries?

5. What legal and administrative reforms can be recommended to align DTT policy with domestic revenue goals?

### **3. Research Methodology**

The research used a qualitative and doctrinal, as well as comparative methods to study the legal, fiscal, and administrative implications of the Pakistan's double taxation treaties on public tax collection. The aim of the paper entails legal instruments, revenue outcomes and the practices of treaty, so a mixed methodological qualitative framework is appropriate for a comprehensive and sensitive picture of the issue. The structure of the methodology is based on exploiting statutory frameworks, treaty texts, and judicial interpretations, as well as in domestic and comparative contexts, to deal with statutory frameworks, treaty texts, and judicial interpretations, as well as policy implications.

#### **3.1 Research Design**

The research is doctrinal in nature, focusing on analyzing statutory provisions (such as the Income Tax Ordinance, 2001), case law, and international instruments governing taxation treaties. It is also analytical, as it critiques the policy design and administrative limitations affecting the implementation of DTTs in Pakistan. Lastly, the study adopts a comparative approach to benchmark Pakistan's practices against those of similar developing countries such as India, Bangladesh, and Sri Lanka.

#### **3.2 Data Sources**

It only uses secondary data from proved, credible and authoritative sources. These include: Domestic legal instruments: Income Tax Ordinance, 2001; Rules under the Income Tax Ordinance; and constitutional provisions relevant to treaty ratification. Importance of judicial precedents in interpreting treaties implementation and domestic law conflicts of such rulings on the Supreme Court as SCMR 2023 1011 and PLD 2021 885.

International instruments and models: OECD and UN Model Tax Conventions; the OECD BEPS Action Plan; and the Multilateral Instrument (MLI).

Government publications: Reports by the Federal Board of Revenue (FBR), Ministry of Finance, and Board of Investment.

International tax policy institutes: Working papers, and reports, in some cases related to more general economic institutions, such as intergovernmental organizations; and, peer reviewed journals.

#### **3.3 Analytical Framework**

The research used a qualitative and doctrinal, as well as comparative methods to study the legal, fiscal, and administrative implications of the Pakistan's double taxation treaties on public tax collection. The aim of the paper entails legal instruments, revenue outcomes and the practices of treaty, so a mixed methodological qualitative framework is appropriate for a comprehensive and sensitive picture of the issue. Methodology of analysis based on statutory framework, the treaty texts, the judicial interpretation, international best practices, and the policy implications are made both in a domestic and comparative context.

#### **3.4 Comparative Case Studies**

The research used a qualitative and doctrinal, as well as comparative methods to study the legal, fiscal, and administrative implications of the Pakistan's double taxation treaties on public tax collection. The aim of the paper entails legal instruments, revenue outcomes and the practices of treaty, so a mixed methodological qualitative framework is appropriate for a comprehensive and sensitive picture of the issue. It is structured

methodologically to analyze statutory frameworks, treaty texts, judicial interpretations, international best practices, as well as policy implications of the same, at the domestic and comparative levels.

### 3.5 Limitations

However, the data for this study are limited to secondary data which can be accessed publicly. It was not possible to access confidential information relating to the treaty negotiations, taxpayer specific data and internal FBR audit reports. Moreover, despite referenced indicative fiscal estimates, the exact quantitative change in tax collection attributable to treaty concessions could not be verified so as to data. While this is true, the most the qualitative and doctrinal analysis does is to set a solid basis for the conclusions that can then be drawn, informed and actionable.

## 4. Double Taxation Treaties in Pakistan: A Brief Overview

In order to understand how essential double taxation treaties are for Pakistan's tax system, we have to know what meaning is to double taxation. In easy terms, it happens when income earned in a country is brought into the country where a person or a business resides and then additionally taxed there. Such tax overlap can be a heavy tax on taxpayers and is usually a determining factor in foreign trade and investment. Any amount of extra tax that individuals or firms know they may need to pay twice on an income will put them off when they do decide to branch out internationally or to put their money abroad. Double taxation treaties exist to prevent this very problem by stipulating who should be taxed on what income and by mechanisms to avert or limit double taxation.<sup>1</sup> These treaties not only safeguard taxpayers from a high level of tax liability in the country but also make the country more open and friendly for foreign investors for developing countries like Pakistan.

Double Taxation Agreement (DTA) are legal treaties signed by two countries (bilateral agreements)—called contracting states—for the reduction and prevention of double taxation of the same income by countries.<sup>2</sup> This is more than just a set of agreements that avoid the risk of double taxation. These provide a platform to assign taxing rights between the country of residence of the taxpayer and the source country of the income. It is this allocation that will guarantee fairness in cross border taxation so as to avoid tax disputes between taxation jurisdictions.<sup>3</sup> Clear agreements on which country has the right to tax what kinds of income are made, giving legal certainty to both businesses and the people that carry out cross-border activities. This also gives clearances and reduces risks of disputes as well as fair taxation among the jurisdictions.<sup>4</sup> This became even more critical after Pakistan joined the Base Erosion and Profit Shifting (BEPS) framework, committing

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<sup>1</sup> Federal Board of Revenue, *Pakistan and Germany Sign Convention for Elimination of Double Taxation* (29 March 2021) <https://www.fbr.gov.pk/pakistan-and-germany-sign-convention-for-elimination-of-double-taxation/173926> accessed 20 April 2025.

<sup>2</sup> Federal Board of Revenue (FBR) and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), *National Law Provisions Concerning International Taxation* (2013) <https://download1.fbr.gov.pk/Docs/20132191124331943FBR-GIZpppnationallawsinternationaltaxation.pdf> accessed 21 April 2025.

<sup>3</sup> Organisation for Economic Co-operation and Development (OECD), *Pakistan Dispute Resolution Profile* (19 September 2023) <https://www.oecd.org/tax/dispute/pakistan-dispute-resolution-profile.pdf> accessed 21 April 2025.

<sup>4</sup> FBR, *Pakistan and Germany Sign Convention* (n 1).

to the automatic exchange of country-by-country reporting. This step has strengthened Pakistan's ability to combat tax avoidance and improve compliance with international standards.<sup>5</sup>

#### **4.1 Historical Development of Pakistan's Treaty Network**

The development of Pakistan's treaty network mirrors the broader evolution of international tax agreements. The roots of tax treaties trace back several centuries, with the first model convention being prepared in 1927 by the Fiscal Committee of the League of Nations. The early framework provided a basis for the current version of the modern international tax treaty system.<sup>6</sup> The Mexico in 1945 and London in 1946 meetings were vital to developing the bases for modern tax treaties. The discussions that preceded these complex international agreements—we do not have anything as simple anymore—were these discussions about how to prevent double taxation and encourage cross border economic activities. Despite the significant changes induced by globalization, modern international tax treaties basically follow the fundamental rules that were set in the 1920s by the League of Nations. Yet, the changing global economic landscape does not cause these foundational principles to be overlooked when countries shape their tax agreements are.<sup>7</sup> Since 1963 the Organization for Economic Cooperation and Development (OECD) has published its initial Model Convention, with important revisions in 1974 and 1977. These updates have also been essential in providing the Ethanopolizing touches that refined the international tax rules, creating a more common ground for tax treaties.<sup>8</sup>

#### **4.2 Types of Double Taxation Treaties Pakistan Has Signed**

The network of Pakistan's tax treaties has been varied in nature exhibiting various types of international agreements lending their purpose to each. The most prevalent types of double taxation treaties are Bilateral Full Scope Treaties, which incorporate essentially all significant tax points, for instance income from employment, profit of a business, interest and dividends as well as royalties. Pakistan also enters into Bilateral Limited Purpose Treaties, which are narrower in purpose and are mostly on limited types of income or are applicable in particular sectors. The country is also part of Multilateral Treaties that bring together multiple nations to give agreement for cooperation and uniform application of the standards of international taxation.<sup>9</sup> The SAARC member countries—Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka—share a significant multilateral tax treaty that underscores their regional cooperation. Initiated in 2011, this agreement goes beyond the usual scope of tax treaties by incorporating additional provisions aimed at strengthening collaboration in tax administration. It facilitates information exchange, mutual assistance in tax collection, and coordinated efforts to combat tax evasion across the region.<sup>10</sup> Today, Pakistan has established tax treaties with over 66 countries across the globe. These agreements reflect the country's

<sup>5</sup> OECD, *Pakistan Dispute Resolution Profile* (n 3)

<sup>6</sup> Barthel, Busse, and Neumayer, *Impact of DTTs on FDI* (n 4)

<sup>7</sup> OECD, *Pakistan Dispute Resolution Profile* (n 3)

<sup>8</sup> Barthel, Busse, and Neumayer, *Impact of DTTs on FDI* (n 4)

<sup>9</sup> Federal Board of Revenue (FBR) and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), *Frequently Asked Questions on Cross Border Transactions and Tax Treaties* (April 2012) <https://download1.fbr.gov.pk/Docs/20132191124740675FBR-GIZFAQTaxTreaties.pdf> accessed 21 April 2025.

<sup>10</sup> OECD, *Pakistan Dispute Resolution Profile* (n 3)

commitment to fostering international economic cooperation, preventing double taxation, and creating a more predictable and investor-friendly tax environment.<sup>11</sup> According to the Board of Investment, Pakistan has signed 50 Bilateral Investment Treaties (BITs) to date, but only 27 of them are currently in force.<sup>12</sup> Notably, the bilateral tax treaty between Pakistan and the United States is among the oldest, having been signed as far back as 1959.<sup>13</sup> This reflects Pakistan's early efforts to establish international legal frameworks aimed at protecting and encouraging foreign investment.

### 5. Key features of Pakistan's Double Tax Avoidance Agreements

Pakistan generally aligns itself with the United Nations Model Convention rather than the OECD Model, as the former is considered more favorable to the interests of developing countries. The UN Model places greater emphasis on source-based taxation, allowing countries like Pakistan to retain taxing rights over income generated within their borders by foreign entities. This approach is consistent with developing economy domestic revenue requirements while advancing the more equitable allocation of taxing rights between the members of cross border transaction.<sup>14</sup>

It is perfectly in line with Pakistan's economy, as the UN Model Convention underlines sourcing based taxation, i.e., taxing income earned within respective countries. This is especially pertinent to developing nations such as Pakistan since its source country taxation is an important component to protect its revenue base. Among other key aspects of Pakistan's tax treaties is the legal hierarchy they establish: international practice and local precedent both hold that where there is conflict among tax laws and provisions, tax treaty provisions prevail. It implies that national tax legislation would be subordinate to tax treaty rules in so far as the relevant national tax legislation is applied to taxation of non-resident's income that is Pakistan source.<sup>15</sup> For example, in Pakistan's Double Taxation Agreements (DTAs), the rates of maximum tax for key categories of income, including dividends, interest and royalties, is usually provided. Thus the existence of these caps seeks to limit excessive taxation and promote investment across borders through establishment of the predictable and equitable tax regime for foreign investors. These agreements set clear limits, promote the economic cooperation between two such countries and ensure that investors do not get overburdened by high taxes in one of the two countries.<sup>16</sup> Further to this, Pakistan's Double Taxation Agreements (DTAs) contain mechanisms of dispute resolution between countries. Dispute resolution procedures such as arbitration or mutual agreement procedures (MAP) are typical among these provisions to settle disputes in case of conflicts over the interpretation or application of treaty provisions. These agreements provide easy and understandable ways of solving disagreements and hence enhance stability and cooperation in the field of international

<sup>11</sup> FBR, *Pakistan and Germany Sign Convention* (n 1)

<sup>12</sup> OECD, *Pakistan Dispute Resolution Profile* (n 3)

<sup>13</sup> Ibid

<sup>14</sup> Fabian Barthel, Matthias Busse, and Eric Neumayer, *The Impact of Double Taxation Treaties on Foreign Direct Investment: Evidence from Large Dyadic Panel Data* (2009) [https://personal.lse.ac.uk/barthel/docs/dtt\\_fdi.pdf](https://personal.lse.ac.uk/barthel/docs/dtt_fdi.pdf) accessed 21 April 2025.

<sup>15</sup> Federal Board of Revenue, *Pakistan and Germany Sign Convention for Elimination of Double Taxation* (29 March 2021) <https://www.fbr.gov.pk/pakistan-and-germany-sign-convention-for-elimination-of-double-taxation/173926> accessed 20 April 2025.

<sup>16</sup> FBR, *Pakistan and Germany Sign Convention* (n 1).

taxation, enabling that cross border business activities are not interrupted by unresolved tax disputes.<sup>17</sup> In addition, these agreements are intended to prevent foreign taxpayers from discrimination. The Double Taxation Agreements (DTAs) serve the purpose of ensuring that foreign investors and business are at par with taxpayers regardless of where they usually reside. This provision is important to avoid unfair discriminatory taxes or taxes at unfairly high rates that can deter foreign investment or the conduct of a business across borders.<sup>18</sup> In all such cases of conflict, the Pakistani courts have consistently held that provisions of a treaty are superior to domestic law. This commitment is reflected by notable rulings such as in 2023 SCMR 1011, 2021 PLD 885 etc. These decisions thus not only continue Pakistan's commitment to its international agreements and giving foreign investors more confidence in the legal stability and the fairness of the business environment of the country's tax system, but also significantly prioritize international agreements.<sup>19</sup>

According to a recent study, Pakistan is required to embark on significant alterations to its tax treaties to guard against the revenue leak that is caused by treaty abuse. In this, the Pakistan US tax treaty is out dated and needs to be re-negotiated in order to fit in with to modern tax practice as well as accommodate for the emerging challenges of the global economic environment.<sup>20</sup>

## **6. Legal Framework Governing Double Taxation Treaties in Pakistan**

The legal framework governing double taxation treaties (DTTs) in Pakistan is based on a combination of domestic tax laws, constitutional provisions, and international agreements. Pakistan follows a dualist approach to international law, which means that while international treaties are signed, they must be formally incorporated into national legislation before they can be enforced. This approach ensures that international obligations, including those under DTTs, are aligned with Pakistan's domestic legal structure, providing a seamless integration of global tax practices with national law.<sup>21</sup> This framework creates a distinctive legal environment that influences how tax treaties are implemented within Pakistan's national system. By integrating domestic laws with international agreements, it ensures that treaties are not just theoretical commitments but are practically enforceable within the country's legal structure.

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<sup>17</sup> Ibid

<sup>18</sup> Federal Board of Revenue (FBR) and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), *National Law Provisions Concerning International Taxation* (2013) <https://download1.fbr.gov.pk/Docs/20132191124331943FBR-GIZpppnationallawsinternationaltaxation.pdf> accessed 21 April 2025.

<sup>19</sup> FBR, *Pakistan and Germany Sign Convention* (n 1)

<sup>20</sup> Muhammad Ashfaq Ahmed, Na Li, and Peter Mellor, *The China-Pakistan Avoidance of Double Taxation Agreement and the China-Pakistan Economic Corridor* (2018) <https://download1.fbr.gov.pk/Docs/2021621263530190M.AshfaqAhmed,NaLi,&P.Mellor-China-PakistanDoubleTaxationAgreement&theChina-PakistanEconomicCorridor.pdf> accessed 21 April 2025.

<sup>21</sup> BDLex, *Comparative Analysis of Corporate Taxation: Bangladesh vs. Regional Neighbors* (11 January 2024) <https://www.linkedin.com/pulse/comparative-analysis-corporate-taxation-bangladesh-vs-0nwoc> accessed 21 April 2025.

### 6.1 Domestic Tax Laws and Their Interaction with Treaties

The Income Tax Ordinance 2001 serves as the cornerstone of Pakistan's international taxation framework. Under Section 107, it grants the Federal Board of Revenue (FBR) the authority to negotiate and conclude tax treaties, enabling Pakistan to engage with other nations in managing cross-border tax matters effectively.<sup>22</sup>

This section addresses the legal mechanisms that support the avoidance of double taxation and the prevention of fiscal evasion in relation to income taxes, both under Pakistan's Income Tax Ordinance 2001 and comparable laws in other jurisdictions. The Ordinance includes several provisions that interact directly with the implementation of tax treaties. Notably, Section 44(1) establishes that "any Pakistan-source income which Pakistan is not permitted to tax under a tax treaty shall be exempt from tax under this Ordinance". This creates a clear legal bridge between international treaty obligations and domestic tax law. Additionally, Section 53 provides further scope for exemptions and tax concessions through the Second Schedule, allowing these treaty-related benefits to be reinforced by domestic provisions.<sup>23</sup>

Section 101(3) of the Income Tax Ordinance 2001 defines what constitutes Pakistan-source business income for non-resident taxpayers. It specifically includes income that is attributable to a permanent establishment in Pakistan, forming the legal basis for applying tax treaty provisions related to business profits. Complementing this, Rule 15—operating under Sections 102 and 103—facilitates the avoidance of international double taxation for resident taxpayers by allowing a foreign tax credit mechanism. However, it explicitly excludes penalties, fines, and interest payments from being treated as foreign taxes, thereby limiting the scope of relief available under this provision.<sup>24</sup>

### 6.2 Constitutional Status of International Tax Agreements

Under the Constitution of Pakistan (1973), the federal Cabinet holds the authority to sign and ratify international treaties on behalf of the state. However, these treaties must be brought before Parliament for approval prior to their implementation. This requirement underscores the significant constitutional role Parliament plays in overseeing and legitimizing international commitments, including tax treaties.<sup>25</sup>

The Ratification of International Treaties Act 2013 outlines the formal process through which Pakistan ratifies international agreements. According to this legislation, the Ministry of Foreign Affairs must first receive a comprehensive review and approval form, which includes detailed responses on how the treaty aligns with Pakistan's national interests, its consistency with constitutional principles, potential reservations, and its broader political, legal, and economic implications. Once the Cabinet grants its approval, the federal minister responsible for international affairs is required to present the treaty bill before Parliament. Parliament holds the authority to approve ratification either in full or with reservations on specific provisions. However,

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<sup>22</sup> Federal Board of Revenue (FBR) & Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), *National Law Provisions Concerning International Taxation* (FBR-GIZ, 2013) <https://download1.fbr.gov.pk/Docs/20132191124331943FBR-GIZpppnationalallawsinternationaltaxation.pdf> accessed 21 April 2025

<sup>23</sup> FBR & GIZ, *National Law Provisions Concerning International Taxation* (n 2).

<sup>24</sup> Ibid

<sup>25</sup> BDLex, *Comparative Analysis of Corporate Taxation: Bangladesh vs. Regional Neighbors* (11 January 2024) <https://www.linkedin.com/pulse/comparative-analysis-corporate-taxation-bangladesh-vs-0nwoc> accessed 21 April 2025.



it cannot authorize ratification if any part of the treaty contradicts the fundamental rights enshrined in the Constitution.<sup>26</sup>

### 6.3 Hierarchy between Domestic Law and Treaty Provisions

Pakistan's legal framework accords priority to double taxation treaties over conflicting domestic tax laws. This principle is explicitly embedded in Section 107 of the Income Tax Ordinance, 2001, which provides that the provisions of a tax treaty shall prevail over other provisions of the Ordinance to the extent of any inconsistency. This ensures that Pakistan upholds its international commitments and offers legal certainty to foreign investors and non-resident taxpayers operating within its jurisdiction.<sup>27</sup> The Supreme Court of Pakistan has consistently supported the principle that international treaties, including double taxation agreements, must be incorporated into domestic legislation to be legally enforceable within the country. In a landmark case concerning the Geneva Convention and its Protocol on Arbitration Clauses, the Court reaffirmed that international obligations are not automatically binding unless they are transformed into local law. This ruling underscores Pakistan's dualist legal approach and highlights the judiciary's commitment to constitutional safeguards while honoring international commitments through proper legislative channels.<sup>28</sup>

In another significant case involving the Pakistan–Netherlands Tax Convention, the Supreme Court reaffirmed the special status of international tax treaties within Pakistan's legal system. The Court emphasized that such conventions are not to be interpreted using domestic legal principles alone; rather, the primary focus should be on the faithful implementation of the treaty's terms. Most countries, including Pakistan, recognize the interpretation principles outlined in the *Vienna Convention on the Law of Treaties* (VCLT) as part of customary international law. Accordingly, it is the VCLT—not domestic statutory interpretation rules—that typically governs how tax treaties are understood and applied. The Supreme Court has clearly distinguished treaty interpretation from ordinary domestic tax law, underscoring the role of the VCLT as the standard framework for understanding double taxation agreements.<sup>29</sup>

This legal framework ensures that double taxation treaties are effectively integrated into Pakistan's domestic tax system while preserving their international character. These treaties operate under the transformation doctrine, meaning that international law influences Pakistan's legal obligations only when treaty provisions are formally enacted into domestic legislation.<sup>30</sup> This approach reflects a careful balance—upholding Pakistan's sovereignty in legislative matters while honoring its commitments under international tax law. By doing so, Pakistan maintains legal consistency, reinforces its credibility on the global stage, and provides clarity and predictability for cross-border taxpayers and investors.

<sup>26</sup> Ismail Dilawar, *Pakistan, Sri Lanka, Bangladesh sign 'landmark' agreement to strengthen capital market cooperation*, Arab News (27 March 2025) <https://www.arabnews.com/node/2595020>

<sup>27</sup> FBR & GIZ, *National Law Provisions Concerning International Taxation* (n 2).

<sup>28</sup> Dilawar, *Pakistan, Sri Lanka, Bangladesh sign 'landmark' agreement* (n 8)

<sup>29</sup> OECD, *Pakistan Dispute Resolution Profile* (n 3)

<sup>30</sup> Ismail Dilawar, *Pakistan, Sri Lanka, Bangladesh Sign 'Landmark' Agreement to Strengthen Capital Market Cooperation*, Arab News (27 March 2025) <https://www.arabnews.com/node/2595020> accessed 21 April 2025.

## 7. Pakistan's current Double Taxation Treaty Network

Pakistan has developed an extensive network of double taxation treaties that spans across major regions of the world, mirroring the country's evolving economic interests and diplomatic relationships. The Federal Board of Revenue (FBR) currently maintains 66 bilateral full-scope treaties, each designed to prevent overlapping tax claims between jurisdictions and to foster smoother international trade and investment flows.<sup>31</sup> These agreements not only mitigate the risk of double taxation but also create a sense of legal certainty and predictability for foreign investors and Pakistani businesses operating abroad. While some of these treaties date back more than seven decades—highlighting Pakistan's early commitment to global tax cooperation—many have been revised or reinterpreted over time to stay aligned with contemporary international tax norms and the OECD's evolving standards.

## 8. Geographic Distribution of Pakistan Tax Treaties

Pakistan's double taxation treaty network reflects its broad and strategic global engagement, covering economies both large and small across Europe, Asia, North America, Africa, and the Middle East. In Europe, our tax treaty framework is anchored by long-standing agreements with influential partners such as Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Poland, Romania, Sweden, Switzerland, and the United Kingdom.<sup>32</sup> These treaties help facilitate cross-border investment and trade with some of the world's most advanced economies. In Asia, our network is equally expansive, covering regional neighbors and major trading partners like Bangladesh, China, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Sri Lanka, Thailand, and Vietnam.<sup>33</sup> The Middle East holds particular importance for Pakistan—not only due to economic cooperation but also because of the significant Pakistani diaspora—reflected in comprehensive treaties with Bahrain, Iran, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, Turkey, the United Arab Emirates, and Yemen.<sup>34</sup> Africa is also well represented through partnerships with Egypt, Libya, Mauritius, Morocco, Nigeria, South Africa, and Tunisia.<sup>35</sup> Rounding out this global footprint are our North American treaty arrangements with Canada and the United States, further reinforcing Pakistan's commitment to maintaining a cooperative and tax-transparent international presence.<sup>36</sup>

Most of Pakistan's double taxation treaties are structured around the United Nations Model Convention rather than the OECD Model. This strategic preference reflects Pakistan's position as a developing country and serves to preserve its taxing rights as a source state. By doing so, the country not only safeguards its domestic revenue but also creates a more favorable environment for attracting foreign investment.<sup>37</sup>

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<sup>31</sup> Federal Board of Revenue (FBR), *Bilateral Full Scope Treaties*, Government of Pakistan, <https://www.fbr.gov.pk/Categ/bilateral-full-scope-treaties/332> accessed 21 April 2025.

<sup>32</sup> FBR, *Bilateral Full Scope Treaties* (n 9)

<sup>33</sup> International Trade Administration, *Pakistan – Trade Agreements*, U.S. Department of Commerce, <https://www.trade.gov/country-commercial-guides/pakistan-trade-agreements> accessed 21 April 2025.

<sup>34</sup> International Trade Administration, *Pakistan – Trade Agreements* (n 33)

<sup>35</sup> FBR, *Bilateral Full Scope Treaties* (n 9)

<sup>36</sup> Ibid

<sup>37</sup> Federal Board of Revenue (FBR) and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), *Frequently Asked Questions on Cross Border Transactions and Tax Treaties* (April 2012)

### 8.1 Major Economic Partners and Theirs Treaty Terms

Among Pakistan's key international tax agreements, the treaty with Germany holds particular significance. Originally signed in 1994, it has served as a cornerstone in facilitating cross-border trade and investment between the two nations. In light of evolving global tax standards and the growing emphasis on transparency, Pakistan and Germany initiated renegotiations in September 2023 to modernize the agreement. The revised version aims not only to reinforce safeguards against double taxation but also to introduce stronger provisions that curb tax avoidance through treaty abuse and aggressive tax planning strategies.<sup>38</sup>

Pakistan's double taxation treaty with the Netherlands, in effect since 1982, entered the process of revision in 2017 to align more closely with contemporary global business norms and evolving tax practices.<sup>39</sup> Similarly, the tax agreement between Pakistan and Switzerland, originally signed in 2005 and implemented in 2008, is now under review. The key focus of this update is enhancing provisions related to transparency and the automatic exchange of tax-related information, in line with international commitments and OECD recommendations.<sup>40</sup> In November 2023, Estonia became part of Pakistan's growing network of tax treaties. This new agreement sets clear and favorable tax rates: withholding tax is capped at 12.5% for dividends and interest income, while royalties and technical services fees are taxed at 10%. These rates reflect Pakistan's ongoing commitment to providing a predictable and stable tax environment for international business.<sup>41</sup>

### 8.2 Recent Additions and Renegotiations

Our treaty network continues to grow and adapt, with new negotiations and updates being made regularly. In addition to ongoing discussions with Germany, Switzerland, and the Netherlands, a significant change occurred on April 1, 2021. This marked the implementation of the Multilateral Instrument (MLI) in Pakistan, which streamlined the process by updating numerous existing treaties without requiring separate negotiations. The MLI automatically amended 28 of Pakistan's double taxation agreements, introducing important improvements like anti-abuse rules, enhanced dispute resolution mechanisms, and provisions to prevent the creation of artificial permanent establishments.<sup>42</sup> These updates impact a wide range of agreements, including those with Austria, Belgium, Canada, China, Denmark, Egypt, Finland, Hungary, Ireland, Japan, Kazakhstan, Malaysia, Malta, Mauritius, the Netherlands, Oman, Poland, Portugal, Qatar,

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<https://download1.fbr.gov.pk/Docs/20132191124740675FBR-GIZFAQTaxTreaties.pdf> accessed 21 April 2025.

<sup>38</sup> Federal Board of Revenue, *Pakistan and Germany Sign Convention for Elimination of Double Taxation* (29 March 2021) <https://www.fbr.gov.pk/pakistan-and-germany-sign-convention-for-elimination-of-double-taxation/173926> accessed 20 April 2025

<sup>39</sup> Federal Board of Revenue (FBR), *Pakistan and Netherlands Renegotiate Avoidance of Double Taxation Agreement* (20 February 2017) <https://fbr.gov.pk/Events/pakistan-and-netherlands-renegotiate-avoidanc/131497> accessed 21 April 2025.

<sup>40</sup> Sardar Sikander Shaheen, "Dual taxation treaty: FBR officials in Switzerland to re-negotiate convention," *Business Recorder* (22 April 2025) <https://www.brecorder.com/news/amp/4414329> accessed 21 April 2025.

<sup>41</sup> Croneri, *GDN01168355* (accessed 22 April 2025) <https://library.croneri.co.uk/wkus-gdn01-gdn01168355>.

<sup>42</sup> PricewaterhouseCoopers (PwC), *AFF Note on MLI – 9 April 2021* (9 April 2021) <https://www.pwc.com.pk/en/assets/document/AFFNoteonMLI-9April2021.pdf> accessed 22 April 2025.

Saudi Arabia, Serbia, Singapore, Sweden, the UAE, and the United Kingdom.<sup>43</sup> The Cabinet has given the green light for fresh negotiations on the Pakistan-Switzerland tax agreement. Special attention is being given to Article 26, which focuses on information sharing. Under the updated terms, Swiss authorities will now provide access to bank account details that were previously private. This shift marks a significant move away from banking privacy towards greater fiscal transparency.<sup>44</sup> These continuous updates and changes to our treaties demonstrate our unwavering commitment to maintaining a robust double taxation network that not only safeguards revenue but also fosters a conducive environment for investment.

## 9. Economic Impact of Double Taxation Treaties on Pakistan

Double taxation treaties (DTTs) serve a purpose beyond simply preventing tax duplication in Pakistan. They play a crucial role in facilitating international business by providing clarity and predictability in cross-border tax issues.

### 9.1 Effect on Foreign Direct Investment Flows

Research indicates that double taxation treaties (DTTs) significantly enhance foreign direct investment (FDI) flows into Pakistan. A comprehensive analysis of bilateral investment trends revealed that DTTs contribute to a 27% to 31% increase in bilateral FDI stock.<sup>45</sup> Tax relief on dividends and capital gains provided through double taxation treaties (DTTs) plays a crucial role in attracting FDI to Pakistan. Interestingly, the data reveals a compelling trend: higher dividend and capital gain taxes within the treaty framework have a paradoxical effect, actually driving an increase in FDI.<sup>46</sup> This apparent contradiction becomes clearer when considering the broader context—double taxation treaties offer foreign investors a sense of certainty and stability regarding tax treatment. By clearly outlining how their returns will be taxed, these agreements protect investors from excessive or arbitrary taxation in Pakistan, encouraging long-term commitments.<sup>47</sup> However, more recent studies present a contrasting perspective. They suggest that the introduction of stricter anti-tax evasion provisions in newer treaties has, in fact, led to a decline in foreign direct investment (FDI) inflows to Pakistan.<sup>48</sup> This decline mirrors a global shift toward greater fiscal transparency and stronger anti-

<sup>43</sup> Federal Board of Revenue (FBR), *Bilateral Full Scope Treaties*, Government of Pakistan, accessed 22 April 2025, <https://fbr.gov.pk/bilateral-full-scope-treaties/132245/152329>.

<sup>44</sup> Business Recorder, “Dual Taxation Treaty: FBR Officials in Switzerland to Re-negotiate Convention,” *Business Recorder*, 26 June 2016, <https://www.brecorder.com/news/amp/4414329>

<sup>45</sup> Fabian Barthel, *The Impact of Double Taxation Treaties on Foreign Direct Investment* (London School of Economics, March 2009) [https://personal.lse.ac.uk/barthel/docs/dtt\\_fdi.pdf](https://personal.lse.ac.uk/barthel/docs/dtt_fdi.pdf) accessed 22 April 2025.

<sup>46</sup> Muhammad Atif and Danish Ahmed Siddiqui, *The Effect of Double Taxation Treaties on Tax Relief and Foreign Firms’ Investment Flows (FDI): Evidence from Pakistan* (June 1, 2019) [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3397474](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3397474) accessed 22 April 2025.

<sup>47</sup> Josh and Mak International, “Double Taxation Treaties (DTTs) of Pakistan,” *Josh and Mak International*, accessed 22 April 2025, <https://joshandmakinternational.com/double-taxation-treaties-dtts-of-pakistan/>.

<sup>48</sup> Iqra Bibi, *Tax Treaty Policy and Foreign Direct Investment in Pakistan*, MPhil Thesis, Pakistan Institute of Development Economics (PIDE), 2024, <https://thesis.pide.org.pk/thesis/tax-treaty-policy-and-foreign-direct-investment-in-pakistan/> accessed 22 April 2025.

tax avoidance efforts—an agenda that Pakistan has embraced through its active participation in the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS).<sup>49</sup>

### 9.2 Impact on Trade Relations and Export Growth

Double Taxation Treaties (DTTs) strengthen Pakistan's trade relationships by clarifying taxing rights and streamlining compliance procedures, making it easier for multinational companies to navigate the tax landscape and conduct cross-border business with confidence.<sup>50</sup> This streamlined tax administration reduces transaction costs, making Pakistan's markets more accessible and attractive to foreign investors and multinational enterprises.

These treaties also foster bilateral economic relationships by ensuring consistent and predictable tax treatment. A prominent example is the China-Pakistan Double Taxation Treaty, which underpins economic collaboration through the China-Pakistan Economic Corridor (CPEC), a strategic initiative valued at approximately USD 61 billion.<sup>51</sup> Although the treaty predates the launch of CPEC, it provides Chinese enterprises with crucial tax certainty and stability for conducting operations in Pakistan.

Double taxation treaties (DTTs) also ease the burden of cross-border taxation by reducing or eliminating withholding taxes. Most Pakistani treaties grant either full exemptions or reduced rates on dividends paid by Pakistani companies to foreign shareholders. This significantly lowers the cost of capital, especially for export-oriented businesses, and enhances their global competitiveness.<sup>52</sup>

### 9.3 Influence on Technology Transfer and Knowledge Exchange

Double taxation treaties (DTTs) deliver long-term economic value by fostering technology transfer and knowledge exchange. By lowering or exempting taxes on educational and research grants between treaty partners, these agreements make cross-border academic collaboration more feasible. Moreover, DTTs often include targeted provisions on royalties and technical service fees, facilitating technology licensing and professional knowledge-sharing. Most of Pakistan's treaties cap withholding taxes on such payments, making it more affordable for local businesses to tap into foreign innovations and expertise.<sup>53</sup>

These treaties also establish robust dispute resolution mechanisms that safeguard knowledge-based investments. Foreign investors covered under bilateral investment treaties (BITs) have access to arbitration through international platforms such as the International Centre for Settlement of Investment Disputes (ICSID) if issues of double taxation arise. This legal protection fosters confidence among technology-

<sup>49</sup> Muhammad Raza, "Proposed Amendments Relating to Tax on Capital Gains & Allied Matters," presented at the Post-Budget Seminar 2024–25, Karachi Tax Bar Association, 2024, [https://karachitaxbar.com/wp-content/uploads/apdp/2024/Presentation-M\\_Raza.pdf](https://karachitaxbar.com/wp-content/uploads/apdp/2024/Presentation-M_Raza.pdf) accessed 22 April 2025.

<sup>50</sup> Josh and Mak International, *Double Taxation Treaties*.

<sup>51</sup> Muhammad Ashfaq Ahmed, Na Li, and Peter Mellor, *The China–Pakistan Avoidance of Double Taxation Agreement and the China–Pakistan Economic Corridor*, Bulletin for International Taxation, Vol. 72, No. 8 (2018), <https://download1.fbr.gov.pk/Docs/2021621263530190M.AshfaqAhmed,NaLi,&P.Mellor-China-PakistanDoubleTaxationAgreement&theChina-PakistanEconomicCorridor.pdf> accessed 22 April 2025.

<sup>52</sup> Josh and Mak International, *Double Taxation Treaties*.

<sup>53</sup> Ibid

intensive companies, encouraging them to collaborate with Pakistani partners without fear of unjust tax burdens or regulatory unpredictability.<sup>54</sup>

#### 9.4 Revenue Implications for Pakistan's Tax Collection

While double taxation treaties (DTTs) offer tangible benefits to Pakistan's economy—particularly by fostering foreign investment—they also present significant challenges for domestic tax revenue collection. Striking an effective balance between incentivizing international investors and ensuring adequate revenue generation remains a pivotal policy concern that requires thoughtful analysis and strategic design.

#### 9.5 Quantitative Analysis of Tax Revenue Changes

Double taxation treaties (DTTs) have a substantial impact on Pakistan's tax revenue. According to a detailed study, Pakistan forgoes approximately PKR 141.34 billion annually due to reduced withholding tax rates on dividends and interest, as required under various treaty provisions.<sup>55</sup> This significant revenue loss highlights the fiscal cost of maintaining an extensive network of treaty partners.

The impact on revenue primarily stems from the way these treaties restrict the source country's taxing rights over passive income such as dividends, interest, and royalties.<sup>56</sup> As a result, Pakistan is often unable to collect substantial upfront revenue. The underlying rationale of such limitations is to offset these losses through anticipated increases in foreign investment and economic cooperation.

The data reveals a striking trend—approximately 95% of Pakistan's revenue losses under double taxation treaties stem from reduced taxation on dividends.<sup>57</sup> Notably, just four countries—Japan, the Netherlands, Switzerland, and Singapore—are responsible for over half of these estimated losses.<sup>58</sup> This highlights how asymmetrical treaty relationships can disproportionately impact national tax revenues in ways that are not immediately obvious.

#### 9.6 Withholding Tax Collection under Treaty vs. Non-Treaty Scenarios

The difference between treaty and non-treaty withholding tax rates significantly affects Pakistan's tax revenue. Under domestic law, Pakistan imposes withholding tax rates ranging from 5% to 20% on non-residents.<sup>59</sup> However, tax treaties often prescribe much lower rates, resulting in substantial and immediate

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<sup>54</sup> Ibid

<sup>55</sup> Iqra Bibi, *Tax Treaty Policy and Foreign Direct Investment in Pakistan*, MPhil Thesis, Pakistan Institute of Development Economics (PIDE), 2024, <https://file-thesis.pide.org.pk/pdf/mphil-economics-2022-iqra-bibi--tax-treaty-policy-and-foreign-direct-investment-in-pakistan.pdf> accessed 22 April 2025.

<sup>56</sup> Harouna Kinda and Abrams M.E. Tagem, *Double Taxation Treaties and Resource Revenue Mobilization in Developing Countries: A Neural Network Approach*, WIDER Working Paper 2023/125, United Nations University World Institute for Development Economics Research (UNU-WIDER), October 2023, <https://www.wider.unu.edu/sites/default/files/Publications/Working-paper/PDF/wp2023-125-double-taxation-treaties-resource-revenue-mobilization-developing-countries.pdf> accessed 22 April 2025.

<sup>57</sup> Petr Janský, *Estimating the Revenue Costs of Tax Treaties in Developing Countries*, IES Working Paper No. 19/2018, Institute of Economic Studies, Charles University, Prague, August 2018, <https://www.econstor.eu/bitstream/10419/203197/1/1030284873.pdf> accessed 22 April 2025.

<sup>58</sup> Janský, *Estimating the Revenue Costs of Tax Treaties*.

<sup>59</sup> PwC, *Pakistan - Corporate - Withholding Taxes*, Worldwide Tax Summaries Online, accessed 22 April 2025, <https://taxsummaries.pwc.com/pakistan/corporate/withholding-taxes>.



revenue losses. Non-resident entities without a permanent establishment in Pakistan are subject to withholding taxes on payments such as technical service fees, royalties, dividends, and interest.<sup>60</sup> Since treaty-based rates are considerably lower than domestic rates, many companies engage in “treaty shopping” — structuring their investments through jurisdictions that offer more favorable treaty terms solely for tax benefits.<sup>61</sup>

This practice leads to tax base erosion, as companies choose investment routes based on treaty advantages rather than genuine economic activity. In response, Pakistan adopted the OECD’s Multilateral Instrument (MLI), effective from April 1, 2021, which introduced anti-abuse provisions aimed at curbing treaty shopping and reinforcing the integrity of its tax treaty network.<sup>62</sup>

### 9.7 Cost-Benefit Analysis of Treaty Concessions

A balanced evaluation of double taxation treaties (DTTs) is essential, as they present both opportunities and challenges for Pakistan’s fiscal landscape. While DTTs limit the country’s ability to tax passive income—such as dividends, interest, and royalties—they may contribute to broadening the overall tax base by stimulating foreign investment and economic growth. Empirical evidence suggests that these treaties enhance foreign direct investment (FDI) inflows into Pakistan,<sup>63</sup> yet they simultaneously erode the government’s capacity to generate revenue, particularly from withholding taxes.<sup>64</sup>

An illustrative example, though not specific to DTTs, comes from Pakistan’s automobile sector. A study on tax expenditures revealed a staggering PKR 1,855.75 billion in forgone revenue, compared to social welfare gains amounting to just PKR 2,338.08 million.<sup>65</sup> This underscores the broader policy dilemma of weighing tax incentives against tangible economic outcomes.

Given these trades-offs, it is crucial for Pakistan to continuously assess the fiscal and economic impact of its tax treaties. The ongoing challenge lies in maintaining an investment-friendly environment while safeguarding domestic revenue. To address this, Pakistan must remain open to revisiting and renegotiating treaty terms to strike a more optimal balance between investment promotion and effective tax collection.

<sup>60</sup> PwC, *Pakistan - Corporate - Withholding Taxes*.

<sup>61</sup> Harouna Kinda and Abrams M.E. Tagem, *Double Taxation Treaties and Resource Revenue Mobilization in Developing Countries: A Neural Network Approach*, WIDER Working Paper 2023/125, United Nations University World Institute for Development Economics Research (UNU-WIDER), October 2023, <https://www.wider.unu.edu/sites/default/files/Publications/Working-paper/PDF/wp2023-125-double-taxation-treaties-resource-revenue-mobilization-developing-countries.pdf> accessed 22 April 2025.

<sup>62</sup> PwC, *AFF Note on MLI* (9 April 2021), <https://www.pwc.com.pk/en/assets/document/AFFNoteonMLI-9April2021.pdf> accessed 22 April 2025.

<sup>63</sup> Muhammad Atif and Danish Ahmed Siddiqui, *The Effect of Double Taxation Treaties on Tax Relief and Foreign Firms’ Investment Flows (FDI): Evidence from Pakistan* (June 1, 2019) [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3397474](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3397474) accessed 22 April 2025.

<sup>64</sup> Bibi, *Tax Treaty Policy and Foreign Direct Investment in Pakistan*.

<sup>65</sup> Kishwer Ali Artas, *Cost-benefit Analysis of Concessionary SROs*, MPhil Thesis, Public Policy, Pakistan Institute of Development Economics (PIDE), 2022, <https://thesis.pide.org.pk/thesis/cost-benefit-analysis-of-concessionary-sros/> accessed 22 April 2025.

## 10. Administrative Challenges in Implementing Double Taxation Treaties

Pakistan's tax system encounters several structural and operational challenges in the implementation of double taxation treaties. Effective application of these agreements requires robust administrative capacity, streamlined verification procedures, and efficient dispute resolution mechanisms to ensure their intended benefits are fully realized.

### 10.1 Capacity Issues in Pakistan's Tax Administration

The Federal Board of Revenue (FBR), which is tasked with collecting over 90% of Pakistan's tax revenue, struggles with the effective implementation of double taxation treaties due to capacity constraints. Many of its systems are widely regarded as outdated and ill-equipped to meet the evolving demands of the global tax environment, often described as "somewhat old-fashioned" and "failing to keep pace with finer improvements taking place across the globe in the international tax arena".<sup>66</sup> This technological lag presents a significant hurdle to the proper administration of international tax agreements.

Pakistan's underwhelming tax revenue performance is also rooted in a narrow tax base, administrative inefficiencies, and persistently low compliance levels. The compliance gap is particularly stark—estimated at 26% of collectible taxes under current policies, equivalent to approximately PKR 1,305.10 billion or 2.7% of GDP.<sup>67</sup> Such a shortfall undermines the practical effectiveness of tax treaties.

Additionally, persistent issues in revenue target setting and forecasting further hinder treaty implementation. The FBR's current methods frequently result in forecast errors, highlighting the need for more accurate modeling using fundamental macroeconomic indicators and reliable estimates of tax elasticity.<sup>68</sup> Strengthening these technical aspects could significantly enhance both domestic revenue mobilization and the execution of treaty provisions.

### 10.2 Verification of Treaty Benefit Claims

Verifying legitimate claims for treaty benefits presents yet another administrative hurdle. Non-resident taxpayers are required to complete specific forms to declare their foreign status in order to access treaty advantages. This process involves proving residency in a treaty-partner country, demonstrating beneficial ownership of the income, and meeting any limitation on benefits (LOB) provisions included in the applicable agreement.<sup>69</sup>

Moreover, Pakistan's anti-transfer pricing regime remains underdeveloped both in legal structure and practical enforcement. The current legal framework is often described as "archaic and insufficient," failing

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<sup>66</sup> Muhammad Ashfaq Ahmed, *Implementing Key BEPS Actions in Pakistan*, Federal Board of Revenue (FBR), June 2017, <https://download1.fbr.gov.pk/Docs/2021621163532304M.AshfaqAhmed-ImplementingKeyBEPSAction-Pakistan.pdf> accessed 22 April 2025.

<sup>67</sup> Asian Development Bank, *Improved Domestic Resource Mobilization Reform Program, Subprogram 1: Program Impact Assessment*, <https://www.adb.org/sites/default/files/linked-documents/56006-001-ld-02.pdf> (accessed April 22, 2025).

<sup>68</sup> Pakistan Institute of Development Economics (PIDE), *Tax Policy Issues in Pakistan*, Macroeconomics Research Section, PIDE Research Report, 2000–2020, <https://file.pide.org.pk/pdfpideresearch/rr-tax-policy-issues-in-pakistan.pdf> (accessed April 22, 2025).

<sup>69</sup> Internal Revenue Service, "Claiming Tax Treaty Benefits," <https://www.irs.gov/individuals/international-taxpayers/claiming-tax-treaty-benefits> (accessed April 22, 2025).



to align with modern international standards. Tax authorities also lack the technical expertise and institutional capacity needed to counter the complex tax avoidance strategies employed by multinational enterprises (MNEs).<sup>70</sup> This combination of outdated regulations and weak enforcement mechanisms significantly undermines Pakistan's ability to safeguard its tax base in cross-border transactions.

### 10.3 Dispute Resolution Mechanisms and Their Effectiveness

The Mutual Agreement Procedure (MAP) remains Pakistan's principal mechanism for resolving disputes under double taxation treaties. The Federal Board of Revenue (FBR) has issued guidelines under Rule 19D to 19G of the Income Tax Rules, 2002, which outline the process for submitting MAP requests. Taxpayers must initially file their application with Pakistan's Competent Authority, the Director General (International Tax Operations).<sup>71</sup>

Although Pakistan meets some of the Action 14 Minimum Standard requirements—part of the OECD/G20 Base Erosion and Profit Shifting (BEPS) framework—it still falls short in several key areas.<sup>72</sup> For instance, Pakistan has not developed clear documentation for bilateral consultations when its competent authority deems a MAP request to be unjustified.<sup>73</sup> Publicly available guidance on the availability and use of MAP also remains insufficient.<sup>74</sup>

A major challenge is the lack of institutional resources. Reports indicate that "Pakistan's competent authority does not have adequate resources to conduct the MAP function," which hampers both the timeliness of case resolution and effective communication with treaty partners.<sup>75</sup> Furthermore, Pakistan currently does not endorse or facilitate arbitration as a method of tax dispute resolution,<sup>76</sup> limiting the country's ability to resolve complex international tax issues through impartial third-party mechanisms.

<sup>70</sup> Muhammad Ashfaq Ahmed, *Implementing Key BEPS Actions: Where Do We Stand?*, Federal Board of Revenue, Pakistan, June 2017, <https://download1.fbr.gov.pk/Docs/2021621163532304M.AshfaqAhmed-ImplementingKeyBEPSAction-Pakistan.pdf> (accessed April 22, 2025).

<sup>71</sup> Organisation for Economic Co-operation and Development (OECD), *Pakistan Dispute Resolution Profile*, last updated September 19, 2023, <https://www.oecd.org/tax/dispute/pakistan-dispute-resolution-profile.pdf> (accessed April 22, 2025).

<sup>72</sup> Organisation for Economic Co-operation and Development (OECD), *Making Dispute Resolution More Effective – Simplified Peer Review, Pakistan (Stage 1)*, Inclusive Framework on BEPS: Action 14, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, September 16, 2024, <https://doi.org/10.1787/9e56fbc7-en> (accessed April 22, 2025).

<sup>73</sup> Ibid

<sup>74</sup> Ibid

<sup>75</sup> Ibid

<sup>76</sup> Muhammad Ashfaq Ahmed, *Tax Treaty Arbitration: A Critical Appraisal of Pakistan's Approach*, Federal Board of Revenue, Pakistan, 2020, <https://download1.fbr.gov.pk/Docs/2021621261259507M.AshfaqAhmed-TaxTreatyArbitration-Pakistan.pdf> (accessed April 22, 2025).

## 11. Comparative Analysis with Other Developing Countries

Examining how neighboring countries manage their double taxation treaties provides valuable insights into how developing economies navigate similar challenges. Each country's distinct policy decisions and implementation strategies reveal key differences that merit close attention.

### 11.1 India's Approach to Double Taxation Treaties

India takes a strategic approach to double taxation treaties, which contrasts with Pakistan's model. Their agreements with developed and industrialized countries encompass all income sources, including technology, industrial equipment, and direct investment.<sup>77</sup> In contrast, their treaties with developing nations focus on facilitating the flow of technology, equipment, and professional services.<sup>78</sup> Notably, the India-Singapore and India-UAE treaties were amended in 2005 and 2007 to include limitation of benefit clauses that prevent treaty abuse.<sup>79</sup>

The India-Pakistan treaty, one of the region's earliest tax agreements, includes provisions that help avoid double taxation on income taxable in both countries.<sup>80</sup> This foundational agreement continues to shape cross-border taxation in South Asia today.

### 11.2 Bangladesh and Sri Lanka's Treaty Networks

Bangladesh and Sri Lanka present interesting alternatives to Pakistan's treaty strategy. While Bangladesh has agreements with most of its regional neighbors, its network of double taxation treaties is not as extensive as India's.<sup>81</sup> Sri Lanka, on the other hand, has a smaller treaty framework.<sup>82</sup>

Despite these differences, the countries continue to cooperate. A landmark tripartite agreement in March 2025 between the Dhaka Stock Exchange, Pakistan Stock Exchange, and Colombo Stock Exchange highlights this collaboration [32]. This memorandum of understanding establishes a formal platform to encourage dialogue and joint initiatives aimed at strengthening regional capital market cooperation.<sup>83</sup>

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<sup>77</sup> Girish, K.R., and Jain, Rohit. "Double Tax Treaties and Transfer Pricing in India." *International Tax Review*, May 27, 2008. <https://www.internationaltaxreview.com/article/2a69zsq7rwskd4jk2hwcg/double-tax-treaties-and-transfer-pricing-in-india>. Accessed April 22, 2025.

<sup>78</sup> Ibid

<sup>79</sup> Ibid

<sup>80</sup> Government of India, *Agreement for the Avoidance of Double Taxation of Income between the Government of the Dominion of India and the Government of the Dominion of Pakistan*, signed on December 10, 1947, <https://www.mea.gov.in/bilateral-documents.htm?dtl/5019/Agreement+on+avoidance+of+Double+Taxation> (accessed April 22, 2025).

<sup>81</sup> BDLex. "Comparative Analysis of Corporate Taxation: Bangladesh vs. Regional Neighbors." *LinkedIn Pulse*, January 11, 2024. <https://www.linkedin.com/pulse/comparative-analysis-corporate-taxation-bangladesh-vs-Onwoc>. Accessed April 22, 2025.

<sup>82</sup> Ibid

<sup>83</sup> Ismail Dilawar. "Pakistan, Sri Lanka, Bangladesh sign 'landmark' agreement to strengthen capital market cooperation." *Arab News*, March 27, 2025. <https://www.arabnews.com/node/2595020>. Accessed April 22, 2025.

## 12. Lessons from Other Developing Economies

Asian countries adopt diverse strategies in negotiating tax treaties, often securing stronger source-based taxing rights than those typically seen in treaties involving African nations.<sup>84</sup> Developing countries, especially those dependent on corporate income tax revenue, tend to negotiate for higher withholding tax rates when dealing with wealthier treaty partners.<sup>85</sup>

With time and experience, developing economies generally become more adept negotiators.<sup>86</sup> In this regard, Pakistan can draw valuable lessons from non-OECD countries, which often impose fewer limitations on the taxing rights of source countries than OECD members do.<sup>87</sup> Strengthening treaty networks with fellow developing nations may also help Pakistan secure more favorable and balanced treaty terms.

## 13. Future Directions for Pakistan's Treaty Policy

Pakistan stands at a strategic crossroads as global taxation norms continue to evolve. The policy decisions it makes regarding double taxation treaties will have long-lasting implications for domestic revenue generation and international economic relations. With the international tax landscape shifting at an unprecedented pace, it is essential for Pakistan to modernize its treaty framework to respond effectively to contemporary challenges.

### 13.1 Addressing Base Erosion and Profit Shifting

Pakistan took a significant step toward modernizing its international tax framework by signing the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), with implementation beginning on April 1, 2021.<sup>88</sup> This development automatically amended provisions in more than 28 existing double taxation agreements without requiring separate bilateral negotiations. By adopting the MLI, Pakistan has aligned itself with global efforts to address tax base erosion and profit shifting, aiming to close loopholes in tax treaties that previously enabled multinational corporations to shift profits to low or no-tax jurisdictions.

### 13.2 Digital Economy Taxation Challenges

Pakistan's traditional taxation framework faces mounting challenges due to the rapid expansion of the digital economy. The seamless nature of cross-border digital transactions complicates the ability of tax authorities to identify and monitor producers and sellers for tax purposes.<sup>89</sup> To remain aligned with evolving global

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<sup>84</sup> Evert-jan Quak & Hannah Timmis, *Double Taxation Agreements and Developing Countries*, Institute of Development Studies, DFID Helpdesk Report, June 1, 2018, [https://assets.publishing.service.gov.uk/media/5b3b610040f0b645fd592202/Double-Taxation-Treaties\\_and\\_Developing\\_Countries.pdf](https://assets.publishing.service.gov.uk/media/5b3b610040f0b645fd592202/Double-Taxation-Treaties_and_Developing_Countries.pdf) (accessed April 22, 2025).

<sup>85</sup> Ibid

<sup>86</sup> Ibid

<sup>87</sup> Ibid

<sup>88</sup> A. F. Ferguson & Co. (PwC Pakistan), *Note on MLI: Impact of Pakistan's Notification for Entry into Force of OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, April 9, 2021, <https://www.pwc.com.pk/en/assets/document/AFFNoteonMLI-9April2021.pdf> (accessed April 22, 2025).

<sup>89</sup> M. Ziauddin. "Tax Challenges of the Digital Economy." *Business Recorder*, February 26, 2020. <https://www.brecorder.com/news/574852>. Accessed April 22, 2025.

standards, Pakistan must consider adapting to the OECD's Two-Pillar Solution designed to address the tax challenges arising from digitalization. Pillar one redefines the nexus and allocation rules, focusing on taxing rights in jurisdictions where users or consumers are located, regardless of physical presence. Pillar Two introduces a global minimum tax to ensure that multinational enterprises are subject to a baseline level of taxation, thereby reducing the incentive to shift profits to low-tax jurisdictions.<sup>90</sup>

### 13.3 Potential Reforms to Maximize Domestic Revenue

Pakistan must strengthen its domestic tax administration to support effective reform of its double taxation treaty (DTT) policy. With tax revenue amounting to only 10.3% of GDP—substantially lower than the South Asian regional average of over 19%—the country faces a serious revenue shortfall.<sup>91</sup> Meaningful reform must prioritize digitization, enhanced enforcement against transfer pricing abuses, and the development of specialized expertise in international taxation.<sup>92</sup> The Federal Board of Revenue (FBR) has expressed a commitment to modernizing Pakistan's tax infrastructure. Its reform agenda includes adopting advanced technologies and promoting public awareness to cultivate greater taxpayer trust and compliance.<sup>93</sup>

## 14. Conclusion

Pakistan's double taxation treaty (DTT) network represents a strategic effort to balance the dual goals of attracting foreign direct investment (FDI) and safeguarding domestic tax revenues. With 66 treaties in force, the country has successfully fostered international economic relations and encouraged cross-border investment, especially by offering tax relief on dividends and capital gains. However, these benefits come at a fiscal cost. Annual revenue losses, estimated at PKR 141,339.99 million due to reduced withholding tax rates—particularly on dividends—underscore the trade-off involved. Compounding this issue are the institutional challenges faced by the Federal Board of Revenue (FBR), which struggles with capacity constraints and verification inefficiencies that hinder effective treaty implementation.

Special reference should be made by Pakistan to modernize its treaty framework in view of the global economy that is evolving, especially as the worldwide economy is turning more towards digital transactions. Digitalization of domestic tax administration as well as improvement in the capacity in international taxation is all indispensable steps towards strengthening domestic tax administration. Targeted treaty negotiations in coordination with national economic priorities produce better results, as compared to generalized negotiations of any kind, as compared with the likes of India, Bangladesh and Sri Lanka. Also, Pakistan's participation in the OECD/G20 Base Erosion and Profit Shifting (BEPS) framework fortifies Pakistan's

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<sup>90</sup> Ibid

<sup>91</sup> Ahsan Zia Farooqui & Farooq Chatha, "Tax reforms and the battle for Pakistan's future in the 2024 elections," *International Centre for Tax and Development (ICTD)*, February 7, 2024, <https://www.ictd.ac/blog/tax-reforms-battle-pakistans-future-2024-elections/> (accessed April 22, 2025).

<sup>92</sup> World Bank, *Pakistan / Reforms for a Brighter Future: Discussion Note 6 – Strengthening Government Revenues*, September 19, 2023, <https://thedocs.worldbank.org/en/doc/7b6ba1ef456f3bc07c84f3af0aa8f4f3-0310062023/original/Pakistan-Reforms-For-A-Brighter-Future-Policy-Note-6-Strengthening-Government-Revenues.pdf> (accessed April 22, 2025).

<sup>93</sup> Federal Board of Revenue (FBR), *Annual Performance Report FY 2022–23*, December 18, 2023, <https://download1.fbr.gov.pk/Docs/20231218121423230Annualreport2022-23published18Dec2023.pdf> (accessed April 22, 2025).

capability of countermeasures against tax avoidance and at the same time keeping up a competitor investment setting.

Looking ahead, Pakistan has to make a fine balance between domestic tax commitments (in light of which it has agreed to tax its overseas income for foreign taxes) and the need to raise resources while assuring free market access with minimal distortions. Elimination of this will be possible through modernized treaty provisions, strengthened enforcement of taxes, as well as effective administrative reforms. Managing these priorities cautiously would allow Pakistan to leverage its DTTs to favorably contribute to Pakistan's sustainable economic development while safeguarding long term fiscal interests of the country.