

ADVISORY COMMISSION ON ELECTRONIC COMMERCE

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**Report on behalf of the Secretariat of the
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(OECD)**

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This outline report is designed to inform the ACEC about the work of the OECD in relation to the taxation questions associated with electronic commerce (e-commerce). The OECD's work in this field is just one part of a comprehensive programme aimed, more generally, at encouraging the positive development of the information society and of e-commerce. This programme includes work to foster a stable and predictable regulatory environment; to promote the enhancement of the information infrastructure and access to that infrastructure, by support for a competitive marketplace; and to address constructively such issues as consumer protection and privacy.

What is the OECD doing on tax and e-commerce?

2. The OECD is fulfilling a well-established role in international taxation issues by helping to co-ordinate the examination of the international taxation implications of e-commerce. Recognising that e-commerce is a global issue, the OECD has very deliberately sought actively to involve both business and non-OECD member economies in a comprehensive dialogue on the taxation implications of e-commerce. The input of business is recognised as especially important. Whatever governments decide that they need to do concerning taxation and e-commerce must take account of the realities of the business world. Legitimate taxation provisions must operate in such a way as to minimise the compliance demands made of business. Equally the involvement of non-member economies – in Latin America, Asia and Eastern Europe – is a vital part of identifying and pursuing options which are as far as possible capable of global application. The overall objective lies in achieving a fiscal climate within which e-commerce can flourish, but which at the same time protects the revenue base and so the revenue yield.

3. The OECD does not make laws in international tax matters. Rather it provides a forum and mechanism for debate, and helps, where necessary, to establish certain international taxation norms. Those norms, agreed by consensus at the OECD and then often reflected in formal legal agreements between countries, provide certainty for governments and business about how international aspects of taxation operate. Not

only do the 29 OECD member countries and an increasing number of non-member countries subscribe to those norms, but they also serve the international community more widely as a basic framework for a range of international taxation agreements and arrangements. An important example of such an international tax norm is the OECD Model Tax Convention which serves as a basis for a very large number of bilateral tax treaties dealing with taxation of income and capital.

4. Against this background then, the international community has selected the OECD to take the lead in the examination of the taxation implications of e-commerce, and to work toward international consensus on what should, as necessary, be done either to adapt existing tax norms or to develop new ones. In the field of indirect taxation, the European Commission has a role in terms of the European Community's VAT system, and so the OECD is working closely with the European Commission on consumption tax aspects of e-commerce. This working partnership with the European Commission should ensure consistently developed and applied principles.

5. Another important feature of the OECD's work on e-commerce is examination of the tax administration opportunities and challenges that it presents: opportunities in terms of improved taxpayer service; challenges in terms of changes to established methods of audit and collection of taxes.

Why is this work necessary?

6. Taxation is an important factor in the 'environment' in which e-commerce – just like any commerce - takes place. And e-commerce, by its very nature, has significant international dimensions and potential. So it makes sense to think about the related international taxation issues sooner rather than later. It makes sense:

- for governments - concerned to foster the growth of e-commerce, and quite properly to secure and safeguard their revenues;
- for business - which wants, quite rightly, to be sure of the taxation rules and to avoid conflicting or unreasonable compliance requirements; and

- for consumers – who are entitled to be sure about how the tax rules affect them, particular in the price that they pay.

7. Furthermore, government, business and consumers have a very real common concern to ensure that taxation does not distort the marketplace. Competition should be as free and open as possible: taxation should not distort the operation of the market. This is especially important in the emerging 'global marketplace' that e-commerce is creating.

Who's involved in the process?

8. Obviously, all of the 29 OECD member countries are directly involved through the established procedures at the OECD. And business and non-member economies have been drawn into the process. In practice, this dialogue is being pursued in particular through a set of Technical Advisory Groups. There are five in all looking at issues ranging from the technological environment of e-commerce, to the practical detail of how to operate consumption tax rules. The Groups each have 20 or so members, with the majority from the business community. In fact, at least two companies represented in this Advisory Commission play active roles on the Technical Advisory Groups. (See Annex for a full list of participants on the Technical Advisory Groups.)

9. The Groups are jointly chaired by business and government representatives, have established their own workplans (within agreed mandates) and have electronic discussion forums through which to progress their work. These Groups are providing valuable input in terms of business expertise – both technological and commercial. In short, the dialogue that the OECD is facilitating goes much wider than just the OECD's member countries, and, with extensive business involvement, well beyond the confines of tax administrations.

What's the starting point for the OECD's work?

10. The core starting point for the OECD's current work on taxation lies in the Taxation Framework Conditions endorsed at the OECD Ministerial meeting in Ottawa in October 1998. These key principles already represent, in effect, an important international consensus to which not only the OECD states have subscribed, but which have gained wider international acceptance. For example, they were welcomed by APEC Finance Ministers in May of this year; and have been noted with interest by a number of other regional tax organisations.

11. The Framework Conditions include a number of key conclusions. These include:

- that the same principles that governments apply to taxation of conventional commerce should equally apply to e-commerce, namely:
 - neutrality – in that taxation should seek to be neutral and equitable between forms of e-commerce and between conventional and electronic commerce, so avoiding double taxation or unintentional non-taxation
 - efficiency – in that compliance costs to business and administration costs for governments should be minimised as far as possible
 - certainty and simplicity – in that tax rules should be clear and simple to understand, so that taxpayers know where they stand
 - effectiveness and fairness – in that taxation should produce the right amount of tax at the right time, and the potential for evasion and avoidance should be minimised
 - flexibility – in that taxation systems should be flexible and dynamic to ensure they keep pace with technological and commercial developments.
- that these principles can be applied through existing tax rules, and that any new or revised administrative measures in the framework of those rules should be directed toward the application of existing taxation principles and should not be intended to impose a discriminatory tax treatment on e-commerce;

- that the technologies underlying e-commerce offer significant opportunities for improved taxpayer service, which governments should actively pursue; and
- that the process of putting flesh on these principles should involve an intensified dialogue with business, with non-business taxpayer groups, and with non-OECD member economies.

12. And just to amplify the principle of 'no discriminatory treatment' of e-commerce, it might be worth stressing too the important distinction between tariffs and taxes. Internationally there is broad consensus amongst developed nations that e-commerce services should not be subject to tariffs ie not subject to customs duties. But taxes – whether direct or indirect – are an entirely different matter. Tariff-free does not equal tax-free.

13. The Framework Conditions also include some more detailed conclusions about different aspects of taxation (direct, indirect, administration) and set out a post-Ottawa agenda which the OECD is currently pursuing.

So what is the work programme on these issues?

14. More detailed work is underway in three main areas:

- consumption taxes;
- international direct tax rules; and
- tax administration.

15. Some 28 of the 29 member countries of the OECD operate a consumption tax system, such as a VAT or GST. Such systems are comprehensive in scope, applying in principle to all goods and services, subject to certain reliefs that are usually quite narrowly defined. Consumption taxes (in the shape of VAT or GST) account for a significant part of the revenue yield in these OECD countries – a little under 20% on average. In this context, the OECD-led work on consumption taxes and e-commerce is

examining how the principles agreed at Ottawa for the treatment of international transactions can be translated into practice, meeting the needs of governments and of business alike. Those principles include:

- that rules for consumption taxation of cross-border transactions should result in taxation in the jurisdiction where consumption taxes place;
- that the supply of digitised products should be not be treated as supplies of goods for consumption tax purposes;
- that, for cross-border business to business transactions of intangible services, self-assessment collection mechanisms are a viable means of safeguarding revenues; and
- that countries should ensure that appropriate systems are developed – in co-operation with the World Customs Organisation, and interested business, such as carriers - to collect tax on the importation of physical goods; and that such systems, while facilitating revenue collection, should support the efficient delivery of the goods to consumers.

16. As a basic principle, e-commerce transactions already fall to be taxed under most consumption tax rules - in common with their conventional commerce counterparts. So what is at issue really, especially for international transactions, is whether the tax rules provide for the desired outcome – that is taxation in the place of consumption – and then how such rules should apply in practice. This is the main focus of the international debate under OECD auspices.

17. The place of consumption principle already works quite readily in many instances for international transactions – for example, imported goods are subject generally to consumption taxes when they enter the country. Again, to emphasise the tariff/tax distinction: goods may well arrive and be subject to no (or very low) customs duties, but tax (such as VAT) is usually payable.

18. But the picture gets less clear when you look at services, albeit that under comprehensive consumption tax systems services are of course taxable. Following through the logic of taxation in the place of consumption, on-line transactions of digitised products should be subject to consumption tax in the country of the consumer – but the challenge lies in identifying clear and practical arrangements for that to happen. Most business to business transactions can probably be administered using self-assessment arrangements. It's sales to private consumers – especially of digitised products - that present a particular challenge to tax administrations, and businesses. And it's this field that's the primary, although not exclusive, focus of the OECD-led work on consumption taxes.

19. Currently that work is examining how the principle of taxation in the place of consumption should operate in practice – ie what 'trigger' should be used to establish the place of consumption in the case of a private consumer; and how will that be determined in the real-time environment of on-line transactions. Linked to that set of questions is how tax that is due should be calculated and paid over.

20. Right now the OECD work is examining a range of options and evaluating them against various criteria, such as technical feasibility and likely compliance and administrative costs. Following existing practice for most consumption taxes, should one look to the supplier to do all this? But how does this work when the supplier is outside the tax jurisdiction of the consuming state? Ordinarily, suppliers are required to register or appoint a representative within the relevant jurisdiction. Should one instead look to the intermediaries in the process, such as financial institutions? Should one look to the consumer, as with American use taxes? But how do you ensure effective collection?

21. There are no easy answers here. What's important is to examine all the relevant options, working closely with business, to identify those options which can strike the best balance between the obligations and/or demands that they place on business and consumers and the security of revenue yield that they offer governments. Harnessing

the technology of e-commerce itself to deliver that sort of balance looks to be the most promising way forward.

22. As regards direct taxes, the OECD-led work is looking at the extent to which e-commerce impacts upon the existing principles of international direct taxation. These principles are widely-accepted and are reflected in a large network of bilateral tax conventions, almost all of which are based on the OECD Model Tax Convention.

23. One important issue is the application to e-commerce of the existing principles for taxing business profits, which are based on the concept of permanent establishment. The OECD recently issued a document that seeks to clarify how the existing definition of permanent establishment applies to e-commerce. In outline, that document suggests that a website alone cannot constitute a permanent establishment, and that the situations in which a server at a fixed location could constitute a permanent establishment would be quite limited. Comments have been invited on that document, and the OECD hopes to finalise it next year. But that document only addresses a narrow issue of legal interpretation. Far more important is the work that the OECD is doing, through the relevant Technical Advisory Groups, examining the application of existing tax treaty rules, including those that determine when business profits should be taxed in a country, and how much of them should then be taxed.

24. Finally, on tax administration, the OECD's work is looking at how the tax systems can be made to work better, harnessing the new technology opportunities associated with e-commerce. For example, how best can the information and audit needs of revenue authorities be integrated with normal business practices and procedures, especially in electronic systems, so that government needs are met with minimum compliance demands made of business? To what extent, for example, can a minimum common framework of tax-related record requirements be identified which is consistent, ideally, with commercial systems?

25. Equally, how can the new technologies available to governments and fiscal authorities best be used to ease tax compliance for business? There are a host of possibilities here – such as electronic filing; on-line information; interactive systems – which many countries are already exploring. And some countries are already very advanced in this area. So here the OECD is working toward a sharing of experience and of best practice.

Where does the United States fit in all this?

26. The US has a very prominent role in all this work, as a leading member of the OECD and a very active contributor to the international taxation debate. Furthermore, US business – given its leading role in e-commerce - is a very welcome and valuable player in the business dialogue, with a wide range of businesses represented on the Technical Advisory Groups. It's also very much in the interest of US business that there are globally consistent rules.

When does the OECD expect to come-up with some conclusions?

27. The post-Ottawa agenda was framed around a two-year period – so the Technical Advisory Groups, for example, each have a two year mandate running through 1999 and 2000. So the OECD work is well down the track. Through 2000, the aim will be: to intensify the dialogue with interested parties, especially business; to expose more ideas and options for public comment; and so to move toward international consensus.

28. Obviously there is a balance to be struck here between, on the one hand, devoting an appropriate amount of time to research and analysis of all the ideas/options/possibilities, and, on the other hand, reaching conclusions on which both governments and business can act as necessary. Business especially needs to know where it stands in terms of any tax-related obligations. So, given such drivers, the aim must be to reach conclusions during 2001.

29. There will be no single set of answers, however. Some issues can very probably be addressed through existing arrangements and agreements between governments (eg the tax treaty network). Others might require new vehicles to reflect international consensus. Still others might remain at the level of government commitments to strengthen co-operation between fiscal authorities (as legal frameworks permit) or to share best practice (for example, in taxpayer service). And in all this tax administrations must also seize the opportunities available for simplification and improved taxpayer service.

Summary

30. In summary then, the OECD work on taxation and e-commerce is directed at:

- establishing an international consensus on the application of taxation norms and practices which will serve the interests of governments, business and consumers in terms, in particular, of certainty, consistency and simplicity;
- doing so through a comprehensive dialogue with business, with taxpayer and consumer interests, and with non-OECD member countries; and, ideally, by building on the technology of e-commerce itself; and so
- delivering an international fiscal environment which fosters the development and growth of e-commerce, and at the same safeguards the revenue yield of countries.

ANNEX

THE COMPOSITION OF THE TECHNICAL ADVISORY GROUPS (TAGs)

Technology TAG

Australia, Brazil, Egypt, Chinese Taipei, France, Ireland, Japan, Malaysia, Norway, Thailand, United States, Ernst & Young, NASSCOM, Consumers International, TUAC, EUROBIT, European Certification Authority Forum (ECAAF), ICANN, IETF, Hitachi, NTT, Mondex, Hewlett-Packard Labs, British Telecom, IBM, Cisco, Oracle, Citigroup

Professional Data Assessment (PDA) TAG

Argentina, Australia, Canada, France, Ireland, Netherlands, New Zealand, Spain, Tunisia, United Kingdom, United States, Arthur Andersen, Ernst & Young, Australian Society of CPAs, ACL Services, Ltd., Deloitte, KPMG, International Federation of Accountants (IFAC), ISACA, Internet Open Trading Protocol (IOTP), Chuo Audit Corporation (PricewaterhouseCoopers), Sagesoft Ltd., American Institute of CPAs (AICPA)

Consumption Tax TAG

Argentina, Brazil, European Commission, Japan, Netherlands, Russian Federation, Singapore, United Kingdom, Nortel, Rhone-Polenc, KPMG, Keidanren, Phillips, ABN-AMRO, Swisscom, Union Bank of Switzerland (UBS), Chartered Institute of Taxation, Microsoft, America Online, AT&T, EDS

Business Profits TAG

Australia, Brazil, Canada, China, Germany, India, Ireland, Japan, Morocco, South Africa, Switzerland, United Kingdom, United States, AMP, Volkswagen AG, Joint EBF / ABA, Fujitsu, British Telecom, Information Technology Association of America, Microsoft, Hewlett-Packard

Income Characterisation TAG

Australia, Chile, Germany, India, Israel, Japan, Norway, Philippines, United Kingdom, United States, IBM Canada, NTT Data, Reed Elsevier, Walt Disney Corporation, Software Coalition