Digital Taxation Framework in Pakistan - Issues and Recommendations Paper

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Subject: Digital Taxation Framework in Pakistan - Issues and Recommendations Paper

On behalf of the Asia Internet Coalition **("AIC")** and its members, I am writing to express our sincere gratitude to the Ministry of Finance and the Government of Pakistan for the opportunity to submit this position paper on **Digital Taxation Framework, highlighting key Issues and Recommendations.** This paper is developed on behalf of the AIC and its members. The AIC is an industry association comprised of leading Internet and technology companies in the Asia Pacific region with an objective to promote the understanding and resolution of Internet and ICT policy issues. Our current members are Airbnb, Amazon, Apple, Expedia Group, Facebook, Google, Grab, LinkedIn, LINE, Rakuten, Twitter and Yahoo (Oath), and Booking.com.

As responsible stakeholders to shape the policy environment around the most pressing issue on Digital Taxation, we appreciate the ability to participate in this discussion and the opportunity to provide inputs into the policy-making process in Pakistan. As such, please find appended to this letter detailed comments and recommendations, which we would like to respectfully request the Government to consider, which could be a useful feedback for future consultations to determine an optimal approach to implementing an effective Taxation Framework in Pakistan.

Should you have any questions or need clarification on any of the recommendations, please do not hesitate to contact our Secretariat Mr. Sarthak Luthra at Secretariat@aicasia.org or at +65 8739 1490. Importantly, we would also be happy to offer our inputs and insights, directly through meetings and discussions, and support shaping a favorable regulatory environment in Pakistan.

Sincerely,

Jeff Paine
Managing Director
Asia Internet Coalition

Introduction

The digital economy is growing rapidly across the globe, and among developing countries. A series of new businesses are emerging at an unprecedented speed and scale. In particular, online transactions of goods and services, or e-commerce, have been exponentially increasing, both domestically and internationally. While these new businesses are benefiting many people, new global challenges are emerging in areas such as consumer policy, science, technology and innovation, industry and entrepreneurship, insurance and private pensions, financial markets, fiscal affairs, and taxation. Among these, the tax implications of a digital economy are perhaps the most urgent issue for governments, international organizations, and civil societies.

Many countries are looking for new ways to collect revenue derived from digital commerce. In light of this, the OECD has been working towards consensus-based international tax reform. AIC is fully supportive of this movement toward a new comprehensive, international framework for how multinational companies are taxed. Corporate income tax is an important way companies contribute to the countries and communities where they do business, and we would like to see a tax environment that people find reasonable and appropriate.

In light of these developments at the OECD level, and given recent discussion of Pakistan's tax policy in the E-Commerce Policy Framework, we would like to share our views on certain Issues and Recommendations for an effective digital taxation framework in Pakistan. The AIC believes a rationalized tax framework will help Pakistan attract international investors, reduce the cost of doing business for the local economy, encourage local technology companies to remain onshore and help Pakistan become a competitive hub for technology companies.

Issues and Recommendations

1. **Pakistan's tax laws (sales tax on services) results in an increased tax liability on the provision of services**

The nature of the services offered through a digital medium often makes it difficult to draw territorial boundaries on the provision of such services – particularly when provided by or to a trans-provincial entity.

As a result, we believe that there are no adequate safeguards in Pakistan's tax laws to prevent the imposition of sales tax by multiple provinces or territories to a single transaction. By way of example, where online advertising space is sold to a reseller (in a province of Pakistan), for further sale by the reseller to a customer (where the reseller and customer are located in different provinces), the said transaction will be taxed in both (i.e. the province in which the reseller is located and in the province in which the customer is located) thereby increasing the overall tax liability in respect of the provision of such services.

The imposition of multiple taxes on a single digital services transaction increases the cost of digital services available locally. This significantly increases the input cost for local technology companies, rendering Pakistan's technology ecosystem uncompetitive with other jurisdictions.

We would request that Pakistan's provincial tax laws be rationalized to prevent the imposition of multiple taxes of the same nature on a single transaction.

2. Pakistan's federal tax laws (income tax laws) impact the application of international tax-treaty obligations

Pakistan's double taxation treaties with countries including the United States and Singapore require that foreign enterprises not be subject to Pakistan income tax unless such enterprises have a permanent establishment in Pakistan or payment is of the nature of Royalties or Fees for Technical Services as per the tax treaty. In fact, Pakistan's income tax law provides for such treaties to override the income tax law, wherever more beneficial.

However, Pakistan's domestic income tax law requires persons making payments to non-residents (including foreign enterprises) on account of fee for offshore digital services to withhold / deduct tax from payments to be made to the recipient of such fees.

Moreover, Pakistan's tax laws require persons seeking to avail the benefit of double taxation treaties to first obtain exemption or lower rate certificates from tax authorities in Pakistan and furnish the same to the payer of the fee, failing which the person making the payment to the recipient outside Pakistan is obligated to withhold / deduct tax from such payments. Thus, application of tax treaty benefits require the payer/ payee to obtain approval from the Government for its application. This unnecessarily causes inconvenience and delays the application of Pakistan's international tax-treaty obligations and should accordingly be revisited and revised to allow for automatic / direct application of international tax treaty provisions.

The current law may discourage investment from foreign digital services providers. Such taxes also tend to raise the cost of digital services for local businesses, making it more expensive to reach global markets and ultimately reducing exports and inward remittances.

In **ANNEX 1**, we have enclosed the relevant provisions of the Income Tax Ordinance, 2001 (with provisions that were inserted vide Finance Act, 2018) that we would request to be reconsidered.

We hope that our initial comments will assist Pakistan in implementing best practice tax regulatory practices to create an enabling environment for the digital economy in Pakistan.

ANNEX 1

2. Definitions. — In this Ordinance, unless there is anything repugnant in the subject or context—

(22B) “fee for offshore digital services” means any consideration for providing or rendering services by a nonresident person for online advertising including digital advertising space, designing, creating, hosting or maintenance of websites, digital or cyber space for websites, advertising, e-mails, online computing, blogs, online content and online data, providing any facility or service for uploading, storing or distribution of digital content including digital text, digital audio or digital video, online collection or processing of data related to users in Pakistan, any facility for online sale of goods or services or any other online facility.”

6. Tax on certain payments to non-residents.—(1) Subject to this Ordinance, a tax shall be imposed at the rate specified in Division IV of Part I of the First Schedule, on every non-resident person who receives any Pakistan-source royalty, fee for offshore digital services or fee for technical services.

(2) The tax imposed under sub-section (1) on a non-resident person shall be computed by applying the relevant rate of tax to the gross amount of the royalty or fee for technical services.

(3) This section shall not apply to —

(b) any fee for technical services or fee for offshore digital services where the services giving rise to the fee are rendered through a permanent establishment in Pakistan of the non-resident person; or

(4) Any Pakistani-source royalty, fee for offshore digital services or fee for technical services received by a non-resident person to which this section does not apply by virtue of clause (a) or (b) of sub-section (3) shall be treated as income from business attributable to the permanent establishment in Pakistan of the person.

101. Geographical source of income. —

“(12A) A fee for offshore digital services shall be Pakistan-source income, if it is –

(a) paid by a resident person, except where the fee is payable in respect of services utilised in a business carried on by the resident outside Pakistan through a permanent establishment; or

(b) borne by a permanent establishment in Pakistan of a non-resident person.”;

107. Agreements for the avoidance of double taxation and the prevention of fiscal evasion.

(1) The Federal Government may enter into a tax treaty, a tax information exchange agreement, a multilateral convention, an inter-governmental agreement or similar agreement or mechanism for the avoidance of double taxation or for the exchange of information for the prevention of fiscal evasion or avoidance of taxes including automatic exchange of information with respect to taxes on income imposed under this Ordinance or any other law for the time being in force and under the corresponding laws in force

in that country and may, by notification in the official Gazette, make such provisions as may be necessary for implementing the said instruments.

(1A) …

(1B) …

(a) Subject to section 109, where any agreement is made in accordance with subsection (1), the agreement and the provisions made by notification for implementing the agreement shall, notwithstanding anything contained in any law for the time being in force, have effect in so far as they provide for at least one of the following:

(a) relief from the tax payable under this Ordinance;

(b) the determination of the Pakistan-source income of non-resident persons;

(c) where all the operations of a business are not carried on within Pakistan, the determination of the income attributable to operations carried on within and outside Pakistan, or the income chargeable to tax in Pakistan in the hands of non-resident persons, including their agents, branches, and permanent establishments in Pakistan;

(d) the determination of the income to be attributed to any resident person having a special relationship with a non-resident person; and

(e) the exchange of information for the prevention of fiscal evasion or avoidance of taxes on income chargeable under this Ordinance and under the corresponding laws in force in that other country.

(3) …"

152. Payments to non-residents. —

"(1C) Every banking company or a financial institution remitting outside Pakistan an amount of fee for offshore digital services, chargeable to tax under section 6, to a nonresident person on behalf of any resident or a permanent establishment of a non-resident in Pakistan shall deduct tax from the gross amount paid at the rate specified in Division IV of Part I of the First Schedule.";

159 Exemption or lower rate certificate. —

(1) Where the Commissioner is satisfied that an amount to which Division II or III of this Part 2 or Chapter XII applies is:

(a) exempt from tax under this Ordinance; or

(b) subject to tax at a rate lower than that specified in the First Schedule; or

(c) is subject to hundred percent tax credit under section 100C,

the Commissioner shall, upon application in writing by the person, issue the person with an exemption or lower rate certificate.

(1A) …

(2) A person required to collect advance tax under Division II of this Part or deduct tax from a payment under Division III of this Part or deduct or collect tax under Chapter XII shall collect or deduct the full amount of tax specified in Division II or III 7[or Chapter XII, as the case may be, unless there is in force a certificate issued under sub-section (1) relating to the collection or deduction of such tax, in which case the person shall comply with the certificate.

Division IV

Rate of Tax on Certain Payments to Non-residents

The rate of tax imposed under section 6 on payments to non-residents shall be 15% of the gross amount of the royalty or fee for technical services and 5% of the gross amount of the fee for offshore digital services.