EDITORIAL

Internet and Electronic Commerce – The Next Frontier

Toshiaki Katsushima, Deloitte Touche Tohmatsu, Tokyo

Electronic commerce and the Internet have created exciting opportunities for consumers and businesses. People throughout the world can now readily communicate and transact business with each other, sometimes without even knowing where the other party is located (or who they are). Digitized products such as software, data and images can be delivered electronically, thus bypassing traditional methods of physical delivery. In addition, the new communications technologies permit professional service providers to serve clients anywhere in the world without having to get on an airplane.

How the tax laws should address these technological changes is likely to be a challenge for tax authorities and business well into the twenty-first century. Threats of new taxes (the most notorious being the 'bit' tax) and concerns of tax-base erosion have stirred emotions on all sides. Equally significant, are the more mundane issues of characterization, source and allocation of income and expenses derived from transactions in electronic commerce.

Governments have in fact begun the task of analysis and policy formulation. In November 1996, the United States Treasury Department issued a discussion paper entitled, 'Selected Tax Policy Implications of Global Electronic Commerce'. The US Treasury Department paper promoted the use of existing tax concepts to provide answers to the tax treatment of global electronic commerce and neutrality of tax treatment between electronic and traditional methods of conducting business. There is also a fairly contentious debate going on in the US on the appropriate application of state sales and the use of taxes to electronic commerce.

In August 1997 the Australian Taxation Office issued a paper entitled, 'Tax and the Internet'. The Australian paper focused heavily on compliance issues and made several recommendations to enable tax authorities to obtain more information on Internet transactions.

The Japanese Ministry of International Trade and Industry in May 1997 issued a discussion paper on the 'Digital Economy'. Unlike the Australian and US papers, it dealt more with policy issues instead of tax issues. However, the government is studying the related tax implications and have invited comments on the matter. Furthermore, at least a dozen OECD countries have set up commissions or *ad hoc* groups to study the tax implications of electronic commerce. While a number of tax questions associated with electronic transactions have been around for some time and are in need of resolution, both the business community and governments have been cautious in providing answers.

In response to the need for an international consensus, the OECD has announced that it will issue international guidelines for the taxation of electronic commerce to be adopted during a ministerial conference to be held in Ottawa, Canada in October 1998.

The first step in the process of forging an international consensus was taken in November 1997 at an OECD-sponsored conference held in Turku, Finland (Finland is the country with the highest per capita use of the Internet), entitled 'Dismantling the Barriers to Global Electronic Commerce'. Prior to the opening of the formal conference, the OECD Fiscal Affairs Division sponsored an informal tax roundtable discussion. Tax experts from business, government and academia participated in a discussion of the tax issues related to global electronic commerce. The goal was to establish a dialogue between the business community and tax administrators with the hope of beginning to forge an international consensus. The roundtable discussion focused on issues in the following subject areas:

(a) consumption taxes (in particular, VAT);
(b) direct tax issues (such as permanent establishment, characterization of income, source vs. residence-based taxation and allocation of income); and
(c) compliance issues.

The roundtable did achieve a consensus on some very general points. On consumption taxation, there was recognition that many of the VAT issues are not new and have presented themselves in the mail order context. While participants felt that existing VAT rules should be able to respond to most issues, they felt that the provision of digitized information to consumers may require new rules. On direct taxation, there was a consensus for tax neutrality and utilization of existing tax principles. There was, for example, general agreement that a Web site should not be considered a permanent establishment.

With respect to compliance, governments recognized that electronic commerce presented opportunities for greater efficiency in tax administration and reduction of compliance costs. They suggested, however, that an increase in international activity might require greater need for mutual assistance and international tax enforcement.

Notwithstanding the consensus on broad principles, a number of participants noted that 'the devil was in the details'. Participants were not ready to reach consensus on many of the specific issues that will shape the taxation of global electronic commerce. How should the provision of digitized information be characterized both for direct tax purposes and indirect tax purposes? Should it be subject to withholding tax? Does the presence of a computer server create a permanent establishment, and under what circumstances? How will tax authorities gather information on Internet transactions and who will be required to report this information? Ultimately, it is the answers to these types of questions that will impact on the day-to-day workings of transactions over the Internet.

It is readily apparent that much work is required by the international tax community if the guidelines to be presented in Ottawa in October 1998 are to be meaningful. The OECD has announced that it will open an Internet discussion forum to air many of these issues. We would urge all affected businesses (and that includes nearly everyone) to make their views known. In the meantime, tax administrators must carefully consider whether their policies will enhance or diminish the growth of global electronic commerce. Ultimately, ease of administration, certainty of result, adherence to existing tax concepts, and general fairness will be essential to industry acceptance of tax policies affecting electronic commerce.

Finally, one of my US partners, Mr. Ned Maguire, once informed me that the term cyberspace is derived from Kybernetes, Ulysses' helmsman. I hope the helmsman for the OECD on this matter steers us on a straighter and speedier course than Kybernetes did for Ulysses.

