

E-Commerce Tax Compliance In Pakistan

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Abstract

The emergence of 21st century is the age of knowledge and the age of economy where the threshold of innovation and new ideas is stronger than wealth. This era of knowledge economy came up with multiverse ideas hitting almost all the fields. Internet changed the conventional business methods and introduced new and innovative ways of transacting business online. E-commerce includes selling of goods and services via internet. E-commerce opened a new platform for conventional businesses as well as entrepreneurs and SMEs. As much as this sector needs galvanization, there is also a need of comprehensive policy for collecting taxes from E-commerce sector. As it is a growing platform, and it has not reached its full growth potential there is a need of harmonized policy that will encourage new businesses to engage and then comply with tax collection mechanism to grow Pakistan both technologically and economically. There is a dire need of incorporating the E-commerce industry in the mainstream tax compliance and give amenities to boost confidence in this new platform which will be lucrative in the future. Encouraging and facilitating E-commerce industry and protecting consumer rights by incorporating E-commerce businesses in the government system via registrations is inevitable as conventional rules cannot be applied to make E-commerce industry comply with the tax requirements.

Keywords: E-commerce Store, Online Marketplace, Sales Tax, Service Tax, Double Taxation

(i) Introduction

As the global outreach of networks and communications has developed in the era of 3G, 4G, and now 5G, it has inculcated almost all sectors of society. E-commerce emerged as the most rapidly growing sector in trading and is expected to grow from 3.53 trillion USD in 2019 to 6.54 trillion USD in 2022. This exponential growth in E-commerce gave new opportunities for growth in SMEs and provided new methods

of transacting businesses to a wider range of audiences globally. A legal framework is, therefore, necessary to embrace this new mode of transacting businesses on a global scale. Old fashioned rules are incapable to deal with intrastate and cross border e-transactions. SMEs and business owners who are desirous of taking their businesses online need to be incentivized and leveraged so that they can become a part of this changing platform for trading. Harmonized

systems of payments in compliance with international practices are required to provide facilities to the growing E-commerce sector. Especially legislation regarding tax compliance by providing easy payment gateways is crucial to fully benefit from this booming industry. Implementation and legislation is the utmost requirement in Pakistan to protect consumers for developing trust in such online marketplaces and individual sales channels. Digitization of conventional methods and provision of single window operation for effective compliance with taxation and registration of such online platforms will give an unprecedented boom to Pakistan's economy in the coming years. Legislation regarding the minimum threshold for taxation is required to promote and support such economic activities which will ultimately generate revenue in return. Export channels compliance with international E-commerce laws are required to give a smooth business opportunity to all sectors contributing towards the growth of E-commerce business. As E-commerce is still in its infancy period in Pakistan and to develop Ecommerce to its full potential, there is a need of revising tax compliance policies. Small businesses must be given tax relaxation incentives to flourish in the vast online space. National and exclusive policies are required to prevent tax evasion in online business. A comprehensive law accredited with binding regulations will be required to compel all E-commerce platforms to contribute towards the economic growth of Pakistan.

(ii) **E-commerce in Pakistan**

Pakistan consists of 65% of population that is below the age of 24 and young population is more educated and acclimatized with the modern mobile device and use it more often than the people of old age. Young people also account to 60% of online purchases (Government of Pakistan Ministry of Commerce & Textile, 2019). Pakistan is also home to the 4th largest

Gig Economy consisting of Freelancers and online service providers (Gilchrist, 2019).

Pakistan in terms of revenue is the 46th largest state involved in E-commerce transactions and as of 2020 revenue of US\$4 billion contributed to 84% of online business growth than the preceding year. This wholesome amount only is from B2C excluding all other

digital media service providers, B2B business transactions and other private businesses carrying out C2C transactions (ecommerceDB, n.d.).

The concept of online business is relatively new to Pakistan. The impact of Covid-19 has hit hard on every sector of the society but the businesses that have grown exponentially in the pandemic are those who have relied on transacting business online. This has led many new users in the E-commerce industry and increased the net revenue from all formats. E-commerce is a platform that offers tremendous opportunities to underdeveloped and developing countries, the factors behind such growth capability include easy access to far off distant markets, moving and delivering goods at a considerably higher rate, protected payment mechanism, welcoming innovative ideas, and creating multiple employments (Government of Pakistan Ministry of Commerce & Textile, 2019).

(iii) **Growth Potential in Pakistan in E-Commerce Sector**

Pakistan is the fastest growing digital economy in the world and ranked at number 4 in providing freelance services throughout the world. This growing sector in E-commerce includes digital services and digital products. According to the Payoneer's statistics report that is a global payment gateway system the contributions from Pakistan in the freelance marketplace have increased 47% in the second quarter of 2019 as compared to the previous year. (The News,

2019). These individual service providers are below 34 years of age that shows more young population is involved in freelance services than any other age group (The News, 2019).

Similarly, the E-commerce sector is specifically sale of goods and services via online platforms have also increased in the first quarter of the fiscal year 2021. It has shown 35% increase from the preceding year reaching up to Rs.96 billion as compared to previous quarter of Rs.71 billion (Dawn, 2021). These statistics show that E-commerce is a growing sector in Pakistan that needs rules of procedure to grow and benefit the economy by contributing towards it.

(iv) Concepts Involved in E-Commerce

There are multiple concepts that revolve around E-commerce industry and before understanding the current situation in Pakistan regarding tax compliance of E-commerce industry it is important to understand these concepts in full depth.

(a) E-Commerce Store

An E-commerce store is an online platform that includes website, application or any other platform that is accessed by the consumers via using internet facility. These platforms offer goods and services to the consumers. E-commerce store directly interacts with the customer on the purchase of goods or services. These online platforms send their products or services to consumers on receipt of an order or online purchase. Examples of E-commerce stores can be taken from online stores actively involved in interacting with customers. It is a B2C or B2B model.

(b) Online Marketplace

Online marketplace is also on online platform same as E-commerce store and it gives a platform to both buyers and sellers to sell their goods or services. It facilitates the sellers to showcase

their products or services and facilitates the consumers to place order on their platforms and make online purchase. Online marketplace is also defined in section 2 (38B) of Income Tax Ordinance 2001 vide Finance Act 2021. These marketplaces allow sellers and buyers to transact business online and in providing such facility a fee is levied by the online marketplace. It acts as a intermediary in the online transactions and never hold inventory of its own. In this online marketplace model, the marketplace owner provides payment method and after deducting the fee, they transfer payment to the seller.

(c) Distinction Between Services and Goods in E-Commerce

The major distinction between services goods is the tangibility of goods and intangibility of services. Services are intangible and are consumed when delivered to the consumer when a consumer opts to obtain it, whereas goods are tangible items having physical nature and are delivered to the consumer via a courier service or local pickup.

(d) Digital Products

Digital products are those intangible products that in electronic form and can be transferred from one person to another via ownership or usage under license from the owner. Digital products include a vast number of items in the E-commerce sector that includes software, applications, websites, digital media content, hosting platforms and other intangible products that can be transferred from one person to another. These products are transferred to consumers via electronic medium.

(v) Taxation of E-Commerce in Pakistan

Pakistan being 70% of its composition as informal economy, only one percent of the population is paying taxes (The News, 2019). As the mode of business in E-commerce is relatively

transparent and recorded, therefore it is much easier to collect tax from this rapidly growing sector. There are different forms of taxes that are collectable from the E-commerce stores. E-commerce stores and marketplaces that offer products and services to consumers are taxed differently. Following are the types of taxes that can be levied on online platforms working in Pakistan.

(a) Income Tax

The tax levied on income accumulated for a period of one fiscal year that is defined in section 9 of Income Tax Ordinance 2001 Chapter III (amended up to June 2020). Such income that resides with an individual for one fiscal year is taxable and there are multiple heads in income tax on which tax can be levied that includes salaries, income derived from a property, income derived from a business, capital gains and income derived from other sources. All these heads of taxable income are mentioned in section 9 of the ordinance. The rate of income tax varies with the annual income and any income less than six hundred thousand in a fiscal year is exempted from income tax. There are different slabs mentioned in the ordinance for levying income tax and under section 11 Chapter III Tax on Taxable Income of the Income Tax Ordinance 2001 and incomes derived from business are categorized in section 18 Part IV Head of Income: Income from Business. The rate of income tax remains the same for all sources.

(b) Sales Tax

Sales tax is often termed as general sales tax and it is levied on products delivered to the consumers. It is defined in Sales Tax Act 1990 in section 2 (29A). Sale tax is levied by the state at federal level, and it is applicable on goods sold in Pakistan. The operative section for calculating general sales tax for E-commerce entity is defined under the head of "marketplace" in section 2 (38B) of Income Tax Ordinance 2001. The minimum tax applicable on such online

marketplaces is 0.75% as mentioned in Division IX of First Schedule. This sales tax is for online marketplaces run by a third party other than buyer and seller. For a marketplace that is run by a seller such as in case of E-commerce store the sales tax levied for sale of goods is 5% under Part II Reduction of Taxes (28C) Income Tax Ordinance 2001. It is the minimum sales tax as opposed to other platforms where 17% of sales tax is levied on sale of goods. The amount will be double in case the person from whom tax will be deducted is not on the active taxpayer list according to Tenth Schedule of Income Tax Ordinance 2001.

(c) Sales Tax on Services

The services sector is diversified further after 18th amendment, as the powers are devolved to provinces, the services tax is levied by the respective province. In Khyber Pakhtunkhwa, the services tax is 15% according to Khyber Pakhtunkhwa Finance Act 2020, similarly in Punjab it is 16%. There is also a change of policy in the provinces, as Punjab offers levying service tax at destination or point of sale whereas in Sindh service tax is charged at the point of origin. Sales tax varies in E-commerce sector as most of the services provided on online platforms have been identified with the threat of double taxation.

Provinces levy taxes on services according to their own taxation requirements as provincial revenue departments work for collecting revenues from the provincial business that are involved in providing services to the individuals.

(vi) Current Issues in E-commerce Taxation in Pakistan

Pakistan as discussed in the study is one of the leading countries in providing online goods and services. There are a key number of issues that need special redressal in terms of policy and legislation to boost E-commerce at its full potential. Currently there are key areas where

there is a need of policy shift and special legislation. In this study key issues have been identified by doing extensive research on the field.

(a) Payment Gateway

The key issue in E-commerce in Pakistan is regarding provision of unified payment system. Asian development bank stated 95% percent of transactions of E-commerce in Pakistan are made through cash on delivery. This is the key issue in tax compliance as cash on delivery cannot be inculcated in the tax regime. This informal source of payment method drifts key players in ecommerce to evade taxes. These payments are often captured by logistic services and transferred manually to E-commerce stores (Saleem, 2020).

There is a lack of unified payment system for E-commerce stores and online marketplaces that needs special attention. Payment gateways are integral part to calculation of taxes on accurate footings. Many stores are giving multiple payment gateway systems for online transactions. There is lack of cohesiveness in ascertaining the actual rate of taxation.

Payment Gateways integration from international platforms like PayPal, Stripe and major credit card processors of the world are reluctant to come to Pakistan due to non-protection of such enterprises. This causes a huge loss to locals who want to export their products in the international markets. As the world is moving towards digitization of crypto currencies, Pakistan is way behind in making its way to the international trade markets.

(b) Customer Protection

Consumer protection is often overlooked in E-commerce sector as this new format is porous and allows new entrants. There is no check on the products being sold on such online platforms. Consumers are often deceived in the products or

services. The whole concept of Ecommerce business is based on hassle free purchase. Any inconvenience that is faced by consumers while transacting online business is a blow to the authenticity of the online commerce system. Consumers are often reluctant to file suits in the conventional consumer protection courts due to the lengthy procedures incurred by such tribunals. There is lack of consumer trust as the cases of fraud in the online sector are on the rise.

(c) Online Complaint Forum

For fraudulent commerce on online platforms there is no unified forum that can protect the consumers of E-commerce products. This is a key issue that creates lack of trust in the consumers. There is no online complaint forum for filing a dispute of payment or product against the online platforms that is effective and expeditious. Most of the systems that allow online complaints including FIA and Citizen's Portal often require further information and ask complainants to physically visit the offices for registration of complaint. Furthermore, there is no mechanism for capturing payments from such online entities. This is a key issue in creating a safe environment for transacting business online safely.

(d) Double Taxation

As opposed to conventional brick and mortar stores the physical location of E-commerce stores are not defined. Their company may be registered in one province and their offices may run from any other province. Especially for services tax the different laws of different provinces create complications in taxing E-commerce entity. For an online store the chances of double taxation are increased due to the online nature of the business. There is no unified process of service taxes collection from the online stores. Both destination tax collection and source tax collection are applicable to these

platforms that encourage the stores to evade taxes instead of complying with it.

(e) E-commerce Registration

Another key issue is the registration of such online platforms. These stores are registered via the conventional company registration process. There is no separate category to register an online business. The registration process of E-commerce store via conventional methods is also troubling for new entrants and startups that are looking for new opportunities. This creates unregistered and unaccounted businesses that do not comply with levied taxes.

(f) International E-commerce

As discussed above Pakistan is still in its infancy period of E-commerce and there is yet a lot to be achieved in this sector. Many international marketplaces and payment gateways are not available in Pakistan. The big E-commerce giants are not conducting business in Pakistan, that creates a vacuum, it also creates vacuum as E-commerce is deprived to follow such practices as applied by E-commerce giants. This also deprives Pakistan from earning income from foreign sources and increasing federal reserves of the country.

Conclusion

E-commerce is an emerging market for Pakistan, but Pakistan needs to do much for development of national and international harmonized policy and legislation to provide easy access to owners of businesses a platform through which they can send their products effectively and in a timely manner. And with that they need to provide a fool proof data security and consumer security so that their data could always be protected, and they are not defrauded by any online business. Such an approach where ease of business is

provided to SMEs in the most applaudable manner is bound to succeed

Consumer trust and consumer protection are the two main points to legislate an effective E-commerce policy in the country. Only when the consumer is satisfied the E-commerce industry will grow with its full potential. This huge potential has revolutionized global economies and Pakistan with its current potential in E-commerce industry has the potential to become a leading country in the global E-commerce. Majority of the population being under thirty years is involved in providing online services globally with limited resources and channels.

There should be a one window registration system. Further to protect the rights of consumers, these online entities should have a physical address and it should be in working condition. It will protect the rights of consumers especially it will reduce fraudulent transactions. A dedicated portal with registration and API integration should also be made for tax compliance of these online stores and marketplaces. A separate system of registration with a separate head of E-commerce should be legislated by the state in order to ease the process of conducting business online.

Furthermore, a unified taxation system is inevitable for online transactions. As the market capital for E-commerce is increasing, the sector also needs special attention from the government side to actively involve it in legislating new laws for the purpose of taxation of online marketplaces and stores.

Similarly, all taxes leviable on the E-commerce stores should come with easy filing and auditing procedures. Registered businesses can easily comply with the tax requirements. For marketplaces acting as a facilitator should be collecting taxes on behalf of the seller and remitting the same in the sales return. As WHT or withholding tax is the applicable sales tax on the

products or services delivered. In marketplace model, such tax should be retained by the marketplace holder and then remitted and filed in the concerned tax collection authority.

Furthermore, taxation in E-Commerce should be made mandatory with registration of the business with SECP. There should be an at least 3 years of incubation period where the system should properly integrate and prosper and after that there should be tax levied. Taxation in E-Commerce should be made mandatory with registration of the business with SECP. There should be an at least 3 years of incubation period where the system should properly integrate and prosper and after that there should be tax levied.

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