Commercial Banks

ADR Tax Revoked; Replaced by Higher Corporate Tax Rate

- The Country's federal cabinet approved revisions in the Income Tax Ordinance for the banking sector. According to newsprint media, the revised ordinance eliminates the previously imposed ADR-related tax of 10-16% on income from Government securities while at the same time increases the corporate income tax rate from 39% to 44% for the tax year ending December 31, 2024. The existing super tax of 10% also remains in place, thus taking the effective tax rate for banks to 54% from the existing 49%.
- According to our estimates, this hike in tax rates is expected to have a negative impact on the earnings of the overall banking sector reducing 10%, 8% and 6% in CY24, CY25 and CY26 respectively.
- Although the hike in corporate tax rates will negatively impact the sector's earnings however this newfound clarity will create a more predictable outlook for earnings. Moreover, the removal of ADR tax will help enable banks to focus on their core operations and extend strategic loans without the pressure of meeting ADR targets to avoid any additional taxation.

Government Eliminates ADR-related Tax, Hikes Corporate Tax Rate for Banks

The Country's federal cabinet approved revisions in the Income Tax Ordinance for the banking sector. According to newsprint media, the revised ordinance eliminates the previously imposed ADR-related tax of 10-16% on income from Government securities while at the same time increases the corporate income tax rate from 39% to 44% for the tax year ending December 31, 2024. The existing super tax of 10% also remains in place, thus taking the effective tax rate for banks to 54% from the existing 49%.

Going forward, the tax rate is expected to be reduced to 43% in CY25 and 42% from CY26 onwards resulting in effective tax rates of 53% and 52% in CY25 and CY26 onwards respectively.

Through this move, the Government is expected to generate additional revenue of PKR 60-70bn helping it to achieve its tax collection targets.

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Analyst

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Banks	Revised EPS (PKR)			EPS Impact (PKR)			P/E (x)		P/B (x)	
	CY24E	CY25F	CY26F	CY24E	CY25F	CY26F	CY25F	CY26F	CY25F	CY26F
ABL	37.2	33.4	35.5	(4.0)	(2.8)	(2.2)	3.9	3.6	0.6	0.5
HBL	36.5	37.8	41.1	(4.0)	(3.2)	(2.6)	4.1	3.8	0.5	0.5
UBL	56.4	58.3	54.9	(6.1)	(5.0)	(3.4)	6.4	6.8	1.6	1.6
FABL	15.7	13.9	13.5	(1.7)	(1.2)	(0.8)	3.4	3.5	0.6	0.5
MCB	48.9	47.7	49.4	(5.3)	(4.1)	(3.1)	5.6	5.4	1.1	1.1
BAFL	26.9	26.1	25.3	(2.9)	(2.2)	(1.6)	3.1	3.2	0.6	0.6
BAHL	36.2	37.9	28.6	(3.9)	(3.2)	(1.8)	3.3	4.4	0.8	0.7
NBP	5.5	21.7	24.3	(0.6)	(1.8)	(1.5)	2.8	2.5	0.3	0.3

Source: Company Financials, Capitalstake, IGI Research

Outlook

The elimination of the ADR-related taxation has provided the much-needed clarity for the banking sector relieving the banks from navigating in an environment of uncertainty and constantly adapting to changes in tax policies and meeting regulatory requirements. Although the hike in corporate tax rates will negatively impact the sector's earnings however this newfound clarity will create a more predictable outlook for earnings. Moreover, the removal of ADR tax will help enable banks to focus on their core operations and extend strategic loans without the pressure of meeting ADR targets to avoid any additional taxation.

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