

Electronic Commerce and International Taxation

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Foreword

by David R. Tillinghast, Chairman of IFA's
Permanent Scientific Committee

For many years, the International Fiscal Association has been a unique contributor to the study and solution of international tax problems through the high-level presentations made at its annual Congresses and through the annual publication of the *Cahiers de Droit Fiscal International*. In 1996 the Permanent Scientific Committee of IFA decided to expand the scope of the Association's work by sponsoring independent research studies of international tax issues of timely interest.

No topic has generated more controversy in recent years and months than the question of how the advent of the Internet and other means of conducting commerce electronically will impact on existing international tax rules, both those found in domestic law and those found in tax treaties. While electronic commerce is still in its relative infancy, it promises to alter dramatically not only the application of particular international tax rules but also, potentially at least, the division of revenues between source and residence countries. Several governments and inter-governmental organizations including both the Organization for Economic Cooperation and Development and the European Community have focussed on the resulting problems and possible responses that might be appropriate. The Permanent Scientific Committee of IFA felt that the Association, as the foremost non-governmental organization in the international fiscal field, could make a unique contribution by sponsoring a study of electronic commerce conducted by two eminent Rapporteurs with the support of experienced Consultants and input from the National Branches of the Association.

Foreword

The present volume is the product of that decision. All of us at IFA wish to express our gratitude and admiration for the scholarship, insight and dedication which Richard Doernberg and Luc Hinnekens contributed to this effort. The task was difficult and huge, but they did it with distinction. We wish also to thank the Consultants who worked with the Rapporteurs, Emilio Romano of Mexico, Prof. Yoshihiro Masui of Japan and Prof. H.A. Kogels of the Netherlands, Professor Jean Pierre Le Gall of France, who prepared the most excellent *Précis* which accompanies the Rapporteurs' paper, and the many members of the National Branches of IFA who submitted both written and oral comments on the subject.

This study does not represent the views of the International Fiscal Association. IFA has not prepared it or approved it. It has sponsored it as an independent study. The paper presents the views of the Rapporteurs, and the *Précis* summarizes views of individual IFA branches to the extent that these are not reflected in the Rapporteurs' text.

IFA looks forward to sponsoring additional research projects of this kind, which will be published in a similar way.

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Introduction*

A discussion of the internet often starts out with a proclamation that the internet is the most important development in communications since. . . . The blank may be filled in with any manner of impressive comparisons. Following the far-reaching claim is a dizzying display of large numbers and upward sloping graphs showing the meteoric rise of internet use.¹ For ex-

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The Rapporteurs received helpful comments from IFA branches in the following countries: Argentina, Colombia, Germany, Ireland, Israel, Italy, Japan, Korea, Malaysia, Mexico, Republic of China, South Africa, Sweden, Switzerland, United Kingdom, and the U.S.A.. The contents of these comments have influenced all aspects of this Report and have been incorporated. Specific references are made where appropriate.

¹Owens, *The Tax Man Cometh to Cyberspace*, TAX NOTES INT'L 1833 (2 June 1997).

A number of OECD studies have focused on electronic commerce including: OECD, *DISMANTLING THE BARRIERS TO GLOBAL ELECTRONIC COMMERCE*, <http://www.oecd.org/dsti/iccp/e-comm/dismantl.htm> (1997); OECD, *ELECTRONIC COMMERCE: OPPORTUNITIES AND CHALLENGES FOR GOVERNMENT* (The "Sacher Report"), <http://www.oecd.org/dsti/pubs/sacher.htm> (1997); OECD, *ELECTRONIC COMMERCE: THE CHALLENGES TO TAX AUTHORITIES AND TAXPAYERS*, Discussion Paper for the OECD Conference, Turku Finland, 19-21 November 1997.

More information regarding international taxation of electronic commerce may be found in the following: Lejeune, Vanham, Verlinden and Verbeken, *Does Cyber-Com-*

ample, fewer than 40 million people around the world were connected to the internet during 1996. By the end of 1997, more than 100 million people were using the internet.² Traffic on the internet has been doubling every 100 days.³ This increased use is reflected in the growth of internet commercial

merce Necessitate A Revision of International Tax Concepts? (Part 1), 38 EUROPEAN TAXATION 2 (1998); Lejeune, Vanham, Verlinden and Verbeken, *Does Cyber-Commerce Necessitate A Revision of International Tax Concepts? (Part 2)*, 38 EUROPEAN TAXATION 50 (1998); PRICE WATERHOUSE, *CAUGHT IN THE WEB: THE TAX AND LEGAL IMPLICATIONS OF ELECTRONIC COMMERCE* (1998); Benjamin and Nathanson, *Conducting Business Using the Internet: Gauging the Threat of Foreign Taxation*, J. INT'L TAX. 29 (March 1988); Sanderson, Merrill and Dunahoo, *Consumption Tax Treatment of Electronic Commerce: Issues and Policy Recommendations*, TAX NOTES INT'L 1083 (6 April 1998); McLure, *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Law* (forthcoming); Pinkernell, *Writer Criticizes Treasury Paper on Global Electronic Commerce*, available in LEXIS/NEXIS, 97 TNT 84-40 (1 May 1997); Hinnekens, *The Challenges of Applying VAT and Income Tax Territoriality Concepts and Rules to International Electronic Commerce*, 26 Intertax 52 (1998) and *New Age International Taxation in the Digital Economy of the Global Society*, 25 INTERTAX 116 (1997); Powers, et al., *International Tax Issues in Cyberspace: Taxation of Cross-border Electronic Commerce*, 25 INTERTAX 120 (1997); Nugent, *Implications of State Tax Practices for United States Tax Policy on Electronic Commerce — MCI Telecommunications Corp.*, International Fiscal Association (27 Feb. 1997); Mall, Leow & Murata, *Taxation of Cross-Border Internet Transactions in Australia, Japan and Singapore*, available in LEXIS/NEXIS, 97 TNI 36-2 (24 Feb. 1997); Owens, *Tax Reform for the 21st Century*, available in LEXIS/NEXIS, 97 TNI 32-27 (18 Feb. 1997); Cigler & Stinnett, *Treasury Seeks Cybertax Answers with Electronic Commerce Discussion Paper*, 8 J. INT'L TAX. 56 (1997); Horner & Owens, *Tax and the Web: New Technology, Old Problems*, IBFD Bulletin 516 (Nov./Dec. 1996); Hamilton, *US to Focus on Substance Rather Than Form in Taxing Electronic Commerce*, Treasury Official Says, available in LEXIS/NEXIS, 96 TNI 221-7 (14 Nov. 1996); Donmoyer, *Tax Principles Must Adapt to Wired Economy*, Richardson Says, available in LEXIS/NEXIS, 96 TNI 185-9 (23 Sept. 1996); Lodin, King & McLure, *Visions of the Tax Systems of the XXI Century*, Jubilee Symposium (1-6 Sept. 1996); Zukowski, *Tax Benefits for Internet Export Sales*, available in LEXIS/NEXIS, 96 TNI 156-11 (12 Aug. 1996); Glicklich, Goldberg & Levine, *Internet Sales Pose International Tax Challenges*, J. TAX. 325 (June 1996); Muscovitch, *Taxation of Internet Commerce*, <http://www2.magma.com/~dbell/tax.htm>; Weizman, *Danish Ministry Rules on Scope of Offshore Activities as a Permanent Establishment*, available in LEXIS/NEXIS, 94 TNI 30-9 (14 Feb. 1994).

²U.S. Department of Commerce, *The Emerging Digital Economy*, Introduction, <http://www.ecommerce.gov> (1998).

³*Id.*

transactions. For example, Cisco Systems, a producer of computer hardware, booked just over \$100 million in internet sales in 1996. By the end of 1997, internet sales were running at a \$3.2 billion annual rate.⁴

People often compare the growth of the internet to the historic growth of other technologies, sometimes to suggest that the internet is just the latest technological advance and may not signal a revolutionary advance.⁵ But there are differences between the birth of the internet and technologies that preceded it. For example, electricity was first harnessed in 1831, but it was not until 1882 that the first power station was built, and it was another 50 years before electricity powered 80 percent of the factories and households across the United States. Radio was in existence 38 years before 50 million people used it; TV took 13 years to reach the same benchmark. It was 16 years before 50 million people used a personal computer. Once the internet was made available to the general public, it took only 4 years for 50 million people to go on-line.

Electronic commerce is an important part of the growth of the internet. The term “electronic commerce” refers to a wide array of commercial activities carried out through the use of computers, including on-line trading of goods and services, electronic funds transfers, on-line trading of financial instruments, electronic data exchanges between companies and electronic data exchanges within a company. To provide figures documenting the growth of electronic commerce is to state the obvious, often with speculative and/or outdated mind-numbing statistics. Electronic commerce is here; it is growing; and it poses new questions for all aspects of society.⁶

⁴*Id.*

⁵The figures in this paragraph are contained in U.S. Department of Commerce, *The Emerging Digital Economy*, Introduction and Chapter 1, <http://www.ecommerce.gov> (1998).

⁶From the birth of the internet in 1986, there are now more than 16 million hosts (i.e., domains with an Internet Protocol address). The growth is not evenly distributed. Some countries like Canada, the United States and many northern European countries have more than 20 hosts per 1,000 inhabitants, while many southern and Eastern European countries, Mexico, and Japan average less than 10 hosts per 1,000 inhabitants. Owens, *The Tax Man Cometh to Cyberspace*, TAX NOTES INT'L 1833 (2 June 1997). It is estimated that while less than 1% of business is conducted over the internet today, that figure will grow to 5% by the year 2000. Interactive Services Association, *White Paper: Logging onto Cyberspace Tax Policy*, STATE TAX NOTES 209 (January 1997).

This report is concerned with the implications of the growth of electronic commerce for domestic and international tax systems. It explores the concern of some tax authorities that current tax principles and rules may not be equipped to deal with challenges posed by doing business in what is sometimes referred to as “cyberspace,” a hazy realm without boundaries inhabited by servers, daemons and webmasters. While the technological changes over the last 25 years have affected all aspects of human life, the focus of this report is on the conduct of electronic commerce over the internet. Even that focus covers a wide array of activities. The discussion and observations will focus on basic rules and policy choices, rather than making specific recommendations.

While electronic commerce is here and is growing, it is also in its very early years and currently represents a small percentage of total world commerce. That is not to say that it is premature to discuss the implications of electronic commerce for taxing systems. The dialogue has begun and should proceed in a reasoned manner with taxing rules reflecting the technological realities of the market. In *A Framework for Global Electronic Commerce*, the United States offers its view of some general principles that govern electronic commerce:

It should neither distort nor hinder commerce. No tax system should discriminate among types of commerce, nor should it create incentives that will change the nature or location of transactions.

The system should be simple and transparent. It should be capable of capturing the overwhelming majority of appropriate revenues, be easy to implement, and minimize burdensome record keeping and costs for all parties.⁷

Similar unassailable principles were set forth in the Bonn Declaration, a product of participating ministers from the European Union, the European Free Trade Association member states, central and eastern European nations and Cyprus,⁸ which expressed the sentiments as follows:

⁷White House, *White House Release on Global Information Infrastructure*, available in LEXIS/NEXIS, 97 TNI 128-23 (3 July 1997).

⁸Hamilton, *World Enters 'Second Wave' of Work on Electronic Commerce*, available in LEXIS/NEXIS, 97 TNI 140-26 (22 July 1997).